

A RADICAL AGENDA FOR THE MILLENNIUM ROUND

FREDRIK ERIXON



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EXECUTIVE SUMMARY

In the new Millennium Round, starting off in Doha, the guiding policy should be:

- ▶ Instead of using tariffs as a method of sanction in disputes settlements, countries who have violated the rules should compensate offended countries by lowering the trade barriers. This compensatory sanctions policy should not be optional, it should be mandatory. Accordingly, trade sanctions in the form of tariffs or non-tariff barriers should be completely banished from the Dispute Settlement Mechanism (DSM)
- ▶ Anti-dumping codes are too unspecific and will have to be changed. At present there are too many abuses of the principle of free trade, committed in the name of anti-dumping. Such measures should only be allowed when market-distorting practices such as export subsidies have clearly been used.
- ▶ Limit the new Millennium Round to three years and indicate in the agreement how further negotiations will proceed in the next round – which areas are to be discussed, what the overall targets are to be and so on.
- ▶ A new agreement on agriculture should result from the new Millennium Round. The guiding policy should be: All export subsidies, export credits included, to be abolished immediately, with no exception. Production subsidies to be phased out over a five-year period. The “green box” exception to be narrowed down, so that it cannot be used to subsidise production. The “blue box” exceptions to be abolished immediately. Agricultural tariffs to be cut on average by half inside three years, and tariff peaks to be reduced even more. A procedure to be outlined whereby a new round will continue the process of agricultural trade liberalisation and drawing up a mandatory programme to eliminate agricultural tariffs within a ten-year period.
- ▶ A new agreement on trade in services (GATS) must increase the transparency of the non-tariff trade barriers in the service sector. Similar to earlier improvements of the GATT, the agreement on trade in services has to be complemented with more specific rules on the discriminatory policies that government regulation by nature apply. Moreover, the GATS should be complemented by an extended “positive” list and a “negative” list. The negative list should specify which sectors are not covered by

commitments. A negative list can, in the long run, contribute to trade liberalisation since governments may be embarrassed by a long list of sectoral exceptions. More important, such a list implies that development of new services would be subject to established discipline.

- ▶ Many of the tariff cuts negotiated during the Uruguay Round have yet to be fully implemented. The first step in a new round must be to speed-up the process, especially the phase-in of textiles and clothing. Other efforts should also be made. All tariffs below 5 per cent should be abolished within 5 years. All tariffs higher than 5 per cent, approximately 10 per cent of all tariffs in the US and the EU on manufactured goods, should immediately be reduced to 5 per cent. This reform should be combined with a 10 year phase-out plan for all tariffs on manufactured goods. This leaves plenty of time for the rich countries to adjust their tariff-protected industry to a new situation. The tariffs on textile and clothing should be acknowledged as an important reform area, and the ATC should be renegotiated in order to reach zero tariffs within five years. Developing countries protecting their industries with high tariffs should take part in this complete reform and can, if needed, be given an extended reform period.
- ▶ TRIPS confuses the WTO. Time and resources have to be spent on an issue that is not primarily a trade matter. The purpose of the WTO is to dismantle protectionism by cutting trade barriers. This should also be the only mission of the WTO. Hence, in the next round, member countries should end the TRIPS agreement.
- ▶ The WTO should focus on supporting the efforts of governments to lower trade barriers. This is the main purpose of the WTO. Labour and environmental regulations are internal matters, which should be left to individual countries to determine. The WTO has an important role in the international community, but that role should be restricted. The role of the WTO should be limited to abolish trade barriers.

PREFACE

In the matter of trade negotiations, ought one to be an optimist or a pessimist?

International trade talks are a peculiar phenomenon. Trade representatives from different countries have armed themselves with strategic and tactical arguments. They have travelled all over the globe – if they come from an affluent country – to investigate the position of other countries. They have presented their agenda – what they can accept and what they will not accept under any circumstances. Though if the pressure gets too high they may perhaps modify their positions.

Few of these delegates, however, speak about the most important aspect of the negotiations, namely which barriers to trade ought to be abolished and how the scope of free trade can be extended. Stranger still, few of them seem to understand the economic reasons and aspects of the trade meeting. In almost Orwellian vein they speak of “concessions” to other countries when they agree to lower the trade barriers. The ultimate solution seems to be for other countries to open up their markets for foreign competition while their own tariffs and non-tariff barriers remain *in situ*.

Frédéric Bastiat, a famous French economist of the 19th century, saw through this thinking and compared it to throwing blocks of stone into our ports if other countries have coastlines with big rocks that hinder our ships from entering a harbour. The British economist Joan Robinson used almost the same words when she spoke of the current principles of many trade negotiations being “if you throw rocks into your port, we’ll throw bricks into ours”. This, in fact, is what it is all about. In the long term, a country benefits economically from lowering its trade barriers, regardless of the trade policy behaviour of others. Of course this means tougher competition for home businesses, but that is a good thing. Consumers will be better off as a result of rising competition and productivity lowering the cost of the products they buy. In the long run too, your own businesses will be more competitive, while protectionist countries will see their business communities losing strength and creating fewer returns for consumers.

In other words, our trade representatives are negotiating about which benefits we should not be given.

225 years after the publication of Adam Smith's masterpiece *The Wealth of Nations*, which demolished the theoretical foundations of mercantilism, our

trade representatives are negotiating in a mercantilist spirit and creating an economic and political environment which tells people: trade is good, but imports are bad.

That is the point of departure for present-day trade negotiations. And, in two respects, it is also the starting point of this study of the World Trade Organization and the new trade meeting in Doha. Firstly, this report is based on a solid belief in free trade and its proven benefits for the economy and society in general. Secondly, the environment in the current discussion regarding free trade and the prospects of a new round in the WTO tells us that the decisions most obvious to the friends of free trade cannot possibly be realised. The Doha meeting will not be a huge success for world trade, because the various members are uninterested in widening the scope of the principles and policies of free trade. What this study offers, therefore, is not the optimum agenda for the Millennium Round, perhaps not even the second best agenda. But, in the light of current positions, it is a radical agenda.

The outlines and propositions in this study are based on the setback in Seattle and the progress of trade talks after that WTO meeting in November 1999. But it has also been inspired by the outcomes of the Uruguay Round in the mid-nineties and the explicit aim – declared not least by the WTO and its Director-General Mike Moore – of making the new Millennium Round a success for developing countries.

In other words, this study suggests ways of abating the spirit of mercantilism which still fetters world trade and the freedom of people to trade with people in other parts of the world.

Where trade talks are concerned, pessimism, or even cynicism, comes easily. Few fields of politics in the course of history have equalled trade policy in proving the applicability of public choice aspects and a rent-seeing perspective. Vested interests with huge resources, allied to ruling parties, have always been a major obstacle to the development of trade agreements. The situation today is no exception. Trade unions and farm lobbies realise that new agreements may put an end to the privileges which protectionist policies have accorded them.

In spite of vested interests and lobbying groups, trade agreements have been signed in the course of history, and recently we have seen almost an explosion of new, preferential trade agreements. Studying developments since the end of the Second World War, we clearly perceive a pattern of piecemeal de-

construction of protectionist policies. There can be no doubt that world trade has gradually become more open. This inspires some optimism about the future of further trade talks and the possibility of multilateral trade agreements extending the principles of free trade to all areas. True, the Seattle meeting was a setback. But it is also true that the Uruguay Round was essentially a great success. The future of trade policy in general is also looking bright, thanks to technological improvements and the growing importance of free capital markets.

Even though many reports speak of a new backlash in Doha, the Millennium Round is not doomed from the outset. The American economist Paul Krugman has criticised the US trade representative Robert Zoellick for using the horrible events in New York and Washington last September to enliven the talks preceding the Doha meeting. Zoellick, however, seems to have done the right thing. All over the world, people are now talking about the importance of a new round. Those politicians who are a kind of spokespersons for protectionism have maintained almost complete silence since 11th September, and it is more difficult today to argue the case of a political régime which does not take part in the process of lowering the barriers between people in different countries and continents. World trade and people in every part of the world, poor as well as rich, would benefit if things were to carry on that way.

Stockholm, October 2001

Fredrik Erixon

INTRODUCTION

In many ways, the World Trade Organization (WTO) resembles the splitting of the atom.¹ Both have a potential for production and destruction. This makes a good descriptive metaphor of the WTO, because that organization is no more than its members make it. Of course, the WTO has institutions for settling disputes and developing the scope of free trade, and every new member has to accept its regulations, but the actual working of the institutions depends entirely on how the member countries behave. The institutions also afford scope for increasing protectionism, with every member able to resort to anti-dumping measures and the dispute settlement mechanism (DSM) entitling a discriminated country to introduce a new tariff in the same range as the first country.

Both these examples, and many more besides, describe the scope of a potentially destructive use of the WTO.

The potential for production, on the other hand, lies in the WTO offering the tools for a multilateral reduction of trade barriers. Then again, the benefits of free trade are all the greater in an organization which includes nearly every country in the world. Increased use of the division of labour, which was already outlined by Adam Smith, has contributed significantly to world economic growth. Since 1950, world trade has been growing at a rate of about six per cent annually, and output during the same period has risen by about four per cent annually.² In other words, and perhaps needless to say, the gradual growth of world trade has stimulated both the business cycle and an increasingly efficient use of resources.

The WTO is not only a natural part of the world trade system today, it is also a desirable part. In the light of trade theory as expounded in standard textbooks of international economics, support for the WTO can be hard to find. But the world does not work in the way which these textbook models describe, and it is almost impossible to find a politician who favours the unilateralism which is clearly the best principle of trade policy. The world is not perfect. That is the simple argument for the WTO. In a world of trade barriers and trade conflicts, there is an obvious mission for an organization that offers methods for solving disputes and which devotes time and resources to trying to avoid them for the future. An organization which also tries to achieve new agreements expanding the scope of free trade is again supremely desirable.

In the Uruguay Round the member countries decided to meet again for further trade talks, especially on agriculture, at the end of 1999. This meeting was held in Seattle at the end of November and will not go down in the history of successful trade negotiations. It did not result in any further agreements on tearing down trade barriers in the agricultural sector. It resulted in nothing at all. Instead Seattle will be remembered as the first meeting where demonstrations against globalisation degenerated into street riots.

It would be wrong to say that many countries rejoiced in the street riots and the collapse of the meeting, but many with no interest in further trade negotiations found a good excuse in these events. Even before the meeting one could see why it was not going to succeed. The preparations were not of the best. The US President at the time, Bill Clinton, had failed to get Congress to extend the fast track authority needed for an agreement signed by the President not to be subject to changes when put through Congress. The latter has the option of rejecting the agreement, but it cannot make any changes if the President has been given fast track authority. Coming to Seattle as he did without this authority, Clinton could not argue and negotiate with the credibility that is needed in the eyes of other countries. Basically a friend of free trade, with the USA heading for elections the following year, he was also obliged to argue for social clauses in trade agreements. The Democrats wanted trade union support, and they are far more protectionist than their European counterparts. In particular, trade unions in the highly protected, government-supported steel industry had devoted a lot of resources to obstructing the Seattle meeting.³

The European Union was also uninterested in further trade talks. New negotiations would, by definition, put further pressure on its protectionist agricultural policy. The agreement on agriculture was the major achievement at the Uruguay Round. For the first time the GATT, precursor of the WTO, made agriculture a systematic part of trade agreements. The outcome was admittedly meagre, but in the Uruguay Round it was pointed out that further talks aimed at narrowing protectionist policies should be held in the near future. At the time of the Seattle meeting, however, the European Union, with its Common Agricultural Policy (CAP), a masterpiece of protectionism and one of the few policy areas where today you can still study the principles of socialist planning, had not met its obligations under the Uruguay Round and did not want to go any further in the process of abolishing barriers to agricultural trade, not to mention its resistance to the reduction of export subsidies and production subsidies. This is not to

say that EU politicians consider the CAP a strong policy, but they acknowledge the political cost of a policy opening up the EU market to foreign producers. The farm lobbies of the EU are one of the most efficient of rent-seeking agencies, and in times of policy modification the farmers have effectively dug their heels in.

Other countries also showed a lack of interest. Japan has never been a front-runner for multilateral trade agreements, least of all in agriculture, and several developing countries were unwilling to discuss the topics which the affluent ones wanted to address at the Seattle talks. More specifically, the developing countries were critical of the Uruguay Round agreement on intellectual property rights (TRIPS) and of the reported concern of the rich countries with investment-related and environmental issues.

There have in fact been no major modifications to national policies since the setback in Seattle. The US, of course, has a new administration which, on the whole, favours free trade. But major concerns regarding the frequent use of anti-dumping measures and the protection of the steel industry and specific parts of agricultural production still put the US in the same corner as the EU.

In the EU as well, the status quo prevails. The trade policy which hampered trade negotiations in Seattle still stands. Social and environmental clauses, an agreement on investment and competition issues and strong opposition to agricultural deregulation are still the policy. Since Seattle, though, the EU has taken the initiative of abolishing tariffs on all products but arms from the world's 49 least developed countries. This "everything but arms" (EBA) initiative was launched last autumn by the European Commission but did not survive unchanged. Opposition from farm producers led to the exclusion of rice, sugar and bananas from the original proposition. These products are also the major export commodities of the countries concerned and in fact the only products in which they are competitive. So the EBA agreement made little difference to the 49 poorest countries.

These modifications have led to some speculation regarding the true reasons for the unexpected initiative. Some argue that it was intended to improve the EU's authority in the Doha trade talks. Pressure on the EU from other countries, especially developing countries and the Cairns group, to lower its trade barriers has united fewer countries following the EBA agreement. And the EU can show evidence that changes have at least begun. The EBA agreement, in other words, is a holding tactic with few if any effects on EU

farmers. Whether this is true or not, it would not be the first time in the history of trade negotiations that this strategy has been employed.

There are also many countries arguing for a new trade agreement which would move the goal posts for the CAP. The Cairns group, founded in 1986 by 14 agricultural exporting countries, wants to see major achievements, and especially so Brazil, which regards agriculture as the sole topic that ought to be addressed by the Doha meeting.

India, an important player in the WTO, is the leading advocate of modifications to the TRIPS. As a country of generic products, India is not fond of the protection of intellectual property rights in the WTO and wants the applicability of the clause providing scope for generic production in times of social crisis to be extended. On the subject of clauses, none of the developing countries agrees with the EU that social clauses should be included in the WTO.

Briefly, then, these are the policies which will create difficulties in Doha. It is hard to say whether the differences between countries will make it impossible to sign a new agreement. There is no prospect of a successful round in which all these topics can be addressed and compromises reached. But perhaps the different countries can get together in a small round with only a few issues to be discussed.

This study should not be taken as a forecast of the likely outcome of the Doha meeting, but as an analysis of how the round should proceed and what topics should be addressed for change. The analysis rests on a firm belief in free trade and is aimed at suggesting changes which can liberalise world trade and strengthen the WTO. Of course, the current trade policy situation has to be taken into consideration, and so we must be rather careful in making suggestions for “danger areas” like agriculture and the protection of intellectual property rights. This, however, does not mean that we should be passive in the face of opposition and tone down our arguments on account of fierce resistance by protectionist groups. On the contrary, this means that we have to make our case even stronger and deal more thoroughly with the basis of the opposition. The most efficient way of doing that is by suggesting a radical gender which allows no scope for the fallacies in the argument for protectionism.

In this study, therefore, we will closely consider the new protectionist argument as well as the old one and study the effects they will have on world

trade and development if realised. First, though, we are going to discuss the development of trade and trade agreements over the past fifty years and study some possible threats to the future efficiency of the WTO. At the end of each chapter you will find conclusions and proposals regarding the policies which should be included in a new Doha Round, the so-called Millennium Round.

WORLD TRADE AND TRADE AGREEMENTS

THE DEVELOPMENT OF WORLD TRADE

Trade patterns and trade strategies have varied substantially over time. Until the nineteenth century, prosperity through trade usually involved a considerable element of beggar-your-neighbour. The limited size of the world market encouraged entrepreneurs and merchants to rely on the small domestic markets and to protect themselves from foreign competition. Trade with other countries also rather resembled a zero-sum game, with prosperous countries often making their fortunes at the expense of ousted or vanquished rivals.

Since 1820, however, trade has accelerated and grown significantly faster than output. Estimates of the growth of world trade and GDP show that since 1820, trade has on average been growing by about 4 per cent a year and output by 2.7 per cent.⁴ This trade development has greatly improved resource allocation and productivity by better specialisation and economies of scale, but the impact has varied over time.

After the end of the Napoleonic wars, trade became an essential part of the re-opened international economy. The growth of trade was an important stimulus to general economic growth and created a relatively liberal pre-war era with a significant trend towards globalisation of both trade and finance. The average growth rate of trade in the countries that today are members of the OECD, as can be seen from table 1, was 3.9 per cent between 1870 and 1913. Without Japan, the average growth rate would barely have exceeded 3 per cent.

The major upward shift in the volume of world trade, based on a solid trend in many countries, comes after the end of the Second World War. In a trade perspective, the inter-war years were lost years. Economic crisis and financial instability in the twenties and the beginning of the thirties spawned protectionism and profoundly autarkic policies all over the world. The Great Depression, it was widely argued, exposed the flaws in a liberal trade régime, and instead of a policy favouring greater trade openness, government should try to mend international trade. This is what actually happened. Discriminatory policies, high tariffs, quantitative restrictions and exchange controls were among the autarkic measures introduced by governments in the Western world. Needless to say, in some Western countries, this autarkic development engendered firm belief, not only in trade protectionism but also in fascism and nazism. As a result of these new policies,

trade grew marginally, at only half the pace of output between 1913 and 1950.

Table 1: Volume of Exports 1820–1989 (Annual Average Compound Growth Rates)

	1820– 1870	1870– 1913	1913– 1950	1950– 1973	1973– 1989	1870– 1989
Australia		4.8	1.3	5.8	4.5	3.8
Austria	4.7	3.5	-3.0	10.8	6.1	3.7
Belgium	5.4	4.2	0.3	9.4	4.4	3.9
Canada		4.1	3.1	7.0	4.8	4.4
Denmark	1.9	3.3	2.4	6.9	4.7	4.0
Finland		3.9	1.9	7.2	3.4	3.8
France	4.0	2.8	1.1	8.2	4.6	3.5
Germany	4.8	4.1	-2.8	12.4	4.7	3.5
Italy	3.4	2.2	0.6	11.7	4.9	3.8
Japan		8.5	2.0	15.4	6.8	7.5
Netherlands	2.3	1.5	10.3	3.6	3.7	
Norway		3.2	2.7	7.3	6.7	4.3
Sweden		3.1	2.8	7.0	3.1	3.7
Switzerland	4.1	3.9	0.3	8.1	3.8	3.6
UK	4.9	2.8	0.0	3.9	3.9	2.3
US	4.7	4.9	2.2	6.3	4.7	4.3
Arithmetic average	4.2	3.9	1.0	8.6	4.7	4.0

Source: Angus Maddison, *Dynamic Forces in Capitalist Development*.

After the end of the Second World War, several attempts were made to restore the pre-war liberal trade régime. Some of them actually succeeded. Quantitative restrictions on non-agricultural products were dropped in the fifties, and successive multilateral negotiations in the GATT reduced tariffs between the member countries. When this new policy took root, international trade accelerated. In European countries as well as in Japan, trade growth averaged up to 10–15 per cent from 1950 to 1973. As exhibit 1 shows, trade grew fastest in the latter part of this period.

Studying trade history from our vantage point, this period marks a major shift in the use of protectionist trade strategies. The establishment of institutional arrangements to guarantee continuation of a liberal economic order

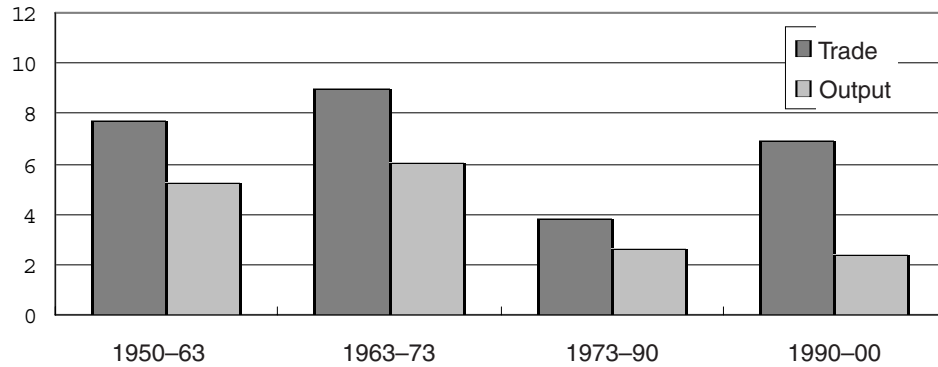
helped substantially to create a climate conducive to high rates of investment. Earlier arguments against a policy of trade openness often reflected a fear of future wars and relied heavily on the policy of self-sufficiency. Trade integration, many people argued, might make us better off, but it also narrowed our freedom of action in times of crisis, making us too dependent on others.

The notion of self-sufficiency lives on, but it is no longer perceived as a real option, nor even as a desirable alternative. The policy of trade openness in the early post-war decades changed the policy agenda in trade matters. For the first time in modern history, many European countries started to come together in a policy of division of labour. After a while, countries were not only better off, but could also rely on the solidity of this policy model. Foreign direct investment took off and countries in the Western hemisphere became closely integrated, politically as well as economically. The Treaty of Rome in 1957, laying the constitutional foundations of the European Community (EC), ushered in a new political era.

At the beginning of 1970, to continue our study of trade statistics, there came a significant slow-down in trade growth. At this point in time, general economic growth also started to fall. In Europe, several countries experienced a deep recession and a collapse of their fiscal and financial policies. Competition from newly industrialised countries (NICs) in the Far East forced many countries into a thorough rationalisation of government support to businesses and a re-think of Keynesian economic policies. New EC treaties from the mid-1980s onwards revitalised European trade development. The Single Market brought better institutional arrangements and a safer environment for entrepreneurs and investors with interests in trade. At national level, the argument of self-sufficiency became still more discredited, and the basic principles of a market economy, expounded by Adam Smith and David Ricardo, could now perform better than ever.

In 1986 a new round of the GATT was started. Known as the Uruguay Round, it did not end until the mid-1990s, but it brought a substantial liberalisation of trade. Still more importantly, in the Uruguay Round the GATT member countries decided to improve the institutional setting of the multilateral trade community. Thus, if a trade dispute occurs today, the WTO offers an enhanced dispute settlement mechanism which has profoundly affected world trade.

Exhibit 1: Average Annual Growth (%) in World Merchandise Trade and Output



Source: WTO, *International Trade Statistics 2000*.

Institutional improvements, coupled with a general fall in transaction costs, gave trade growth an upward turn. During the nineties, as exhibit 1 shows, the average annual growth of trade was about 7 per cent. New statistics from the WTO show that this development continued into the new millennium. With a growth of world commodity trade at 12 per cent, year 2000 was one of the best ever in trade history. The same statistics, however, indicate a sharp decline in merchandise trade growth in the first quarters of 2001, and growth this year is expected to be only 2 per cent.⁵ The economic slow-down in the Americas and the continuing recession in several EU countries, combined with a general uncertainty after the terror attacks in New York and Washington, DC, are the main reasons for this deceleration of trade growth.

This brief sketch of modern trade history can be accused of being somewhat West-centred, or even Eurocentric. Modern trade history, of course, is not only about the Western countries, but trade statistics tell us that, until the 1960s and 1970s, international trade was almost an inter-European issue.⁶ Since then, several Asian countries have become industrialised and are now important players in the international trade community. Japan's development induced other Asian countries to abandon an autarkic economic policy with high trade barriers. Countries like Korea and Taiwan followed the Japanese model and became important exporters of manufactured goods. Singapore, Thailand and some of their neighbours in Southeast Asia waited a little bit longer, but in the mid-1980s these countries adopted a general outward policy which spurred exports. This new policy

profoundly improved the welfare of their citizens, and today they are fully integrated in the world economy.⁷ With China becoming a member of the WTO next year, the importance of Asia, as well as the volume of trade between Asia and other continents, will literally sky-rocket.

In spite of this development, trade between countries is still mainly about trade between neighbours, or at least between countries located on the same continent. As table 2 shows, cross-border imports in Western Europe mainly come from countries in Western Europe. In relative terms, intra-Western Europe imports declined during the 1990s, but their share of total imports remains almost 63 per cent. Meanwhile, Asian exports to Western Europe increased. The Asian share of imports in Western Europe was more than 2 per cent higher at the end of the nineties than it had been at the beginning of the decade. The rising importance of Asian imports to Western Europe is due not least to the increasing contribution to world trade by China.

Table 2: Western European Merchandise Imports by Origin, 1999
(bn USD and %)

	Value	Share of imports		Annual percentage change			
	1999	1990	1999	1990-99	1997	1998	1999
Intra-Western Europe							
Europe	1634	69.0	67.6	4	-2	6	0
<i>EU (15)</i>	1514	63.2	62.6	4	-2	6	0
Asia	296	10.0	12.2	6	4	8	3
<i>China</i>	52	0.8	2.2	15	11	11	11
North America	204	8.2	8.4	4	6	5	-1
<i>United States</i>	186	7.3	7.7	5	10	5	-1
C/E Europe/ Baltic states	122	3.6	5.0	8	5	5	10
Africa	65	3.9	2.7	0	-5	-8	5
Latin America	46	2.3	1.9	2	2	0	0
Middle East	36	2.3	1.5	-1	-1	-11	9
Inter-regional trade	768	30.3	31.8	5	4	4	3
World	2418	100.0	100.0	4	0	6	1

Source: WTO, *International Trade Statistics 2000*.

Table 3 presents a similar pattern to that of Western European imports, but this time we are studying Asian exports. Regional trade still accounts for the biggest share of total exports, and that share actually increased between

1990 and 1999. The sharp decline of exports in 1998 can be put down to the Asian crisis which was triggered in Thailand at the beginning of July 1997. One consequence of this financial turmoil was rising barriers to trade.

Table 3: Merchandise Export of Asia by Destination, 1999
(bn USD and %)

	Value	Share of Imports		Annual percentage change			
	1999	1990	1999	1990–99	1997	1998	1999
Intra-Asia	649.6	42.1	46.6	9	2	-17	12
North America	366.6	28.3	26.3	6	9	3	8
Western Europe	251.6	20.0	18.1	6	9	8	1
Middle East	36.9	2.9	2.6	6	6	9	-7
Latin America	34.6	1.8	2.5	11	22	4	-8
Africa	21.3	1.5	1.5	8	6	5	0
C/E Europe/ Baltic states	12.8	1.9	0.9	-1	11	-9	-13
Inter-regional trade	723.8	56.4	51.9	6	9	5	3
World	1393.6	100.0	100.0	7	5	-6	8

Source: WTO, International Trade Statistics 2000.

There are several reasons why trade is mainly a business between countries on the same continent. First of all, freight costs remain high, even though they have gradually declined since 1950. In other words, transactional costs continues to be an obstacle to foreign trade. Tariffs and non-tariff trade barriers, of course, are another reason for the regional pattern of trade. Even if production in one part of the world is more cost-efficient than in other parts, tariffs impede consumers from buying cheaper products from other countries. Unfortunately, the principle of comparative advantage, as originally stated by David Ricardo and later developed by Eli Heckscher and Bertil Ohlin, has yet to leave a clear imprint on the world economy.

However, agreements on free trade between countries have grown in number during recent decades, and today we are witnessing several regional trade agreements – aka preferential trade agreements – all over the world. The customs union of the EU is probably the most significant of them all. Naturally, there are essential differences between the regional agreements, but they all share the common purpose of dismantling trade barriers between member countries. None of these agreements has abolished all

barriers to trade, but tariffs – the profoundest expression of protectionism – have definitely declined.

Trade agreements can also be signed multilaterally, as in the WTO, but developments in recent years suggest that regional trade agreements are more popular. The growth in the strength and number of regional trade agreements has affected the pattern of world trade. Without them, perhaps we would have seen more in the way of truly global trade, and less of the regional variety. Or, to speculate still further, perhaps we would not have seen any substantial growth of world trade at all.

WTO OR PTA?

There are many ways of drawing up a trade agreement. It can be an agreement between just two countries – a bilateral agreement – or else between several countries, a plurilateral agreement. When nearly all the countries in the world sign an agreement, it becomes a multilateral agreement. In terms of trade strategies, one can also speak of a unilateral approach, meaning that a country decides its policy regardless of the policies of other countries. For example, one unilateral strategy of trade policy can be to eliminate trade barriers even though other countries retain them. Estonia since the collapse of the communist régime has adopted a unilateral trade policy.

The only multilateral trade agreement in the world today is the World Trade Organization (WTO). This was created in 1995, succeeding the GATT, General Agreement on Tariffs and Trade, which was founded in Geneva in 1947. The first treaty was signed by 23 countries, and the number has expanded since then. When China joins the WTO at the beginning of next year, it will be member number 143.

The first agreement mainly focused on industrial products, but since then the organization has extended its jurisdiction to services (GATS, General Agreement on Trade and Services) and agriculture (URAA, Uruguay Round Agreement on Agriculture).

The WTO is a slow-moving organisation which requires unanimous consent for new agreements. For this and other reasons, the development of trade agreements in the post-war era has mainly featured bilateral trade agreements and regional trade agreements, otherwise known as Preferential Trade Agreements (PTA). Studying the later post-war years, we can clearly perceive a growth in the importance of PTAs. The EU single market is a typical regional trade agreement. Using the explicit option of the original

GATT treaty to sign agreements discriminatory to other countries, EU member states have reduced several trade barriers within the community and agreed on a common policy towards other countries. This customs union is quite unique, but confining our attention to co-operation aimed at the mutual abolition of trade barriers, we find it to be a common feature of trade policy. In North America we have Nafta, soon to be converted into the Free Trade Areas of America (FTAA). In Latin America, countries like Brazil, Argentina, Uruguay and a few others are co-operating through the Mercosur trade agreement. In Asia we have the Asean, and new agreements have also been developed recently between various African countries, especially those with a similar colonial heritage.

Jagdish Bhagwati, the highly regarded trade economist, has described the system of PTAs as the “spaghetti bowl” of trade agreements.⁸ The swarm of PTAs makes it difficult to study trade agreements, and even counting the number of PTAs is quite a complex undertaking. The latest estimate showed more than 400 instances of preferential trade agreements, with the number growing week by week.

One question raised by several trade analysts is whether the development of PTAs has been good for world trade. Bhagwati, for example, is not just being ironic when he speaks of the PTA spaghetti bowl. He makes several important remarks about the systematic discrimination of non-member countries in a preferential trade agreement, and he articulates other drawbacks to the system of PTAs. The most obvious drawback, of course, is that the workings of the principle of comparative advantage (first described by David Ricardo and later developed by Swedish economists Eli Heckscher and Bertil Ohlin) and the division of labour are narrowed down to just a few countries. If more countries had been parties to the agreement, the market allocation of resources would have been more efficient, with bigger returns to consumers and investors.

Another side-effect of regional trade agreements is that countries can be too dependent on other countries. In Latin America it is obviously the case. In Mercosur, Brazil and Argentina have lowered trade barriers within the community but kept them high for outside countries. This co-operation has caused trade between Brazil and Argentina to increase, but at the same time it has hampered trade with other countries. In times of economic and financial crisis, such as the current situation in Argentina and the situation in Brazil in 1998, this gives rise to severe difficulties. Brazil's devaluation, for example, gave its export industries a shot in the arm and raised the relative

price of Argentine export products. Since the trade patterns of these countries are closely interlinked, crisis in one country profoundly affects the other.

The most compelling argument against the spaghetti bowl, however, is that it removes the need for a multilateral trade agreement. If it hadn't been for PTAs, the argument goes, the multilateral trade system would have developed faster.⁹ So there is something of a zero sum game about the development of trade agreements – a regional trade agreement means less scope for multilateral agreements.

The problem with this argument is that it cannot be verified. On the contrary, considering the foundations of multilateral trade systems and the narrow scope of free trade sentiment in many countries, it is arguable that the multilateral trade agreements would not have made swifter progress even if PTAs had grown less rapidly. Instead it is more convincing to view the EU and other regional or bilateral trade agreements as the only possible outcome, in view of the given situation.

Today, however, it is more correct to speak of the “dangers” of preferential trade agreements. The development of PTAs has gone so far that we are speaking of trade blocks, and regional thinking has become deeply rooted in trade policy. Every country would be better off if the policies of low trade barriers within the PTAs were extended to other countries in a multilateral agreement. There is an obstacle to the prospect of such a development. Many countries want to broaden the WTO by adding tasks of new kinds, such as an investment agreement or social clauses. If this is to be the future of the WTO, then most probably we will see regional trade agreements acquiring more scope and the WTO making slow progress. To avoid locking on to regional trade patterns, the WTO should concentrate on its main mission – the multilateral process of eliminating trade barriers.

A RADICAL AGENDA FOR THE MILLENNIUM ROUND

BUILDING NEW INSTITUTIONS

There are several ways of describing the basic principles operating within the WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT). Researchers often speak of the reciprocity model in the WTO, meaning a top-down view of trade agreements based on the principle of “we do what you do”. In general this principle resembles the tit-for-tat strategy used in game theory where co-ordinated behaviour is possible.¹⁰ Underlying this principle is the mercantile notion that trade is good but imports are bad. This, of course, is not the ultimate solution for creating free trade. The best way is a unilateral approach supporting trade liberalisation regardless of what principles other countries may choose to pursue. But the reciprocity model is a solution and a much-needed principle in a world where the mercantile notion predominates and has to be reckoned with. In this situation, the WTO can help to smooth the process of trade liberalisation, since other countries will do the same in keeping with the reciprocity principle. It can be easier to make a case for lowering trade barriers and subsidies when foreign countries importing your products go down the same path. And so the WTO facilitates the process of developing a liberal trade régime having openness of trade as its basic principle.

But the reciprocity principle also has its drawbacks, especially when it comes to educating people on trade issues, because, basically, reciprocity strengthens the mercantile notion of trade. If, for whatever reasons, a country will not open up its markets to, say, agricultural produce, then you should not do so either. That, basically, is the message of the reciprocity model. If we go even further in the process of trade liberalisation, to a point where the agreements have been signed and in fact are supposed to have been adopted by all the member countries, a reciprocity principle says that if a country deviates from the agreed course, the other countries are right to act similarly by also departing from the original agreement.

The WTO has been called a free traders' pact with the devil. The expression is easy to understand in the light of the reciprocity model, because that model can pose major obstacles to the arguments for free trade and the process of realising them. Ultimately they even undermine trade negotiations in general, by fostering protectionist misconceptions and thus lending support to a political culture hostile to the demolition of trade barriers. This is perhaps to exaggerate the reciprocity principle's effects, but a brief study of the discussions in trade negotiations affords numerous examples of

the way in which this principle is rooted in the general mentality. This is specifically a problem for free traders. By adopting the reciprocity model they help to make trade policy a zero-sum game. Every aspect of trade negotiations is coloured by the notion that a good deal is one where the other countries make “concessions” and open up their markets without you yourself having to do anything. A “bad” deal, in which you open up your markets but the other countries don't, is, according to this way of looking at things, worse than no deal at all.

There are ways of overcoming this problem. It is of course difficult to change the general thinking habits of each and every country on the subject of trade, but the institutional setting of the WTO can avert the major pitfalls by instead allowing another principle to take root.

In a new approach, policy-makers and the WTO itself should recognise that the primary benefit of participating in trade agreements is that they open up your own markets and generally leave consumers better off. This dynamic, suggested by US scholars, would infuse new thinking into trade negotiations.¹¹ The guideline for this new principle should be “co-ordinated unilateralism”, and instead of affording scope for the concept of “concessions”, trade negotiations should focus on areas where there is an obvious case for widening free trade. This can only mean a sea change in trade negotiations. And it would be no small change, the atmosphere of trade negotiations having clearly been poisoned by the reciprocity model. A brief study of perspectives among policy-makers in the US and the EU clearly indicates the scope of this thinking. This new approach, however, deals not only with the mode of thinking but also with the basic institution of the WTO, namely the dispute settlement mechanism (DSM).

The DSM is the backbone of the WTO.¹² It was incorporated in the multi-lateral trade community in the Uruguay Round. Before that, the GATT did not have an effective mechanism for settling disputes. An aggrieved country could turn to the GATT, but the settlement of disputes under the GATT system was based on unanimous consent, which in practice meant that a country violating the GATT agreement could escape sanctions by breaking the consensus on the dispute panel. Needless to say, this lack of an efficient method for settling disputes left controversies unresolved and created an environment of disrespect for the agreement and the settlement body.

The DSM has changed the settlement procedure by a new dispute settlement understanding (DSU). Today the introduction of a trade sanction

against an offending country does not require the unanimous consent of a dispute panel. Accordingly, rulings will be issued automatically unless they are unanimously opposed. This means that a country which has won its case will have to oppose sanctions against the offending country, which is most unlikely even in theory.

The DSM has been a major success and for the first time in trade history has created a mechanism for settling international trade disputes efficiently. The number of cases has grown rapidly and important settlements have been made.¹³ With few exceptions, the system is working well. One of the exceptions, though, is the heated debate on the conflict between the US and the EU regarding hormone-treated beef and bananas. In both these cases the WTO dispute panel has come out in favour of the US.

There are technical aspects of the DSM that can be discussed, but the major need for a change in the ruling process stems from the reciprocity model and the acceptance of trade sanctions in favour of the country winning its case. The weakness of the DSM is that it offers the aggrieved country the right of imposing a tariff against the offending one. Basically, this means that sanctions run counter to the purpose of the WTO, i.e. the reduction of trade barriers. Instead of eliminating trade barriers, the DSM is liable to increase them. Not only does this put the entire multilateral system unnecessarily at risk, but it is also based on the idea that, if a country violates a trade agreement, the aggrieved country will be entitled to harm its economy still more by imposing more tariffs. This, briefly, is where the weakness of the reciprocity principle lies.

The institutional problem with this policy is that it tends to aggravate conflicts instead of solving them. Consider, once again, the dispute between the US and the EU about bananas and hormone-treated beef. The American response, sanctioned by the WTO, was to impose new tariffs on food imports from the EU. This triggered a new dispute between the two protagonists, because food producers in the EU were made worse off by the new US tariffs. The militant French farmer José Bové, for example, was a victim of this policy and embarked on a kind of anti-globalisation crusade after it. The Bové reaction, of course, was strange and illogical, but this example in itself demonstrates the potentially devastating effect of the WTO method for settling disputes. Atlantic trade relations deteriorated, with harmful effects on consumers both in the USA and in the EU.

A better “sanction” method is, in fact, already available in the DSU but is not mandatory, and little use is made of it. Instead of resolving disputes by raising tariffs, the basic principle of sanctions against an offender should be that of compensation. In other words, the cost to one country of the agreement being violated by another should be compensated for by trade liberalisation in another policy area if the offending country does not change its policy.

CONCLUSION: Article 22:1 in the DSU states that “compensation... are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time.” This compensatory sanctions policy should not be optional, it should be mandatory. Accordingly, trade sanctions in the form of tariffs or non-tariff barriers should be completely banished from the DSM.

This new policy will not solve all problems concerning disputes within the WTO. At the end of the day, the only possible way of avoiding disputes is by member countries adhering to the agreements. But, given the purpose of the WTO and the nature of current trade conflicts, this will be a more efficient way of settling disputes. And - an important side-effect - it will also narrow the scope for the future addition of social clauses. The idea of such clauses derives partly from the use of trade barriers as sanctions against a country violating the rules adopted.

Another drawback to the institutional setting in the WTO, partly deriving from the reciprocity model, is the use of anti-dumping measures. This is becoming an increasingly severe problem within the trade community. In many cases where countries believed themselves to be up against “unfair” competition from other countries, the remedies are anti-dumping measures such as tariffs. A recent NBER study showed anti-dumping cases to have numbered 2,113 between 1990 and 1998.¹⁴ Anti-dumping policies are most frequently employed by the USA, Australia and the EU.¹⁵ This is a significant increase in the number of anti-dumping cases, which was 1,401 between 1980 and 1989.

The same study concluded that anti-dumping is often prompted by a strategic consideration and is not really in accordance with the original anti-dumping agreement. Anti-dumping measures were intended as retaliation against foreign companies dumping products in a foreign market (which in general, though, must be considered a good thing for the consumers) and acting contrary to the principles of truly fair trade – trade without barriers

and subsidies to distort the market mechanism and the division of labour. But, as many studies have clearly shown, the use of anti-dumping measures ought generally to be regarded as a purely protectionist policy.¹⁶ Efforts were made in the Tokyo Round to change the legal possibilities of anti-dumping measures, but no consensus was achieved. Many countries wanted to discuss this policy at Seattle, with a similar end in view, but President Clinton was strongly opposed to addressing anti-dumping issues. US opposition still stands, largely due to the use of anti-dumping measures in the highly protected steel industry, and US trade representatives have no difficulty in finding support for such an agenda. The EU is also generally in favour of anti-dumping measures and uses them to avoid fair competition from foreign producers. Conflicts between EU member states can be seen, but there is no doubt that the use of anti-dumping measures by the EU runs counter to the basic idea of this policy option.¹⁷

CONCLUSION: Anti-dumping codes are too unspecific and will have to be changed. At present there are too many abuses of the principle of free trade, committed in the name of anti-dumping. Such measures should only be allowed when market-distorting practices such as export subsidies have clearly been used.

The GATT rounds have been in progress for several years now. The Uruguay Round started in 1986 and ended in 1994. Before that the Tokyo Round lasted for six years, between 1973 and 1979. These long periods have been partly due to the nature of trade negotiations involving many countries with different wishes and agendas. Since decisions in the GATT, and now in the WTO, have had to be unanimous, much time has necessarily been spent on almost endlessly writing and re-writing compromises, and week after week has had to be spent negotiating about details which perhaps affect only one company in just one country. But multilateral trade agreements are like that.

It would be an improvement, though, if the rounds were to be given a time limit. That would speed up the negotiations and limit the number of issues for discussion. It would also impose a rule of “early harvest” on negotiations, as it would then no longer be possible to put off actual policy changes.

CONCLUSION: Limit the new Millennium Round to three years and indicate in the agreement how you will proceed in the next round – which areas are to be discussed, what the overall targets are to be and so on.

A NEW AGRICULTURAL AGREEMENT

Ever since the signing of the GATT treaty in 1947, agricultural protectionism has been almost inviolate. Repeated efforts to include agriculture in the GATT were thwarted largely by fierce resistance to agricultural liberalisation in almost every developed country. The opposition, of course, is orchestrated by the farm lobbies. Few interest groups can rival their goal achievement. Neither economic crises, imposing restrictions on government spending, nor the visible impact of vested interests on food prices have made any difference to agricultural subsidies and tariff protectionism. Generally speaking, the prices of manufactured goods have fallen substantially during the post-war era. This has been partly due to the lowering of tariffs during the same period. The average tariff on manufactured goods today is about five per cent. But the average tariff on agricultural produce still exceeds 40 per cent.¹⁸ And the dominant pattern of agricultural production since 1950 has been a substantial growth of agricultural protectionism.¹⁹

Exhibit 2: Average Annual Growth (%) in World Agricultural Trade and Output



Source: WTO, *International Trade Statistics 2000*.

This policy has done nothing but harm to consumers. Tariffs as well as non-tariff barriers mean higher food spending than would otherwise be necessary. The cost of agricultural protectionism has been variously estimated. Studies by the World Bank estimate that the annual welfare loss in developed countries due to agricultural protectionism at USD 63bn. In developing countries the welfare loss is about USD 20bn, each and every year.²⁰ OECD studies suggest that an EU consumer spends twice as much on food as would be the case in a free market régime.²¹

The European Union is, in fact, one of the worst sinners where agricultural protectionism is concerned. It has high tariffs on agricultural produce and spends nearly half its budget on agricultural subsidies.²² A study commissioned by the Swedish Ministry for Foreign Affairs estimates the annual welfare loss caused by the CAP to the average family at about USD 1,200.²³

Table 4: The Cost of Agricultural Protection

	Annual welfare gain from 50 % cut in agricultural protection ²⁴	Share of World welfare gains	Total agricultural support estimate ²⁵
US and Canada	6.0	6.7%	101.5
EU	12.7	14.3%	142.2
Japan	43.1	48.4%	56.8
LDC's	10.3	11.6%	N/A
Other countries	16.9	19.0%	N/A
World total	89.0	100%	362.4

Sources: Lindsey et al (1999). The estimates on annual welfare gains is from a study made by the Australian Department of Foreign Affairs (1999), *Global Trade Reform: Maintaining Momentum*. The total support estimates is from OECD (1999), *Agricultural Policies in the OECD Countries*.

Consumers in the developed world as well as in the developing countries would be far better off if agricultural trade were to be liberalised. In fact, agricultural liberalisation should not be seen as a “concession” to developing countries but as something universally beneficial. As Table 4 shows, the total annual welfare gain from a 50 per cent cut in agricultural protection will be USD 89bn. Japan will make the largest gains, but the effects on EU consumers would also be substantial.

One of the major achievements at the Uruguay Round was to bring agriculture under the discipline of multilateral trade rules. This was a huge step forward. Several attempts to include agriculture in the GATT jurisdiction had failed, but at the beginning of the Uruguay Round in 1986 almost every country was in favour of some agricultural negotiations. The cost of agricultural policies in the affluent world had greatly increased, owing to fluctuations in world market prices, and new pressure on protectionist policies stemmed from the Cairns group which gathered for the first time in the opening year of the Uruguay Round.

In the so-called Uruguay Round Agreement on Agriculture (URAA), three areas were acknowledged to be in desperate need of reform: market access, export subsidies and domestic price support.

Market access, firstly, was hampered by high tariffs and by many non-tariff barriers, such as quotas. In the URAA the member countries decided to convert all non-tariff barriers – so-called hidden trade barriers – into bound tariffs. The unweighted average tariff level should, according to the URAA, be reduced by 36 per cent (24 per cent for developing countries) from the base-period of 1986–1988, with a minimum reduction of 15 per cent in each tariff line.

Secondly, export subsidies severely damaged the idea of fair trade. In the URAA the GATT countries decided to reduce all export subsidies, the aim being to abolish them completely in the near future.

Thirdly, domestic subsidies to agriculture impeded world trade in food products. According to the URAA, production subsidies should be reduced by at least 20 per cent from the base period. Exceptions were made for subsidies in the so-called “green box” which, for example, included expenditure on domestic food aid and income support divorced from production. “Blue box” expenditure on direct payments under production-limiting programmes were also exempted.

Another agreement on agriculture in the Uruguay Round was the Sanitary and Phytosanitary Agreement. This agreement, for example, rejects the possibility of hidden protectionist policies in the name of human or animal health. Any bans or quarantines prompted by such aims must be based on “sound scientific evidence” and cannot be used as a means of avoiding foreign competition.

The URAA is a first step towards trade openness in the field of agriculture. It should not be the last step, because several exceptions were made and the agreement left many trade barriers unsettled. The conversion from quotas to tariffs, for example, implied that the average tariff in the EU was not lowered in the URAA. The initial EU tariff binding (the base period) was set on average at about 60 per cent above the actual tariff equivalents of the CAP in recent years. Under this agreement, in other words, EU tariffs may actually be higher today than they were in the late eighties or early nineties.

This so-called “dirty tariffication”, however, was based on the idea of upcoming trade talks aimed at taking a further step in the process of agri-

cultural deregulation. The original plan was for these negotiations to be held at the end of November 1999 in Seattle. They were not, and this is what makes it so important for the Doha meeting to address agricultural matters.

CONCLUSION: A new agreement on agriculture should result from the new Millennium Round. The guiding policy should be:

- ▶ **All export subsidies, export credits included, to be abolished immediately, with no exception.**
- ▶ **Production subsidies to be phased out over a five-year period. The “green box” exception to be narrowed down, so that it cannot be used to subsidise production. The “blue box” exceptions to be abolished immediately.**
- ▶ **Agricultural tariffs to be cut on average by half inside three years, and tariff peaks to be reduced even more.**
- ▶ **A procedure to be outlined whereby a new round will continue the process of agricultural trade liberalisation and drawing up a mandatory programme to eliminate agricultural tariffs within a ten-year period.**

TRADE IN SERVICES

Somewhat surprisingly, agriculture is one of the most protected and government-supported sectors in the affluent and, technologically, most advanced regions of the world. Moreover, until the Uruguay Round, agriculture was not included in the GATT, and, consequently, was not identified as an important trade sector. In the new multilateral trade organisation, it is more of a rule than an exception, for agricultural products *not* to be objects of free trade.

Still more surprisingly, though, important services, a part of every political speech about work in the future, are not identified in the WTO. Knowledge-based industries are commonly regarded as the most dynamic field in the world economy and make large contributions to the GDP of affluent societies. Services are also generally considered a key engine to growth. Not only in the developed world, where services account for more than 70 per cent of the GDP, but also in the developing world. Tourism is one of the most important sectors in many poor countries. In a tourism-intensive country like Thailand, the service sector's share of GDP is about 50 per cent. And in an even poorer, insecure country like Kenya, the service sector accounts for nearly 35 per cent of annual GDP.²⁶

Moreover, a study commissioned by the Australian government suggested an increase in global welfare of 250,000,000,000 USD (*sic!*) if distortions in the provision of services were cut by 50 per cent.²⁷ Those gains, naturally, will not only be realised in services but in other industries as well. This is because liberalisation in services will promote transparency and provide the markets with more relevant and reliable information, causing the price mechanism to operate more efficiently.

To conclude, affluent societies as well as the developing world will benefit from a liberal reform of policies affecting trade in services. How come, then, that trade in services is considered to be highly-protected and that the General Agreement on Trade in Services (GATS) is, to put it mildly, somewhat flawed?

Surprising as it may seem, the reason is quite simple. In this world of mercantilist calculation, the scope of trade in services is hard to estimate. This problem of comprehension also applies, of course, to a free market model of trade, but there it would be no obstacle, apart from being a headache to statisticians. But today it is a problem. More specifically, the root of the problem is difficulties in the process of dissociating the provisions of services from movement of capital and labour. Therefore, services are often considered as non-tradable.

Realising this problem, the economists Gary Sampson and Richard Snape developed a model for classifying different types of “mode” in which transactions take place.²⁸ This model is also used by policy-makers and in the WTO. Sampson and Snape identified four modalities:

- 1 *Cross-border.* Neither the supplier nor the producer moves physically. Instead they both rely on intermediate services such as telecommunications networks.
- 2 *Consumption abroad.* Movement of a consumer to a supplier's country, as in tourism.
- 3 *Commercial presence.* Movement of commercial organisation to the consumer's country, as for example in the case of foreign direct investments.
- 4 *Presence of natural persons.* Movement of a individual supplier, such as a consultant or fashion model, to the consumer's country.

As this classification implies, the major problem with trade in services is *not* tariffs. In many cases, the barriers to trade are by nature non-tariff, and the most important feature is government regulation.

In the Uruguay Round, member countries decided to establish a set of multilateral rules on trade in services. GATS, created in 1995, was the first set of rules ever established for the trade in services, and it is similar to the basic principles of the GATT. Though riddled with exceptions, GATS extends the GATT principles of “national treatment” and “most-favoured nations (MFN)”. Basically, these principles regulate against discrimination: discrimination of foreign producers, relative to domestic producers, and discrimination against a WTO member, relative to another WTO member.

The GATS, however, is in many respects a defective agreement. The very nature of barriers to trade in services makes it very hard to tell whether countries are acting in accordance with the agreement. As a general rule – and of course there are exceptions – they don't. Due to the lack of specification in the GATS, member countries cannot receive much help from the WTO, and discriminatory behaviour is therefore quite common.

Of course, there is a reason for the unclear rules in the GATS. In almost every member country, political regulation is a sensitive issue and a potential source of political conflicts. Since the service sector also involves essential parts of the “untouchable” public sector, politicians in every camp try to avoid the GATS area. An experienced observer can therefore notice differences in attitude, and disputes over issues, between politicians and trade negotiators from the same country.

CONCLUSION: In order to be an effective part of the multilateral body of dispute settlement and trade liberalisation, the GATS is in desperate need of a reform. First and foremost, a new agreement on trade in services must increase the transparency of the non-tariff trade barriers in the service sector. Similar to earlier improvements of the GATT, the agreement on trade in services has to be complemented with more specific rules on the discriminatory policies that government regulation by nature apply. Moreover, the GATS should be complemented by an extended “positive” list and a “negative” list. More specifically, a positive list with extended trade liberalisation commitments made by member countries. After the Uruguay Round, member countries continued the negotiations on telecommunications and financial services. Similar negotia-

tions, with the explicit aim of thorough trade liberalisation, should be conducted on other services. Naturally, services already deregulated domestically in many countries will be in focus. Special efforts, though, should be made with regard to services traditionally dominated by government monopolies, such as communication sectors. Non-discriminatory rules on public procurement should, basically, be the guiding principle. The negative list should specify which sectors are not covered by commitments. A negative list can, in the long run, contribute to trade liberalisation since governments may be embarrassed by a long list of sectoral exceptions. More important, such a list implies that development of new services would be subject to established discipline.

DEVELOPMENT IN FOCUS

International trade is one of the most important features in a development-oriented policy. As far as we know, every country that made it from rags to riches has been an exporting country with a general outgoing trade policy, far removed from the autarkic model formerly advocated by many development economists. And we have not seen one single country, with sound and stable economic institutions and a solid policy of trade openness, that has not experienced real growth and rising welfare for the common man.

The WTO can play a significant role in promoting development by trade. The Director-General, Mr Mike Moore, early acknowledged the need for a new round with the explicit aim of discussing typical development issues. Unfortunately, it seems Mr Moore will not be a part of any such round, since he retires from the WTO next year. More importantly, since the affluent countries are not interested in dealing with the most essential area for developing countries – agriculture – the prospects of a development round could have been much better.²⁹

Several other issues, however, that have been raised by developing countries deserve attention. Most notably, the tariffs on manufactured goods and the protection of intellectual property rights.

TARIFFS ON MANUFACTURED GOODS

The initial purpose of the GATT, was the removal of tariffs on non-agricultural, mainly manufactured, products. The efforts made in the GATT, it must be acknowledged, have been successful. The average tariff of 40 per cent in industrialised countries has fallen to 5 per cent since the end of the 1940s. This does not mean mission accomplished. On the contrary, since trade in manufactured goods is the backbone of global commerce, even

small tariffs entail substantial losses in welfare. In other words, huge benefits can be gained by cutting existing tariffs on manufactured goods.

The Australian study referred to above also estimated the rise in global welfare that can be achieved by cutting existing tariffs by 50 per cent. Following a cautionary principle, it suggested a gain of about 66 billion USD.³⁰

There is also a development aspect to the tariff on manufactured goods. One of the first steps towards becoming an affluent society is to develop an industrial sector. Naturally, poor countries cannot develop high-technology industries, because they lack physical capital and knowledge (human capital). But it is feasible to develop low-technology industries, especially in sectors closely integrated with agriculture, such as textiles, clothing and food industry. Poor countries have the comparative advantage of low labour costs, and so for them labour-intensive production is cost-efficient.

As a study by UNCTAD and the WTO has shown, however, the tariff peaks in the field of manufactured goods affect low-technology products such as textiles, clothing, leather and footwear.³¹ These tariffs, needless to say, severely damage on the ability of the developing countries to grow by trade.

Since 1995, trade in textiles and clothing is under the supervision of the WTO through its Agreement on Textiles and Clothing (ATC). The ATC rules that tariffs on textiles and clothing should be brought under normal GATT discipline, but the ATC was preceded by the Multifiber Arrangement, which departed from normal GATT rules. There is therefore a long phase-in period for countries that today, for example, are using quantitative restrictions - in general forbidden by the GATT. This phase-in process has clearly been delayed due to opposition from textile lobby groups in OECD countries and needs a push forward.

CONCLUSION: Many of the tariff cuts negotiated during the Uruguay Round have yet to be fully implemented. The first step in a new round must be to speed-up the process, especially the phase-in of textiles and clothing. Other efforts should also be made. All tariffs below 5 per cent should be abolished within 5 years. All tariffs higher than 5 per cent, approximately 10 per cent of all tariffs in the US and the EU on manufactured goods, should immediately be reduced to 5 per cent. This reform should be combined with a 10 year phase-out plan for all tariffs on manufactured goods. This leaves plenty of time for the rich countries to

adjust their tariff-protected industry to a new situation. The tariffs on textile and clothing should be acknowledged as an important reform area, and the ATC should be renegotiated in order to reach zero tariffs within five years. Developing countries protecting their industries with high tariffs should take part in this complete reform and can, if needed, be given an extended reform period.

NEW PROTECTION OF INTELLECTUAL PROPERTY RIGHTS

The TRIPS agreement is generally considered one of the major achievements of the Uruguay Round. The signing of the agreement marked the end of a long and heated debate in the GATT. The process was largely driven by the US, which from 1984 had started to use its “Super 301 rule” against countries violating the protection of intellectual property rights. With the increased importance of the pharmaceutical industry, and innovations in general, the process was revitalised.

TRIPS has been intensely debated in the past few years, due mainly to the HIV crisis in Africa and the “copying” of pharmaceuticals in Brazil and India, which clearly infringes other companies, patent rights. The moot point, therefore, has been whether TRIPS should allow countries to buy cheaper pharmaceuticals from pirating countries. Almost everyone has agreed in a statement that in times of severe health crisis, such as the current situation in South Africa, it should be allowed. As work is still in progress and regulations have never been tested, many argue that TRIPS in fact does allow exceptions in times of crisis.

In general terms, it is the US and Switzerland who want to see a more thorough regulation, while other countries, to a greater or lesser degree, oppose their policy. The latest development in this issue, however, is the Canadian purchase of “copied” medicine against anthrax, and perhaps this will soften the US policy.

It is empirically proven that intellectual property rights as well as general property rights promote innovations and economic growth.³² This is not generally an issue in the WTO member countries, most of whom are members of the World Intellectual Property Organization (WIPO) and have for a long time participated in international co-operation on intellectual property rights.

However, the most important question that should be addressed regarding TRIPS and the WTO, is whether protection of property rights should, or should not, be part of a multilateral trade organisation. Many policy-

makers argue that it should be, since trade, basically, is about transactions in property rights.

This argument, however, does not fully answer the question. Trade is certainly about property rights, physical as well as intellectual, but no one seriously argues that we should not have any system to protect intellectual property rights. The WIPO and international treaties is well-suited to take care of these issues.

CONCLUSION: The main argument against TRIPS is that it confuses the WTO. Time and resources have to be spent on an issue that is not primarily a trade matter. The purpose of the WTO is to dismantle protectionism by cutting trade barriers. This should also be the only mission of the WTO. Hence, in the next round, member countries should end the TRIPS agreement.

THE LIMITED ROLE OF THE WTO

Before the last attempt to begin a new round in Seattle, several member countries argued for special agreements on investments and competition policies. The same countries are also in favour of clauses regarding social and environmental issues. This is the case of the EU negotiators, who are expected to launch a new effort to include labour and environmental issues in the Doha agenda.

There are two arguments in favour of the inclusion of labour and environmental standards in a multilateral trade agreement. The first one is purely economical and argues that less-developed countries with lower standards give their industries an unfair advantage. The industries in the affluent societies have to bear the extra cost of higher social standards. In the long run this unfair advantage induces the advanced economies to lower their labour standards, and the competition will result in a “race to the bottom”. Hence, a WTO harmonization would, as the argument goes, “level the playing fields”. The other argument, which is essentially of a moral nature, simply states that it is wrong to trade with countries that do not properly protect their environment and workers' rights.

There are serious flaws in these arguments, and it would be a substantial setback for the development of poor countries if new clauses were to be included in a multilateral trade agenda. Nor would it benefit the consumers in advanced economies.

Several studies on the notion of a “race to the bottom” have clearly shown that this process is not valid in reference to international trade. The theory falsely assumes that lower standards give poorer countries a significant advantage in attracting global capital. On the contrary, foreign direct investments are almost exclusively destined to advanced economies. Strong evidence also supports the notion that trade liberalisation encourages higher standards. For different reasons, multinational companies tend to impose higher standards on their overseas plants than required by local law. Hence, in reality it might turn out to be a race to the top. Allowing scope for the law of comparative advantage, both affluent societies and developing countries will be better off.

Developing countries consider social and environmental clauses to be a new form of protectionism. In the multilateral trade community, member countries have committed themselves to cut tariffs, but in many cases the domestic opposition against specific parts of a trade agreement has been

strong. With different sets of clauses, many fear that it would be even more difficult than before to implement the agreements, since several countries are expected to use them when vested interests lose the protection of tariffs.

Needless to say, the argument against social and environmental clauses in the WTO, is not an argument against better standards in developing countries. On the contrary, strong efforts should be made by international organisations, such as the ILO, to improve general conditions in production. But to include clauses in trade agreements is not the right way to deal with these issues. Moreover, it might also put up new obstacles to improving general welfare standards in developing countries, since it would be more difficult for them to grow by exporting their products to richer countries.

The main argument against including social and environmental clauses in the WTO is that primarily this is not a trade matter. Similar to the argument against an agreement on intellectual property rights, the purpose of the WTO is to curb protectionism, and further tasks will confuse the organisation. The same argument can be applied to the inclusion of agreements on investments and competition in the WTO.

CONCLUSION: The WTO should focus on supporting the efforts of governments to lower trade barriers. This is the main purpose of the WTO. Labour and environmental regulations are internal matters, which should be left to individual countries to determine. The WTO has an important role in the international community, but that role should be restricted. The role of the WTO should be limited to abolish trade barriers.

NOTES

- ¹ Lash (1999:1)
- ² WTO (2001). In the past year, however, world trade growth has diminished to about two per cent.
- ³ Cf. the United Steelworkers of America website, www.fairtradewatch.org
- ⁴ Maddison (1991), p. 74.
- ⁵ WTO (2001). New statistics from BIS show that since 1998 there has also been a decline in the volume of international capital transactions.
- ⁶ Maddison (2001).
- ⁷ Mr Supachai Panitchpakdi, who succeeds as Director-General of the WTO next year, is from Thailand.
- ⁸ Bhagwati (2001) and Bhagwati & Panagariya (1996).
- ⁹ Bhagwati (2001), chapter 3.
- ¹⁰ Axelrod (1984).
- ¹¹ Lindsey et al (1999), pp. 8.
- ¹² Various aspects of WTO jurisprudence are discussed in Weiler, ed. (2000).
- ¹³ Messerlin (2001), pp. 238 ff., discussing the usefulness of the DSM.
- ¹⁴ Prusa & Skeath (2001).
- ¹⁵ Bhagwati (1989), pp. 54 ff., shows the use of antidumping by these countries to date back to the end of the seventies.
- ¹⁶ Bhagwati (1989), Messerlin (1987) and (2001), Hoeckman & Martin, ed., (1993).
- ¹⁷ Messerlin (2001), pp. 348 ff.
- ¹⁸ See Josling (1998) for an estimate of average tariff rates.
- ¹⁹ Anderson (2001), p. 26. Huan-Niemi et al (2000).
- ²⁰ World Bank (2000).
- ²¹ OECD (1999).
- ²² Wickman (2001) sketches an outline for a radical reform of the CAP.
- ²³ Francois, Glismann & Spinanger (2000). Messerlin (2001) estimates the annual welfare loss in the EU due to all trade barriers at about 5–7 per cent of GDP.
- ²⁴ USD bn.
- ²⁵ USD bn.
- ²⁶ Central Bureau of Statistics (1999).
- ²⁷ Australian Department of Foreign Affairs and Trade (1999).
- ²⁸ Sampson & Snape (1985).
- ²⁹ See the specific discussion on agricultural trade earlier in this study.
- ³⁰ Australian Department of Foreign Affairs and Trade (1999).
- ³¹ UNCTAD and WTO (1997).
- ³² Block (2001).

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