Eurasian Journal of Business and Management, 1(1), 2013, 41-50

EURASIAN JOURNAL OF BUSINESS AND MANAGEMENT

http://www.econjournals.net

COMPETITIVE STRENGTH OF NATIONS: DOING BUSINESS IN A GLOBAL MARKET

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Abstract

This paper is designed to study strength and capability of nations to do business under a competitive system devised and monitored by the World Trade Organization. The main objective in this attempt is to review and evaluate the impact of WTO's policies on the economic welfare of the developing countries and to see how far the producers on the one side and consumers on the other side have benefitted in general. The study while reviewing historical experiences of countries under laissez-faire policies, examined the effectiveness of the negotiations carried out by the WTO for enhancing international trade. The study found that under the infant industry argument, many of the WTO member countries are still protecting their businesses and violating the laid down principles of free trade. Since the WTO is to promote international trade and watch the interest of the producers, the consumers seem to have been left unattended. As a result of which the corporate sector continues to maintain its hold in protecting their monopolies in various forms. The study strongly recommends consumer protection rather than producer protection as the fundamental goal for the WTO to keep in view in its policy prescriptions.

Keywords: Competitive Strength, Free Trade, Infant Industry, Corporate Sector, Consumer Protection

1. Introduction

The world as a whole is undergoing structural changes on account of rapid integration of trade, finance, human skills, and innovations in a global market setup. As a result the interdependence of countries is increasing to evolve a highly competitive market structure. Under such a system it is essential for the business organizations to remain competitive in terms of size, innovations, quality and costs among their competitors. This becomes a necessary condition for their survival. The move towards globalization seems to have been started in 1940s, immediately after the commencement of reconstruction of economies damaged during the World War II. However, recently the pace of globalization seems to have been increased much faster due to several inter-related causes, affecting producers and consumers of goods and services in developed as well as in developing countries of the world.

Since 1980s the volume of world trade has increased far more than the world income. In fact, the share of developing countries in the total volume of world trade has increased from 19 percent in 1971 to 46 percent in the year 2010. Thus developing countries as a whole have become the key driving force behind global trade change. Much of that growth in the exports of developing countries has been seen in manufacture, which adds up to almost 70 percent of developing country exports. The shifting global balance is visible in the changing distribution of exports by destination. The rise in South-to-South trade has been more prominent. The volume of world trade in the year 2010 was around 15 trillion in current US dollars. In this total the share of developed countries was 54 percent, registering a drop from 60 percent in the year 2005. China's share of world exports increased to 10 percent in 2010, apparently highest when compared with United States (8 percent) and Japan (5 percent). Despite these highly welcome recent changes in global trade balances, the concerns of developing countries remain underrepresented globally.

The rate of increase in world trade and flow of direct foreign investment and many other growth indicators show that globalization has directly affected the economic growth prospects of both developed and developing countries. This enhanced performance of economies has been primarily made possible on account of rapid technological advancement and dissemination of knowledge for universal application. Many of the developing countries like South Korea, Singapore, Hong Kong, India and China are now counted among the most progressive countries of the world. Looking at the very many benefits of globalization, more and more countries have opted to become the members of World Trade Organization (WTO).

This paper is to analyze the impact of WTO policies in realizing free trade and the benefits, which are likely to accrue to the developing countries. In this attempt both qualitative and quantitative information has been collected from the secondary sources to provide supporting evidence in support of the conclusions reached in the study. The role of WTO in promoting free trade between countries in accordance with the standard rules and regulations agreed with its member nations have been studied in-depth to see how far WTO is able to deliver according to its charter of responsibilities. A brief survey of the laissez-faire economies and the views of the reputed economists on the adoption of free trade are to form part of the study for further discussion and for the formulation of final conclusion in this paper.

2. Literature Review: Past Experiences and Lessons

Traditionally countries have been very protective in safeguarding their national interest when trading with other countries. This is why we see that countries in olden days wanted their balance of trade between countries to show surplus in their favor. They were of the view that it is a good sign of governance to have positive balance of trade. "We must always take heed that we buy no more from strangers than we sell them, for so should we impoverish ourselves and enrich them" this was Elizabethan era, and the quote is from "Discourse of the Common Weal of this Realm of England"(Lamond, 1893). These were the policy guidelines to conduct business in the society. Similarly Thomas Munn (1630) wrote "England's treasure by foreign trade, or, The balance of our foreign trade is the rule of our treasure".

In fact, from 16^{th} to late 18^{th} centuries, Mercantilists had a complete domination over Western Europe's economic policy. They strongly believed in government control of foreign trade to ensure military security of the state. In this era, trade policy was aggressive and rather uncompromising (Crafts, 1985). Britain was running highly protective system to safeguard domestic industry and to extend the British Empire in places where trade was considered lucrative.

Adam Smith (1976) was highly critical of Mercantilists policies of trade restrictions. In his views such policies had actually reduced the quantum of international trade. Smith was a great believer of free trade and he wanted the international trade to be run on the same lines as domestic trade. He recommended a policy of laissez-faire on the ground that it would lead to ever-higher levels of wellbeing in all trading countries. Very similar policy lines were advocated by David Ricardo, who favored an end to Corn-Laws, and recommended that Britain ought to import corn from countries better equipped to produce it at lower cost (Formaini 2004; Hollander, 1977). This way he recommended Britain for importing most of its food and out-sourcing most of its agriculture employment.

Over the course of the nineteenth century there were many serious efforts to reduce impediments to foreign trade. Britain took a lead role in relaxing international trade rules for trade negotiation with its neighbors. There were many bilateral treatise[9] signed between France and England, the sole purpose of which was to reduce duties on a number of products for mutual benefits (Irwin, 1996). However, the infant industry policies adopted by the United States came under severe criticism. John Stuart Mill (1848) who apparently found some justification to defend the principle of protection under infant industry argument later withdrew his stance and said “an organized system of pillage of the many by the few” (Melitz, 2004). Marshall (Wood, 2008) and Taussig (1883) while examining the U.S. experience with infant industry protection was convinced that there is lot of difficulties associated with protection under infant industry argument. He (Taussig) in his doctoral dissertation came to the conclusion that “little if anything was gained by protection”. However, Great Depression of 1930 pushed countries back to protectionism and there were widespread import restrictive tariffs to safeguard domestic industry.

In fact, advocates of protection often argue that new and growing industries, particularly in less-developed countries, need to be shielded from foreign competition. Secondly many developing countries justify protection on the ground that there are economies of large-scale production in many industries and the developing countries have difficulty in establishing such industries.

It is becoming more and more clear that protection in any form or for any reason is very costly for the economies as a whole. The argument is simple and straight because by closing off markets, protection results in reducing and limiting the ability of firms to gain economies of large-scale. The supporting evidence (Baldwin, 1969) is based on a very logical and convincing explanation. If a group of countries practices infant-industry protection, it is actually splitting the market; each country is bound to end up with small-scale, localized, inefficient output levels, resulting in reducing the prosperity of all the countries.

Infant industry argument calling for protection is unrealistic and controversial. Even in its application, very few governments can justify and identify which industries they need to protect; “infant” industries are seldom seen “grown up” in comparison to “adult” foreign competitors. In the real world the infant argument is commonly abused in practice. There are very many cases in developing countries where industries have failed to attain international competitive strength even after 20 years of operation.

There are at least two cases fully documented where infant industry argument has been almost defeated. In the first case we see that Brazil in 1980s enforced strict controls on the import of foreign computers in an effort to nurture its own “infant” computer industry. But this industry never grew to a takeoff position. The technological gap between Brazil and the rest of the world actually widened, while the protected industries merely copied low-end foreign computers and sold them at inflated prices to the local consumers. In the second case we find that an empirical test for the validity of the infant industry argument was also carried out using Turkish data (Krueger and Tuncer, 1982). The authors on the basis of data relating to input per unit of output (Turkish Data) found that the situation has not improved on account of protection given to the industries considering infant industry argument. They concluded that input per unit of output must fall more rapidly in more protected industries, therefore protection did not justify the growth performance in output per unit of input on which infant industry argument can be defended in Turkish case.

The Indian and South Korean comparisons further illustrate ineffectiveness of infant industry argument in promoting economic growth. India protected many of its domestic industries (automobiles, iron and steel and others) for a long period of time without any noticeable improvement in their competitive ability. In fact, these industries remained heavy drain on the exchequer for many years. By relaxing rules and regulations, India invited foreign direct investment to revolutionize its auto industry in the late 1990s and then it was able to produce autos at international prices.

On the other hand South Korea did subsidize its heavy and chemical industrial operations, but these subsidies were performance related and required industries to emerge with strong export products (trading at world prices) after completing their initial period of protection.

The Bretton Wood Conference (1944) recommended establishment of international institutions, such as the International Monetary Fund and International Bank for Reconstruction and Development to accelerate post-war recovery and development. During the same period General Agreement on Tariffs and Trade (GATT) was created in 1947-48. GATTs coverage was limited. Its scope included only trading of merchandised goods and it was not very effective in executing its own policies. As a result World Trade Organization replaced GATT in the year 1995 with the objective of promoting free trade following five key principles- nondiscrimination, reciprocity, enforceable commitments, transparency, and safety valves. Looking at the promises of WTO, many of the developed and developing countries joined WTO as members with the hope that it will bring prosperity among all the countries alike. There are nearly 157 member nations of WTO; about 80 percent of these members are from developing countries.

According to its charter of responsibilities, WTO is to treat all countries alike and equal in terms of conducting trade. Thus the policy of a country to give favored nation status to any country is against the standard rules laid down by WTO. Even in the same country, local and foreign trading firms are required to be treated equally and without any discrimination. This is what the developed country in pursuit of trade liberalization; want developing countries to establish domestic competition policies and laws reflecting equal treatment for the local and foreign investors. On the other hand the developing countries are of the view that domestic investors need certain exclusive advantages to withstand competition from the might of foreign investors. Hence providing the giant international firms equal rights would outclass the local business firms which being relatively small and medium-sized may not remain viable (Khor, 2001). This is an argument very similar to the one raised and defended by the developing countries to justify protection under infant industry argument.

3. Methodology

The study while focusing on the plight of poor countries has made in-depth study of the advantages and disadvantages of free trade. The main purpose was to find out the success and failure of WTO in promoting international trade on the principle of free mobility of goods and services between countries. In this context the contribution of various renowned economists was reviewed to seek guidance for analyzing the impact of free trade on the developing countries and the consumers of final goods and services in general. The infant industry argument to justify protection was examined in detail to see how far it has contributed in enhancing the economic welfare of the people and the economy as a whole. This paper while examining the role of producers of various goods and services looked at the ways the consumers have been exploited by restricting competition.

The paper while examining the international trade policies adopted in different time periods, lays down possible ways and means to bring better results. The study focuses on the role of GATT and WTO in bringing unbiased policies to promote international trade, so that rich as well as poor countries can claim their fair share in selling their products and services in the global market. In view of the failure of these international agencies in bringing equal opportunities for countries to trade, the study proposed possible solution to overcome the hurdles in pushing international trade between countries.

4. Discussions and Analysis

Economists have developed a logical evidence to support free trade policies over the past two hundred years. Starting with Adam Smith in the 18th century justifying free trade on the basis of absolute advantage, and later David Ricardo found comparative advantage as the most gainful advantage for carrying out international trade. These ideas favored free movement of goods and services to promote low cost efficiencies between countries. Contrary to the thinking and approach of the economists of that time, the Corn Laws (1815-1846) were passed by the United Kingdom of Great Britain to protect their own corn producers (land owning community) from import of corn from the neighboring countries. These Laws were considered justified; even when the price differentials were very high and against the interest of the common consumers. Britain's own corn producers were selling corn at a price of 126s. 6d a quarter of corn while when imported the price in Britain was 65s. 7d. David Ricardo favored an end to Corn Laws on the plea that Britain ought to import corn from countries better equipped to produce it at lower cost. In fact, Ricardo's free trade doctrine became fountainhead of contemporary thinking in the nineteenth century.

Ultimately Corn Laws were repealed in 1846 by UK parliament and the corn became cheaper in Britain (Schonhardt-Baily, 2006). It was Sir. Robert Peel, the conservative Prime Minister of Britain, took this decision against his own party principles. He also went against the financial interest of the land-owning aristocracy of that time. This incidence provides sufficient basis to claim that free flow of goods and services between regions or countries are beneficial for the society as a whole (Sally, 2012). However, in the later years the advocates of free trade modified their support for free trade with the sole purpose of protecting infant industry in developing countries where free trade was considered a serious threat to their survival.

The infant industry case in its simplest form is understandable from the point of view of developing countries, where some newly established business firms might require protection from foreign well-established business firms. It is quite valid argument to prove that newly established business firms couldn't make large investment unless they have been given sufficient time to establish themselves and reached a stage of maturity to compete with the well-established business firms in the global market. This sounds justified and quite in line with the country's national interest. Many developing countries in order to strengthen the competitive ability of their local business firms provided necessary support programs to protect the infant industry from foreign competition. But the end result seems to be very disappointing. The available evidence suggests that many of these infant industries, availing all these concessions for many years, never reached a stage of maturity to stand international competition. This particularly refers to the outcome of Brazilian and Turkish case studies. In fact, the local consumers in those countries, majority of them earning sub-standard incomes, have been the worst sufferer while the business firms protected under infant industry argument are making monopoly profits.

Due to lack of built in checks and control to monitor the performance of infant industry, the protected industries have been exploiting the consumers by providing them with inferior quality products at exorbitant prices. This apparently is the outcome of all such measures, which have been adopted to restrict competition and allow protection to the business firms to strengthen their competitive ability. By restricting competition we are in fact protecting producers and their inefficiencies and the consumers are made to pay to safeguard the interest of the producers.

The most effective way to serve the consumers in the global market is to promote competition without boundaries. Since long we are all very much concerned to facilitate production process by providing incentives to the producers to deliver according to the market demand. But we failed to protect the consumers against the exploitation of the producers so that consumers can be served with goods and services at reasonable prices. The governments in poor countries provide tax holidays; high tariffs on imported finished products and allow tax-free import of machinery and raw materials to help the local producers to grow and develop competitive strength to stand competition in the global market. Apart from the fact that all these concessions are paid out of national funds, the consumers are rarely compensated or protected against their exploitation.

The consumer is fully protected when he is given the choice to buy a product at a competitive price (being lowest) in the global market. It is not his concern how and where the product is to be made. The consumers ought to be the ultimate beneficiaries in the production of goods and services for the domestic as well as for the international markets. This calls for free mobility of resources within and between countries in support of free trade. In this particular context the establishment of World Trade Organization in 1995 is seen as the most beneficial move for providing global competition to safe guard the interest of buyers and sellers.

Looking at the charter of responsibilities of WTO, the developing countries expected radical reforms from developed countries to bring pro-development changes very much in line with developing countries need. An identified agenda that directly focuses the interest of developing countries includes elimination of export subsidies, drastic reductions in domestic support and substantial improvements in market access for agricultural products, and removal of industrial tariffs imposed by the developed countries. So far WTO failed to eliminate protection in its various forms for running unrestricted free trade without any discrimination between countries. Instead developing countries have been completely sidelined by the economic and political interests of global powers.

4.1. Failures of WTO

Some of the failures of WTO seem to have directly hit the welfare of the developing countries (WTO, 2001). These largely relates to the special treatment provided by the WTO to more rich and powerful countries against their competitors. The Fair-trade Foundation, a UK based organization revealed that the rich-country producers of cotton (USA, European Union, China and Indian cotton growers) were paid $47 billion in subsidies in the last 10 years (2000-2010) as a consequence of which about 15 million cotton farmers across west Africa were directly hit, who were trying to trade their way out of poverty. The Fair-trade

Foundation further found that EU pays $2.51 per pound of cotton to support its 100,000 cotton growers, which is more than the market price of cotton.

The developed countries continue to have many high tariffs. Especially the rich countries have higher tariffs on processed goods than on raw materials. Presently manufactured goods alone forms three quarter of developing-country exports, which are directly affected on account of developed countries high tariffs. According to a World Bank study (Pack and Saggi, 2006) barriers to manufacturing exports account for around 70 percent of the total export barriers faced by developing countries. In fact the developing countries are deeply concerned to see that the textiles, clothing and leather products, being the major export items, is completely liberalized and to that effect these countries have raised their concerns at various WTO forums. The US and the EU are the main parties that are required to liberalize, but nothing substantial has been achieved so far. On this very account, the developing countries are unable to increase their textile and clothing exports to developed countries. In fact, reverse seems to be the outcome of WTO's policy impact in this area which allows developed countries to protect their domestic industries from international competition.

A very similar situation prevails with regard to agricultural subsidies. The WTO Agreement provides selective deregulation of agricultural products, to enable large exporting countries, such as, US and EU to maintain their high levels of subsidies while the developing countries are stopped from making such concessions to their farmers or from introducing new subsidies to make the agriculture sector more competitive. In developing countries, as many as four out of every five people make their living from the land. But the WTO's Agreement on Agriculture requires that market forces should control agriculture policies in all circumstances. Such an Agreement is hardly beneficial for the developing countries that have given national commitment to guarantee to maintain decent family farm income for their farmers.

In fact, the overproduction of farmers in rich countries has threatened the livelihood of farmers in poor countries. The Agriculture Agreement works out to favor the corporate agribusinesses of the developed world. It is continuously squeezing and pricing out the smallholder farmers in developing world. The OECD (2009) provided support to agriculture producers to the tune of US$ 265 billion in 2008. This is equivalent to 21% of aggregate gross receipts of OECD farm producers. The consequences are detrimental to the food security of developing countries, since local production to support local food needs are severely at risk and many low-income countries and people will not have sufficient financial resources to purchase even the basic foods they require.

4.2. Biased Decisions

So far WTO's efforts to remove all the barriers to free trade between countries have not shown impartial handling of negotiations and settlements when dealing between countries. The power play between the rich and poor economies that has taken place in bilateral trade relations prevails in the WTO, and in fact these are institutionalized in the WTO. The rules and regulations of the WTO remain imbalanced and rather biased in favor of the corporate interests of developed countries.

The WTO is required to operate on a consensus basis, with equal decision-making power for all. In actual practice, many important decisions get made in a process whereby poor countries' negotiators are not even invited to attend the meetings. This is what happened at the Singapore Ministerial Conference (Dec. 1996) where only selected countries were invited to carry out negotiations. In such circumstances it is difficult to accept

WTO's decisions, which seem to be creating an impression that WTO policies are rather undemocratic because of the lack of transparency during negotiations.

5. Conclusions

The establishment of WTO is a welcome sign and its creation must be seen as a necessary step to strengthen competitive environment in the international trade. Its objectives as laid down in its charter of responsibilities, such as free mobility of goods and services between countries without protection in any form that restricts market competition are highly beneficial for the global market. All these goals are desirable to promote and encourage cost efficient production processes, no matter where the goods and services are produced, to serve the best interest of the consumers globally.

Globalization is brining structural changes in the pattern of demand and supply of goods and services all over the world. The business organizations (domestic as well as multinationals) are to remain competitive to reach everywhere for their future survival. There is a growing interdependence of countries resulting from increasing integration of business, finance, knowledge and physical inputs in a global market setup. China is providing a highly cost efficient skilled manpower in accordance with the global market trend. Evidence shows, that many foreign investors in China have prospered and doing far better than what they were doing in their home country.

By restricting competition we are promoting monopolistic culture, not in the interest of the consumers. In fact, it leads to exploitation of consumers in various forms (low quality products at exorbitant prices) and loss of tax revenue to the exchequer. We have learned and experienced that market competition brings in cost efficiencies, innovations and the competent producers offer lowest price to lead the market. The rules and regulations laid down by WTO are meant to create a highly competitive global market environment and the international community is to fully cooperate in doing the needful.

Since the establishment of WTO, the direction and flow of direct foreign investment towards developing countries has increased significantly (UNCTAD 2013). The economic welfare of the people in these countries has increased (higher wages, opportunity to learn new skills, and better working environment) many folds. The producers on their own are moving their processing plants to places where cost of inputs is relatively low. China and India are good examples where foreign direct investment flows are ranked among the top destinations in the world. More and more developing countries, especially highly populous countries, like China, India, Brazil, Nigeria, Pakistan and many more are migrating to other countries to earn and learn better skills. Thus any attempt to obstruct free mobility and competition between countries is to result in high prices of goods and services and consequently it is to affect the economic welfare of the consumers.

Looking at the promises of WTO, many of the developing and developed countries rushed to become its member. Presently there are about 157 member nations as WTO's member, out of which nearly 80 percent are from developing countries. This shows the amount of confidence and the trust the developing countries have placed in the functioning of the WTO and the likely benefits, which are to accrue to them. However, so far WTO has not been successful to play its role impartially and with all the fairness that the developing countries deserve. The domination of rich and powerful corporate sector seems to have put greater pressure in restricting competition in areas where the developing countries have cost advantage, such as agricultural products.

Most of the developing countries in the world have the potentialities to become trendsetters in economic growth. China is a very good example. Its economy is growing around 10 percent per annum while its export are ranked 2nd highest in the world. The developing countries by holding nearly 80 percent of the WTO membership can become the dominant force for implementing the rules and regulations impartially without fear and favor. The WTO has to ensure that benefits of building competitive strength of all nations must flow to the consumers and they must be protected against exploitation by the rich and powerful corporate sector.

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