The Misuse of Trade Statistics

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Introduction

The World Development Movement (WDM) is a UK-based organisation with some 13,000 supporters campaigning to change UK, European and International policies to tackle the root causes of poverty.

WDM has local groups around the country which provide a means for people to get together to take joint action. The organisational ethos is to help people who care about international development issues to do something about it – whether by joining together locally in groups, or by taking individual actions.

I start off with a very brief introductory side-swipe at one of the most obvious and most used bits of rhetoric in the trade debate. Then I go onto discuss how our government – and various international institutions – play fast and loose with the facts, firstly with the term 'openness' and secondly with the use of computer modelling.

What is 'Free Trade'?

To, begin at the beginning, with the wonders of so-called 'free trade', because this term has defined public discourse on international trade.

If you ask most people whether they think free trade is a good thing, they will most likely say yes without really knowing what it is. And politicians and the media use the phrase 'free trade' all the time.

But the problem is that nobody really knows what 'free trade' actually means. The international rules of trade now encompass a very wide range of policies, so it is hard to know what 'free trade' would look like across all these policy areas.

While it is perhaps easier to define in terms of eliminating border tariffs and quotas, but would 'free trade' also mean getting rid of every single subsidy, every single environmental, health and safety regulation that affects trade, every trade affecting qualification requirement and technical standard? Who knows? The issue is totally subjective. One person's 'free trade' is another person's 'protectionism'.

Yet the fact that we don't really know what 'free trade' really means does not stop politicians from using the phrase at every opportunity. In fact, in the real world, 'free trade' is used to pursue the interests of big business in rich countries. This is because the phrase 'free trade' is used by our government – and institutions like the World Bank - to argue that poor countries should open their markets to rich country products and companies.

This moves onto the second topic: our politicians argue that poor countries are poor because they are not open enough and countries that are open and 'integrated into the global economy' perform better.

The standard quote from Gordon Brown is as follows, *"In the last forty years, those developing countries which have managed to be more open and trade more in the world economy have seen faster growth rates than those which have remained closed"*.

But openness, in the academic literature, is used to describe how *much* a country trades. This is measured by the contribution imports and exports make to National Income (GDP). Openness therefore is not a measure of government trade policy.

It is only politicians who, either accidentally or deliberately, confuse the term "openness" with how low a country's trade barriers are. It is quite possible to be "open" (for example export a lot) whilst maintaining tariff and non-tariff barriers to trade.

In any case, the link between openness (i.e. how much a country trades) and economic development is complex. For some countries – such as Malaysia, Korea, Taiwan, Thailand and China – more trade, and in particular more exports have been accompanied by economic growth. Other countries however, are trading like mad but getting nowhere.

For example, according to the UN in 2002 Least Developed Countries (LDCs) are more open to trade than developed nations. Trade as a share of GDP in the 49 LDCs is 43%, compared with 40% in the world's richest countries. These countries, contrary to the spin of our politicians, are more 'integrated into the world economy' than we are; so increasing 'openness' (i.e. exports and imports) is clearly not a precondition for being a rich country.

So the quantity of trade would seem not to be the issue. It is the quality of trade that is key.

Yet the 'openness' rhetoric has been used by the industrialised world – through the International Monetary Fund (IMF) and World Bank – to push poor countries into abandoning attempts to develop higher value-added domestic industries and pursue instead so-called 'export-led development' based on low value commodities.

The result has been a sad story of collapsing prices, crippling debt and grinding poverty.

Lets look at coffee as an example. During the 1980s, in the pursuit of free markets rich countries abandoned a coffee commodity price control agreement while at the same time, through the IMF and World Bank, they pushed poor countries into producing more coffee for export.

In the name of 'export-led development', poor countries have been told to open their own markets to high-value manufactured products from the rest of the world while specialising in the production and export of low value commodities.

But has this export drive yielded any benefits for the millions of people in the developing world whose livelihoods depend on coffee production or any benefits for the poor countries dependent on coffee for foreign exchange earnings?

Sadly not. The result is entirely predictable. A massive oversupply on world markets and a price collapse. Between 1980 and 2000 coffee prices slumped by over 60% in real terms throwing producers into crisis.

Any standard economic textbook will tell you that an increase in supply, without an increase in demand, will lower prices. Yet, incredibly, it looks like the IMF and World Bank economic experts forgot - or chose to ignore - the basics as they ranged around the globe encouraging increased production and exports and reducing state intervention.

So, somewhat bizarrely, the mantra of openness, free markets and export-led development has been used by neo-liberals to circumvent one of the building blocks of their own belief system – supply and demand.

Yet, despite such glaring failures, our politicians and major global institutions continue to argue for 'free trade' or 'open markets'. And recently their crusade has been 'blessed' with a new weapon to add to their armoury – the results of what are called Computable General Equilibrium (CGE) modelling.

The Problems With CGE Modelling

As you may know, CGE models are an attempt to create a model of how economies work and interact with each other so that variables – such as tariffs – can be altered to see what the economic outcome would be. These models tend to produce great figures that both Governments and NGOs have used in their arguments

This results in figures such as, trade liberalisation by all countries would increase developing country income by $1.5 trillion dollars between 2005 and 2015. And services liberalisation in developing countries will result in benefits of $900 billion dollars by 2015.

Here's a typical quote from, the then, Trade Secretary Patricia Hewitt: *"If we cut all trade barriers in half, we could raise the income of developing countries by $150 billion a year - three times the value of all aid budgets put together."*

And because these figures are produced by computers operated by clever mathematicians, they have a veneer of academic respectability that most would find hard to question.

However, although these models produce figures that are great for pithy, publicly digestible messages, they may end up obstructing debate on the complexities of trade. I am keen for WDM to become much more circumspect about using information from such models because they epitomise three critical tensions that we constantly encounter in discussions over ‘the evidence’.

Assumptions in models

The first tension concerns the assumptions in models versus the real world. In order for CGE models to work, they have to hold various factors constant, and make a range of assumptions to avoid dealing with the chaos of real economies.

For example, if you care to delve into United Nations Conference on Trade and Development (UNCTAD) or World Bank CGE analysis of liberalisation – where most gains for developing countries are usually predicted to stem from their own liberalisation – you will find they tend to be based on the following assumptions:

1. Perfectly competitive markets: this involves, for example, everyone having access to perfect information, producers having no influence over prices and cost-free entry into markets.
2. Consumers all having exactly the same tastes.
3. Perfect substitution of capital: in other words, a set of ploughs can be effortlessly converted into a textile mill which can effortlessly be turned into a tomato canning factory which can effortlessly be converted into an office producing computer software.
4. No supply side constraints (for example, perfectly functioning transport infrastructure).
5. Full use of land, labour and capital.

Now those in power tend to characterise the so-called ‘anti globalisation’ movement as being naïve and unrealistic. Yet how can you possibly claim to be making a prediction that is even roughly correct when your assumptions are so far out of line with real world conditions?

In consequence, the estimates produced by CGE models are likely to be grossly inflated. At best, therefore a CGE model can provide an indication of the direction of benefits (i.e. positive or negative). But to trust the figures as some sort of accepted truth – and more importantly to base policy on them – is irresponsible.

And the theory has become so unchallenged that we have the bizarre situation where, if free market policies fail, Governments are blamed for not correcting the various market imperfections, rather than the economists being blamed for not taking into account market imperfections in their policy prescriptions.

Aggregation versus case specificity

The second tension concerns aggregation versus case specificity. CGE models are an attempt to aggregate broad economic impacts across countries, groups of countries or even the whole world. They do not take into account differences between localities, regions or countries.

Case studies, on the other hand, can develop a more detailed picture of what can work in different circumstances. However, the message from case studies is often not popular. Case studies often show that the world is extremely complex and what works in one circumstance may not work in another.

The rise of CGE modelling as a tool to help define policy is dangerous because it tends to ignore complexity – which leads to simplistic policy solutions – such as all developing countries should liberalise their economies as soon as possible.

Analysis of the future versus analysis of the past

The third tension is between analysis of the future versus analysis of the past. The 'end of history' – as proclaimed by author Francis Fukuyama in 1992 – was supposedly the final and lasting triumph of western style free market capitalism. However, the real triumph seems to have been convincing people that the industrialised world really did develop and grow wealthy through free markets and so-called 'free trade'. This is a complete myth.

The reality is quite the opposite. The development history of the industrialised world is characterised by a process of economic advancement based on active industrial policy – including, amongst other things, the selective use of tariffs, subsidies, industrial espionage, state trading enterprises and weak intellectual property laws. In other words, government interventions aimed at boosting the competitiveness and success of domestic businesses.

The problem is that such historical economic analysis seems to play little or no part in decision-making. CGE models look only at what might happen in the future if the world worked like an economics text book.

Once countries get rich and have companies that are competitive and operating globally, the politicians and the companies develop a sudden and near total bout of amnesia. They suddenly decide that so-called 'protectionism' is a terrible thing and must be stamped out. They develop a near theological belief in free markets and become vociferous cheerleaders for what they call 'free trade'.

This is because the best way of protecting many of our companies is now by promoting so-called 'free trade' and stopping other countries from using the same policies we used to develop.

As Cambridge economist Ha-Joon Chang described it, "now that we have reached the top, we want to kick away the ladder to development for other countries". Rich countries – including our own – are telling poor countries to liberalise more in order to develop. We are telling them to do as we say, not as we did.

Such a stunning and audacious bit of hypocrisy might not be such a problem if it constituted a bit of friendly – albeit erroneous – advice over a pint in the pub. However, poor countries are caught in a pincer movement by the industrialised world. On one side they have got the IMF and World Bank requiring more deregulation, more privatisation and more liberalisation in return for loans and debt relief. On the other, they have got rich country pressure to 'lock-in' these policies through the World Trade Organisation (WTO). This has massive implications for democracy and for the options of future governments to change economic policies if they are not working.

Concluding remarks

In conclusion, our governments have reinvented development as a process that can only be achieved through free market reforms and trade liberalisation. They pursue this by trumpeting the rhetoric of 'free trade' and labelling those questioning their approach as 'luddite protectionists' who oppose 'freedom'.

And they support their 'free trade' mantra by deliberately abusing terms such as openness and by using the so-called hard evidence of CGE models that attempt to predict the future by assuming that economic textbooks are a decent proxy for reality. And they use their influence in the World Bank, IMF and WTO to create policies to benefit domestic corporate interests.

If we are to move forward on the trade debate, we have to develop a much more critical and balanced view of the evidence. We need a more rigorous use of terms such as openness and free trade. And while modelling can have a place, we need to be aware of – and publicise - its limitations. We need to use case studies and more qualitative evidence, and we need to look at the past to see what has worked and what has not. The more these models are used without explaining their limitations, the more they become accepted as gospel truth and the harder it is to have a sensible trade debate.

And all this starts with us. The corporate lobbyists, free market ideologues and politicians who they influence are not going to do this out of the kindness of their hearts. They need to be held to account and made to properly justify their actions. This is a crucial first step in pushing for change – which is why I think it is so important that people are committed to a more honest approach to statistics.

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For more information on any aspect on the talk please feel free to contact Peter on the email address above.