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The Dangers of Aggressive Trade Liberalization: Why the Washington Consensus is Not a Global Consensus

Stephen T. Hanshaw
Sacred Heart University, hanshaws282@gmail.com

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The theory of trade and capital market liberalization has been floated around in discussions about economic stability and development for decades. Due to the fact that the world is becoming more and more interdependent and interconnected each and every day, the necessity for a global market emerged in the early 1990's. The Western response to globalization in many cases was dubbed the "Washington Consensus," of which trade liberalization is a huge part. The idea of trade liberalization is centralized in the idea of a free-market economy, originally posited by Adam Smith. His model proposed the idea of the "invisible hand", the idea that the market would regulate itself and would not need government interference in order to do so; this led to many of the ideas discussed in the concept of trade liberalization. By opening markets and removing or at least reducing trade barriers with countries around the world, the hope was that economies would thrive. This theory of aggressive trade liberalization, however, has numerous flaws which must be taken into consideration before applying the policies to developing nations. While the Washington Consensus policies of trade liberalization may work for some countries, it has effectively crippled numerous others, due to its inability to take into account numerous other factors within a country. As economic and political history has shown, the idea of aggressive policies of trade liberalization is not always the smartest option to pursue, while a greater focus on the inner development of a country and slow liberalization may be the true keys to economic success in developing countries. Discussions about such policies of trade liberalization were brought about through a concerted realization of the need for a global economic structure and stability following one of the most devastating wars in recent memory.

In July of 1944, after the conclusion of World War II, approximately 730 members from 44 different nations met in Bretton Woods, New Hampshire to discuss the prospects of global financial development.[1] This has since been known as the Bretton Woods Conference, and established the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), which was later absorbed by the World Bank. Both of these organizations were created in order to rebuild economies which were devastated by the pains of war, and to provide financial stability within the international community. Up until recently, the IMF focused solely on policies involving inflation. However, recent trends have increased their awareness of further global issues, and interest has now shifted to poverty reduction as a whole. Joseph Stiglitz describes this trend in his book Making Globalization Work, in which he writes, "Until recently, IMF perspectives have been paramount in economic policy discussions, and the IMF traditionally focused on inflation rather than on wages, unemployment, or poverty. Its view was that poverty reduction was the mandate of the World Bank, while its own mandate was global economic stability. But focusing on inflation and ignoring employment led to the obvious result: higher unemployment and more poverty. The good news is that, at least officially, the IMF has now made poverty reduction a priority."[2] With the creation of the IMF and parts of the World Bank, the Bretton Woods Conference has allowed us to work toward greater partnership within the global economic community, which led to the very fabric of the Washington Consensus and its policies of trade liberalization.

[1] Wolfensohn, James D. and Rodrigo de Rato y Figaredo. "What is Breton Woods?" Breton Woods 60th Anniversary Virtual Exhibition. 2004. <http://external.worldbankimflib.org/Bwf/whatisbw.htm>
[2] Stiglitz, Joseph E. Making Globalization Work. W. W. Norton & Company, New York, NY. 2007. P. 14.

What exactly is the Washington Consensus? The Washington Consensus is a collective policy decision on how to allow for developing countries to enter into the global economic market. As Phillip Arestis writes in his article "Washington Consensus and Financial Liberalization," the Washington Consensus is actually composed of ten specific measures to ensure economic stability and growth. He writes, "The Washington Consensus (or the "ten commandments") is actually very specific in its policy approach: Williamson (2002; see also 1990, 2004-5, this issue) summarizes it as follows: (1) fiscal discipline, (2) re-ordering public expenditure priorities, (3) tax reform, (4) liberalizing interest rate, (5) liberalization of inward foreign direct investment, (6) trade liberalization, (7) a competitive exchange rate trade, (8) privatization, (9) deregulation, and (10) property rights."[3] Each of these policies has its own importance, but the one which must garner the most attention is the sixth point, trade liberalization. Trade Liberalization is an extremely important measure to accept once a nation is stable, but during the process of development, may not be the best option.

Trade liberalization has been at the forefront of globalization and economic growth for a very long time. The idea of free-market economics has been around since Adam Smith's publication, and even before that. The concept of trade liberalization takes the idea that when all of the restrictive forces within an economy are neutralized, it will in turn correct itself, either fixing or creating a new economic structure. As Stiglitz writes in his book, however, the concept of trade liberalization is one of great controversy. He writes, "Trade liberalization – opening up markets to the free flow of goods and services – was supposed to lead to growth. The evidence

[3] Arestis, Phillip. "Washington Consensus and Financial Liberalization." Journal of Post Keynesian Economics, Vol. 27, No. 2 (Winter, 2004-2005), pp. 251-271. M.E. Sharpe, Inc. JSTOR. <http://www.jstor.org/stable/4538923>

is at best mixed. Part of the reason that international trade agreements have been so unsuccessful in promoting growth in poor countries is that they were often unbalanced: the advanced industrial countries were allowed to levy tariffs on goods produced by developing countries that were, on average, four times higher than those on goods produced by other advanced industrial countries."[4] Trade liberalization is a concept which can quite easily be manipulated by developed nations in order to give them an edge over the still developing countries. Numerous different problems have surfaced with trade liberalization which show that rational self interest always prevails in foreign relations. Although developed countries convey to the global community their willingness to work with developing nations, what goes on behind the scenes is quite another story, and is really a case of simple leverage.

The idea of leverage within trade liberalization policies has been studied at length, as the developed countries use their wealth and power to make sure that they are getting the best deal in terms of what they receive from countries they trade with. This has been shown time and time again in the case of so-called "dumping laws" where firms which are producing goods at a lower cost than those within the United States are accused of dumping their products when, in reality, they simply have a lower cost of operation. In this sense, each of the developing countries which enters into trade agreements with those countries with lesser stature seeks their own rational self-interest, even if it is damaging to the other countries. In a study of the North American Free Trade Agreement (NAFTA), Jen Baggs and James A. Brander discuss the importance of trade liberalization and leverage within such an agreement. They write, "We draw attention to the idea that changes in trade policy might induce a change in the

[4] Stiglitz, Joseph E. Making Globalization Work. W. W. Norton & Company, New York, NY. 2007. P. 15-16.

appropriate financial structure in the firm. However, it is likely that many managers do not react effectively to such changes. Even among those who do react, many managers are 'forced into' changing leverage by default as profits fall or rise rather than by anticipating the effects and acting accordingly. It is quite possible that firms would do better by intentionally changing leverage at an early stage."[5] This is an extremely important distinction which must be made in terms of trade when discussing the idea of trade liberalization. Mutual benefits are a must, and those countries who are being victimized by unfair regulations or sanctions put forth by the developing country must be able to establish some sort of financial leverage before entering into the global economic arena. Without comprehensive financial responsibility from developed countries, it is highly unlikely that those developing countries will benefit from instantaneous liberalization, as it will only serve to crumble their economies.

An extremely pertinent aspect of trade liberalization is the speed at which it occurs. Advocates of immediate and aggressive trade liberalization are said to be proponents of what is known as "shock therapy." Shock therapy supposes that the only way for a developing country to build its economy is to be thrown into the global financial market through reform, trade agreements, and reduction of tariffs. This has been shown in many cases, however, to be an extremely dangerous and sometimes foolish plan. Shock therapy operates under the assumption that each individual country which enters into the global economy will be on the same relative playing field. This, however, is very much not the case, as has been shown in many historical cases, such as Russia and many Latin American countries.

[5] Baggs, Jen and James A. Brander. "Trade Liberalization, Profitability, and Financial Leverage." Journal of International Business Studies, Vol. 37 No. 2 (Mar., 2006), pp. 196-211. Palgrave Macmillan Journals, JSTOR. < http://www.jstor.org/stable/3875155>

Joseph Stiglitz discusses the problems which were brought about as a result of the Washington Consensus policies in both Russia, and numerous countries of Latin America. Concerning Latin America, Stiglitz is extremely disheartened in the way which adoption of such policies crippled their economy. He writes, “Meanwhile, Latin America embraced the Washington Consensus more wholeheartedly than any other region (indeed, the term was first coined with reference to policies advocated for that region). Together, the failures of Latin America and the successes of East Asia provide the strongest case against the Washington Consensus.”[6] Latin American countries had been experiencing relative economic success prior to the adoption of Washington Consensus policies, but were forced to do so because of the Latin American debt crisis of the 1980s. Stiglitz discusses the idea that as high inflation broke out as a result of the debt crisis, the Washington Consensus policies simply made sense to adopt in the Latin American countries. However, the growth which came from these policies was not sustainable at all. They saw a large consumption boom, followed immediately by recession and stagnation, which created a greater gap between the very poor and the very rich. Stiglitz writes, “At this writing, it is fair to say that there is widespread disillusionment in Latin America with the Washington Consensus: a growing consensus against the Washington Consensus reflected in the election of leftist governments in Brazil, Venezuela, and Bolivia.”[6] The turmoil in Latin American countries due to the Washington Consensus provides one of the strongest arguments against implementation of such policies. The inability to craft specific policies for the economic development and recovery for each country or group of countries individually is seen as a major flaw in the system of Washington Consensus policymaking.

[6] Stiglitz, Joseph E. Making Globalization Work. W. W. Norton & Company, New York, NY. 2007. P. 35-36.

In the case of Russia, the underestimation of precisely how much damage policies of trade liberalization and financial liberalization could do led to tough economic times for the country. With Russia, and similar nations in transition from communism, the belief was that so-called "shock therapy" would be able to stabilize the nations by quickly converting them to capitalism. Stiglitz writes of this subject, saying "After the Berlin Wall fell, there was hope of democracy and economic prosperity throughout the former Soviet Union and its satellite states. Advisers from the West rushed to Eastern Europe to guide those countries through their transitions. Many believed, mistakenly, that 'shock therapy' was needed – that the transition to Western-style capitalism should take place overnight through rapid privatization and liberalization. Instantaneous price liberalization brought with it – predictably – hyperinflation."[7] Stiglitz notes that because of this hyperinflation, at one point, prices of goods in Ukraine increased at a rate of approximately 3,300% per year.

Along with the economic mess which was occurring within the countries in transition from communism, there was also widespread corruption within each of the governments, as the wealthy rulers sought to accumulate all of the money which was being funneled into the countries which was designated for assistance by the IMF. The problematic assumption which the IMF and other financial organizations made was that they believed that this money would be used for reconstruction and assistance for those in need. They trusted in the honor and leadership of those who were in power, when they should have realized the demonizing effect which money and power have on individuals. Stiglitz puts this phenomenon best when he writes, "Capital markets were liberalized in the mistaken belief that money would be induced to

[7] Stiglitz, Joseph E. Making Globalization Work. W. W. Norton & Company, New York, NY. 2007. P. 37.

come in. Instead, there was a massive capital flight, including the famous purchase of the Chelsea football club and numerous country estates in the U.K. by one of the oligarchs, Roman Abramovich. Ordinary Russians, naturally, found it hard to see how this helped Russia's growth. It was as if the advisers believed that opening a birdcage would encourage birds to fly into the cage, rather than encouraging the birds in the cage to fly out."[8] This was an extremely problematic assumption, as trade liberalization and shock therapy only worked to empower the governments of former Soviet countries, allowing them to horde all of the money which was supposed to be coming into the country purposed for relief efforts. The rapid privatization and liberalization which was pushed, coupled with the lack of accountability from the organizations lending the money, led to fantastic living for Russian oligarchs, but terrible conditions for the economic situation and citizens of Russia. Luckily, as Stiglitz admits, experts now widely agree that the speed at which such privatization and liberalization reforms were made within the Soviet bloc countries was a grave miscalculation, and that sound regulations and strong tax laws must take precedence over liberalization.

In Russia particularly, this compounding problem of lack of institutional strength and quick liberalization was extremely evident. As Stiglitz writes, "The rapid and corrupt privatizations in Russia set in motion a vicious circle. The meager amounts received by the government led to questioning the legitimacy of the transfer of public resources to the private sector. Investors - those who had acquired the assets – then felt, quite rightly, that their property rights were not secure, that a new government might, under popular pressure, reverse privatization. As a result, they limited their investment and took as much of their profits

[8] Stiglitz, Joseph E. Making Globalization Work. W. W. Norton & Company, New York, NY. 2007. P. 38-39, 41.

out of the country as they could – leading to further disillusionment with the privatization process, making property rights still less secure." [8] This is an extremely evident consequence of the lack of trust in the financial stability of a developing market economy completely destroying the prospects of growth and development, both at a foreign and domestic level.

In addition to Latin American countries and countries in transition, African nations were also adversely affected by the adoption of Washington Consensus policies. Stiglitz writes in his book, of these countries, "They were provided with assistance – typically loans rather than grants – accompanied by conditions designed to assist their 'structural adjustment.' Too often, though, the conditions were misguided, the projects for which the money was lent misconceived. The borrowing countries were required to adapt the structure of their economy to the IMF's market fundamentalism, to Washington Consensus policies. Liberalization opened up African markets to goods from foreign countries, but the African countries had little to sell abroad… Not surprisingly, the policies failed to bring growth. But the burden of debt remained."[8] This is yet another blow to the Washington Consensus policies of aggressive trade liberalization within economies that are simply not ready to discuss the macroeconomic actions in the future, as they still need to focus on the microeconomic actions to take presently. The ideas of shock therapy and aggressive trade liberalization simply do not take into account the previous conditions of these economies. In order for a country to be considered viable in a world economic system, it must have a solid economic base within its own borders, coupled with stable financial institutions which will be able to lead them into such a forum. Without both of these ideas in place, there is no way that an economy can be shoved into the global arena and be expected to compete with countries which have a massive leg up on them. A slower transition, however, would allow these countries to build their economies at home, and set up these financial institutions so that when they are ready to face the global economic market, they will be able to do so with some leverage.

Stiglitz makes an extremely important point about trade liberalization and shock therapy when he writes, “Some countries, like Poland and Slovenia, managed the transition better, partly because they did not embrace shock therapy as strongly. The countries of Eastern Europe as a whole did well largely, I think, because of the prospect of joining the EU. It forced them to adopt quickly a sound legal framework, and that reassured investors.”[8] This is the crux of the argument which will now be made within this paper. Policies of trade liberalization and shock therapy must be evaluated, and shock therapy must be replaced with a policy which allows for much slower and gradual transition of a state into the global economy, so that a country is able to create a solid foundation which will be able to support it when it is brought into global competition. There have been too many instances of countries being rushed into an economic transition ending in failure to think that the Latin American countries and formerly Soviet countries are misnomers. It must be noted that those developing countries which follow the route of a much more gradual and slower-paced shock therapy are the ones which reach the actualization of a stable economy and gain the ability to compete on a global level.

While the countries of Latin America and countries which were in transition from communism to capitalism show the strongest case against the Washington Consensus’ use of shock therapy and aggressive trade liberalization, countries such as China and India provide a solid framework for the type of trade liberalization policies which should be considered for developing nations. In his book, Joseph Stiglitz once again considers the policies of trade liberalization and shock therapy, but as they apply to China, when he writes, "The Soviet bloc countries were not the only ones transitioning from communism. China and Vietnam, while retaining a Communist political regime, also began to move to a market economy, and the contrast was striking. As incomes in Russia plummeted – falling by a third from 1990 to 2000 – incomes in those countries soared, increasing by 135 percent in China and 75 percent in Vietnam. They rejected Shock therapy in favor of a slower and more gentle transition to a market economy. Today the vibrancy of their economies suggests that the tortoise has outpaced the hare."[9] China provides one of the most important examples of how shock therapy and trade liberalization policies should be adopted by developing countries and economies. The pattern seems to hold for each and every country which experiences the process of trade liberalization – if it is a process of aggressive and fast sanctions, then the country will not fare nearly as well as the one which allows its domestic economy to build to the point which they are ready to compete when they are thrust into the global economy. By spending the time to hone the infrastructure within its country, China was able to take doses of shock therapy at its own pace, an experiment which has paid off, and which more and more countries will try to replicate. Stiglitz would agree with this assessment, as he sees the development of the Asian countries as a model which developing countries should seek to follow. He writes, "Today, developing countries around the world are looking to Asia, to the examples of success, to see what they can learn. It is not surprising that global support for the Washington Consensus has

[9] Stiglitz, Joseph E. Making Globalization Work. W. W. Norton & Company, New York, NY. 2007. P. 40.

waned. Its failures can be seen around the world, in Africa, Latin America, and the countries in transition. The clearest test was in the transition from communism to a market economy; those that followed the Washington Consensus failed, almost to a country."[10]

The success of China specifically provides a monumental boost to proponents of a slower paced form of trade liberalization, rather than the shock therapy policies of aggressive trade liberalization. In their article, "Market Liberalization and Firm Performance during China's Economic Transition," Seung Ho Park, Shaomin Li and David K. Tse discuss the effect to which China's slower paced trade liberalization led to success within their current economic transition. They begin by noting, as previously mentioned, that China took a relatively unconventional route to trade liberalization, refuting Washington Consensus policies of aggressive trade liberalization and shock therapy in favor of a more incremental increase, a slower form of shock therapy. They write, "China has followed a different path toward economic development from Western and other Asian countries that made a rapid transition from a hierarchical to a market system. China has pursued an incremental transformation by decentralizing government control and allowing a variety of property rights through continuous negotiation among central, regional, and private interests."[11] Through this method of slow trade liberalization backed by strong institutional control, China was able to mold different aspects of the Washington Consensus into its very own distinct type of financial liberalization.

They then used this newfound increase in wealth allowed them to then liberalize their

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[10] Stiglitz, Joseph E. Making Globalization Work. W. W. Norton & Company, New York, NY. 2007. P. 44

[11] Park, Seung Ho, Shaomin Li and David K. Tse. "Market Liberalization and Firm Performance during China's Economic Transition." Journal of International Business Studies, Vol. 37, No. 1 (Jan., 2006), pp. 127-147. Palgrave Macmillan Journals, JSTOR. <http://www.jstor.org/stable/3875219>

own market back home, allowing for increased productivity and firm performance. Park, Li and Tse write of this phenomenon, “Empirical findings support the contention that the market liberalization in China has had a significant effect on firm performance through various institutional changes, primarily the decentralization of control to local governments and firms, ownership restructuring, and industrial policies.”[11] By realizing that shock therapy and aggressive Washington Consensus policies of trade liberalization created growth which was unsustainable, China was able to provide a model of precisely what action should be taken by a country which hopes to work its way up to be a significant contributor to the global economy. Through a slowly paced trade liberalization regime, and strong institutional foundations within the country, they managed to create the perfect recipe for success in trade liberalization. These policy decisions should be revered as the precise measures which a developing country hoping to be competitive economically should take in order to start along the path.

China and India provide the strongest arguments as to what parts of the Washington Consensus actually work, and what parts are in need of tweaking. In terms of trade liberalization, shock therapy can never be the answer unless the economy is fully functional on its own, and there are institutions set within the country to ensure that entrance into the global economic sector goes smoothly. For many developing countries, these factors are all but a twinkle in the eyes of the leaders, and must face globalization and trade liberalization as China did, making sure to allow for an extremely slow transition into the global economy, rather than trying to privatize the assets of a country in one fell swoop. Shock therapy is a policy which is constantly on the defensive, as numerous historical examples have shown that such a quick transition just does not work. Numerous studies and discussions have been centered on the idea that no one-size-fits-all approach can possibly capture the complexity of a transition economy, and that each economic transition must have its own individualized path to success. Park, Li and Tse describe this very phenomenon in their article, as they write, ". As scholars of transition economies have argued, economic transitions are path-dependent, and thus each post-communist experience is unique."[11] This is an extremely important observation to be made, and serves the argument that Washington Consensus policies of broadly-based reforms should not be the norm for trade liberalization in developing nations.

Strong financial institutions are immeasurably important to the success of developing countries, and are a necessary prerequisite for entrance into the global economic state. By capitalizing on this slow trade liberalization, rather than focusing on "shock therapy" policies, developing countries will be given time to foster those prerequisites, in order to ensure that they are ready to compete on a global scale. Within their article "Financial Liberalization and Stability of the Financial System in Emerging Markets: The Institutional Dimension of Financial Crises, J.P. Allegret, B. Courbis and Phillip Dulbecco discuss the importance of strong financial institutions within a country, and the idea that these financial institutions must provide the very foundation for a country which hopes to adopt policies of trade liberalization. They write, "The analysis developed by McKinnon and Pill therefore leads us to question the role of institutional factors in banking crises. More precisely, the Washington Consensus which makes economic liberalization the necessary and sufficient condition of world growth, seems inadequate because the liberalization process underlies this consensus underestimates the need to invest in the institutional infrastructure before introducing financial reforms."[12] This idea of institutional control is integral to the development of a nation which hopes to actively participate in a global economic structure. Without strong leaders and regulations, much like the case of countries in transition from communism discussed earlier, a country which will enter into the global market will be extremely unstable, and simply unable to compete. Without a strong macroeconomic stability, a country will be wholly unprepared to enter into the global economy, which hints at the idea that a strong economy within one's borders is a natural prerequisite for policies of trade liberalization.

Matias Braun and Claudio Raddatz also discuss this concept of financial institutions in their article, "The Politics of Financial Development: Evidence from Trade Liberalization." They write, "We find that those countries where trade liberalization results in an increase in the relative strength of promoters end up with a significantly larger financial system than those countries where trade liberalization favors those who oppose financial development. he difference in financial development, measured as the ratio of private credit to GDP, between these two groups of countries increases by 18 percentage points."[13] This shows that countries which rely heavily on their own economic situations before entering into the global economy will stand an immeasurably better chance of succeeding than those who oppose this prior financial development. In order to ensure that trade liberalization will be successful, one must

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[12] Allegret, J.P., B. Courbis and Ph. Dulbecco. "Financial Liberalization and Stability of the FinancialSystem in Emerging Markets: The Institutional Dimension of Financial Crises." Review of International Political Economy, Vol. 10, No. 1 (Feb., 2003), pp. 73-92. Taylor & Francis, Ltd., JSTOR. <http://www.jstor.org/stable/4177451>

[13] Braun, Matias and Claudio Raddatz. "The Politics of Financial Development: Evidence from Trade Liberalization." The Journal of Finance, Vol. 63, No. 3 (Jun., 2008), pp. 1469-1508. Wiley for the American Finance Association, JSTOR. <http://www.jstor.org/stable/25094478>

be sure that each and every one of these preconditions should be put into place. Stable financial institutions are large prerequisites for success in the global economic forum, as they help to ensure that the fiscal policy of the country is as pointed as possible, so that the country possesses some type of leverage which they can then use to make sure that they are benefiting from trade negotiations with other nations.

Joseph Stiglitz could not agree more about the necessity of institutional control as a prerequisite for trade liberalization, as countries must have a very strong foundation in order to be effective players in the world economy. Only when these strong institutional foundations are coupled with a slow pace of trade liberalization will a country be successful in their aspirations to become part of the global economic system. He writes of this idea in his book, saying:

"*Managing change is extraordinarily difficult. It is clear that rushing into major reforms does not work. Shock therapy failed in Russia. China's Great Leap Forward in the 1960s was a catastrophe. What matters, of course, is not just the pace of change but the sequencing of reforms. Privatization was done in Russia before adequate systems of collecting taxes and regulating newly privatized enterprises were put in place. Liberalizing the free flow of foreign exchange before the banking system was strengthened turned out to be a disaster in Indonesia and Thailand. Educating people but not having jobs for them is a recipe for disaffection and instability, not for growth… Many of the development strategies that were not well implemented failed because they were based on a flawed vision of development. Successful countries have a broader vision of what development entails and a more comprehensive* *strategy for bringing it about. Sensitive to concerns such as those just described, they were better at implementing change."*[14]

There are many ways in which the implementation of trade liberalization must vary within countries which are facing different situations. Allegret, Courbis and Dulbecco continue to discuss the idea of the necessity of strong financial institutions, and the challenges which emerging markets may face. They write, "The situation is very different in emerging economies and markets. On the one hand, institutions of market economies are by definition relatively undeveloped. On the other hand, and more importantly, the financial system in many emerging markets resulted from policies implemented by political authorities. That means that in these economies financial practices developed in a less spontaneous way than in mature markets. Thus any financial reform is rarely a process of incremental institutional change but always a process of radical change. This characteristic is accentuated by the fact that recent financial liberalization is largely in response to external pressures."[15] This is an extremely important point to take into consideration, as emerging economies may be ones in which the political and economic situation may have changed overnight. Policymakers must be extremely sensitive to this issue, which is why a much slower pace of trade liberalization is recommended in order to ensure stability within the state, so that these prerequisites are able to be met, rather than prescribing to rapid trade liberalization.

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[14] Stiglitz, Joseph E. Making Globalization Work. W. W. Norton & Company, New York, NY. 2007. P. 54.
[15] Allegret, J.P., B. Courbis and Ph. Dulbecco. "Financial Liberalization and Stability of the Financial System in Emerging Markets: The Institutional Dimension of Financial Crises." Review of International Political Economy, Vol. 10, No. 1 (Feb., 2003), pp. 73-92. Taylor & Francis, Ltd., JSTOR. <http://www.jstor.org/stable/4177451>

Evidence of the strengthening of financial institutions as a prerequisite for opening up an economy can be seen through numerous examples. An important point which Allegret, Courbis and Dulbecco bring up is the prevalence of external pressures on the decisions of countries when it comes to trade liberalization. Developed countries, pushing practices like the Washington Consensus, only take into account their self-interest in many respects, and may thus undermine the ability of a developing country to develop a strong foundation before entering into the global economic arena. Jiandong Ju, Yi Wu and Li Zeng[16] also discuss the effects which come with trade liberalization, except they focus on its effect on overall trade balance. Although their findings are inconclusive, they determine that there is not strong enough evidence to suggest that trade liberalization alone has a negative effect on overall trade balance. This implies, however, that many other factors must come into play when determining whether or not trade liberalization is effective within an economy, such as institutional control and pace at which the liberalization takes place.

Issues and problems with trade liberalization have been at the forefront of political discussion for decades. In many senses, although policies such as the Washington Consensus are the compiled theory of economists and bureaucrats, the support for policies of trade liberalization back at home continues justifies their use. In their article, "Explaining Citizen Support for Trade Liberalization," Karl Kaltenthaler, Ronald Gelleny and Stephen Ceccoli discuss the support which comes from the citizen populace in terms of policies of trade liberalization. In their discussion, they write, "Given this considerable debate [including protest movements

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[16] Ju, Jiandong, Yi Wu and Li Zeng. "The Impact of Trade Liberalization on the Trade Balance in Developing Countries." IMF Staff Papers, Vol. 57, No. 2 (2010), pp. 427-449. Palgrave Macmillan Journals on behalf of the International Monetary Fund, JSTOR. <http://www.jstor.org/stable/25681052>

during World Trade Organization (WTO) meetings], it is readily apparent that public opinion is a critical factor in the trade liberalization process. It has been shown in the U.S. and other advanced industrialized democracies that public opinion is, at the least, a constraint, if not a determinant of foreign policy decisions."[17] They state that public opinion is motivated by both political and economic interests, much like the case which was discussed prior in terms of the motivation of nations to pursue such policies. The basic underlying factor for the willingness of the public to act as a part of global integration is self-interest. In the case of trade liberalization, the motivating factor which comes into play most obviously is a concerted economic interest. The authors of this article write, "Proponents of trade liberalization argue that the integration of the world's economic markets encourages economic growth and efficiency. Opening domestic markets to trade and capital flows establishes powerful and direct ties between national economies and the international system."[12] This is obviously a benefit to those countries in which trade liberalization is done in the correct manner, but when policies such as shock therapy are used in order to speed up the process, the result for the developed countries can be increased cash flows in the short-term, but the destruction of the economies of the developing countries in the long-term. A concerted effort must be made to show both the citizens and leaders of the developed nations that both economic and institutional integrity within the developing countries must be a prerequisite for any adoption of policies of trade liberalization, and entrance into the global economic forum.

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[17] Kaltenthaler, Karl C., Ronald D. Gelleny and Stephen J. Ceccoli. "Explaining Citizen Support for Trade Liberalization." International Studies Quarterly, Vol. 48, No. 4 (Dec., 2004), pp. 829-851. Wiley on behalf of The International Studies Association, JSTOR. <http://www.jstor.org/stable/3693537C>

Many who discuss the idea of trade liberalization know that each country cannot gain its benefits equally, but that the overall benefit to the global economy must be in the forefront of any decisions which are made concerning it. Carl Davidson and Steven Matsuz discuss this very idea within their article, "Trade Liberalization and Compensation," saying that given the realization that some countries will be better off than others due to trade liberalization, it only makes sense to create a system which works to compensate those who ultimately lose. They write, "Two of the most generally accepted propositions in economics are that trade liberalization harms some groups but that it also generates aggregate net benefits. In fact, there are large literatures devoted to identifying the winners and losers from freer trade and measuring their gains and losses. Yet, there has been surprisingly little research aimed at investigating the best way to go about compensating those who lose."[18] This shows that the effort to maximize the benefits of global trade within the already developed countries of the world is a calculated risk, and that efforts which may be made to ensure the inclusion of developing countries may work against the interest of the developed nations. This is an extremely interesting concept, as it seems that the purpose of Washington Consensus policies is not to create economic equality, but to minimize the risks and losses which developing countries take. However, if such compensation policies were taken into account, the developed nations may be able to provide a much more equal footing in the economic global playing-field, allowing for the dangers of trade liberalization to be minimized.

[18] Davidson, Carl and Steven J. Matusz. "Trade Liberalization and Compensation." International Economic Review, Vol. 47, No. 3 (Aug., 2006), pp. 723-747. Wiley for the Economics Department of the University of Pennsylvania and Institute of Social and Economic Research -- Osaka University, JSTOR. <http://www.jstor.org/stable/3877468>

Although the pace at which countries should enact trade liberalization policies is quite obvious from historic example, the extent to which liberalization should occur is still rather unclear. Xianming Li discusses this very idea in his study, "Liberalization and Real Exchange Rate Movement." They examined the extent to which financial liberalization of a country affects its real exchange rate. Their findings were quite interesting: "Two key findings emerge from the study. First, controlling for country-specific factors-such as deviation of the real exchange rate from its long-run equilibrium, relative gross domestic product (GDP) growth, terms of trade, the share of government expenditure in GDP, and net capital inflows-the real exchange rate depreciates after a country's most recent episode of trade liberalization. Second, in countries with multiple liberalization episodes, no significant changes in the real exchange rate were found at the start of trade liberalization in early episodes, suggesting that partial or transitory trade liberalizations slow down the adjustment of the real exchange rate toward its equilibrium level."[19] Basically, the idea behind their findings is the idea which was discussed prior, that not every country can accrue the benefits of market liberalization, that it has a sort of equilibrium to which trends converge. In order to ensure that trade liberalization is most effective, these rises and falls must be as close to the equilibrium as possible.

There are many dangers of trade liberalization which must be considered before a developing country proposes to jump into the fray of the global economy. As we have seen throughout history, the policies of shock therapy and the Washington Consensus simply do not work as proposed. From Latin America and countries in transition, to African nations which are

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[19] Li, Xiangming. "Trade Liberalization and the Real Exchange Rate Movement." IMF Staff Papers, Vol. 51, No. 3 (2004), pp. 553-584. Palgrave Macmillan Journals on behalf of the International Monetary Fund, JSTOR. <http://www.jstor.org/stable/30035962>

just beginning to consider trade liberalization, and opening their borders, these policies have shown time and time again that they simply do not create sustainable growth. On the other hand, however, we have seen numerous success stories come out of countries which tweak these policies, and focus on much stronger development within the nation, while slowly liberalizing their trade regime. Countries such as India, China and Vietnam have shown that this policy is the one which should be followed. Having the creation of stable financial institutions and an accountable government as prerequisites for launching into trade liberalization is an idea which many have proposed, and may be the strongest argument out there. Regardless, we know that the unsustainable trade liberalization policies of the Washington Consensus simply do not work with developing nations, many of which have none of the prerequisites which would make them viable in a global economic system. It must be realized that trade liberalization is not something which simply happens overnight, and that it should not be expected to be that way, lest it end in disaster.

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