

2006

Session Three: Trade and Development

Beverly Carl

Recommended Citation

Beverly Carl, *Session Three: Trade and Development*, 12 LAW & BUS. REV. AM. 473 (2006)
<https://scholar.smu.edu/lbra/vol12/iss4/7>

This Symposium Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Law and Business Review of the Americas by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

SESSION THREE: TRADE AND DEVELOPMENT

PROFESSOR BEVERLY CARL

I am going to talk about trade, and I am going to play the devil's advocate a little bit. For a number of years, free trade has been sold to the world as the panacea for all problems. I think we can now start questioning that. Free trade between two countries of more or less equal level can be very satisfactory. An example of that is the European community. But on the other hand, if you impose free trade upon two economies that are greatly different, it can produce enormous hardships. An example occurred way back in the nineteenth century that people seem to forget: Great Britain, who controlled India, removed the protective tariffs and the protective structure against textiles. That meant that British textiles manufactured by more sophisticated machinery in Britain could come in and literally end up destroying the Indian textile industry. I think we have to be very careful that we do not get carried away with this idea that free trade is going to solve all problems. Free trade is a two edged sword; it can be very helpful, but it can also be very damaging. I never hear anybody talk about the fact anymore that the rich U.S. economy developed behind extremely high tariffs. Free trade can accomplish a lot of things, and it is very nice for the affluent. We are producing all sorts of things that are wonderful, and if you are rich enough to buy them, then that is great, but think of this: we are also producing things in excess. It is estimated now that there is an excess of eighteen million automobiles. Meanwhile, people are going hungry.

The WTO model, in my opinion, is too rigid. It imposes a real hardship on some of the poor countries, and I will give you some examples today. For example, traditionally one of the things that poor countries try to do to become industrialized is create taxes and subsidies. Now, under the WTO, that is a no-no under the terms of agreement, and subsidies that help industries start up is a no-no. Would we have had in the United States the Tennessee Valley Authority without a federal subsidy? Probably not. Brazil would not have had the Brazilian aircraft industry without a start-up subsidy. Suddenly all of these things have become a no-no under the WTO.

To me the greatest problem in the WTO is the TRIPS agreement (Agreement on Trade-Related Aspects of Intellectual Property Rights—that is the agreement on intellectual property), and one of the things it did was it changed the period of patent protection from seventeen to twenty years. That means that the companies can enjoy this monopoly profit for another three years. This became part of the American law

when we ratified the WTO. The American public never really knew anything about it, never debated it, and for retired people with problems paying the extremely high pharmaceutical prices, it is a problem. The other thing that has happened under the TRIPS is that if you can get a patent on something, then you can go out and force all the countries that are members of the WTO to enforce it. The multinationals are around searching the world for crops and native products that the local people have been using for centuries, bringing it back to the United States, patenting it, and then suing the local people for violation of our patent laws. One of the examples of this was somebody who went out and patented basmati rice, and then said that the local people cannot do that because we have an American patent on it. My biggest objection to this agreement is that it is extremely complicated; very few people other than specialists really understand it. I was lecturing in Indonesia on the patent and the intellectual aspects of the WTO. I had an audience of maybe 200 people—lawyers. I could tell from the looks on their faces that nobody understood it. Then afterwards a gentleman came up and he said, “I am not a lawyer. I am the Dean of the veterinary school in Sulawesi.” He said, “Did you say so and so? Does that mean so and so? That is just terrible for us.” I said, “I know it is, but you are the only one who has ever understood in Indonesia. You are the only one I have ever talked to that understood it.”

What happens? I do not think that the Americans are evil and that they are pushing this. But in most countries, most lawyers do not have any scientific background or technical background, and the lawyers from Indonesia, for example, that go to these conferences and agree to these provisions do not really understand what they are getting into. We in the United States have a great advantage because most of our patent lawyers have some kind of background in engineering or chemistry. This is the kind of disadvantage that the poor countries have run into in negotiating these treaties. Some of them now are catching on, and what they would like to do is allow developing countries to exempt out of TRIPS and TRIMS (The Agreement on Trade-Related Investment Measures). But who knows what is going to happen today.

As a result, if you look at Latin America, for the first time in eons, the left is really gaining some very strong power in Venezuela, and in other countries too, the left is coming to power. I think the best answer for poor countries is not this worldwide integration meeting the tremendously high standards that have been set primarily by the rich but local integration with other countries of similar economic levels. This is already happening to a large extent. You have the Central American Common Market, MERCOSUR in South America (*Mercado Común del Sur*), ASEAN in Asia (Association of Southeast Asian Nations), and a number of organizations in Africa. If you look at those and you study their history, you can be very critical, and you can come back and say they are not perfect. And they are not, but I think they offer a much better chance for

healthy economic growth than trying to compete equally with the rich countries.

Something I see that has happened that I am very disturbed about: I was talking in El Salvador a few years ago, and they all wanted to have a free trade association with the United States and the thinking was that if we join a free trade association with the United States, we will become rich like the Americans. It does not work that way. If you took all the barriers down between Central America and the United States, between El Salvador and the United States, you might have a few El Salvadorians that did very well, but the bulk of the people would not be favorably affected. Now we have the new free trade association with El Salvador, and there are several provisions in there that bother me. For one thing, water used to belong to the government, and it could be provided to people for free. The new CAFTA (United States-Central American Free Trade Agreement) agreement provides that water should belong to private enterprise. The other thing in that agreement that really bothers me is they are undercutting the Central American Common Market. That agreement provides that provisions in the free trade association between the United States and the CAFTA nations, or El Salvador, will prevail over provisions in the Central American Common Market. What bothers me about that is the Central American Common Market was an attempt to create a common market between nations of more or less similar economic level. This is totally undercutting it by the provision that says "oh, if it is inconsistent with the U.S. FTA, then it is the FTA that will prevail."

I have talked about impact, and I am just barely scratching the surface of the impact on the poor countries, but we also have to say what is happening to the United States and what has happened with free trade to us. First of all, we can see very dramatically that the American workers and farmers are suffering—our middle class. It is estimated that we have three million unemployed American workers which are attributable to our free trade policies. Even the other workers are being affected. They are being pulled into cycles of debt, bankruptcy, and low wage service jobs. What is happening to their pensions and healthcare in the United States is absolutely disgraceful for a wealthy country.

The WTO right now is engaged in extremely complex negotiations in which they are trying to give a little bit more to the poor countries, but at the same time the wealthier countries like the United States are really concerned about what is happening to our workers. So we are kind of reluctant to do away with all of our prime subsidies and protections, and it is almost an impossible job for the WTO negotiators to come up with something that is going to work well on both sides. All I have done so far is just present to you a few problems with this model of the WTO, which I think is too strict right now, especially for the poor countries. I think it is time to step back a bit.

I called my talk "prudent pretension," and I think what we need to think is what is really important to the human being. The Bible says,

“You shall not live by bread alone;” so let’s ask ourselves, “What do we really need?” We all need food—1.5 million children in Africa are now starving. Malnutrition is widespread in the world. Personally, I think every country should have the right to protect its own basic food supply. If this means subsidies and tariff barriers, and if the protection is reasonable under the circumstances, I would say let them do it. Every country, I think, should have the right to protect the safety of its food supply. The Europeans think that GMOs (genetically modified organisms) are very dangerous to the environment, and a lot of Americans do, too. I live in Santa Fe, and we are kind of a flaky, left-type anyway, but most of my friends will not eat GMOs, and we all buy our stuff in stores that say they do not sell GMOs. But now a decision by the WTO says that Europe has to accept our GMO products.

Secondly, I believe there is a human right to potable water, but in our rush to industrialization and international trade we are seriously threatening our water supply. Our local paper had an article the other day that cancer-related pesticides have now been found in almost every river and every stream in the United States. In China—poor China—they have rushed so fast in this process that today 1.3 billion people in China no longer have access to safe water. There are literally villages in China that they call “cancer cluster villages.” Shanghai water has excess salt. At an industrial site recently, a chemical blast spilled 100 tons of toxic benzene into the Songhua River near Harbin. If you are rich, you can buy bottled water, but the average Chinese cannot afford that.

Third, I think we are all entitled to breathable air. You go to Peking and Beijing, at least when I was there, it was absolutely horrible, and it is a problem.

Another thing I would say is that there is a human right to land. Land to farm and grow your crops and so on, but we have produced so much heat going up into the atmosphere that we are melting the glacier in the North and South Poles. I just read that the glacier on top of Mount Kilimanjaro in Africa had decreased 30 percent. To these little nations down in the South Pacific, it means they are going to disappear. I would say there should be a basic right to have a little land to grow some crops on.

Regarding adequate health care, and I cannot criticize any other nation, I find that what is going on in the United States is just appalling. In my state of New Mexico, which is a poor state to begin with, lower middle class and working class people have no health insurance, and the only way they get anything is through some charity, but the charities cannot afford to treat them all. In the case of China, they are trying to use market principles in the medical area. Government funding for health care has fallen from 36 percent to 17 percent. Doctors and hospitals are expected to live from their profits. And what is happening is that infant mortality is rising and infectious diseases are rising.

We are doing some things to our infrastructure that are very frightening. My sister lives near Nogales, and Nogales used to be a very nice little

area. Now there are so many trucks coming across the border there with NAFTA, the free trade, that they are absolutely ruining the roads and they are ruining the environment with pollution. I understand the same thing has happened in Texas, that the roads coming up from Mexico are just over-burdened with this tremendous traffic. In searching around for the cheapest alternative, in keeping with the thought of total free trade, we, the United States, are now considering sacrificing national control of our ports. I will not say anything more about that.

A safe environment, that should be another basic right. Coal and oil pollute, and when you send things on ships across the world, they cannot help but pollute. I think it is time for us to stop and think, "Do we really have to send this to the other side of the world?" The other day I walked into the local supermarket in Santa Fe. Usually I get Mexican avocados there, and that is fine because Mexico is not that far away. This day I picked them up in the middle of winter, and they are from Chile. Now think what that means in the cost to the environment to transfer that all the way from Chile. Do I really have to have Chilean avocados in the middle of winter? These are the kinds of things that we all should be thinking about. It has been preached to us for so many years that trade is good that we have failed to analyze what is behind it.

The final consideration I would like to raise is sharing. Every world religion tells us that we must share with the less fortunate, and even most non-religious folks believe that, too. Greed alone will not save us, and I think we need to explore new ways of sharing and weaving in a concept of sharing into the norms for international trade.

ROBERTO MACLEAN, JR.

Because I am a practicing lawyer, I will try to focus on what issues practicing lawyers, or myself in my experience, have met during the course of practice as a result of commercial integration with the United States, which is definitely the largest market to which a country like Peru exports, and in general, I think for most of the countries in Latin America. Of course, because my empirical experience is in Peru, I will focus on what I have seen. Nevertheless, it does not mean that it is not applicable to other countries in the region and other Central American countries like Colombia, Venezuela, or Argentina.

Beverly Carl is very right; our societies and developing countries tend to see foreign trade as a panacea in order to solve a lot of things, mainly because if we are trying to pursue that second model that Professor Salacuse spoke about earlier in the morning, societies need a market. They need somewhere to sell whatever goods they produce. In order to be able to industrialize, you need to make machines work, create employment, and someone needs to buy the output. So where do you sell it? You sell it to places like the European Union, the United States, and China. China is now buying many manufactured products from our countries, mostly raw material, but it is devouring them at an incredible rate,

and someday it will also buy manufactured products. The United States and the European Union buy a lot of manufactured textiles. For example, if you go to an Abercrombie or Gap store, a lot of the T-shirts are made in Peru, Vietnam, or the Dominican Republic. Each of these companies competes to be able to access and sell to these U.S. buyers. Of course everybody's dread is what will happen when China begins selling its textiles to the United States at the same rates that are now being accessed by countries like Peru or the Dominican Republic. That is part of the challenge that I wish to talk about.

Let us now focus on trade agreements, because trade agreements actually tend to reflect a reality which is already preexistent. Peru, and many other countries in Latin America, has been exporting their products to the United States for a while now. A free trade agreement which is being discussed right now, and actually the negotiations have finished, tries to make a permanent status out of something that was thought of as temporary, but the reality is there. Peruvian industries really work and grow on the basis of selling their products abroad. This is one of the reasons that a country like Peru has been looking for other markets, such as the Andean community. If you go into pure numbers, there is really no comparison between selling your products to a U.S. market or to a European market, and sometimes the members of the Andean community, unfortunately, have been lost in different political gains without any real resorts. They could work together to build a bigger market, but it just has not happened. When talking about a trade relationship between a U.S. importer or exporter and the Peruvian producers, we have to remember to focus on what exactly is a symmetrical relation. Again, Beverly Carl made it very clear, and I think she is very right; it is one thing when you have a trade agreement among peers, and a very different thing when you have a trade agreement between countries who are really not peers.

For example, with a country like Peru, which could be any South American country except Brazil, what are you looking at when you look at the country and its business as a counter-party? First, you find that large capitalized businesses are not predominant. You do not have these huge companies that you have in industrialized countries. Most of the large Peruvian companies are family owned and they are made up of the savings of the company. As wealthy as each family or group could get to be at any point in time, there is always a limitation. You do not have huge public corporations yet and that is the reality. The consequence for our countries is that when we look to huge power projects or mining projects that require funding in the billions, not just millions, we definitely have to look to foreign entities that have the capacity to invest in these types of projects. There is migration to large cities in some countries, but this labor force is not absorbed by the industries in the large cities. So they leave the country and come to the large cities, and they have no place to work. As a consequence, if they are not absorbed by the demand for labor, the answer is that they can make up their own personal

business or their own small family business. A lot of these personal businesses make up the informal sector.

To put this into context, the banking industry in Peru will define a large business as any company with sales above ten million dollars per year. A medium size business is an entity that sells between one million and ten million dollars per year, and a small business is anything that sells below one million dollars per year. In the middle there are micro-businesses that will sell \$50,000 to \$100,000 dollars per year, and will even get to make some exports. All of these companies in all of these sectors can be found in the exporting industry. If you are a businessman in the United States and you supply Tom Thumb or Publix with mangos and you want to provide mangos year round, you have to grow throughout Latin America, go through the different growing seasons, and buy from different producers all over the continent. You will end up buying containers for which you pay \$50,000 to \$100,000 dollars to a producer of mangos. In some places there are even smaller producers, but they are not even on the map for a United States buyer.

Peru has 5400 total exporting companies that exported in 2005, and of those, 207 were companies that exported about \$12 billion dollars. These are the exporting companies that focus on the traditional products, which are mostly natural resources, minerals, and fishing. The 5200 other companies export non-traditional products and account for \$4.2 billion of the exports. Of that \$4.2 billion, eighty-seven companies exported \$2.2 billion, which were the large entities. This means that on average, each company exports about \$25 million per year. 517 companies exported \$1.5 billion, and 4600 exported \$500 million altogether. Here you include the small mother and daughter jewelry shops and small mango producers. In the end, you have countries which are full of small producers that want to relate to a country full of medium and large buyers. This definitely presents to any Latin American exporter a huge opportunity, but also, as we shall see in a minute, a number of challenges.

What are the challenges? In 2005, there were 2164 new exporting companies. By the end of the year, 77 percent (1672) had gone out of business. In 2004, the number of new companies who had left the business by the end of the year was 75 percent of the original newcomers. However, Peruvian authorities are being conclusive when analyzing these numbers. It is not surprising that Peruvian authorities are very focused on the export industry, because they believe that will generate the market for the country to progress. They have concluded that there are five main causes for this. First a country full of small producers does not meet the adequate needs and volume of the purchaser in the market which Peru is looking to, basically the United States and the European Union. Second, the size of these companies accounts for the lack of adequate financial capacity in the Peruvian exporters. Third, there is very little working capital and almost no investment in research and development, and also very little capacity to give financing to their own suppliers. A fourth reason is

the cost of market inefficiencies, and, again, this has to do with financial capacity because the more inefficiencies your own local market has, the greater the impact on the price the United States seller or exporter has to take. Fifth, because the country still does not have a huge management class taking over most of the businesses, there is not adequate management in the companies. In a country dominated by families and family businesses, having third-party managers come into your business and tell you what to do is something that is met by a cultural resistance. In a developed country, for example the United States, some of the top CEOs of the largest companies are well known, more well-known than the owners of the company. In countries in South America, and generally in Latin America, the owner's names are more well-known and more often seen in the papers than the managers. It is beginning to change, little by little, but that is the dominant trait in these economies.

There are two main challenges that lie ahead when looking at the relationship between a country like Peru and the United States in terms of commercial exchange. I think it is a question of trust. How do you build trust between the importing country and the exporting country so that transactions flow adequately? How do you look inside a country with a fragmented economy, when there are so many small players? How do you improve the conditions of trust so that all of these players actually begin to get together and are better prepared for the needs of the importing countries with the larger economies? In the case of Peru, textiles are a great example, because right now Peruvian textiles are very high in demand. A Peruvian producer that produces a good quality will most surely place its product in the United States or Europe. But once China comes into play and Chinese textiles flow into the United States under the same conditions as Latin American products, this Peruvian textile producer is really going to have a problem in front of him, and he will have to devise something in his product to make it different than the Chinese product that will be 30 to 40 percent cheaper. Latin Americans tend to think that they already have cheap labor compared to industrialized countries, but there is no way to compete with China in terms of costs. The answer must be to build up the level of trust among the different players inside of the economy so that they can get together and produce better results.

We also have a challenge to become more productive. There are a couple of instances where we have seen this challenge in the integration of capital and the integration of capacity. I refer to integration of capital when an entrepreneur tries to access capital markets and opens up his or her own enterprise either through issuing bonds or issuing stock in the stock exchange and bringing in new shareholders. Our economies are still more family-oriented and people have gone to the capital markets to issue bonds, rather than bringing in new stockholders. Still there is no way to describe the reaction of the minority shareholders, when the main shareholder is the one running the show.

There are two other mechanisms which have been put into place and have proved to work very efficiently, although they need their strengths. The first is a subcontracting structure and the second are the consortiums. The subcontracting structure has worked very well in the textile industry and the agriculture industry. In this structure the exporter is the largest player. The company that exports \$50 million to \$70 million a year is the one that deals with foreign purchasers and acquires the commitments to purchase. Of course these commitments exceed that business's capacity and it is forced to hire and subcontract the capacity of other smaller producers, which are made up of excess labor which could not access the industries. In the textile industry, they have either 1000 women to sew the nice phrases on the t-shirts that you find in Abercrombie or they have the machines to sew the t-shirts. They are sent the fabric and they sew the t-shirt. In agribusiness, for example, the largest player in the valley will one day begin to access a foreign market and, instead of each little producer accessing the foreign purchaser, that larger player will have a relationship with the foreign importer and he will buy from the smaller producers of the valley and sometimes rent the land. In the end, what you have is a good result for the economy. For example, I have this friend whose family owns a textile industry. He directly employs 2000 people, but by subcontracting, the number of people employed by his factory can be between 4000 and 5000. Giving employment to 4000 people might not be as relevant in a huge economy, but in a smaller economy it is. A president or politician looks better when people are employed, and that is the sort of promises that free trade agreements contain.

What is the role of the legal practitioner and what is the role of the courts here? These relationships and the level of trust that we have to build among the producers, the foreign importers, and the local parties themselves need adequate protection. Everybody will say that we need the rule of law and we need to be able to enforce contracts, but that is easier said than done. When we have imports or transactions for such small amounts, the first question that comes into our mind is when contracts are defaulted for \$50,000 to \$100,000 dollars and one party is in Florida or Los Angeles and the other party is in some distant province of Peru, are these disputes even reaching the courts? These disputes are not even reaching their jurisdictions.

I leave you with a question that as a civil law student in law school in Peru we always asked ourselves, and later as an L.L.M. student in the United States, I still ask myself: Is it possible that a court in a civil law jurisdiction can have as much direct impact on society as common law courts where there is a precedent that needs to be followed? I believe that the impact in civil law jurisdictions is not as direct as in common law countries, where jurisprudence is part of the legal profession on a daily basis. That is not the case in civil law countries. They still need to find a way in which courts can influence the behavior or business practices of people. I think it is the roles of practitioners to focus on the way we

advise our clients and the way we prepare our contracts; for example, making sure the United States buyers contact the bigger players in the market rather than the smaller ones. Also, if United States buyers are not interested in large amounts, they can get together and relate to counter-parties that make cost more efficient in cases of non-compliance.