

Strategic Insight

The Cancun Conundrum: What Future for the World Trade Organization (WTO)?

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"I said in Seattle that the World Trade Organization (WTO) is medieval, but I'm now wondering whether Neolithic isn't a more appropriate term."^[1]

Pascal Lamy, European Union Trade Commissioner

"We are told that trade can provide a ladder to a better life and deliver us from poverty and despair... Sadly, the reality of the international trading system does not match the rhetoric."^[2]

Kofi Annan, Secretary General, United Nations

"Many countries—developing and developed—were dismayed by the transformation of the WTO into a forum for the politics of protest.... The key division at Cancun was between the can-do and the won't do."^[3]

Robert Zoellick, United States Trade Representative

Introduction

The fairly representative quotes above reflect a growing disillusionment with the international trade system in general and the World Trade Organization (WTO) in particular. The WTO ministerial meeting in Cancun, Mexico (September 10-15, 2003) brought together delegates from 148 member countries and was intended as a general stock-taking session to assess the way to move forward in key areas such as tariff reduction on industrial products, agricultural reform, foreign investment rules, and competition policies. The meeting was part of a new round of world trade talks launched in Doha, Qatar in November 2001 intended to focus on the needs of the developing countries. To the surprise of many, but not all, the conference collapsed in the face of fundamental differences between rich and poor nations.

The financial implications of this breakdown are staggering. A recent World Bank study ^[4] projected that a new trade agreement would have a major impact on the global economy. The Bank's estimate is that an accord promoting free trade would produce for the world economy an annual income growth of between \$290 billion and \$520 billion. This income growth would lift approximately 144 million people out of poverty by 2015. In East Asia alone, free trade policies on agriculture, services, logistics, and trade facilitation would create annual benefits of \$300 billion or 10% of the region's GDP within a decade.^[5]

Clearly, the happenings at Cancun require an assessment, not just of what went wrong at the meetings, but also of the broader issue of whether or not the existing structure of the WTO is up to the challenges ahead. With this in mind, this *Strategic Insight* will examine the main issues confronting delegates at the Cancun meetings. What were the main issues? The positions taken? The main reasons for failure? Based on this assessment, the final sections speculate as to the WTO's future with implications drawn from the lessons of Cancun.

Main Issues on the Cancun Agenda

The new round had a large, rather cluttered agenda. Several of the more important areas for discussion were to include:

Agriculture

Ministers were asked to agree on a framework for proceeding with negotiations on farm trade liberalization. Here the three main areas of debate were border protection, export subsidies and domestic support. The draft for discussion referred to the possible phasing out of export subsidies. It also envisaged cuts in domestic farm support that went well beyond what the EU had stated it could accept.

Of these issues, developing country subsidies was perhaps the most contentious, pitting the rich nations against the poor ones. Many economists feel that the subsidies that developed countries pay to farmers increase supply and thus contribute to developing country poverty through lowering world prices of key products.^[6] While developing nations want the developed countries to cut their subsidies, developed countries contend subsidy cuts must be matched by concessions from poor countries. These focus mainly on lowering tariffs on imports of manufactured goods.

With regard to the extent of developed countries' farm subsidies, it is estimated that^[7]:

- The industrialized world spends \$1 billion a day on agricultural subsidies.
- In 2002, U.S. farm support was 17.6 percent of the total value of agricultural production, compared with 36.5 percent in the European Union, and 59 percent in Japan.
- While the 1996 U.S. Freedom to Farm bill was designed to reduce payments to American farmers, between 1996 and 2002 payments grew 300 percent, to \$22 billion. Under the 2002 U.S. Farm bill, Washington has allocated up to \$190 billion more—over the next 10 years—for America's farmers.

Particular attention was to be focused on cotton, stemming from a plea from four west African cotton-producing countries—Burkina Faso, Benin, Chad and Mali—to eliminate the \$6 billion a year now spent on cotton subsidies by the U.S., Europe and China. The four African countries contend their farmers are losing \$250 million a year from subsidized competition and depressed world prices, while the overall cost to their economies could amount to \$1 billion a year. They wanted the ministers in Cancun to agree a timetable for scrapping the subsidies, and compensation during the phase-out period—but the United States opposes a deal outside the main agricultural talks.

Non-Agricultural Market Access (NAMA)

The original purpose of the GATT was to create a multilateral trading system in which tariffs on industrial goods would be minimized as much as possible. At the Doha Ministerial, members raised concerns about the implementation of this goal. At the Cancun meetings ministers were to agree on a framework for proceeding with negotiations on opening markets for non-agricultural products—mostly industrial goods. Many spokesmen from the developing countries contend that developed country trade barriers are higher than theirs and hence the global trading system is unfair.

A closer look at the levels of protectionism around the world presents a somewhat different picture. For trade in manufactures (excluding textiles and clothing), the developed countries average tariffs are 3% compared to 13% for the developing countries. Even in textiles and clothing, the poor-country tariffs at 8% exceed the rich-country tariffs at 3%.^[8]

Singapore issues

During the 1996 Singapore Ministerial, members agreed that the relationships between trade and competition and between trade and investment required further examination. Trade facilitation and transparency in government procurement were also set apart for further study. Three working groups were organized within the WTO to address these areas, but a decision on whether or not to formally integrate these four issues, now known as the Singapore Issues, into the WTO framework was delayed until Doha in 2001. It was there that the WTO recognized a "case for multilateral rules" in these areas, and mandated that decisions at the 5th Ministerial be reached as to whether negotiations on these issues could begin.

Developing Country Issues

In Doha, ministers asked negotiators to review WTO provisions on special and differential treatment for poor countries "with a view to strengthening and making them more precise, effective and operational". One concerns compulsory licensing of imported generic drugs for countries without domestic production capacity. The other two concern 'implementation' issues and 'special and differential treatment'. With regard to the drugs issue, some progress was made before the meetings. Negotiators agreed on a resolution that appears to allow poor nations to buy generic drugs from Brazil, India and other producing nations. Pharmaceutical companies, citing intellectual property rights, have historically resisted such plans, but global pressure forced the companies to change their position. At the Cancun conference, however, it was apparent that many technical details remained unresolved.

Explanations for the Failed Talks

As it turned out, talks in Cancun centered on five areas: agricultural subsidies, industrial tariffs, market access, investment and competition rules and special help for the poorest countries. Inside sources note that progress was minimal in many areas and time ran out to bring the opposing camps together.[\[9\]](#)

Explanations abound for the failure of the member countries to arrive at an agreement despite the enormous potential benefits stemming from the completion of the Doha round.[\[10\]](#) By most accounts, in the final hours it was the African countries' refusal to accept talks on the Singapore issues which proved the greatest impediment to an agreement. However, the Cairns group of agricultural exporting countries was also reported to be refusing to reopen talks on agriculture, believing the deal on the table was to favorable for the protected markets of the EU and the United States.[\[11\]](#)

Many more subtle, not necessarily mutually exclusive, factors have also been suggested for the failure of the Meetings:

Sluggish World Economy

General world economic conditions in the last several years have not been conducive to advances in trade liberalization. In 2001, the year talks got underway, the world economy contracted by 6.5 percent. While the world economy is picking up, there is still great hesitancy in some quarters to expose struggling firms and their workers to increased competition.

US/EU Conflicts

Second is the continuing conflict over key issues between the United States and the European Union (EU). In the bigger scheme of things, many of these seem petty—banana wars, export subsidies for American companies (the so-called Foreign Sales Corporation case in the WTO), disagreements over data and privacy protection in telecommunications and more recently over genetically modified organisms. One could go on. Clearly, the United States and the EU have moved from an era of Cold War cooperation to a more adversarial post-Cold War era of competition.

The Group of 21 (G21)

Third is the increased role that the developing countries are now playing in the multilateral system and in the WTO.^[12] While 80 of the member countries are classified as developing, many are too weak economically to have much influence. On the other hand a group of 21 countries (G21), including China, India, Brazil, South Africa, Korea and Egypt have emerged as a fairly cohesive block of countries.^[13] This group differs sharply with the more developed countries over a wide spectrum of issues, and as a result the developed countries were not able to easily have their way on a number of key issues. Many in the developed countries cited the G21's unwillingness to bend as the main cause of the Cancun debacle.

Significantly, this group and many other member developing countries feel that the previous round of trade negotiations, the Uruguay round that ended in 1994, treated them unfairly and have been highly damaging to their economies. Barfield notes that under the Uruguay round of talks developing countries were promised increased trade in agriculture and textiles and apparel in exchange for agreeing to new rules in services, intellectual property and health and safety measures. "What they subsequently discovered was that in agriculture, virtually no liberalization actually occurred and in textiles and apparel the deadlines were back-loaded and didn't kick in for a decade^[14]," The result is that they have demanded compensation and roll-back of some Uruguay trade rules as a condition for undertaking any new obligations in the Doha round.

As noted above, the Doha round was supposed to address the concerns of the developing countries. It was actually dubbed the Doha Development Round. In retrospect, expectations among the developing nations may have been raised too high. Perhaps because of this many of the developing nations at the Cancun trade talks were not willing to offer anything in return for promised concessions from the rich nations.

In any case, the developing countries for the first time in twenty years were beginning to unite in a common bargaining position. Whether these countries will resurrect something along the lines of the New International Economic Order (NIEO) remains to be seen. Ironically, the NIEO was effectively ended after a 1982 conference at Cancun.

Overloaded Agenda

Fourth, as the WTO system has evolved, items open for negotiation and new forms of protectionism have increased. The push for free trade has been overwhelmed by calls for fair trade, investment rules, labor agreements, intellectual property regimes, pharmaceutical pacts and scores of other issues. As Bardhan^[15] notes, many of the complaints lodged by the South are better served with other international agencies. In any case, to roll all these into an already overloaded agenda is to invite more Cancun-type disasters.^[16]

A variant of this theme is the overly complex nature of many of the new issues now opening for debate. Many of the developing countries just do not have the manpower to dissect all of the agreements and clauses proposed by the developed countries. To effectively participate at the meetings, each country now needs a small army of lawyers, accountants, writers and other professionals—manpower they simply can not afford. Referring to the investment proposals submitted at Cancun, Bhagwati noted that "When I looked through the investment agreements, it was worse than reading my insurance policy for the fine print. I couldn't make anything out of it, and I'm a reasonably informed person, a pretty smart economist as they go."^[17]

Role of Non-Governmental Organizations (NGOs).

Finally, other observers like Franz Fischer, European Union farm commissioner, put a great deal of the blame on the hundreds of Non-Governmental Organizations (NGOs) who denounced the WTO for what they said was its subservience to big business and indifference to the poor. Whether intentional or not ,

Fischer observed that "the NGOs gave the impression that no deal was better than a bad deal—there was no preparedness to change positions."[\[18\]](#) Along the same lines, de Jonquieres observed that:

The battle line has been intensified by many poor countries' reliance on advice from activist groups openly hostile to the WTO and free markets. When the Cancun talks collapsed, activists and African delegates whooped for joy—even though poor countries lost most.[\[19\]](#)

Future Scenarios

A number of scenarios are plausible for the WTO. Each is based on implicit assumptions concerning the desire of member countries to move ahead in the liberalization of world trade and the development of lower income countries.

North/South Split

Based on a continuation of developments at Cancun, this is not a particularly optimistic scenario. As noted above, the WTO works by consensus. Unfortunately, there are no formal procedures to arrive at a joint agreement. Under these circumstances, the WTO would likely become another bureaucratic agency continually presiding over North/South issues with no real resolution. The increasingly polarized ideological gaps (the Neo-liberal and Structural lines in [Figure 1](#)) between the rich and poor would be too major to accommodate any type of consensus other than on the most trivial of issues. In this scenario, the North perhaps under U.S. prodding, would largely adhere to neo-liberal economic principles of free trade and open markets advancing a pro-globalist agenda while dismissing the structuralist more anti-globalist arguments of the South as unsound.

Likely outcomes would be the creation of more and more bi-lateral trade deals, and regional trading groups. The WTO would become marginalized or at best seriously weakened. Clearly, if the North and South could agree on a common approach to development and trade, perhaps through blending the sound portions of neo-liberalism (efficiency) with those of structuralism (governmental safety-nets and assistance) into some sort of policy consensus (the Policy Consensus line in [Figure 1](#)), a major stumbling block in arriving at an agreement would be eliminated and the WTO would be a much more effective organization as a result. Given the fact that extreme versions of both the neo-liberal and structural models have been largely discredited[\[20\]](#), this scenario is not as far-fetched as it might seem. Many of the recent writings of Joseph Stiglitz, former Nobel Prize winner and former head economist at the World Bank, have focused on developing just this sort of framework.[\[21\]](#)

EU Dominance/US Ambivalence

In this scenario, the EU gradually captures the WTO agenda, while the United States largely abandons the organization to pursue an agenda of bilateral and regional deals. Rather than achieving or even pursuing any dramatic new ground in trade liberalization, the WTO would become bogged down in Singapore type issues—standards harmonization and regulatory overload—meetings would become long, drawn-out, and infrequent. The WTO would become an increasingly irrelevant force in world trade. There is a good chance this scenario will play out in some form.

Strengthening the WTO Financially

The WTO differs from the other Bretton Woods Institutions in that it has no real power, i.e. financial leverage over the member countries. Both the IMF and the World Bank can provide a number of financial inducements for member countries to undertake reforms, adopt rational economic policies and the like. The WTO as constructed largely relies on the good will of the member countries. It is ironic that even though billions of dollars of increased income were likely to be generated by a successful conclusion to the Doha round, there was so little interest on the part of a large number of the poorer countries. Clearly many of these countries perceived that, as in the case of the Uruguay round, the initial impact of the Doha

treaty would be to reduce their incomes even further. If the WTO were empowered to tax only part of the billions of dollars in income gains from a trade round and then compensate the losers (or even the relatively low winners) of the round, this would bring many of the developing countries back to the bargaining table. Clearly, this scenario would require the member countries ceding a certain amount of national sovereignty to the international organization. In addition, there would be a number of operational issues involved in identifying trade related income and the proper taxes to apply—no simple task on technical or political grounds.

Strengthening and Restructuring the WTO Out of Necessity

In addition to providing the WTO with an independent source of funding, member countries might cede much greater authority to the WTO, with world trade ultimately resembling inter-state trade in the United States, or to a lesser extent the current EU. This of course is an extreme solution and one not likely in the near future. However ultimately it may be necessary if the process of increased world economic integration globalization is to proceed smoothly. Here Rodrik argues increased globalization might encounter the so-called "trilemma" or international trade-off problem.[\[22\]](#)

Originally the trilemma analysis was applied to the international financial system ([Figure 2](#), Financial Trilemma) where it was argued that on technical grounds of the three goals— (a) monetary autonomy or economic national sovereignty; (b) stable exchange rates; and (c) goal of free capital flows or greater international economic integration—only two could be achieved simultaneously. For example, if a country pursued an independent monetary policy and increased its money supply at a greater rate than its major trading partners, domestic interest rates would fall and capital would flow out of the country seeking higher rates of return. Capital outflows would place great pressure on the exchange rate, ultimately forcing a devaluation of the country's currency. In other words, macroeconomic fundamentals dictate that the three goals are not attainable simultaneously.

According to Rodrik, the same dilemma applies to further globalization. ([Figure 2](#), Rodrik Trade Trilemma). Here Rodrik assumes countries are constrained to just two goals of three: (a) further economic integration; (b) the social contract—high levels of social spending; and (c) national sovereignty. If nations opt for national sovereignty and high social spending, they must take steps to impede integration. If they do not, their higher tax rates (to fund the expenditures) will result in their losing investment to countries with lower public spending and levels of taxation. This is the localism[\[23\]](#) option often championed by the anti-globalists. On the other hand, if nations opt for sovereignty and integration, they must scale down social programs—the "golden straitjacket" coined by Thomas Friedman.[\[24\]](#)

If nations opt for social programs and deeper economic integration then they would have to give up considerable sovereignty to strengthen and expand the authority of the WTO in ways that would allow that institution to set international standards, norms, rules for trade and the like—otherwise there would be a "race to the bottom," with governments cutting social expenditures, allowing the environment to deteriorate, and so on to enable them to remain competitive with lower wage countries.

While all this sounds plausible, casual empiricism suggests that the "race to the bottom" and the Rodrik trilemma is more of a political constraint than an economic one. In the financial trilemma, there were strong, stable market forces that precluded the achievement of a fixed exchange rate, capital flows and an independent monetary policy. That does not appear to be the case with the so-called trade trilemma. Most of the developed countries sustain high levels of social spending, yet remain quite competitive due to their ability to innovate, and sustain rapid increases in productivity[\[25\]](#)—there are simply more degrees of freedom than in the monetary case.

In short, a strengthening/restructuring of the WTO out of pure economic necessity is unlikely—it is hard to see how the developed countries would cede a considerable degree of sovereignty in the absence of any serious, exogenous economic constraints on social spending forcing them in this direction.

Enlightened Unilateral Strengthening of the WTO

Any proposed fundamental change to the WTO structure or scope of responsibility has to confront the fact that:

Any one of the organization's 148 members can hold up any aspect of any negotiation. Efforts to create smaller informal groups are decried as "non-transparent" by those left out. Not surprisingly, this lends itself more to grandstanding than to serious negotiation. The worst problem, though, is that the WTO's requirement for consensus makes it virtually impossible for it to be reformed.[\[26\]](#)

Enlightened unilateralism is summed up by a quote from the famous Cambridge economist Joan Robinson who observed that "if your trading partner throws rocks into his harbor that is no reason to throw rocks into your own."[\[27\]](#) As noted above much of the discontent at Cancun centered on the South's perceived hypocrisy of the North. Perhaps the best thing that the United States and other like-minded countries can do to strengthen the WTO is to simply set a good example.

Unilaterally reducing tariffs and other trade barriers is an obvious place to start, but there are many other and possibly more politically acceptable courses of action. In the context of the Cancun furor over agricultural subsidies in the developed countries, the United States for example might consider a particularly creative approach suggested by Amity Shlaes.[\[28\]](#) Her notion is that "it is time to take a truly radical and multinational step—pension off the farmers".[\[29\]](#) As she notes, this idea is not as wild as it may seem. The U.S. Senate has already authorized a buy-out program for tobacco growers. As it stands now U.S. subsidy programs transfer to farmers on average the equivalent of \$16,000 per annum. Shlaes suggests a buyout of 15 years worth of subsidies in one payment—or \$240,000. With this payment, protectionism and subsidies would end. In the longer-term, of course this is a much cheaper solution than perpetuating the dole. Actions like this might convince the South of the sincerity of the advanced countries in promoting free trade.

Conclusions

The WTO meeting in Cancun provided a vivid illustration of how the North and the South are drifting apart due to diverging agendas and the lack of political will to bridge the gap.[\[30\]](#) In addition to the staggering loss of potential income to be derived through a successful trade treaty, this situation is particularly unfortunate given the fact that a recent public opinion survey indicated that large majority in 38 of 44 countries surveyed in the summer of 2002 thought growth global trade and business ties were good rather than bad for their country.[\[31\]](#) Interestingly, there was strong support for global commerce in France (88%), Brazil (73%) and India (69%), countries that have been critical of the current Doha negotiations and were instrumental in the collapse of the Cancun Meetings. Given this, it is especially troubling in that:

The breakdown was entirely unnecessary. Trade ministers were not trying to come to a final agreement on the Doha round; they were not even making difficult choices about exactly how far to open their economies. The purpose of Cancun was far more limited: to be no more than a mid-course stock-taking, a time to agree on principles for taking negotiations forward. It is extraordinary, and all the more shameful, that ministers failed to do this.[\[32\]](#)

While it is possible to visualize of a number of future alternatives for the WTO, it is very hard to be optimistic that the organization will arise from the ashes of Cancun and move ahead to complete the Doha agenda on schedule.

Barring any fundamental change in the organization, several lessons have come out of this experience:

1. Cancun in particular, and the Doha round in general demonstrates the growing limitations of the WTO as a force for trade liberalization. For years the United States, Europe and Japan

cooperated to move the organization forward with new trade agreements. However, this model of negotiation has hit diminishing returns; it is becoming less and less effective.

2. The main problem facing the WTO is the disparity between its members' levels of income and development—one size will not fit all and the organization must tailor make its policies and rules for individual groupings of countries.[\[33\]](#)
3. Partially because of these disparities, it is absurd to push as the EU has done to impose rules in complex areas such as competition and investment on countries that do not have the infrastructure (manpower) to bargain effectively.
4. The G-21 is a force to be reckoned with. They and many other developing countries will no longer be passive participants, especially on issues that affect their development process.[\[34\]](#)
5. Special attention to the special problems of some developing countries should not be interpreted as general license to avoid trade competition.[\[35\]](#)

In terms of the future, several policy shifts should be considered:

1. Ministers should focus on economic gains to be derived from freeing trade—perceived trilemma tradeoffs are an illusion and no reason to expand negotiations into such areas as labor standards, environmental conditions and the like. These issues should be dealt with in issue specific forums such as the International Labor Organization, Food and Agriculture Organization etc.
2. The top 20 importers (with the EU counted as one) account for 80 percent of world merchandise imports and the top 50 for 92 percent. Procedures in the WTO should focus on an agreement between the top 30 or so traders, with the other countries not automatically bound to the agreement.[\[36\]](#) It makes no sense to allow a country with less than 0.1 percent of world trade to derail the whole process.
3. A similar principle would apply to market access. The best policy would be to offer barrier-free access to the small traders. If this impossible, simply extend any agreed liberalization to them within the principle of non-discrimination.
4. To achieve good will amongst the member countries the United States as well as other developed countries should open up their economies unilaterally.[\[37\]](#) This is simply good economics. More importantly, once the developing countries experience the practical benefits of increased trade, there is a good chance they will come to the table with more motivation to arrive at a constructive treaty.[\[38\]](#)

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