

7

*International Trade and the WTO:
Old Debates and New Passions*

Brazil wins ruling on EU sugar subsidies.

The World Trade Organization increased the pressure on the European Union to make sweeping reforms of its costly sugar regime yesterday by finding that subsidies paid under the policy violated global trade rules.

The preliminary ruling—in a case brought by Brazil, Thailand, and Australia—is expected to strengthen the hand of agricultural exporting countries that want wealthy nations to agree to deep cuts in their farm support spending as part of the Doha global trade round.

The decision by a WTO disputes panel follows a WTO ruling in June in favor of a complaint from Brazil that \$12.5 billion of subsidies paid by the United States to its cotton farmers were illegal. Washington plans to appeal.

Financial Times, August 5, 2004

Ernesto Zedillo, former president of Mexico and today a global leader in the debate about growth, development, trade, and economic governance, was giving a lecture in one of the top Turkish universities in front of about 300 students and faculty members in March 2004. The audience, full of idealistic young women and men with the “Porto Alegre spirit,” was very interested in hearing about globalization, trade, and the dilemmas facing the world from someone who had led one of the major emerging-market countries.¹ It was close to the time of the Mumbai, India, meeting of the “alterglobalization” movement. President Zedillo surprised and destabilized the audience with the following question:

How is it that Jose Bove, the French activist who leads a campaign in France with the aim of protecting French agriculture, is celebrated as a hero by the alterglobalizers? Is it not true that agricultural

1. Turkey and Mexico are similar in many ways. In both countries, democracy emerged from a revolutionary one-party system. Both countries have strong economic ties to prosperous advanced economies in the North. Both countries have experienced dynamic growth, but both have gone through more than the average number of financial crises.

protectionism and subsidies paid to their farmers by the rich countries undermine poor peasant producers in the developing countries and contribute in a significant way to continuing poverty? By closing their markets and subsidizing their producers in just the way Jose Bove wants to perpetuate, the rich countries make it impossible for millions of poor farmers in Asia, Africa, and Latin America to produce more and sell more of their products. How can the alter-globalizers claim to care about the poor in this world and have their interests at heart, and, at the same time, applaud Jose Bove?

This example struck a particularly responsive chord in Turkey, as the impact of American cotton subsidies on otherwise quite competitive Turkish cotton farmers had been much in the news. Why indeed would young people interested in development and intent on fighting world poverty be on the side of an agricultural protectionist from a rich country? And on whose side is the World Trade Organization? The quote from the *Financial Times* at the beginning of the chapter refers to two rulings against the United States and the European Union. Is the world changing more rapidly than we think?

Passions about Trade

The Jose Bove example illustrates the complex nature of the passions unleashed in the debate about trade and the WTO. These passions, of course, are not just about trade, but also about the many dimensions of globalization, and they go well beyond international trade itself. Jose Bove's attack of a McDonalds outlet in France reflected not only agricultural protectionism, but was also perceived as a protest against the American superpower, an expression of cultural nationalism and rejection of global standardization, and as the "small guy" standing up to the huge multinational corporations. The debate about trade and the WTO, even more than the debate about global finance and the Bretton Woods institutions, is a debate about globalization itself with all the economic, political, and cultural dimensions.

On one side of this debate are the arguments of the economics profession, which, to a large extent, stress the potential benefits of more and freer trade. There are, of course, exceptions to the beneficial role of trade recognized by professional economists, and this chapter will provide a review of the purely economic aspects of the debate. But, by and large,

economists support more and freer trade—even those, such as Paul Krugman, who have developed approaches that go beyond the basic comparative advantage models with competitive markets and diminishing or constant returns to scale, and who stress that, under certain conditions, managed trade could be superior to free trade.² Professional economists tend to believe that, both for comparative advantage reasons and for reasons linked to the exploitation of economies of scale and the benefits coming from enhanced competition, trade is most likely to have overall beneficial effects in the medium and long run, although there may be transition costs and distributional effects that should be taken into account when designing optimal policies. Looking at the empirical evidence, it is not easy to substantiate strongly a simple link leading from open trade policies to more rapid growth. It does seem clear, however, that countries that have been good *export performers*—particularly countries that have been able to conquer important shares in the world market for *industrial* products—have also been the better overall performers in terms of long-run growth and living standards.³

On the other side of the debate is a wide and diverse coalition that uses not only economic but also many noneconomic arguments to contest the benefits of international trade and criticize the WTO.⁴ There is a wide spectrum of opinion represented in this coalition, with positions ranging from those wanting to reform the WTO-centered system to those wanting

2. See, for example, Krugman (1986); Krugman and Smith (1994); Brander (1995); and Krugman (1999).

3. The link between trade, openness, and economic growth has received ample attention from economists. Edwards (1993) provides a comprehensive survey of the literature on openness and growth through the late 1980s. Dollar (1992), Sachs and Warner (1995), Ben-David (1993), Edwards (1998), Frankel and Romer (1999) are among the most cited papers of the literature in the 1990s, all of which find a positive relationship between trade openness and economic growth. Rodríguez and Rodrik (2000), however, provide a critical analysis of these papers and cast doubt on the empirical evidence, although their criticism concerns methodologies of these researchers rather than an argument in favor of trade protection. The more recent paper by Dollar and Kraay (2001) again presented arguments relating protrade policies to growth, but Birdsall and Hammoudi (2002) show convincingly that if one controls for primary commodity dependence, the Dollar and Kraay conclusions no longer hold. Cline (2004) provides a comprehensive survey of all the empirical work and concludes that the weight of the evidence suggests a substantial link going from trade openness to more rapid growth, although a link between open trade *policies* and growth is harder to substantiate.

4. The WTO is criticized as the symbol of the protrade and globalization-is-good-for-you worldview, although, as discussed later in this chapter, it has very little institutional power itself, certainly much less than the Bretton Woods institutions.

to abolish the WTO and drastically reduce international trade. The quote below is taken from *A Better World Is Possible*, a report by the International Forum on Globalization, which is not a marginal group but a non-governmental organization referred to as one of the more significant civil society critics by prominent mainstream and free trade advocate economists such as Jagdish Bhagwati. This example shows how far some of the critics want to go:

The goal of societies should not be to find cheaper prices for products but to find the means to ensure that all the needs of all people are met and that a satisfactory and stable life is perpetuated within a system that does not collapse from being part of the volatile global market. If people grow their own food, produce their own necessities and control the conditions of their lives, the issue of price becomes irrelevant (International Forum on Globalization 2002, 20).

Passions run high on both sides of the trade debate. Those who see international trade as the key engine of world growth do not disguise their antagonism towards the “protectionists” who back narrow special interests against the common good, or their contempt for those who, while perhaps well intentioned, fail to understand that trade is a vehicle to spread knowledge, improve productivity, exploit both comparative advantage and economies of scale and thereby reduce poverty. Some sentences from Bhagwati’s *In Defense of Globalization* give a good flavor of the strong feelings among the free traders:

As for the charges of hypocrisy, double standards, and unfair trade that are passionately leveled today at these (IMF, World Bank, WTO) international institutions and also at the rich nations—in particular that they maintain protection for themselves while they force others into free trade. . . . these beliefs and allegations are often little more than rubbish (Bhagwati 2004, 6).

And a few paragraphs further in the same book, Bhagwati criticizes Oxfam, one of the largest, most serious, and active development-oriented nongovernmental organizations, with very strong language:

Causing harm to the poor cannot have been the intention of Oxfam, yet the road to hell is paved with good intentions. Oxfam knows a little, but not enough about trade policy, I am afraid, and I have been moved to remark, not just in this instance, that mission creep,

even by noncreeps, is often not a good idea. Their overreach subtracts from the great good that they have done when they concentrate on what they do best (Bhagwati 2004, 6).

As an official international institution, the World Bank is more measured in its style. Nonetheless, reading *Global Economic Prospects 2002: Making Trade Work for the World's Poor*, for instance, one still feels the passion with which the authors believe that trade is one of humanity's great instruments in the fight against poverty. Simultaneously, the World Bank team working on the Global Economic Prospects series is well aware of the various theoretical and practical qualifications relevant in this context and of the need for complementary policies and efforts that should be implemented for protrade policies to yield the desired results.⁵

Passions also run high in the opposing camp, where there is a broad coalition made up of disparate groups that can mobilize important segments of public opinion against more and freer trade in both the rich and poor countries. In this coalition one finds, of course, the old-fashioned and well-known protectionists representing their various sectoral interests: American steel producers, European dairy farmers, the Indian car industry, or Turkish sugar manufacturers simply want measures to protect their sector from more efficient foreign producers. Protectionism as such does not have much ideological appeal, although many are understandably concerned about the transition costs associated with sudden and rapid liberalization. There are deeper fears and less self-serving forces, however, that explain the appeal of the antitrade component of the alterglobalization movement beyond sectoral interests.

Trade is part of the process of increasing international integration that makes the world a more cosmopolitan place by leading to a dazzling increase in the diversity of products consumed and encouraging shifts in tastes and habits, while allowing successful producers or brands to exploit large economies of scale, make huge profits, and threaten old habits or entrenched positions. An extreme and telling example of what an opening to trade can do not only to individual sectors, but also to

5. Since 2001 the World Bank's Global Economic Prospects studies, published once a year ahead of the annual meetings, have formed a series that provides one of the best presentations of international trade issues as they have been discussed in key trade meetings and grounded in empirical analysis of global trends. The fundamental message is one that strongly believes in the benefits of more and freer international trade. See World Bank (2002, 2004). For another recent eloquent defense of more and freer trade, see Cline (2004).

whole economies and lifestyles, is the fate of the ex-Soviet style economies in the 1990s. Countries that *appeared* to be upper-middle-income countries in terms of their per capita income suddenly became much lower-income countries, as the capital stock they had accumulated in their industries became practically worthless. My point here is not to argue about whether or not this collapse was inevitable in the long run (it was), but to show how opening to trade forces standards and transformations on societies that can be very threatening in the short run, although they may bring great benefits over time. Another example of such dramatic transformation is found in the impact modern shopping malls have on small scale shops and the whole lifestyle associated with traditional retailing, including personal contacts, informal credit, and neighborhood solidarity. Multinationals such as Carrefour, Wal-Mart, and Ahold, as well as smaller global chains such as Macro, Metro, and Casino, have been at the forefront of such transformations.⁶ Globalization often triggers a sense of upheaval of identity, linked to rapidly changing production and distribution structures, which leads to insecurity and fear about the future. The truth is that when one carefully considers these factors, trade is only one rather small component of a multifaceted process that is creating this new type of insecurity. What is perceived as threatening is not *just* the economic insecurity linked to the loss of protected income or employment, but also the loss triggered by a change in lifestyle. It is difficult in this context to disentangle the purely economic factors, such as the fear of unemployment, from these identity and “sense of belonging” related insecurities. The latter exist and magnify the impact of the former, particularly when large segments of a population are affected in a short period of time. Moreover, in the rich countries, trade, outsourcing, and immigration often get linked in the minds of those affected and give rise to an overall “conservative” reaction against *cosmopolitan globalization*, despite the fact that trade is in fact an economic substitute for immigration! Given its shrinking labor force, a result of its demographic structure, Germany, for example, will either have to “outsource” an increasing part of its production or encourage immigration. As unreasonable as it may

6. Peter Timmer and others are doing work on the impact of the rise of supermarkets in developing countries on local food supply chains. They argue that small local suppliers and distributors may be squeezed out of the market because they cannot meet (or verify) that their produce meets the required standards and quality of the supermarkets, and that it is necessary to redesign development policy to enable small local suppliers to meet these challenges. See, for example, Reardon et al. (2003).

seem to pragmatic economists or to cosmopolitan elites, the trade debate is not unrelated to the cultural insecurities and even to the religious confrontations that, unfortunately, we are witnessing at the beginning of this new century. The famous Arab-French novelist Amin Maalouf has written an important, somewhat autobiographical book on the cultural-religious tensions that the world faces at the turn of the century. In part 2 of this book, which has the theme “when modernity comes from elsewhere,” he writes:

For the Chinese, the Africans, the Japanese, the Indians, the American-Indians and also for the Greeks and the Russians as well as for the Iranians, the Arabs, the Jews or the Turks, modernization has always implied a certain “giving-up” of part of oneself. Even if at times modernization generated enthusiasm, the process never took place without a certain feeling of bitterness, including some humiliation and self-denial. It never took place without a profound crisis of identity (Maalouf 1998).

A second dimension of antitrade sentiment is linked to negative feelings about the power and functioning of large multinational corporations. These corporations are perceived as “organizing” an increasing part of economic and social life worldwide by influencing or even determining decisions thanks to their lobbying at the level of national governments or international institutions. It is feared that the multinationals are encouraging an “international race to the bottom” in environmental standards and social policies. Their capital and know-how, and the cosmopolitan skilled labor they employ, are believed to allow them to move production to wherever environmental and social standards are lowest, forcing governments to compete for investment by lowering these standards and thus contributing to environmental degradation, lower taxes, and diminished social benefits. Critics of the current international economic system perceive as both important and deeply objectionable the following aspects of what they call “corporate globalization:”

- Erosion of the tax base of the welfare states that were developed after much social and political struggle in the 20th century. First, corporations can use the complex system of transfer pricing to shift their profits to whatever jurisdiction has the lowest corporate income taxes. This can be done without actually moving the location of production. Second, corporations can actually move their production

facilities to the lowest tax host countries. In an attempt to attract footloose capital, countries will compete with each other in lowering taxes and thereby erode the basis for a social welfare state that can redistribute income and provide generous social services. A free and open trading system facilitates this type of behavior by multinational corporations.

- A similar race to the bottom with regard to environmental standards. Production facilities can be installed wherever environmental standards are lowest, potentially leading countries to compete with each other by lowering their environmental standards in a fashion very similar to the presumed race toward lower tax rates.
- The same race to the bottom with regard to labor standards. Production facilities can be moved to wherever the right to strike is the most circumscribed, wherever it is easiest to fire workers, wherever hours are longest, and wherever unit labor costs are lowest. They could even be moved to locations where child labor can be exploited.
- By freeing production from the necessity of being located close to consumption, international trade allows capital and highly skilled labor to move to wherever the most advantageous conditions exist. In today's world, capital and highly skilled labor is mobile, facing few effective barriers at borders, whereas unskilled labor is immobile. This mobility of capital and skilled labor is seen to change the very nature of the political process and of the conditions determining the bargaining strengths of social actors. If the representatives of unskilled labor become politically too powerful in a particular country, or if they bargain too aggressively, the mobile factors can just leave instead of having to face their opponents and agree to a compromise within a given geographical location. This is believed to undermine the very core of democracy.

Taken together, all of these *possible* consequences of the liberal globalization process facilitated by free trade *could* indeed amount to a massive downside; unless there are compensating measures, they could overshadow the benefits the world can obtain by taking advantage of comparative advantage and economies of scale through more and freer international trade. The key set of questions that arises in this context is *how important* these negative aspects have been and are likely to be in practice and to what extent public policy can counteract them while still allowing the world to realize the benefits from trade. The answer is that,

so far at least, there is not much evidence that a strong race to the bottom is actually taking place.⁷ On the tax front, for example, there is no evidence that total taxes are declining in economies of member countries of the Organization for Economic Cooperation and Development (OECD), although there are some shifts away from direct income and profit taxation with possible consequences on income distribution. Taxes on foot-loose capital have declined in many countries, often compensated for by taxation of purchases of goods and services. On the environment, there is even less evidence of a race to the bottom actually taking place. It is not hard to understand, however, that these potential negative aspects are perceived as dangers and that fear of these dangers has the potential to trigger a passionate rejection of the whole trade-driven globalization process.⁸ The fact that there has not been so far a race to the bottom does not prove that it cannot take place in the future.

Finally, there is a third dimension in the broad alterglobalization or antiglobalization movement related to, but distinct from, the cultural fears and opposition to corporate domination referred to above. Particularly among intellectuals (writers, artists, academics), there has long been a “revolt” against *possessive individualism* as a philosophy of life that seems to come with and be imposed by the global marketplace. According to this critique, human beings are being pushed to become single-minded profit maximizers, pursuing *economic* objectives at the expense of *all* other objectives in life. The more the world integrates economically, the more difficult it becomes for countries, communities, or individuals to balance purely economic objectives against other pursuits in life. Consider the difficult trade-off between leisure and work, where leisure can stand for time spent with family and friends, time spent on artistic and aesthetic pursuits, or time spent pursuing culinary and other pleasures. Is it sustainable in today’s world economy for a community to decide as a collective choice to restrict work time in favor of more leisure, as in the case of France’s experiment with the 35-hour week? Can individuals and

7. See Wolf (2004) for an accessible and well-presented review of the evidence. On issues related to investment rules, foreign direct investment, and multinationals, see also Graham (2000).

8. Note that these fears are not at all confined to less well-educated electorates in poor or middle-income countries—witness the emphasis on the dangers of outsourcing in the 2004 US electoral campaign or recent warnings by the West European leaders against the low corporate taxes their new East European partners are planning to offer.

communities opt for less work and less consumption to make space for more leisure and greater happiness derived in nonmaterial ways without the risk of increasingly losing ground to individuals and communities that opt for more material production and more competition? In a world where dynamic effects are very important and where one has to innovate and constantly “learn by doing” in order to remain competitive, can those who want to move a little less rapidly and “smell the roses” survive? Is it still possible to make marginal choices in these fundamental matters, or does the international economic “system” now have such “winner takes all” characteristics that it imposes a lifestyle? Additionally, solidarity and a sense of community are desirable features of life in themselves, and there may be a trade-off between achieving solidarity, on the one hand, and competition in the market place, on the other.

These thoughts express real questions and real fears. Such dilemmas may not mean much to those who struggle to simply survive; for the poorest there is no doubt that access to food, shelter, basic health care, and basic education overshadows all other aspirations. It would be a mistake, however, to think that it is only the very rich who need more than material goods and services. One can sometimes sense a certain amount of elitist contempt for the poor, mostly unconscious, in a way of thinking that argues that leisure and quality of life are irrelevant for the vast majority of humanity. To sum up, there is fear that a global culture with excessive focus on economic competition and material consumption would bring with it tremendous dangers of alienation and despair. This fear has been expressed forcefully by authors such as Pierre Bourdieu, whose views have a substantial following.⁹

It is good to keep all of these broader dimensions of the debate in mind when evaluating the current difficulties faced by the WTO framework and the attempts to move toward further trade liberalization. Nowhere else are the arguments about institutions, policies, special interests, and broader philosophical viewpoints so intertwined. Nowhere does one find stranger bedfellows, as illustrated in the quote from Zedillo above. And yet, good trade policies and improved institutions have real potential to advance the welfare of many and reduce global poverty very significantly.

9. See Pierre Bourdieu's many publications. Bourdieu argues that US-led corporate capitalism is trying to impose a specific narrow set of values on the entire world that are not the outcome of some kind of natural universal evolution but the product of one geographically and historically limited social structure.

Institutional Framework

From GATT to WTO

The World Trade Organization was established in 1995 as the successor to the General Agreement on Tariffs and Trade (GATT). As discussed in chapter 2, GATT was created in 1947, a product of the Bretton Woods Conference but quite different in structure from the International Monetary Fund and the World Bank. GATT was essentially a “facilitator” for rounds of intergovernmental conferences and negotiations rather than a large international organization wielding some degree of bureaucratic power. Indeed, the original idea for the third pillar of the international economic and financial architecture was much more ambitious in scope than GATT, as John Maynard Keynes had envisioned what would have been called the International Trade Organization (ITO) with a mandate to stabilize primary commodity prices and address a very wide range of trade issues.

Most participants at the Bretton Woods Conference were convinced that a third pillar dealing with trade was necessary, and initially they strongly supported the ITO proposal. However, disagreement between the United States and the United Kingdom, with the latter supported by European and developing countries, over fundamental aspects of the proposed trade policy paradigm made concrete agreement difficult. Most notably, the UK insisted on “escape clauses” that would enable temporary protection when a domestic economy was in trouble and wanted to maintain imperial preferences in its colonies.

This disagreement regarding the limits to free trade was not a surprise given the structural difference between the European and US economies in the postwar period. In Europe, governments played much more active and substantial roles in domestic economies, largely because European nations had to be reconstructed after a war that took place in Europe and because, philosophically and politically, Europe was much more strongly influenced by socialist thought than the United States.

By 1946, 23 of the 50 countries that were negotiating the creation of the ITO had nevertheless decided to reduce and bind customs tariffs. This first round of negotiations resulted in 45,000 tariff concessions, affecting almost one-fifth of the world’s total trade. The 23 countries, which are known as GATT’s founding members, meanwhile agreed to accept some of the trade rules of the draft ITO charter in order to protect the value of the tariff concessions they had negotiated. The end result was a combined

package of trade rules and tariff concessions called the General Agreement on Tariffs and Trade. It entered into force in January 1948, while the ITO charter was still being negotiated. The ITO charter was presented and finally accepted at the UN Conference on Trade and Employment in Havana, Cuba, the same year.¹⁰ Unlike GATT, however, the ITO charter aimed beyond tariff reductions: it included rules on employment, commodity agreements, restrictive business practices, international investment, and services.

The charter needed ratification, however, and that proved impossible to achieve in the United States. US president Harry Truman did not even try to seek congressional approval for the ITO charter. There was growing skepticism in the US Congress concerning the UN and international institutions, and also strong opposition to the ITO charter. Without the ratification of the treaty by a sufficient number of national legislatures, it was impossible for the ITO to become an international organization. Even if countries signed the ITO charter, without the United States on board it would amount to an exercise in futility. Because of the premature death of the ITO, GATT remained the only agreement governing international trade until 1995.

The pillars of GATT were nondiscrimination, tariff bindings, and elimination of quantitative restrictions. Nondiscrimination rested on two basic principles: most favored nation rule (MFN), by which member nations would generally agree to accord no special trade status to any one member that was not accorded to all; and the national treatment rule, which required that foreign products be treated no less favorably than competing domestic products (for example, agreement not to impose higher domestic sale taxes on foreign products than on competing domestically produced ones). Tariff bindings simply mean that a member, after agreeing to tariff concessions, cannot raise the tariffs above bound levels. Finally, to ensure that nontariff measures do not impair the value of tariff concessions once tariffs had been bound, GATT prohibited quantitative restrictions on exports and imports. Agricultural products were an exception, with qualitative restrictions and subsidies still allowed in many cases. Tariffs on agricultural products were in many cases not bound until the Uruguay Round. The Multi Fiber Arrangement (MFA) also made an exception to this rule by allowing textile and apparel quotas in the form of “voluntary” export restrictions.

10. Information in this section is based on World Trade Organization (2003).

Trade Rounds Held under the Auspices of GATT

GATT was a provisional legal agreement, not an international organization with permanent arrangements, although a small secretariat was established in Geneva.¹¹ As the initial agreement was limited in scope, eight rounds of multilateral negotiations have been carried out since to increase GATT coverage. The first five rounds of multilateral trade negotiations held under GATT auspices dealt with tariff reductions only. These rounds were the Geneva Round (1947) with the participation of 23 countries, the Annecy Round (1949) with 13 countries, the Torquay Round (1951) with 38 countries, the Geneva Round (1956) with 26 countries, and the Dillon Round (1960–61) with 26 countries.

For the first time in GATT's history, the Kennedy Round (1964–67), with the participation of 62 countries, went beyond tariff reductions and included a GATT antidumping agreement and addressed several other trade-related issues. One hundred and two countries participated in the seventh multilateral trade negotiations held under GATT, the Tokyo Round (1973–79). Tariff reduction negotiations led to an average one-third cut in customs duties in the world's nine major industrial markets, bringing the average tariff on industrial products down to 4.7 percent. The tariff reductions, phased in over a period of eight years, were designed to ensure proportionally larger cuts on higher tariffs. The Tokyo Round covered a wide range of issues, from agriculture and subsidies to safeguards (emergency measures to limit imports temporarily in order to protect domestic markets), and from technical barriers to trade to public procurement. Yet success with dealing with these issues was limited, and the resulting agreements were not accepted by the whole GATT membership. These agreements and rules were accepted only by some members (mostly industrialized countries) and for that reason were referred to as "codes." The result was a "plurilateral" system instead of a comprehensive multilateral one.

Thus, GATT was initially limited to negotiating tariff reductions, but as tariff levels were reduced drastically and as international trade evolved into a much more complex system, the expectations for further rounds and for the secretariat as a *de facto* world trade organization grew. However, having bound tariffs at low levels, governments responded

11. For a comprehensive background on GATT and the WTO, see World Trade Organization (2003), upon which this section is based.

to the series of economic recessions in the 1970s and early 1980s, which resulted in a period of stagflation during which a slowdown in growth was accompanied by rising prices, by devising other forms of protection for sectors facing increased foreign competition. With the 1973 OPEC (Organization of Petroleum Exporting Countries) oil embargo, the price of oil increased almost 10 times, hundreds of thousands of workers were laid off, factory closures became everyday business, and unemployment rates jumped to disturbingly high levels across Western Europe and the United States. Governments in Western Europe and North America tried to soften the hardship by negotiating market-sharing arrangements with competitors (for example, in the automotive sector) and provided farm subsidies to maintain their global market share in agriculture. These neoprotectionist trends undermined GATT's credibility and effectiveness.

In addition, the expansion of trade in services and international investment posed new challenges. GATT's institutional structure and its dispute settlement system were also causing concern. The efforts to deal with all these issues resulted in the Uruguay Round and finally the creation of the WTO.

The Uruguay Round was a long and difficult process. GATT members took four years to reach agreement on launching a new round of negotiations after a failed ministerial meeting due to conflicts on agriculture in Geneva in 1982. By the time the round was launched in 1986 in Punta del Este, Uruguay, the negotiating agenda covered almost every outstanding trade policy issue. This included the most contentious areas of international trade such as trade in services, intellectual property, and reform of trade practices in the most sensitive sectors, namely agriculture and textiles and apparel, in which industrialized countries refused to open their domestic markets to imports from developing nations. Member countries also decided that in this round all of the original GATT articles would be put on the table for review. The Uruguay Round was the single largest negotiation ever undertaken, and not surprisingly it took four years to draft it and an additional four years to get all members to sign a final agreement.

The GATT ministers met again in Montreal, Canada, in 1988 to clarify the agenda for the remaining two years. Although no comprehensive agreement was in the end reached on the agenda, they agreed on some concessions on market access for tropical products, aimed at assisting developing countries, a streamlined dispute settlement system, and the

Trade Policy Review Mechanism, which provided for the first comprehensive, systematic, and regular reviews of the national trade policies and practices of GATT members. The Uruguay Round was to be concluded in 1990 with a final ministerial meeting in Brussels, but sharp disagreements on agricultural trade reform led to the extension of the talks.

Despite the hopeless environment, GATT director-general Arthur Dunkel compiled a first draft of a final legal agreement, the “Final Act,” and it was put on the table in Geneva in 1991. The text fulfilled every part of the Punta del Este mandate except that it did not contain the participating countries’ lists of commitments for cutting import duties and opening their services markets. The draft became the basis for the final agreement.

Over the next two years new areas of conflict emerged besides agriculture, including disputes over services, market access, antidumping rules, and the proposed creation of a new institution, the WTO. A large part of the problem was solved in 1992, when the United States and the EU settled most of their differences on agriculture in a deal known informally as the “Blair House accord.” By July 1993, the Quad countries (the United States, the EU, Japan, and Canada) announced significant progress in negotiations on tariffs and related subjects such as market access. It took until December 15, 1993, for every issue to be finally resolved and for negotiations on market access for goods and services to be concluded. On April 15, 1994, the deal was signed by ministers from most of the 123 participating governments at a grand meeting in Marrakesh, Morocco. The Uruguay Round agreements contained timetables for new negotiations on a number of topics, and the Marrakesh agreement included commitments, now incorporated into the Doha Development Agenda, to reopen negotiations on agriculture and services at the turn of the century.

The major institutional result of the Uruguay Round was the creation of the WTO, which replaced the GATT secretariat as an international organization. The General Agreement, though updated as a result of the Uruguay Round negotiations, still exists as the WTO’s umbrella treaty for trade in goods.

Organization of the WTO

The WTO secretariat is located in Geneva and has a staff of around 550, headed by a director-general who has to be appointed by consensus of all

the WTO members.¹² In 2003, the annual WTO budget amounted to 155 million Swiss francs (\$116 million), with individual contributions calculated on the basis of shares in the total trade conducted by WTO members. This was less than just the travel budget of the IMF. Part of the WTO budget also goes to the International Trade Centre (ITC), which is the technical cooperation agency of the WTO, and the United Nations Conference on Trade and Development (UNCTAD) for operational, business-oriented aspects of trade development.

As of April 2004, the WTO had 147 members. Most WTO decisions require the *consensus* of all its members, either at ministerial conferences held at least once every two years or by members' delegates who regularly meet in Geneva. Thus the WTO significantly differs from the Bretton Woods institutions, where decision making is delegated to a board that represents countries or groupings of countries through a weighted voting scheme. Moreover, the rules are enforced by *the members themselves* through the use of trade sanctions. If reaching a consensus is not possible on certain issues, the WTO agreement allows for voting based on a one country, one vote principle. There are four cases for which the WTO agreement allows for voting. First, a majority of three-quarters of WTO members can vote to adopt an interpretation of any of the multilateral trade agreements. Second, a majority of three-quarters of members may decide to waive an obligation imposed on a particular member by a multilateral agreement during the ministerial conference. Third, decisions to amend provisions of the multilateral agreements can be adopted through approval either by all members or by a two-thirds majority depending on the nature of the provision concerned. However, such amendments only take effect for those WTO members that accept them. And lastly, according to the WTO agreement, a decision to admit a new member is taken by at least a two-thirds majority in the ministerial conference. While the WTO agreement states these exceptions to the consensus requirement, in practice the pursuit of consensus dominates WTO decision making.

12. It took months to solve a deadlock over who would become the next head of the WTO in 1999. Two candidates were the former New Zealand premier, Mike Moore, who was supported by the United States and most of the EU, and the deputy prime minister of Thailand, Supachai Panitchpakdi, who was supported by the Asian bloc and the UK. Overall, the support of the WTO member countries was almost equally divided between both candidates. After months of negotiations, member governments came up with an unprecedented time-sharing arrangement and decided to divide a regular term into two, allowing Moore to serve for the first three years and Panitchpakdi the last three years of the presidency.

The ministerial conference, which has to meet at least once every two years, is a venue for all decisions on any matter under any of the multilateral trade agreements. Day-to-day work in between the ministerial conferences is managed and performed by the general council, the dispute settlement body, and the trade policy review body, which all include all members of the WTO. The general council acts on behalf of the ministerial conference on all WTO affairs, and also meets as the dispute settlement body and the trade policy review body to oversee procedures for settling disputes between members and to analyze members' trade policies. Three subcouncils report to the general council, each handling a different broad area of trade: goods, services, and trade-related aspects of intellectual property rights (TRIPS). Each of these councils also has its own subsidiary bodies: for example, under the goods subcouncil, there are individual committees dealing with agriculture, market access, antidumping measures, etc.

In addition to the formal meetings, informal meetings are held that still include the full membership, such as those of the heads of delegations. Most of the difficult issues, however, are negotiated in smaller groups. A common practice is for the director-general or the chairperson of a negotiating group to hold consultations with delegations individually, with a few delegations, or in groups of 20–30 of the most interested delegations in order to achieve a compromise. This is what has come to be known as the “green room” process, a phrase taken from the informal name of the director-general's conference room. For a long time, most developing countries were practically excluded from the process; during Tokyo Round years, for example, participants in this process usually numbered less than eight parties. At present, up to 25 to 30 delegations may meet in the green room, with the countries that participate generally including the Quad countries, Australia, New Zealand, Switzerland, Norway, possibly one or two transition economies, and some developing countries.¹³ As participation and the number of issues covered in the green room process have grown over time, so have criticisms of this procedure. Several nongovernmental organizations and some delegations in the WTO argue that the green room process excludes most developing countries from decision making and results in deals that are struck behind their backs.¹⁴

13. Schott and Watal (2000, 285)

14. Perhaps the most official expression of frustration with this process was the open letter (November 6, 1999) to WTO chairman of Ambassador Ali Mchumo of Tanzania from

Like the informal “green room” decision-making process, the WTO’s formal decision making by consensus rule has also received much criticism. Jeffrey J. Schott, for example, a prominent expert on trade policy, argues that “the WTO will likely suffer from slow and cumbersome policy-making and management—an organization with more than 120 member countries cannot be run by a ‘committee of the whole.’ Mass management simply does not lend itself to operational efficiency or serious policy discussion. Both the IMF and the World Bank have an executive board to direct the executive officers of the organization, with permanent participation by the major industrial countries and weighted voting. The WTO will require a comparable structure to operate efficiently. . . . [But] the political orientation of smaller . . . members remains strongly opposed.”¹⁵

As mentioned above, the decision to admit a new member to the WTO is made either by a two-thirds majority in the ministerial conference or the general council in between conferences. The WTO allows, in principle, any state or customs territory having full control over its trade policies to join the WTO, but accession negotiations can be quite complex and difficult. The applicant submits detailed documentation of its trade and economic policies that have a bearing on WTO agreements in a memorandum. The memorandum is evaluated by a working party formed to work on this specific accession case (working parties are open to all WTO members, so any member can volunteer to be in), and the working party reviews the applicant’s trade regime in detail. The next step is parallel bilateral talks between the applicant and individual countries on tariff rates, specific market access commitments, and other policies with regard to trade in goods and services. The new member’s commitments have to apply equally to all WTO members under normal nondiscrimination rules, even though they are negotiated bilaterally. Once the working party has completed its examination of the applicant’s trade regime, and the parallel bilateral market access negotiations are complete, the working party finalizes the terms of accession. These appear in a report, a draft membership treaty, “protocol of accession,” and lists, “schedules,” of the

11 developing countries (Bolivia, Honduras, Cuba, Mauritius, the Dominican Republic, El Salvador, Guatemala, Uganda, Paraguay, Panama, Djibouti) stating their concern over the lack of transparency, i.e., the “green room” process in the WTO in the context of the preparations for Seattle.

15. Schott quoted in World Trade Organization (2003, 101). To read more about his proposal to remedy the WTO decision-making process, see Schott and Watal (2000).

applicant's commitments. The final package, consisting of the report, protocol, and lists of commitments, is presented to the WTO General Council or the ministerial conference. If a two-thirds majority of WTO members vote in favor, the applicant is free to sign the protocol and to accede to the organization. In many cases, the country's own parliament or legislature has to ratify the agreement before membership is complete.

The WTO Rounds

The first WTO ministerial conference (or round, as conferences are sometimes called) held in Singapore in December 1996 launched exploratory work on four new areas: investment, competition, transparency in government procurement, and trade facilitation. These are now simply referred to as "Singapore issues." The second conference in Geneva in May 1998 took place at a particularly significant time, during commemoration of the 50th anniversary of the establishment of the multilateral trading system.

The third conference in Seattle in December 1999 was a watershed event for any number of wrong reasons. Approximately 50,000 protesters crammed into downtown Seattle, shutting down WTO sessions as overwhelmed police fired tear gas and rubber bullets. Some 600 people were arrested and there was \$3 million in property damage. While the street protests certainly did not help produce an atmosphere conducive to productive negotiations, the Seattle conference was a failure mainly due to a growing rift between the industrialized and developing countries, and because of strong differences within the Quad nations. The United States, the European Union, Japan, and Canada were unable to reach agreement on such substantial issues as agriculture, antidumping, investment and competition policy, trade and the environment, and labor issues. Despite 36 straight hours of negotiations by trade ministers, they were unable to set the agenda for a new round of global trade talks.

Labor issues in particular became a contentious area of disagreement in Seattle between the developed and developing nations.

"The scenes at Seattle . . . gave a sharper edge and clarity than ever before to the poor countries' growing concerns," writes Bhagwati (2004). "After all, at the close of the Uruguay Round, they had already been bamboozled into accepting intellectual property protection into the WTO even though it was clearly not a trade issue and it was equally obvious that it was a dagger aimed at the poor countries. Now, labor issues, framed deliberately so as to aim at them, were sought to be imposed on

the WTO: a bone thrown to the unions in the rich countries but down the gullets of the poor countries.”

The fourth ministerial conference in Doha, Qatar, in November 2001 was the starting point for what came to be called the Doha Round of new trade negotiations. The Doha talks tried to make many issues of specific concern to developing countries central to future trade negotiations. These issues included access of agricultural goods to developed world markets, access for poor countries to pharmaceuticals at affordable prices, and possible financing to help poor nations cover the cost of implementing trade policies. These aims were only expressed in general terms, however, leaving much work to be done at subsequent meetings.

The fifth conference in Cancún, Mexico, in September 2003 started with the aim of reviewing the state of the Doha Round, although in the period between Doha and Cancún there had been little reason for optimism regarding progress with the new negotiations. None of the self-imposed deadlines had been met, and developing countries were more vocal and discontent than ever about the concessions that the developed nations had offered. The EU-US compromise agreement reached just before Cancún exacerbated the dissatisfaction of the developing nations. A last-minute agreement prior to the conference allowing poor countries without manufacturing capacity to import cheap medicines briefly raised hopes for a compromise, but it was not enough.

The failure in Cancún was different from that in Seattle because it was due not to confusion and chaos, but rather to a new and more unified front among major developing countries that denied consensus to the European Union and the United States. Cancún also illustrated the inherent difficulties of decision making by consensus when negotiation involves close to 150 participants.

Finally, in July 2004, WTO members reached agreement (the “Geneva compromise”) that marked progress in the trade negotiations under the heading of a development-oriented Doha Round. However, both the aims of the round and the institutional framework in which it is to take place remain controversial. It is only after the new US administration and the new EU Commission are in place that it will be possible to move forward. Overcoming the difficulties and finding common ground are among the major challenges to better global governance facing the international community.

The sections that follow review the economic arguments and counter-arguments of protagonists on both sides of the trade debate—arguments

that underlie not only the acrimony in recent WTO negotiations, but also the passionate and distinctly different positions on trade and globalization issues.

Economics and the Trade Debate

Theoretical and Empirical Considerations and National Policy Choices

The economics profession in general strongly supports free trade. The classical Ricardian comparative advantage model and the neoclassical Heckscher-Ohlin factor-endowments model laid the foundation for the basic proposition that trade allows a country to augment the utility of the amount of goods it can consume: countries import goods that they can produce with relatively more difficulty in exchange for exporting goods that they can produce more easily. To take an extreme example, if there are two countries, one of which is only able to produce cheese and the other only bread, they would both clearly be better off if they traded with one other and enabled the citizens of both countries to enjoy both bread and cheese. Even if the first country were able to produce some bread, though with difficulty, in addition to easily producing cheese, and the second country could produce some cheese, with difficulty, alongside its easily produced bread, both countries would still be better off importing the more difficultly produced commodity in exchange for exporting the more easily produced one. Moreover, if these two countries constituted the entire world, allowing free trade between them would lead to the best possible global allocation of resources in terms of maximizing the benefits derived by consumers from world production.

Both of these propositions are quite robust in the sense of holding true given a wide range of circumstances, although the “free trade is best” proposition is not as obviously true as the “some trade is good” proposition.

Theoretical complications arise quickly when one asks, for example, whether a country can influence to its own advantage the relative world prices of cheese and bread, i.e., the rate at which cheese is exchanged for bread, with taxes and subsidies. The simple answer is yes, if the country is a big supplier in the world market. But countries must also worry about the reaction of other countries to their attempts to favorably influence prices: if every nation tried to influence prices to its own advantage the end result for all countries might be much worse than if prices were not

manipulated at all. Moreover, most (though not all) countries worldwide are too small to influence global prices.

Questions of income distribution also arise even in the simplest models of distribution effects. It can easily be understood, for example, that if labor is used intensively in the production of cheese in the country that produces cheese with difficulty (perhaps because it has very little labor), allowing importation of cheese from the country that easily produces cheese may reduce the income of labor in the first country because labor will become less valuable in the production process, although the same labor may gain by being able to consume a better combination of bread and cheese. If the first effect outweighs the second, labor in the first country will be worse off.

On the other hand, the owners of land used intensively in the production of bread, the commodity which can be exported and for which there is greater overall demand, will be better off on both counts: their land becomes more valuable in production and they benefit from a more balanced (and more desirable) consumption bundle thanks to international trade. Furthermore, using reasonable assumptions about technology and tastes, it can be shown that the landowners could compensate labor and still accrue a net gain. Thus it is possible for the country in question to gain in the broadest overall sense from opening to trade. Of course, this theoretical ability of landowners to compensate labor means nothing to those who could lose from trade unless the compensation actually occurs. This point is important and quite basic to welfare economics. It is perfectly rational for a group of people who will lose because of a particular policy to oppose that policy, even though the country as a whole may benefit. Using US steel producers as an example, if losses are so concentrated that this group cares very strongly about the issue, while the gains are distributed over a wide number of consumers and other steel-using industries, democratic politics may allow a small minority to block a policy that would ultimately benefit a larger number of people.

Other theoretical considerations have been discussed by economists who analyze the possible benefits and costs of trade, such as arguments having to do with risk. More open trade tends to transfer risk from consumers to producers. As an economy opens to trade and increases specialization in production, producers become more vulnerable to changes in world market conditions. Consumers, on the other hand, face reduced risk because increased imports can compensate for domestic production shortfalls. As in other aspects of life, there is a cost of insurance against

risk. World market conditions may be such, for example, that it would be best for a coffee-producing country to simply produce coffee and not much else. But if for some reason there were to be a dramatic fall in the price of coffee, the country in question would suffer greatly. If it had insured itself by protecting the production of some other items instead of importing everything but coffee, it would be less affected by the coffee collapse. Insurance can take other forms, of course, which may be preferable, such as nations accumulating large reserves while times are good. However, the basic worry about overspecialization due to trade remains, particularly for small economies.

Another set of arguments relates to macroeconomics and unemployment. If for macroeconomic reasons a country does not have the full employment assumed in most trade models, the removal of protectionist policies may lead to greater unemployment rather than to the beneficial reallocation of employment foreseen in trade models, and therefore to welfare losses rather than gains. In other words, in the short run, protection can play the role of a Keynesian effective demand policy that channels demand to domestic producers. It is not a first-best effective demand policy because it has negative side effects, not least indirectly hurting exports by making the imports needed as factors of production for exports more expensive. An exchange rate devaluation would usually have better effective demand stimulating effects. Essentially, then, trade liberalization can in the short run lead to an increase in unemployment.

Economists get quite passionate about the basic proposition that trade is beneficial because the basic economic theorems are quite robust and because antitrade propaganda is so often driven by narrow and purely protectionist interests. Take cotton subsidies in the United States, for example. When a University of California economist documented the harm they did to producers in developing countries, as well as to American taxpayers, the protectionist lobby went so far as to accuse him of treason and argued that if this professor had been in the army he would have been court-martialed (Edward Alden, "Cotton Report Frays the Tempers of US Farmers," *Financial Times*, May 21, 2004, 8).

While it is the blatantly misleading propaganda of the protectionist lobbies that triggers emotional protrade reactions by economists, there also are intellectually valid and honest arguments for some policy interventions that may sometimes restrict trade. Though this book is not a comprehensive survey of the economic literature on trade, it may be useful to briefly review some key points that should be kept in mind when discussing the

problems faced by progressive international governance in the context of trade.¹⁶ The first point to consider is that what happens over time is much more important than what happens in a short period, or, to use more technical economic language, dynamic effects matter more for the welfare of the people concerned than comparative static effects. The famous “welfare triangles” of basic comparative static welfare economics are invariably quite small, except where protection is high initially. These welfare triangles refer to the real income that can be gained thanks to a reallocation of existing factors of production and adjustments in consumption following the removal of policy distortions resulting from trade protection, holding constant technology and the physical productivity of labor and capital. For example, if a country has a comparative advantage in agriculture but a high protective tariff for industry, removal of that tariff will shift resources into agriculture and allow higher real income thanks to the “better” allocation of resources. Through the use of computable general equilibrium models, this underlying analysis has been extended to multisector models that are closer to reality than simple agriculture-industry models, and the results can be quantified.¹⁷ Such static welfare analysis, given plausible values for some key variables—like the degree of substitutability of various factors in production and of goods and services in consumption and the initial degree of protection—invariably comes up with results showing gains of around 1 to 2 percentage points of GDP. As levels of protection have declined over the last three decades, the static gains from moving to free trade have, naturally, also declined, and current estimates are closer to gains of 1 percent of GDP rather than the 2 percent that could have been attained starting from the much more distorted environment of the 1960s and 1970s.

Such static effects, however, are only part of the story in a world where markets do not extend perfectly into the future. If factors of production can only move between sectors gradually, and if some sectors are inherently more conducive to various forms of technical progress than others, it may be advantageous to attract factors into such sectors

16. See Corden (1985, 1992, 1997), Cline (1994, chapter 3), and Stiglitz (2003) for analyses and surveys on international trade that are accessible to the nontechnical reader.

17. For a comprehensive discussion of computable general equilibrium models, see Dervis, de Melo, and Robinson (1982) and also Brown, Deardorff, and Stern (2001). For a recent general equilibrium analysis of trade liberalization and its impact on global welfare, see World Bank (2002), Organization for Economic Cooperation and Development (2003), and Cline (2004).

by policy interventions, even if such interventions distort optimal resource allocation at a given point in time. If technical progress depends on what the economic literature refers to as “learning by doing,” such dynamic effects gain an added dimension if labor acquires skills more rapidly by working in high-tech industries. It may make sense to attract labor (and capital to work with labor) into such sectors by policy interventions, even though, again, these interventions may have real economic costs at any point in time. Finally, a case exists for policy interventions if there are secular trends in the world economy leading to relative price declines for a category of products, such as primary commodities,¹⁸ and if the absence of highly developed, long-term future markets prevents market-based decision making from taking these trends adequately into account in production and investment decisions.

This is the essence of the well-known “infant industry” argument for protection. The cumulative welfare benefits of dynamic effects can be large compared to the invariably modest static welfare effects referred to above, since the latter are “once and for all” effects, whereas dynamic effects can cumulate exponentially. Suppose, for example, that free trade were to lead to a resource allocation that increases GDP by 2 percent. Suppose, on the other hand, that if a particular trade policy intervention remained in effect it would lead to an increase in the average growth of the economy of 0.5 percent per year. After four years, GDP would be larger with “protection” than without, although it should be remembered that in each of the first four years of the period under consideration, citizens would have lost approximately 2 percent of income because of the distortion, and they would continue to miss that 2 percent as long as the distortion remained in place.¹⁹ Nonetheless, as the additional half a percent accumulates exponentially, the dynamic effect ends up more than compensating for the static loss and, as times goes on, the dynamic effect completely dominates the static effect.

18. Primary commodity prices, excluding oil, have declined by 20 to 50 percent relative to the price of manufactures over the last three decades (World Bank 2001a). Some predict that this decline will reverse at least temporarily due to a massive increase in demand for many of these commodities, particularly from the rapidly growing Chinese economy. A similar terms-of-trade loss currently affects producers of low-skilled and labor-intensive manufactured goods.

19. The “once and for all” higher income obtained through free trade will also have a small dynamic effect, as more income leads to more saving and investment. If the marginal savings rate is 20 percent, 2 percent more income could lead to an increase in investment of 0.04 percent of GDP, which would have a small growth effect that must be subtracted from the infant industry effect to obtain the net growth benefit of infant industry protection.

Much needs to be added to this discussion. First, a direct subsidy to the infant industry, if financed by nondistorting taxes, could induce the same dynamic effects without the static costs caused by trade protection. Second, the state might pick losers rather than winners, and if it turns out that the wrong industry is protected, dynamic costs could result rather than benefits. This is a variant of the usual point: while markets do not efficiently extend into the future, there may be public choice failure that is as bad or even worse than market failure. Third, while there may be an initial period with dynamic technology and learning-by-doing benefits, this period could be short, and protection, once established, might be politically difficult to remove. Finally, the entire argument can be and has been turned on its head by those who argue that it is exposure to harsh competition, rather than subsidization or protection, that spurs technical progress, and thus that there is no trade-off between static and dynamic welfare analysis. In fact, increasing evidence shows that openness to trade stimulates total factor productivity growth. Few take the extreme view that the development of a new activity would not be assisted by initial help, but many argue that as soon as the infant becomes a child, protection actually harms development, whereas competition leads to more rapid learning.²⁰ In the end, theory alone cannot settle all of these questions. As Rodrik (2002a) maintains, “The answer (on the link between trade and growth) varies depending on whether the forces of comparative advantage push the economy’s resources in the direction of activities that generate long-run growth (via externalities in research and development, expanding product variety, upgrading, product quality, and so on) or divert from such activities.”

The extent to which trade brings these benefits and the type and degree of policy intervention that maximizes these benefits are empirical questions. It is quite clear from the evidence and stands to reason on *a priori* grounds that autarchy or near autarchy is bad for growth. However, Bird-sall and Hammoudi (2002) have shown in their critique of the Dollar and Kraay (2001) paper on trade, growth, and poverty that some of the sweeping generalizations about the link between increasing openness

20. See Cline (2004) for an up-to-date review of recent evidence on the dynamic effects of trade openness and trade policy. The balance of evidence does not seem to favor the traditional infant industry argument when it is applied to subsectors within industry and services. Nonetheless, it is significant that a free trader such as Martin Wolf (2004, 2006) concludes that “commodities seem to be a bad place for countries to be” and urges nations to encourage diversification. While the world may have entered a new cycle of higher commodity prices in 2003–04, Wolf’s recommendation is likely to remain valid in the long run.

per se and growth are misleading. Dollar and Kraay's category of slow globalizers that failed to grow after 1980 "because they had policies leading to a decline in the trade-to-GDP ratio" essentially was a group of countries dependent on primary commodity exports that faced a steep decline in the terms of trade. The successful globalizers specialized in manufactures and were successful at exporting them. On balance, the evidence suggests that trade policies that have successfully sustained rapid export growth—climbing up the ladder of comparative advantage over time, reaching production of more sophisticated products, and avoiding terms-of-trade losses—have stimulated more investment and greater productivity growth, and in turn more rapid development.

This overall conclusion favorable to protrade policies should not lead one to forget the dimension of the debate that relates to income distribution effects. There may be net gains from trade liberalization for a country as a whole, but not only will there be some who gain much more than others, but some may actually lose while others gain. The Stolper-Samuelson (1941) theorem postulates that trade liberalization will increase the income of the abundant factor. Simply put, the theory suggests that trade liberalization will increase the real wages of unskilled labor in developing countries, where it is the abundant factor, but decrease the real wages of unskilled labor in industrialized countries.

Another important theorem, resulting from the Heckscher-Ohlin model, is factor-price equalization. The implication of this theorem is that, as the prices of goods equalize with free trade, and assuming the same technology is available everywhere, the wages of unskilled workers will converge to a common international level. Thus, in an otherwise static world an absolute decrease would occur in the wages of unskilled workers in industrialized countries. Numerous rigorous theoretical and empirical studies emphasize the restrictive conditions required for the strict validity of this theorem and therefore challenge its practical relevance, but economists agree that trade liberalization one way or another is likely to create some losers, not only because of the broad Stolper-Samuelson factor-price equalization effect, but also simply because capital and labor in formerly protected sectors and subsectors will lose their relative positions with liberalization and may have trouble relocating for a long time.²¹

21. Many factors apart from trade, of course, affect distribution of income, most notably the nature of technical change, but also demography, immigration, and education policies. See Cline (1997) for a review of the literature on trade and income distribution.

*Theoretical and Empirical Considerations
in a Multicountry Setting*

The discussion above examined the advantages and disadvantages of alternative trade policies for a single country, but trade, of course, is a multicountry endeavor where the actions of one country often immediately affect other countries. Moreover, the policies adopted by one country may affect the policies adopted by others.

The first important multicountry issue relates to the potential ability of one nation's policies to affect world prices, i.e., the prices at which they import and export. A country may be a large enough importer of a particular commodity that importing less of it will lower the price of that commodity, leading to a welfare benefit for the importing country. Very large consumers such as the United States, the European Union, or China may be in such a position. Or, as happens more often, a country may be a large enough exporter of a commodity that exporting less will increase the world price and generate a welfare benefit for that country (Saudi Arabia and oil, Turkey and hazelnuts). More generally, while a single country often is too small to have much of an impact on world market conditions, the combined behavior of many small and medium-sized countries will affect world prices.

In its global setting, the trade debate analyzes the reactions of countries to each others' policies and the movement of prices (terms of trade) in response to these different policies, taking into account the effects of these various interactions. Such global general equilibrium analysis is useful for clarifying the issues at stake for the WTO-sponsored multilateral trade negotiations. Reliable quantification is not easy, of course, because it involves estimating degrees of substitutability between all kinds of inputs in the production process and between a multitude of commodities and services in consumption. Moreover, as is the case in a single country setting, the short- and medium-term effects of various policies will have different magnitudes.

Fortunately, there is now a large amount of literature on the quantitative effects of trade policy that uses various partial and general equilibrium models supplemented by econometric analysis of key relationships and substitution elasticities.²² While there is still considerable uncertainty

22. This section draws on several sources. A study by Cline (2004) cosponsored by the Center for Global Development and the Institute for International Economics—and conducted just in time for the beginning of the new Doha Round—provides a comprehensive

about the empirical relationships, some agreement has emerged on the broad orders of magnitude.

To start, it is important to consider the base or initial conditions from which the Doha Round negotiations begin. Industrial country protection against imports of manufactures from other industrial as well as developing countries has been considerably reduced over the past few decades, with the exception of textiles and apparel and selective antidumping measures, mostly in the steel sector. While industrial countries apply only modest average tariffs to manufactures from developing countries (the poorest countries enjoy special privileges), those tariffs are still significantly higher than tariffs on imports from other industrial countries. Estimates are 3.84 percent and 2.25 percent, respectively, for bound tariffs in the United States. The difference is due overwhelmingly to the composition of imports, not to different tariffs applied to different countries, which is not possible under most favored nation practice. The situation is broadly similar in other OECD countries, although Europe and Japan started the Uruguay Round with much higher protection levels. Tariff protection in the European Union remains a little higher than in the United States, while in Japan it is slightly lower. It must be added that average nominal protection is not a reliable indicator of the real protection given to capital and labor in a particular sector of production. What is called effective protection also depends on the structure of tariffs on inputs and outputs. For example, a high input duty on cotton fabric combined with a low tariff on shirts would not really protect the shirt producers. On the contrary, a high duty on imported cotton shirts combined with a low duty on fabric could be highly protective.

Industrial country protection remains substantial in agriculture, services, and the textile and apparel sectors. For textiles and apparel, tariffs are in the 10 to 20 percent range and quotas remain in effect despite the fact that it was agreed at the Uruguay Round that these quotas would be phased out by 2005. The industrial countries have moved very slowly toward eliminating quotas, and there are now worries that they will violate the spirit of the Uruguay agreement by replacing quotas with contingent protection measures (such as safeguards against import surges and

survey of the various estimates and presents the results of the study's own general equilibrium analysis. The World Bank (2002) also provides up-to-date information on the quantitative work conducted over recent years. A report by Stiglitz, Charlton, and the Initiative for Policy Dialogue (2004) prepared for the Commonwealth Secretariat also contains quantitative estimates of the results of various trade policies.

antidumping duties) after 2005. In the United States and the European Union, as of one year prior to the supposed phaseout, the practical importance of quotas remains comparable (and additional) to that of existing tariff protection.

In agriculture, the combination of import tariffs and export and production subsidies amounts to substantial support for advanced country farmers. Tariff protection averages about 9 percent for the United States, 30 percent for the European Union and Canada, and an amazing 76 percent for Japan (Cline 2004, 118, table 3.7). In addition, industrial countries use a multitude of farm subsidies (export, input, and production subsidies, direct income support to farmers, and rural infrastructure subsidies) to protect agriculture. The WTO framework attempts to distinguish between subsidies that directly distort trade, such as export subsidies and direct support to production, and subsidies that do not directly affect amounts produced, such as support for agricultural research or payments delinked from production. The total support for agriculture in the advanced economies, including the effect of tariffs, is in the \$300 billion to \$350 billion range, although only part of that support is directly linked to trade and considered by the WTO to distort trade. The distinction between that which is trade distorting and that which is not is somewhat tenuous, however, because any support for activities that benefit agriculture ultimately leads to a cost advantage for some farmers, although it is true that the chain of causation is much more indirect for infrastructure support and crop research than for export subsidies or price support programs. The upshot is that directly production-oriented subsidies amount to a tariff equivalent of 10 percent for the United States and the European Union, 16 percent for Canada, and only 3 percent for Japan, which relies much more on very high tariff protection as mentioned above.²³ Finally, as is the case in industry, calculating effective protection to producers would have to take into account not just average subsidy and protection rates, but also the dispersion and structure of the agricultural tariffs and other support measures.

To date, services have not been significantly subject to trade liberalization negotiations, so much less empirical work on them is available. Preliminary discussions in the Uruguay Round distinguished between cross-border services (back-office and software services, call centers, etc.),

23. Tariff-equivalent estimates depend on the share of imports in total demand. Subsidies are higher in the European Union than in the United States, but the share of imports is also much higher, so the subsidies apply to a larger base, yielding lower tariff-equivalent figures.

consumption abroad (tourism, medical treatment received abroad), commercial presence (direct establishment of firms abroad), and temporary movement of workers (as opposed to long-term immigration). It is increasingly clear that liberalization of trade in services by the advanced countries, particularly if one includes even modest liberalization in temporary immigration, has the potential for welfare gains perhaps even two to three times larger than gains from liberalization of all the other sectors (Rodrik 2002b).

It should also be noted that their protectionist policies notwithstanding, advanced economies have provided special access to some of the poorest nations. In 2001, the European Union added the “Everything but Arms” initiative to the duty-free access regime that already applied to a large number of products, mainly from African countries. The United States supports the least-developed nations through its Caribbean Basin Initiative, Andean Trade Preference Act, and African Growth and Opportunity Act. Japan also has special access programs for very poor countries.

As beneficial as these programs may be, however, they do not account for a significant proportion of advanced country imports. Even if the programs were broadened to include essentially all imports from a group of 64 very poor countries, they would account for just 4 to 9 percent of wealthy country imports (Cline 2004, 100). Nonetheless, from the point of view of these poor countries, the trade preferences of advanced economies are significant. If there were an immediate move worldwide toward a global free trade regime under which these poorest nations would have to compete with all other countries on equal terms, the least-developed nations could suffer noticeable trade losses.

The extent of protection by developing countries is another dimension of the prevailing conditions at the start of the Doha Round negotiations. By the late 1990s, most developing countries had reduced their protection levels quite rapidly from the high and differentiated tariffs and widespread quantitative restrictions that prevailed through the mid-1980s. Nonetheless, outside of agriculture, developing country tariff protection remains higher than protection in advanced economies. Though average developing nation tariffs in 1997–98 on agriculture, textiles, and other manufactures were 30, 18 and 11.5 percent, respectively, production subsidies for agriculture were much lower than in advanced economies, and consequently the level of protection accorded to agriculture in poor countries is roughly equivalent to that in rich countries (Cline 2004, 100).

Starting from these initial post-Uruguay Round conditions, many authors have attempted to simulate the results of various Doha Round liberalization packages on total income worldwide and the distribution of income both within and across countries. A key distinction in the estimates is between the static (i.e., short-term) effects, holding the total amount of capital and total factor productivity constant, and the dynamic effects, where the total amount of capital and/or technology and productivity changes. Given the number of assumptions one has to make about the nature of key parameters and behavioral relationships—often without being able to base them on solid econometric evidence—the results of the various simulations should be evaluated with caution. Nonetheless, the simulations are useful in providing orders of magnitude and drawing attention to interaction effects that one might miss in more partial forms of analysis. Some of the key points that have emerged from this work are the following:

- The overall static effects of movement to complete liberalization of trade in agriculture and manufactures are no longer very large, with an order of magnitude slightly below 1 percent of world GDP. Developing countries gain a little more in relative terms, about 1.25 percent of their GDP compared to about 0.80 percent for the advanced economies.
- Close to half of these static effect gains can be attributed to liberalization in agriculture. Moreover, more than half of the developing countries' total short-term gains from liberalization would, in fact, be due to liberalization by advanced countries. What others do matters—welfare gains do not depend primarily on what the developing countries do by themselves. The forming of coalitions to press others to act does have a compelling rationale.
- Close to 30 percent of the total short-term gains would be due to liberalization in the textiles and apparel sector, with about two-thirds of the gains going to the developing countries. Workers in these industries in wealthy countries would lose, while consumers would gain, with the consumer gains outweighing the producer losses.
- Careful analysis of changes in the terms of trade is crucial to understanding the results. Agricultural liberalization, including removal of production subsidies, could raise world agricultural prices by about 10 percent. This would benefit countries with a comparative

advantage in agriculture and hurt countries without such an advantage. However, it is incorrect to simplistically define comparative advantage by whether or not a country is a net importer of agricultural products. If a country has an overall trade deficit in which the deficit in nonagricultural goods is higher than the deficit in agricultural goods, it will still benefit from a rise in the price of agricultural goods because such a rise implies a (relative) fall in the price of other goods (Cline 2004, 134).

- Some countries that currently benefit from preferential access to wealthy country markets could lose from complete liberalization of world trade. Mexico, because of NAFTA, is in such a situation. The group of very poor countries that have preferential access to EU and US markets would also lose that advantage in a global free trade scenario. The various simulations show, however, that on the whole the loss of privileged access status would be offset by free access to other developing country markets, as well as by domestic efficiency gains in the poorest countries themselves. Nonetheless, some individual countries could be net losers because of preference erosion.
- Global trade liberalization would have significantly divergent effects on different income groups within the various regions and countries. Global agricultural liberalization, for example, will hurt wealthy country farmers and poor country urban consumers, while benefiting wealthy country consumers, who would be better off despite the higher prices because they would not have to subsidize their own countries' farmers any more. In some sectors, these consumers would also gain from lower world prices for the most protected products such as sugar. Poor country farmers, of course, would also benefit. Liberalization in the textile and apparel sectors would bring widespread gains for consumers in wealthy countries but concentrated losses for some highly protected producers in the OECD countries, sometimes in the most disadvantaged regions within these countries.
- Most simulations do not include liberalization in services. Those that do, suggest that the gains from a comprehensive opening of the services sector, even excluding the temporary migration category, could be two to three times as large as the effects of liberalization in all the other sectors combined. If one were to include temporary migration, the estimates go through the roof because one would be

essentially starting from a very highly protected situation, as evidenced by the very large wage and salary differential between labor of similar quality, as opposed to the much smaller differential that prevails for product prices (Rodrik 2002b).

- When the modelers include dynamic and longer-run effects, the gains from liberalization get multiplied by a factor of two to three. This implies that negative short-term effects on various groups are more than offset by the dynamic gains. The key question concerns the strength of the link between trade liberalization and productivity growth. If one believes that link to be very strong, as implied by the World Bank (2002), trade liberalization would lead to global welfare gains on the order of 2 percent of world GDP over a decade and lift somewhere between 300 million to 400 million people out of poverty. The strength of the empirical link between the pace of productivity increases and trade policies are not based on reliable econometrics, however. There are good reasons to believe that the nature of the link is quite complex and dependent on sector, stage of development, and the overall quality of complementary policies. In some sectors at very early stages of development there might still be a case for infant industry protection. Nonetheless, the weight of existing evidence supports the view that the information sharing, learning, and enhanced competition that comes with greater openness leads to an acceleration of productivity growth, and that if more liberal policies can be sustained politically they will lead to widespread gains, even for groups that might be initial losers in the process of opening.

A Stronger Trade Agenda and the WTO

The *in extremis* agreement reached in Geneva at the end of July 2004 on the broad framework of how to proceed in the Doha Round trade negotiations showed that, despite all the acrimony and doubts during the previous two years, practically all of the official actors recognized that much could be gained from further trade liberalization, and that there are scenarios likely to benefit their principals or constituents. The Geneva agreement is only a broad framework, however, committing the wealthy countries to substantial cuts in support to their agriculture sectors in exchange for commitments by the developing countries to cooperate on efforts to further liberalize trade protection policies across the board.

For the Doha Round to be successful, three main sets of issues deserve particular attention, and a reformed approach is needed to achieve real progress.

First, it must be accepted from the start that most if not all liberalization packages to be discussed and negotiated will lead to winners and losers, both among and within countries. A package might emerge where the world taken as a whole is much better off, but if enough countries perceived as the losers vis-à-vis that particular package try to block the entire deal, they will likely succeed, given the WTO's consensus-based decision rules and the previous successes of such efforts. Similarly, if particular groups within countries stand to lose, they will try to prevent their country delegations from agreeing to proposed deals.

Within the trade negotiations themselves, the deal making essentially aims to compensate those who stand to lose from a particular set of measures by offering other trade measures in return. As mentioned above, the Geneva compromise was based on the developing countries offering the wealthier ones more liberalization in manufactures in exchange for decreased farm subsidies. But the fact that this compensation comes only in the form of trade measures can make compromise difficult. For example, a number of the least-developed countries that already have substantially free access to developed country markets may lose from the combination of reduced agricultural subsidies and manufacturing tariffs. This owes to the fact that they do not have comparative advantage in agriculture, and at the same time already have free access to wealthy country markets for their manufactures. Extending that free access to the middle-income countries is likely to displace some of their exports, and so they may be hurt both as food importers having to buy more expensive food and as exporters of manufactures who would no longer have privileged access to developed country markets.

Similarly, within countries, prospective losers will campaign against an accord, particularly in an environment where employment seems at risk, as reflected in growing concerns over outsourcing in the United States and Europe. As basic welfare economics always stresses, winners actually may have to compensate losers in order to achieve an overall desirable outcome. The question not sufficiently addressed is how to organize this compensation process within a country and across countries.

The second matter critical to success of the Doha Round relates to the interaction between trade and nontrade issues. Some of the policy issues that people care about are intimately and immediately related to trade,

such as customs procedures (trade facilitation). Other issues are connected to trade, but not as immediately, such as public procurement rules and regulations regarding competition and investment. Still other issues such as standards on labor (working hours, minimum wages, child labor laws) and the environment (protection of natural resources, emission controls, biodiversity protection) have even less of a direct link to trade, although regulations in these areas will sometimes significantly affect the composition and direction of trade. Finally, there are the even broader issues of human rights, democracy, and individual freedom, which are part of the international agenda and about which people often care deeply. All of these issues have become part of the trade debate and have inspired some of the protests from Seattle to Cancún and beyond. One could argue that each of these sets of issues should be debated and addressed separately, and that many have only a remote connection to trade as such. On the other hand, in a world of sovereign nation-states, trade is often the only way that the international community or a group of nations can influence what happens inside the borders of an individual nation-state. During the period of apartheid in South Africa, the international community through the United Nations imposed a (partial) trade embargo on South Africa, thereby using trade sanctions as a tool to bring about change. On the other hand, most would agree that it would not be reasonable to impose a trade embargo on a country because it does not sufficiently protect biodiversity. Where does one draw the line? Who bears the burden of particular measures? Did not poor and black South African children bear much of the cost of the trade embargo even though it was designed to help them live in a more just society? What part of the overall burden of desirable socioeconomic policies should the WTO framework have to carry?

These issues need to be discussed and clarified in order to better understand what the WTO framework can and cannot be expected to achieve, who bears what costs, and where protests should be directed so that they can be most effective.

Finally, the third set of issues important to Doha relates to the decision-making rules used in WTO negotiations. WTO decision-making rules are quite unique in that they rely mostly on consensus and include a one nation, one vote principle irrespective of the country's size or weight in the world economy. However, with almost 150 WTO members, the process has become extremely cumbersome. Given these difficulties and what one might call anomalies, it is not surprising that informal procedures have

taken over, with the biggest countries taking the lead in the “green room” process and with various forms of pressure brought to bear on the smaller countries to conform. Somewhat miraculously, this mixture of a formally democratic but unwieldy structure combined with informal but less democratic arrangements has actually produced results. Nonetheless, it must be asked whether a more effective and streamlined decision mechanism could not produce better and more rapid results. In this context, one should also clarify which issues to address and subject to trade negotiations under the WTO umbrella, and which others to take up through different international negotiations under different auspices. Moreover, the question of who should discuss and decide this allocation of issues must also be addressed.

Winners, Losers, and Compensation

One of the characteristic features of the current globalization process is the accelerating nature of change. A corollary is that rapid change creates winners and losers without the latter having much time to adapt, a phenomenon that has contributed to the increasing anxiety about globalization even in the most prosperous economies. Lifelong employment and careers have become less common, and new skills must be learned constantly as the work-a-day world evolves far more rapidly than was the case just decades ago. International trade intensifies competition and the need to rapidly adapt. Economic activities can relocate with greater ease, choosing new bases from which to serve world markets. The freer trade is, the easier it is to relocate without losing the home market. The upside is that this mobility and flexibility bring with them the potential for worldwide improvements in efficiency, reductions in costs, and increases in productivity, which, if fully exploited, could accelerate the growth of the world economy and greatly enhance the potential for poverty reduction.

As regards poverty reduction, however, the emphasis should be on the word “potential,” because not all boats get lifted together. Worse, in the short to medium run, some people may lose significantly from change. According to estimates by Cline (2004) and Stiglitz, Charlton, and the Initiative for Policy Dialogue (2004), poverty in a number of countries would actually increase as a result of the global agricultural liberalization package, at least in the short run. Moreover, in a much larger number of countries, the urban poor would lose because of agricultural trade liberalization. In the longer run, the benefits will trickle down from the winners, and as productivity increases everybody may become better off. The

long run may amount to decades, however. Moreover, if the losers organize, they could well prevent the policy changes from being implemented in the first place. Reforms that could in the long run make everyone better off are often blocked both at the national and international levels. US and European dairy farmers and steel workers have successfully slowed liberalization that would increase overall welfare in their own countries and the world. African cotton producers joined by other constituencies in Cancún in 2003 contributed to blocking the Doha Round, which undoubtedly could increase overall world welfare, because they felt their needs were not met, and indeed that they might suffer negative consequences because of the erosion of preferences that a multilateral liberalization process might entail.

Thus, a basic problem that must be addressed to realize the potential benefits from trade liberalization is to find ways to compensate potential losers. The problem has several dimensions, one of which relates to who those losers actually are. The richer they are, the less attractive it is to have to essentially buy them off. Most cotton and dairy farmers in the developed countries are actually quite well off compared to poor urban slum dwellers in developing countries. It would certainly not be possible to mobilize international resources to buy off these cotton and dairy farmers, so that problem has to be solved at the national level. On the other hand, who should pay out compensation to poor urban slum dwellers in developing countries if they lose out as part of a global agricultural liberalization package that benefits developing country farmers and rich country consumers? Or if the least-developed countries lose out as a result of the erosion of the special preferences they enjoy because of multilateral trade liberalization?

All this suggests that globalization, liberalization, and the speed of technical change greatly augment the need for public resources to finance change. While US presidential candidate John Kerry may have been right in 2004 to express concern about the impact of outsourcing on US workers and job security, what is the reality and what is the solution? Some surveys show that the outsourcing of US jobs has accounted for less than 2 percent of the nation's job losses to date, but many corporate executives share the view that outsourcing may increase and have a far larger impact in the future.

Is the solution to try to slow change that appears inevitable, in turn harming US corporations vis-à-vis those in other nations that might be able to outsource without incurring fiscal penalties, as well as harming US

workers in other industries whose expansion is slowed by protection provided to the older industries? Or is the solution to provide proactive retraining and reinsertion assistance to US workers in sectors that are no longer competitive? Even subsidizing early retirement for workers over a certain age, say 50, may make more sense than protecting jobs that will be dysfunctional in the long run and whose transfer to countries where labor is more abundant fully conforms to principles of comparative advantage.

What criteria should be chosen, however, to determine who gets and who does not get support? How can one ensure that the support provided does not create disincentives for retraining, active job search, and personal effort to adapt to change, particularly as regards young workers? At the national level, the question is how to adapt the proactive, caring welfare state to the needs of the 21st century. This certainly cannot be done by minimizing public resources or the role of the state. As has been noted by Rodrik (1998), globalization actually requires a larger government that can help manage the increases in risk and vulnerability and compensate the losers. At the same time, public policy must not just protect and conserve the old but also facilitate and promote change. The welfare state must be progressive, intelligent in its targeting, selective in its support, and realistic in its ambition. The modern progressive state needs fiscal resources, however. Change does not finance itself.

The problem is greatly complicated by the fact that some of the compensation—and therefore some of the resource deployment required—would be international in nature. Exactly the same principles that apply at the national level apply internationally. To head off a coalition of potential losers from blocking necessary reforms, some resources need to be available to help this coalition overcome its short- to medium-term losses. Sometimes the give-and-take within the trade negotiations themselves may be sufficient to generate an overall balanced compromise. Often, however, trade measures alone may not be enough to bring about a solution where everyone gains. Similarly, a solution restricted to trade measures may constrain potential total welfare gains. A key question, therefore, is how to generate the resources for compensation and how to deploy them in support of a global trade liberalization package. The WTO is not equipped to answer the question or finance the answer. It has neither the authority nor the means to raise these resources, nor would it be equipped to use them. How to address this issue will be revisited later in this chapter in the discussion of governance and decision-making issues that relate to the trade agenda.

Trade and Nontrade Issues and the WTO

In his book entitled *One World*, Peter Singer uses the “tuna-dolphin” dispute as an example of the interaction between trade and other issues in the GATT-WTO framework (Singer 2004, 58–64). As do many other countries, the United States has domestic environmental and animal protection laws and standards. In addition, however, the United States often prohibits the import of goods produced in other countries with processes that would be in violation of US laws and regulations. The US Marine Mammal Protection Act sets standards that apply to tuna fishing boats in areas of the Pacific Ocean where schools of dolphin swim over schools of tuna. If a country cannot prove that it meets these standards, the US government embargoes all imports of fish from that country. A dispute erupted with Mexico when the United States tried to ban US imports of Mexican tuna because Mexico violated US dolphin protection regulations. But the GATT panel arbitrating the dispute found that the United States had no right to use trade sanctions to enforce a production process outside its area of jurisdiction.

The WTO has continued to make the distinction between process—i.e., the way something is produced—and product, i.e., the nature of a good itself. A country cannot apply differential trade policies on identical products just because different processes produce them. The basic principle underlying the distinction relating to environmental issues is that the WTO framework should ensure a level playing field for products of equal quality, but should not be used to further other social or political objectives. If every country were to use trade sanctions to enforce standards that it has adopted by itself for itself, there could be no free and open system of international trade. Environmentalists would like to see the WTO help enforce environmental or animal protection standards by authorizing trade sanctions, not only for offenses related to trade policy, but also for failure to practice certain environmental or animal protection standards that a particular country has decided to adopt.

The same kind of dilemma arises in other domains, with one of the most hotly contested issues relating to labor standards. On one side of this debate are those who argue that the WTO should enforce certain labor standards, including limits on hours worked and the age of workers, as well as guarantees ensuring adequate working conditions and worker rights, by allowing trade sanctions against countries that do not implement these standards. On the other side are those who argue that countries may differ, sometimes greatly, with respect to labor market

situations, and that labor standards, however desirable, should not be a subject of trade negotiations. Many on this side of the debate suspect those who want to enforce labor standards of purely protectionist aims, while those who want to enforce these standards within the WTO framework suspect the others of wanting to further corporate interests and sponsor a worldwide “race to the bottom” to maximize the return to capital without any regard for social concerns.²⁴

Another dimension of the debate on what should and should not be subject to trade negotiations relates to the “Singapore issues” of trade facilitation, public procurement, investment incentives, and regulations and competition policies. It had been agreed at the Singapore ministerial conference in 1996 to put the negotiations on these four issues on the agenda of the next round of trade negotiations. At the end of the Uruguay Round negotiations, many European and American analysts again were calling for broadening and deepening the trade agenda by including the Singapore issues in the next round of negotiations. Frank (1994) summarized the philosophical underpinnings of their position: “What globalization implies, therefore, is the need to extend the horizon of international negotiations from the liberalization of strictly border measures, such as tariffs and quotas, to the coordination of various areas of *domestic* policy that substantially affect the *ability of firms* to conduct their operations worldwide” [emphasis added].

The basic argument for including the Singapore issues is that globalization implies much more integrated production chains, with an increasing role of intrafirm trade, global investment, and production strategies of multinationals. In this new environment, it may not always be easy to distinguish trade from competition policy or public procurement rules, just to cite one example. For the advanced countries, encouraged by the corporate sector, one of the key objectives of the new round was deeper liberalization—a worldwide policy environment supportive of global integration of production chains and favorable to the operations of multinational corporations. Indeed, large corporations were active in influencing the content of the policy agenda. Their first big success was attained by the pharmaceutical industry when the trade-related intellectual property rights (TRIPS) agreement became part of the “single undertaking” agreed upon at the Uruguay Round. Bhagwati (2004, 182) argues that “pharmaceutical and software companies muscled their way into the

24. Elliott and Freeman (2003) examine labor issues and globalization.

WTO and turned it into a royalty-collection agency simply because the WTO can apply trade sanctions.” The advanced countries have since stepped back on the Singapore issues in the face of more organized and coordinated opposition from major developing countries wanting to retain greater flexibility for their industrial and competition policies.

Finally, broader democracy and human rights issues are periodically raised in the context of the WTO. Trade sanctions have been a traditional tool for both national policies (i.e., US trade sanctions against Cuba and Iran) and international policies implemented under a UN umbrella (South Africa, Iraq). Moreover, many civil society organizations and advocacy groups would like the WTO-sponsored negotiations to include human rights and democracy issues in the Doha Round. They argue, for example, that there should be prohibitions against importing natural resources exported by countries ruled by dictatorial elites who appropriate the proceeds for themselves or squander them on arms to keep themselves in power. The argument is similar to that against allowing such countries to acquire burdensome debt, which then needs to be serviced by taxes on the poor and by subsequent generations.

Reviewing these arguments, it becomes quite clear that if all were to become part of the WTO agenda, trade negotiations would have to solve almost every problem in the world. Many of these issues deserve priority attention by the international community, but if they all must be solved as part of the Doha Round, the negotiations will never be completed and the significant gains within reach if a balanced and prodevelopment package can be agreed upon will not be achieved. That said, rules clearly are needed to determine what should and should not be part of multilateral trade negotiations. How to reach agreement on these rules is part of the question as to what would be the most appropriate and legitimate governance mechanisms for trade and the WTO.

Overall Governance of the WTO and Trade

Chapter 4 proposed a new UN Economic and Social Security Council that could decide on the overall allocation of functions in the international economic system. The council should not manage the WTO secretariat or the multilateral trade negotiations any more than it should run the IMF, World Bank, or the United Nations Development Program (UNDP), but it could be entrusted to decide which issues are best handled where. For example, the council could agree to a plan whereby the International Labor Organization (ILO) negotiates a progressive worldwide

strengthening of labor standards, reasonably differentiated according to country circumstances and initial conditions, and with specific targets to be revised every five years.

Few would insist that labor standards be exactly the same in Sweden and in Bangladesh, because imposing Swedish standards on Bangladesh would hurt Bengali workers and their families by creating much higher unemployment. And yet, most would agree that there should be some universal labor standards, graduated by income and labor market conditions and evolving over time. The UN Economic and Social Security Council, working with the ILO and other relevant organizations, would provide the negotiators of the Doha and subsequent rounds of trade negotiations with a basic framework for labor issues. This framework would be given to the trade negotiators, relieving them of the additional burden of having to deal with the labor standards issue while they are negotiating trade measures. A similar logic would apply to environmental or health problems. The UN Economic and Social Security Council, working with such organizations as the World Bank and the World Health Organization as well as NGOs and various global networks, would try to arrive at a sensible framework of rules within which the trade negotiations could proceed.²⁵

The advantage of giving the UN Economic and Social Security Council this role would be twofold. First, the council would have a global, comprehensive, and at the same time bureaucratically impartial perspective, which would help it to fill gaps, organize possible synergies, and promote efficiency. The WTO could concentrate on trade, just as the WHO could concentrate on health, and the ILO on labor issues, while the UN Economic and Social Security Council would deal with the interactions that arise and help streamline the whole process of policy reform.

The UN Economic and Social Security Council could also address the difficult issue of marshaling resources to compensate some of the most deserving losers in any trade agreement. Working with the World Bank, the regional development banks, and the UNDP, the council could help mobilize and support the deployment of resources to facilitate acceptance of compromise solutions to critical trade issues.

25. Issues that are narrowly political or security related—such as the oppression of minorities, gross violations of human rights, or failure to cooperate with efforts to combat international terrorism—would best be handled by the UN Security Council rather than the UN Economic and Social Security Council. Such is the case today for the existing UN Security Council, which handles trade sanctions as applied to such issues.

The second advantage of assigning the UN Economic and Social Security Council overall allocation of functions in the international economic system is that its universal participation by weighted voting governance, as described in chapter 4, would give its proposals and decisions the legitimacy needed for the new system to enjoy broader-based support. Of particular relevance to trade matters, the council would not be a forum where individual countries could easily block compromises acceptable to a great majority of nations. At the same time, the weighted votes would reflect the relative importance of countries and country groupings and could be expected to lead to realistic proposals that take into account the interests and concerns of those with economic power and resources.

By providing the basic terms of reference at the start of trade negotiations—including a framework for debate and a definition of the trade issues to be negotiated—the UN Economic and Social Security Council could protect the negotiations from being captured by various special interest groups and single-issue networks. The WTO process would then take over and deal with the actual negotiations. In some ways, this already happens: the Doha, Cancún, and Geneva meetings attempted over a period of more than two years to define the broad framework for the next round of trade talks. It is not clear whether the Geneva compromise finally succeeded in providing a workable framework, however, and reaching it was time consuming. Moreover, both the coverage and the legitimacy of the proposed framework will inevitably be challenged in various ways. It is quite likely that had a UN Economic and Social Security Council existed, it could have provided a more comprehensive framework more rapidly and with greater support from public opinion and civil society.

Turning to the WTO process itself, decision making has become difficult because of the size, complexity, and all-encompassing nature of the “single undertaking” approach employed during negotiations. With the exception of the “special and differentiated treatment applicable” to a group of developing countries, the “single undertaking” approach requires everyone involved in a comprehensive round of multilateral negotiations to subscribe to and implement policies agreed to in their entirety. This does not preclude the formation of customs unions or free trade agreements among willing coalitions, provided that they do not result in increased protection against imports from third countries compared to the situation before these regional trade agreements were formed. There is scope for enhanced cooperation, to borrow a term from

the European Union, among subgroups of WTO members. But these groups must nevertheless conform to the “single undertaking,” although they are free to go further in terms of freer trade among themselves.

Even within a framework supported by a UN Economic and Social Security Council, the world’s trade system would still involve complex and technical negotiations conducted among some 150 countries, each impacted differently by any particular issue. Even with such a complex negotiating process, however, the essentially consensus-based nature of the WTO rules should be preserved. In practice, the consensus rule does not really allow any one country or small group of countries to block progress in a totally capricious way. There would be too much peer pressure on such an outlier or outliers, and the majority could impose serious costs on countries if they were to play a purely obstructionist role. At the same time, the single undertaking rule and nonplurilateral nature of WTO negotiations give developing countries leverage to negotiate with much more powerful counterparts such as the United States or the European Union—as they have shown over the past two years. This has allowed for the formation of developing-country coalitions that have been effective in forcing the developed countries to revise their positions and shift to a more development friendly stance in negotiations.

Without giving up the consensus rule for actual decision making, it would be beneficial to introduce more transparency and formality into the “green room” process by which countries currently reach informal agreements. This could be accomplished by requiring some objective criteria to determine participation in green room sessions based on comprehensive geographic representation, volume of trade, and the relevance of a particular issue under discussion to a specific group of countries.

Schott and Watal (2000) propose that the WTO “establish a small, informal steering committee (20 or so in number) that can be delegated responsibility for developing consensus on trade issues among the member countries. Such a group would not undercut existing WTO rights and obligations or the rule of decision making by consensus.” Schott and Watal do not advocate proportional or weighted voting. “Each member would maintain the ultimate decision to accept or reject such pacts. Participation should be representative of the broader membership, and be based on clear, simple, and objective criteria: absolute value of foreign trade (exports and imports of goods and services), ranked by country or common customs region; and global geographic representation, with at least two participants from all major regions.”

In conclusion, a package of reforms including the following would go a long way toward building much greater support for further trade liberalization of a kind that benefits the greatest number:

- a high-level oversight role for the UN Economic and Social Security Council,
- appointment of the WTO director by that council according to transparent criteria,
- assigning of important nontrade environmental and social issues during trade negotiations to other agencies in consultation with global civil society and stakeholders (with time-bound follow-up),
- greater priority to liberalization in the service sector including facilitation of temporary migration,
- mobilization of resources to compensate relatively low-income groups that stand to lose from liberalization or that face substantial adjustment costs, and
- streamlining and increased transparency in the WTO processes themselves.

Such reforms would channel the energies unleashed by the passion for greater justice and equity into efforts that can produce real results for the billions of people who stand to benefit from progress toward more and freer trade worldwide.