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Topic:

Are free markets and free trade good for all?

Germany is preparing for the next Group of the Eight meeting. This is the 13 kilometres long, 12.5 Mio. Euro expensive protection fence, which is exclusively built up for the summit. 500 tons of steel, 900 kg cement blocks anchored in the ground, fused bolts, motion detector, video control, microphones.

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- *Altogether an annual death toll over 18 million people can be directly or indirectly explained with poverty issues*[1]. *10 millions of this are children under the age of five, who die of preventable illnesses – 30 000 a day*[2].

- *1 200 million people in the developing world are income poor (less then 1 US$ a day), half of them live in South Africa*[3].

- *Suppose, an US politician had said in 1942, that […] the world governments should aim to achieve a 19 % reduction in the population of [German concentration] camps by the year 1957. […]* [1]

So why were we not similarly horrified when the world's politicians proposed, in 2000 [Millennium Development Goals], to reduce extreme poverty so that, 15 years later, […] the annual death toll [declined] from 18 million to 14 million?[1]

”

[1] Pogge 2004, 385-386.
[2] United Nations Development Program 2003, 1- 13.
[3] United Nations Development Program 2000, 29–43.

Outline

Abstract

Title: Are free markets and free trade good for all?

This essay critically examines some of the consequences of trade and market liberalisation – with a focus on growth and income/inequality progress in developing countries. It concentrates on the recent discussion and critics of the today world economic management system, ruled by the International Monetary Fund and the World Bank.

It argues that economic growth did not improve though opening markets. Instead the opening, especially of the financial markets, leads to serious financial crisis.

Nearly all reliable poverty measures show a devastating outcome of the liberal policies. Poverty is not only not reduced, but increased. Countries, which rejected the advices, are better off, than countries that follow them. Free markets and free trade are therefore not automatically good for all.

Abbreviations

G8 = Group of Eight
GDP = gross domestic product
GJM = Global Justice Movement
FDI = foreign direct investment
IFI = International Finance Institutions
IMF = International Monetary Fund
LDC = [the 50] Least Developed Countries
NGO = non-governmental organization
PPP = purchasing power parity
TRIPS = Agreement on Trade-Related Aspects of Intellectual Property Rights
UNCTAD = United Nations Conference on Trade and Development
UDG = United Nominations Development Goals
UNDP = United Nations Development Program
WB = World Bank
WC = Washington Consensus
WTO = World Trade Organisation

I. Introduction

In June 2007 the heads of governments of the eight leading industrial countries (the Group of Eight {G8}) are going to meet in my home country Mecklenburg Western Pommerania in a lovely spa at the Baltic Sea. But to secure the summit, the federal police built up a 12.5 million Euro expensive protection fence against demonstration and riots, not mentioned the American warships, tactical airplanes, submarines and tens of thousands of policeman. Why do eight people need such a defence wall? This fence is already a symbol for the summit and the strong disagreement on globalization in general.

Globalization and the therewith associated liberalisation of markets and trade are strongly promoted throughout the last three centuries. In the front line of the promoters one finds the United States of America, the G8, most of the developed countries, most of the International Finance Institutions (IFI) like the International Monetary Fund (IMF), the World Bank (WB), the World Trade Organisation (WTO) and in addition a huge number of transnational cooperations as well as the international finance investment community (eg. lobby groups from the Wall Street). They refer to the popular and broadly accepted economic theories: The theory of 'comparative advantage' based on Adam Smith and the theory of prosperity of open markets and free trade, in one word: 'Neoliberalism'.

Although this is an impressive coalition, there are more and more doubts about globalization, popularized through the anti-globalization movement (better "Global Justice Movement" {GJM}). This essay puts one of the most basic, but also most important questions: Are free markets and free trade good for all? Is it in favour for everybody or just another unfulfilled 'American Dream'?

The academic debate about this issue is running now for twenty years. One of the conclusions I agree on – according to Graham Dunkley – and I would like to emphasize, is, that there is no 'false' or 'true' about globalization. Instead, there is a debate about rival ideologies and world views, which is followed by some with religious favour. To shorten the essay I will concentrate on the recent discussion and on the impacts for the least advantages in the developing countries. There are also impacts on the developed countries, I let go.

This short essay can only give an introduction in this broad debate and raise some questions. It is fragmentary and represents my special points of view.

II. Definitions and concepts

1. What is globalization / liberalisation?

Globalization is "the growing interconnectedness between political, social, and economic systems beyond national or regional borders" (Dictionary of Contemporary World History, 2007). In this essay I try to avoid the often occurred impression that globalization equals liberalisation. Therefore I will use the word liberalisation separately to describe the effects of free trade. Liberalisation is one possibility of economic globalization. Liberalisation means relaxations of previous government restrictions, mostly in economical and financial markets.

2. What are free market and free trade?

A free market economy is "a market in which people buy and sell voluntarily, without legal compulsion. Neither the quantities traded nor the price at which trade takes place are subject to control by third parties" (Oxford Dictionary of Economics 2007). Free trade is here basically understood as "international trade free from protectionist tariffs, quotas, export subsidies, and other government intervention" (The Canadian Oxford Dictionary 2007). For both terms the idealistic aim is to reduce state intervention to a minimum. These politics are also known as Washington Consensus. While most of the developed countries are far away from this ideal, the IMF forces the developing countries to open up.

3. What is poverty?

To give a single definition of poverty is a difficult task, because usually the definition of poverty entails the answer, if poverty (through liberalisation) is reduced or not. Let's look at two quotes. On the one hand James Wolfensohn (President of the WB from 1995 – June 2005) can say: "[…], since 1980 the total number of people living in poverty worldwide has fallen by an estimated 200 million […]" (cited by Pogge 2004, 380). While on the other hand Jan Nederveen Pieterse, from the University of Illinois, claims, that "the [relative] share of the richest 20 % rose from 70 % of global income to 85 % - while that of the poorest declined from 2.3 % to 1.4 %" (2002, 1023). Both answers are true depending on their definition. There are at least four important measures:

a. Relative (distribution of wealth) or absolute poverty (number of people under a certain income line {e.g. WB} or access to a good minimum of needs {e.g. Human Development Index}).

b. Definition of absolute poverty and conversion of money currencies (currency exchange or purchasing power parity {PPP}) or rather chosen indicators for relative poverty.
c. The basic year chosen for comparison.
d. Included and excluded countries in the survey.

Agents of liberalisation tend to look more at the absolute poverty, to use aggregated data (such as GDP or average income), to count in favourable purchasing power parity, to pick very early basic years to show 'long development' and to include all countries. The IMF and the WB and the United Nominations Development Goals (UDG) use for example the '1 US Dollar per day' line and pick years around 1990 or earlier, looking at all nations. If done so, poverty is decreasing (World Bank 2007, 39).

Agents of the GJM tend to look more at relative poverty on the international and national level, to evaluate the outcome of growth on countries effectively. Or they pick out only countries which really liberalised and accepted the rules of the IMF. That usually excludes China, India and most of the Asian Tigers. If done so, poverty is still on the rise (Wade 2001, 38).

I will come to this in Argumentation again.

4. What criteria should be used to assess liberalisation?

Liberalisation should be defended, if it would be possible to prove that liberalisation produces stable and sustainable growth, which reduces unemployment and therewith reduces existing distribution inequalities and poverty on the international and national level in all countries.

Liberalisation should be reformed or improved, when any of these criteria are not met.

III. Argumentation

1. Is growth coming from liberalisation?

The IMF[4] says "openness to international trade is a key ingredient of more rapid growth" (Masson 2001, 6). In fact until today there is no proof that liberalisation causes growth. Statistics like the one in the IMF-Paper (Masson 2001,7) show mysterious graphs, trying to establish a relationship between openness and economic growth. But in fact one can interpret the graphs the other way round: The growth in Ghana was stable over years although it opened up and protect again within this time. Also Korea and China are shown in these graphs as examples of success, although they restricted liberalisation and IMF politics for a long time.

Graham Dunkley (2004, 221) opposes the IMF. He argues in this book *Free Trade – Reality and Alternatives* that "[…] improvements in growth or general living standards are often the result of domestic factors rather than freer trade […], that growth often causes increased trade […] rather than the reverse". This is particular convincing for developing countries, because their participation on world trade is marginal: "Even if the LDCs exported all their output, their share of world exports […] would be only 2.4 %"[5] (UNCTAD 2003, 17).

In the chapter *That's the Theory! Debating Free Trade Doctrine Forever* Dunkley points out that the gains from free trade like the theoretic 'consumer surpluses' are much smaller than estimated in common and only appear on the long run. And theorists tend to forget the social and non-economic structural cost of change[6] (Dunkley 2004: 30).

Walden Jomo (2005, 4) shows that more than 80 % of the so much treasured foreign direct investment (FDI) in the 1990s consisted of mergers and acquisitions. In the developing countries "most of these have been acquisitions, rather than mergers. Hence most FDI is not 'green-field' investment that creates new productive capacity. […] Meanwhile there has been a decline of global FDI especially to the South, since the mid-1990"(Jomo 2005, 4).

The belief that liberalisation automatically has any advantages for growth is implausible.[7]

2. Is this growth stable?

The fact is quite obvious: If one opens up financial marked radical and fast (what the IMF is still today in favour for), a lot of money can come in, but due to removed controls can leave the country very fast, too. This brings huge risk especially to developing countries, because some have a hardly functioning bank system. Stiglitz (2002a, 30), US Nobel prize laureate for

[4] Like every IMF Policy Paper it officially represents only the view of the author. But the fact that it was published in a time the IMF was severely criticised emphasise that this is really a point of view of the IMF.
[5] Although the LDC's share of the world population is more than 10 %.
[6] There are e.g. unemployment, migration, instability, adjustment, re-education, relocation, psychological support.
[7] Supporter of the liberalisation theory may argue that this of cause comes neither automatically nor from alone. But this is exactly what the economic theory is suggesting. You remember: "The invisible hand of market"? It also reflects the policies of the IMF, which dislikes any intervention or stimulation into the free market.

economics and former Chief Economist of the WB, says that "nowhere is the disparity between developed and less developed countries greater than in their capital markets" [8].

At the end, this had caused the repetitive phenomena of devastating financial crisis like in Mexico, Brazil or Russia. The most famous crisis occurred in East Asia, after South Korea (and other Asian Tigers) opened up rapidly under the pressure of the IMF and the U.S. Treasury for foreign investors. When western investors lost confidence about the future of high growth rates they pulled out an enormous amount of money within weeks. This lead to a crash-down and high currency exchange rate. The evidence of the connection to liberalisation policies (mostly of the IMF) is clear and broadly accepted[9]: "The WB itself has recognized the risks involved" (McCorquodale and Fairbrother 1999, 743).

Most of the poor are suffering through these financial crises, because of unemployment and famine. While the IMF invested 23 billion US Dollar e.g. in Indonesia to support the currency and bail out all the creditors, the IMF did not have the much smaller amount of money necessary to keep on paying food and fuel subsidies for the poor. Bursting riots after the announcement of the cuts of subsidies, threw back the economy for years, re-established old ethnical conflicts and ran the manageably crisis into a catastrophe (Stiglitz 2002a, 119).

The scale and importance of these crises for the development can be understood with a look on 'the 50 Least Developed Countries' (LDC), which are watched by the UNCTAD. 33 of them have experiences with economic crises. 21 of these collapsed countries have still a GDP (in 2003) which is lower than it had been 20 and 30 years earlier (UNCTAD 2003, 13).

The other negative effects of financial liberalisation are high volatility in exchange rates and high interest rates (Jomo 2005, 4). Both are counterproductive for creating new jobs and enterprises. In connection with liberalisation of trade this "rather than moving workers from low-productivity jobs to high-productivity ones, moves them from low-productivity job to unemployment" (Stiglitz 2002b, A19).

To avoid financial crises, governments are forced to keep a huge exchange reserve in US Dollar to prevent speculations (UNCTAD 2003, 73). Because they do not have huge reserves they have to borrow it for high interests rates around 20 % (Stiglitz 2002b, A18).

Liberalisation does not stabilise financial markets in developing countries, indeed, it does the opposite.

3. Is this growth actual reducing poverty?

Even under the assumption that liberalisation leads to growth and growth reduces poverty, the question remains: Is this reflected through a declining number of poor?

Not surprising the WB says that the poverty rate is declining, after all to reduce poverty is its mission. But these numbers, published by the WB and the IMF (see 3.2.), are in my view

[8] Stiglitz (2002, 30) says e.g. Ethiopias entire banking system is in its size of its assets somewhat smaller than the banking system in a suburb of Washington.
[9] A detailed description of this effects one finds in Joseph Stiglitz book "Globalization and its Discontents" in the chapter "The East Asia Crisis: How IMF Policies Brought the World to the Verge of a Global Meltdown."

not only highly questionable, but also designed to deliver wrong (namely positive) results since the indicators are undifferentiated.

- There are a lot of problems with absolute poverty measures. First to look only on income is a very narrow view. Second, it is very complicated to define a fair minimum line. The WB says that 1 US Dollar per day (32,74 Dollar per month) is enough to be 'not poor'. But according to Thomas Pogge (2004, 381), one needs at least circa 427 Dollar per month to afford minimal nutrient constraints in the US.
- The next step is to change this 1 Dollar into other currencies. The WB uses the PPP instead of the exchange currency. The PPP exchange rate is much lower, because it includes services, which are cheaper in most developing countries compared to the US. However this is problematic, because poor do not need nor could afford services, but have to spend all there money on food. But food is relatively more expensive than the PPP suggest[10].
- Pogge also finds internal unreliableness. Depending on the PPP base year poverty rates of the WB e.g. for Nigeria and Mauritania jump from 31.1 % and 31.4 % in the 1999 report to 70.2 % and 3.8 % in 2000, without a huge difference in economic or social development (Pogge 2004, 384).

Pogges (2004, 383) conclusions are that a "more credible poverty line would *not* deliver the same [positive] trend" and the arbitrary PPP calculation shows, that "the World Bank's method for producing poverty estimates is unreliable" (2004, 385).

In addition, if one excludes countries like China and India, which refuse the IMF liberalisation policies[11], even the official WB numbers turn down: "Excluding China, the number of extremely poor people actually increased by 28 million" (UNDP 2000, p. 5).

The WB is the only institution with an absolute poverty data correlated to income. So the alternative is to look on relative poverty measures. In fact inequality measures like 'Gini coefficient' offering a more reliable picture and lead to a deeper understanding.

High distributional inequalities, you find in mostly all the developing countries, explain at best[12] why the poor – although there are moderate growth rates in some countries – can not profit. The profit is just concentrated on a small elite[13].

While there was a debate about the correct interpretation of the absolute poverty numbers, inequality measures were broadly accepted, also by the IMF (2000)[14]. These meas-

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[10] A detailed explanation one can find in Pogge's (2004) article, p. 381 – 385.
[11] China and India still sheltered their currencies (a serious sin according to the IMF) and have protectionist markets.
[12] Other effects like jobless growth are more significant for developed countries. Jobless growth can occur e.g. with new techniques and increased productivity or as an effect of tie-ups
[13] Detailed information one can find in the annual Human Development Index (HDI), published in the Human Development Report by the UNDP.
[14] The IMF however tries to qualify the inequality measures with references to increasing GDP (2000).

ures can be transferred to an international level. Robert Hunter Wade (2001, 38) calculated eight different measures of inequality of world income distribution: "[…] even the most favourable combination of measures shows rising inequality over the past twenty years". Weller and Hersh (2002, 13) are spotlighting that the median income of the richest 10 % of countries compared with the poorest 10 % has gone up from 77 times greater to 122 times from 1980 to 1999. "The (inflation-adjusted) income levels of today's poor countries are still well below those of the leading countries in 1870" (IMF 2000). Some other numbers the UNDP Reports (2006

- 30 countries accounting for more than half a billion people today have a per capita income lower than two decades ago (UNDP 2000, 31)
- 21 countries have declined in the HDI (UNDP 2003, 1-13)
- Compared to 1990 (UNDP 2003, 2):
    - 54 countries are poorer now.
    - In 21 countries a larger proportion of people is hungry.
    - In 14, more children are dying before the age of five.
    - In 12, primary schools enrolments are shrinking.
    - In 34, life expectancy has fallen.

Neither the World Bank nor the IMF could prove a declining of poverty. If one looks a little bit closer, all measures show the opposite.

4. Is poverty reduced everywhere?

Even under the assumption that liberalisation reduces poverty, does it happen everywhere automatically and similarly good? Although Neo-Liberals argue that state engagement is inefficient (see World Growth 2005, 11), the reality is – especially for the developing countries - the opposite. South Korea's government e.g. developed a high competitive steal industry. New industries innovations like the first telegraph line in the US or the internet were originally pushed through the state. In particular in developing states, the government has a major role. Not trade barriers are to overcome and governments to get out of the way, but markets to create (UNCTAD 2006, 75).

Therefore it is not surprising that countries, witch focused on developing their economy on their own, instead of hoping for the invisible hand of the market and rejecting the shock therapy and force of the IMF[15], were better off (Stiglitz 2002b, A16 and Jomo 2005, 2). The World Development Movement (2005, 10-12), an NGO from Great Britain, examines that the IMF still follows a market-fundamental 'One size for all'-strategy, instead of taking in account special circumstances of each country.

[15] Prominent countries who reject the IMF are China, India, Hong Kong, Poland. Prominent clients of the IMF shock therapy are Russia and huge number of African as well as Latin American countries. South Korea rejected the IMF policies a long time. When they introduced them in the end, this leads into the East-Asia crises.

UNCTAD (2006, 1 – 3) demands a “paradigm shift” and “new policy orientations” who aims to increase domestic resources instead of extend trade liberalisation, which often “offer[s] very limited opportunities”.

The results of the citied researches are devesting for the IMF and the WB. Not only poverty is not reduced, their programs achieve the opposite. Poverty is reduced mostly in these countries, which resist the IMF.

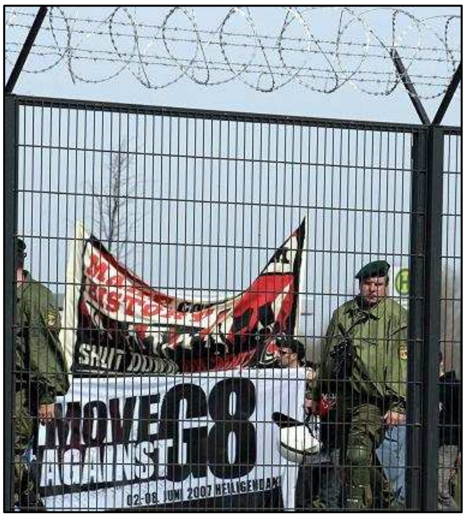
IV. Conclusion

It could be shown that rapid liberalisation in the way the IMF promotes, neither leads to growth nor reduces poverty. Instead, liberalisation and the therewith connected phenomena like financial crisis and unstable exchange rates, are likely to spread poverty in developing countries. So, free markets and free trade are not automatically good for all. Still there are some progresses, through e.g. wisely managed, slow opening like in China or in non-economic areas like in medical improvements.

These conclusions open several other questions about an alternative management of the global economic system. This should not only be improved to deliver better results, but also to ask for its legitimation. Who are we to dictate anybody how to establish their markets best? A lot of the IMF client countries have not a real 'free choice', they depend on external help. And it is without question our historical commitment to assist these countries since the depredation in the time of colonialism.

Sebastian Jabbusch.de , April 24th 2007

"At the current pace Sub-Saharan Africa would not reach the Millennium Development Goals for poverty until 2147 and for child mortality until 2165." [16]



[16] United Nations Development Program 2000, 29–43.

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