

IS FREE TRADE FAIR? HAS IT GONE TOO FAR?

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INTRODUCTION

Since the meeting of trade ministers in Seattle in December 1999, the World Trade Organization has been at the epicenter of protests against globalization. This is to give the WTO more credit than it deserves. It confuses trade liberalization with globalization, which is a broader phenomenon. The removal of barriers to trade and investment, which is the province of the WTO, is only one of the factors driving closer integration and interdependence of the world economy. Equally important, arguably more so, are technological advances in communications and transportation which have expedited the flow of ideas, capital and goods around the world and lowered transaction costs. Whereas these technological changes are irreversible, trade liberalization is not. What is sometimes referred to as the first wave of globalization was brought to an abrupt end after the First World War when the big powers reverted to a policy of high tariffs and protectionism. By some measures, it took the rest of the century to recover the lost ground.

This paper is about trade liberalization, not globalization. It considers whether the significant steps that have been taken in this direction since the formation of the General Agreement on Tariffs and Trade (GATT) in 1948, have resulted not only in the freer movement of goods and services across borders, but also in a fairer, more open international trading system. There have been many criticisms that the new system spearheaded by the WTO is unfair. Opponents argue that the process is flawed and opaque, that the playing field is uneven and that the big, industrialized countries control the agenda. This results in a zero sum game where gains and losses are distributed

inequitably within and between countries. Governance is non-democratic because member states have surrendered sovereignty to the non-accountable WTO.

After considering each of these allegations, I conclude that the more open, rules-based trading system in place today is fairer than what preceded it. Although we are still a long way from “free” trade, the liberalization achieved through eight rounds of multilateral negotiations has spurred economic growth and the creation of wealth on a global scale. This is not the perception of a minority, but vociferous segment of the public, however. There is a disconnect between the politics of liberalization and the economic facts. If governments are to consolidate what has already been accomplished, let alone move the agenda forward, they must address this political deficit by actively championing the benefits of open markets, while at the same time responding to legitimate critiques.

Before proceeding, it should be clear that we are talking about “freer” trade, not “free” trade. Substantial progress has indeed been made in reducing tariffs from an average of 40 percent in the early years of the GATT to 4 percent today. Yet for sensitive products like rice in Japan and dairy products in Canada, peak tariffs are still prohibitively high, while in much of the developing world a wide gap remains between the applied and legally bound tariff rates. As industrial tariffs have come down, the importance of non-tariff barriers such as technical standards, subsidies and regulatory measures has become more apparent. Negotiators have therefore turned their attention to these less visible forms of protectionism, as well as to new sectors like agriculture, services and investment. Here too there has been some success in dismantling barriers,

but a long list of thorny issues was left on the negotiating table at Seattle. The ingenuity and persistence of protectionist interests should not be underestimated.

Another way to gauge how far trade liberalization has gone is to look at trade flows since the formation of the GATT. The volume of world merchandise trade is now about sixteen times what it was in 1950, while total output is only five-and-a-half times as big. The ratio of world exports to GDP has more than doubled in the same time frame from 8 to 15 percent¹. Yet despite this rapid rise in international trade, full integration of the global economy still has a long way to go. Jeffrey Frankel makes this point by using the American economy as a proxy. Since the United States accounts for about twenty-five percent of gross world output, if Americans were as likely to buy from foreigners as from each other, imports would represent approximately seventy-five percent of GDP. In fact, the ratio is about twelve percent, or one-sixth of what it would be in the hypothetical case of full economic integration². Of course, there are a variety of factors at play besides import barriers, but the point is well taken.

Even when there is nominal free trade, economic integration is less than complete. Despite the North American Free Trade Agreement, the province of Ontario in Canada exports three times as much to its sister province of British Columbia than to California, which is approximately the same distance away and has ten times the population. It is apparent that claims of complete interdependence are overstated.

WHY THE FUSS NOW?

The first eight rounds of multilateral trade negotiations, which took place between 1948 and 1995, generated relatively little public interest. Of course, various groups who saw their ox being gored mounted well-orchestrated and often quite public opposition. French and Japanese farmers were particularly adept at attracting attention during the Uruguay Round. But, for the most part, the public took little notice. The negotiations were conducted by government officials advised, critics would say directed, by business constituencies seeking better access to this or that market. The process was opaque, but nobody cared. Contrast this earlier apathy with the scene in Seattle, where it is estimated that thirty thousand members of “civil society” protested against the WTO, some of them in a very uncivil way. What happened to bring them to the barricades? Why the sudden interest in the arcane world of trade policy?

There are several explanations. First, the trade agenda has changed significantly. For most of the life of the GATT, the focus of negotiations was on reducing industrial tariffs. During the Tokyo Round, negotiated between 1973 and 1979, a start was made at tackling other trade-distorting practices by introducing codes of conduct. Codes were introduced covering esoteric subjects such as valuation and licensing procedures, technical barriers, anti-dumping and countervailing duties. However, adherence to the codes was voluntary and there was no effective means of enforcing them.

The real watershed was the Uruguay Round. It established the World Trade Organization and consolidated the patchwork of previous GATT obligations into a single undertaking. Rule making was extended to the new areas of agriculture, services, investment and intellectual property. The inclusion of services was particularly

momentous because they represent such a large and growing segment of the world economy. In addition to financial, telecommunications and professional services, they also encompass healthcare, education and culture. These are sensitive subjects at the heart of domestic policy making. National regulations governing product safety and health standards were also targeted. The new agreement on intellectual property strayed even further from the border oriented origins of the GATT by actually prescribing the form of domestic legislation required to implement the agreement. Some alarmed members of civil society saw this new prescriptive approach as an assault on national sovereignty.

The much-strengthened dispute settlement process reinforced their concern. The new mechanism has teeth. Whereas under the GATT, the reports of panels convened to adjudicate disputes between member countries could be blocked without a consensus of all the members, including the offending party, the onus is now reversed. Panel reports are adopted unless there is a consensus against it. The offending member is obligated to remove the basis of complaint, failing which it must pay compensation or face retaliation. This more judicial approach to dispute settlement and the closed nature of the proceedings compound concern that national sovereignty has been eroded.

The expanded trade agenda and effective enforcement of the rules have attracted much more attention to the WTO. A growing number of state and non-state actors realize that they have a vital stake in the outcome of trade negotiations and therefore demand say. This is a second reason for the end of apathy and the increasing climate of controversy and confrontation that exploded in Seattle.

Twenty-three countries created the GATT in 1948; today the WTO has 136 members and 31 countries have applied to join. Two-thirds are from the developing

world. During the early rounds of trade negotiations, most developing countries subscribed to the import substitution theory of economic development. Because they were not interested in opening their domestic markets, their objective in the GATT was to win exemptions from obligations intended to do just that. Their focus was on securing “special and differential” treatment, rather than promoting further liberalization. The lead up to the Uruguay Round coincided with a change in outlook. Struck by the success of the East Asian Tigers and prodded by the proponents of the Washington Consensus school of development, a growing number of developing countries adopted a strategy of export led growth. The collapse of communism provided additional impetus for this reorientation.

The results of the Uruguay Round reinforced their recognition of the need to play a bigger role in trade policy debates. The adoption of the agreements as a single package meant that countries could no longer pick and choose which elements to subscribe to. The administrative and financial burden of implementing the sweeping new obligations also proved to be more onerous than anticipated. Added to this was a general disenchantment stemming from the belief that the developing world had been shortchanged. In return for agreeing to new disciplines in intellectual property and services, they had expected better access for their exports of agricultural products, textiles and clothing. The results were meager to say the least. By the time trade ministers met in Seattle, the developing countries had learned their lesson well. They were better prepared and determined to make their voice heard.

The other area of burgeoning interest in trade is so-called “civil society”. In the last decade of the twentieth century, the number of international non-governmental

organizations (NGOs) grew from six thousand to twenty-six thousand, ranging in size from the Worldwide Fund for Nature with five million members to tiny network organizations³. Their proliferation reflects a lot of things, from dramatic changes in communications technology to more assertive expression of citizens' rights. In the trade field, it also reflects skepticism about the ability of trade negotiators to represent the public interest, as well as less deference towards political leaders. Concern is fuelled by the intrusive nature of the regulatory measures that are being negotiated internationally. The environment, food safety standards and other social regulations are emotive subjects that touch citizens' lives directly. They demand to be consulted on these issues. Greater transparency of the political process and the speed at which information can be transmitted make this feasible.

At the international level, decision-makers are remote and seem to be less accountable. To remedy this perceived democratic deficit, the NGOs are making their presence felt. Skilled at using the media to optimum effect, they have frequently wrong-footed governments by taking the moral high ground in defence of democratic values. In the past, the public generally supported government objectives of creating jobs and growing the economy. Today however, the new inward looking agenda faces opposition at each step along the way from a constellation of special interest groups, each purporting to represent so-called civil society. Paradoxically, in light of the debacle in Seattle, their interest in the WTO is piqued by the fact that alone among other international organizations, it is seen to be effective in reaching decisions and enforcing them.

WHAT IS UNFAIR?

What is it about the international trading system, epitomized by the WTO that is unfair?

There are almost as many criticisms as there are critics, and there are plenty of those. By and large, they fall into two categories: criticism of the negotiating process and criticism of the results.

Uneven Playing Field

The starting point is usually that the playing field is not level. Disparities in economic and political power mean that some countries are more advantaged than others. Rich countries have more skilled human and financial resources to devote to trade negotiations than developing countries. Almost one quarter of WTO members cannot afford to maintain permanent representatives in Geneva. Usually they are short of trade policy expertise at home as well. Deep pockets allow the United States, Japan and the European Union to subsidize sensitive sectors like agriculture and to cushion the impact of market-opening measures on the local economy.

With size comes leverage. The ability to offer access to a large domestic market is a significant asset in extracting concessions from negotiating partners. This advantage is enhanced because small countries are generally more trade dependent than larger economies and therefore have more at stake in trade negotiations. On the other hand, western critics argue that less developed countries can and do exploit lower standards of labour and environmental regulation to obtain an unfair advantage. Unless checked, they fear this will lead to a race to the bottom.

The first response to these charges is that they ignore reality. Resources are not evenly distributed. Rich countries have more clout than poor countries do. The issue is whether they are free to abuse that power or are constrained by international agreements. Does the law of the jungle or the rule of law prevail?

Membership in the WTO means adhering to a body of rules that apply equally to all members. Each member has one vote in deciding what those rules should be. In practice, decisions are taken by consensus which has a powerful equalizing effect. So does the principle of non-discrimination which is embedded in the WTO. It finds expression in the most-favoured-nation and national treatment clauses which require that concessions granted to any one member must be extended to all members, and that imported goods and services be treated no less favourably than similar domestic products. Over the years, rules have been agreed that constrain the use of subsidies and other trade distorting practices used predominantly by the industrialized countries.

As mentioned earlier, the particular difficulties faced by developing countries is recognized in the “special and differential treatment” accorded them in the agreements. This includes rights to protect infant industries, preferential access to developed country markets for indigenous products and delays in implementing new undertakings. The WTO has also recently announced a package of initiatives in cooperation with UNCTAD, the World Bank and other international institutions to deliver trade related assistance to forty-eight of the world’s poorest countries. The aim is to build up their institutional and human capacity and the infrastructure needed to participate more successfully in the global economy. The most important requirement for sustained growth however, is better access to developed country markets for primary exports in which the developing

countries have a competitive advantage. This is problematic because it affects entrenched, politically sensitive sectors such as agriculture and textiles.

As for the charge that lower labour and environmental standards give developing countries an unfair advantage, it is well to recall that at similar stages of development, standards in industrialized countries were much lower than they are today. Empirical studies show that as per capita income rises, the level of social regulation does too. In the case of the environment this makes intuitive sense, since a clean environment is a public good that people want more of as they can afford it. Similarly, there is little evidence to indicate that low environmental standards give a significant boost to competitiveness, if only because the cost of complying with environmental regulations is typically a small part of total production costs.

The same holds true for labour standards. Low wages do not necessarily imply a competitive advantage. Usually they are more than offset by lower productivity. On the issue of labour standards more broadly, work done by the OECD concludes that there is no evidence that low-standards countries enjoy a better global export performance than high-standard countries.⁴

This is not to say that efforts should not be made to improve environmental and labour practices worldwide. However, as Seattle demonstrated, the WTO is not the right venue. A more acceptable approach would be to agree a core list of standards in a specialized international institution, such as the ILO in the case of labour and perhaps the UNEP or one of the other myriad environmental agencies. If deemed appropriate, enforcement could be linked to the WTO dispute settlement process.

This is easier said than done. No consensus exists on this issue and before moving ahead, the relevant international institutions would have to be considerably strengthened or created. This is expensive and therefore unlikely at a time when funding is scarce. Another way of dealing with these social issues is through voluntary codes of conduct or self-regulation. The idea is that transnational companies agree to conform to specified labour and environmental standards against which they are held accountable by consumer and investor pressure. Failure to measure up results in “naming and shaming” with consequences for the offending company’s brand image and bottom line. There is evidence to suggest that this kind of collective standard setting by multinational companies combined with effective publicity can result in a race to the top rather than a race to the bottom⁵.

Might is Right

The second major criticism flows from the first. Because the playing field is seen to be uneven, some countries are more equal than others. This allows them to dominate WTO agenda setting, negotiations and enforcement. As the number of members has grown from 23 to 136, it is clear that some countries do play a more prominent role than others do. Not surprisingly, these have been the members with the most at stake in the negotiations. At the outset, the developing countries were willing to let the industrialized countries take the lead, since they could benefit from the concessions negotiated between other members under the MFN principle, and could opt out of less favourable provisions. The downside of this strategy was that the industrialized countries controlled the agenda

and, apart from a limited number of special preferences, paid little heed to the issues of greatest interest to the developing world.

This changed with the Uruguay Round. Not only was the result adopted as a single undertaking with no opting out, but the concept that less developed members should have permanent special privileges was replaced with the idea that they should participate fully in the mutual obligations with only time limited exemptions for compliance. This had a galvanizing effect. By the time they reached Seattle, the developing countries had coalesced and took the offensive by putting forward more than half of the proposals for a new trade agenda. They also stood united in refusing to accept the inclusion of labour and environmental standards.

Another source of controversy in Seattle was who should be at the negotiating table. As membership in the GATT swelled and the issues became more complex, it was not practical for everyone to be there. The solution was the “Green Room”, a process in which twenty to thirty self-selected developed and a few developing countries met to discuss divisive issues and to plot the course of the negotiations. This was in addition to ad hoc meetings of the Quad (the United States, Canada, Europe and Japan), the Cairns Group of agricultural exporters and other regional and sector groupings.

It was clear in Seattle that the current system of governance which excludes a majority of the members from the decision-making process is defective and would no longer be accepted. A variety of proposals have been put forward to rectify this, such as a constituency approach similar to that used in the World Bank and IMF; a steering committee selected on the basis of the value of trade, geographic representation or other criteria; and resurrection of the GATT policy forum. Membership in the latter would be

established on a rotating basis to ensure that all countries and regions are represented within a given time frame. Whatever formula is ultimately adopted, it clearly has to be acceptable to all the members and should be in place before the next round of negotiations is launched.

Enforcement is the third area where rich countries are said to dominate. When disputes are adjudicated before WTO panels, they can afford to retain expensive legal counsel to supplement sizable cadres of permanent trade policy specialists. Most developing countries cannot compete. Although still a problem, this imbalance is being ameliorated by technical assistance from the WTO and a clutch of specialized NGOs.

A second concern is that superior economic and political resources put industrialized countries in a better position to enforce panel decisions or, if they see fit, to act unilaterally. The new WTO dispute settlement process addresses this complaint. Because the old system was ineffective, larger countries responded by taking matters into their own hands and compelled compliance by threatening retaliation. In the case of the United States and the European Union, this was a punitive sanction. Not infrequently they by-passed the dispute resolution process altogether and coerced other countries into adopting voluntary export restraints or other trade distorting measures. Unilateral action under section 301 of the U.S. Trade Act was a particularly effective threat used by the Americans.

The new dispute settlement procedure is more credible. The onus has been reversed so that a panel report is now adopted unless there is a consensus to block it. Members are obligated to implement panel decisions by removing the basis of complaint or by paying compensation. Failure to do so can result in authorized retaliation.

Recourse to non-tariff barriers such as quantitative restrictions has been outlawed. The efficacy of this new regime is indicated by a big increase in the number of disputes referred to panels for resolution. Significantly, a large number of these have been initiated by developing countries against each other as well as against the big powers. What is more, the formidable section 31 has been sheathed, at least for the time being. There is a risk however, that by making the process more legalistic, there is less likelihood of reaching a negotiated settlement in the case of intractable disputes. If this results in controversial decisions being ignored, the new process will be discredited.

Lack of Legitimacy

A third complaint is that the rule making process is undemocratic and lacks legitimacy. We have already seen that developing countries feel they have been relegated to a minor role. Certain activist groups in civil society attack the process from a different angle. They argue that it has been captured by an international cabal of faceless bureaucrats and business interests who negotiate behind closed doors and are accountable to no one. While this was less objectionable when the subject was border tariffs, it certainly is not tolerable today. Matters such as consumer health and safety are deemed to be too intrusive to be regulated by trade negotiators. A growing backlash against globalization and anxiety about increased vulnerability to global shocks reinforces their determination to be heard.

Is concern about legitimacy well founded? On the face of it, no. The WTO is a weak organization that is run by its member governments on a budget of eighty million dollars. This amount is dwarfed by the budgets of the non-government organizations

who oppose it. Moreover, trade negotiations are conducted by trade ministers and their officials who reach decisions by consensus. Most ministers are responsible to elected legislatures who have the final say in ratifying the agreements that have been negotiated. There is a clear, albeit attenuated, chain of political accountability.

There are stronger grounds for criticism on the issues of transparency and participation. Historically, trade negotiations have been conducted in an air of secrecy because it facilitated the deal-making necessary to reach agreement. So long as the result was on balance positive, the public accepted it. Now that the stakes have changed, there is pressure to open the process up to make it more transparent and participatory. The public wants to know what is going on and to be heard.

Transparency is the easier of the two issues to deal with. The WTO has made major strides in opening up its process to public scrutiny. Practically all WTO documents are now public and the Director General is actively engaged in winning support for WTO objectives and operations. The same is true at the national level. Governments have made the formulation of trade policy far more public and inclusive by consulting widely and regularly. There really is no other option in this age of investigative reporting and instant communication.

Participation is a more troublesome issue, especially at the international level. The fight is led by the NGOs, but there is considerable resistance to their participation from the developing world. This is because they are largely based in developed countries and are seen to advocate positions inimical to developing country interests. The bona fides of these organizations is not apparent when their affiliations and funding are not disclosed. On the other hand, all parties agree that some of these groups bring valuable

technical expertise to the debate. Given more disclosure on the part of NGOs and broader representation from organizations based in the developing world, there is no good reason not to invite their input and much to be gained politically from doing so.

The same issues apply at the domestic level, but are more manageable. It is easier for national governments to ensure that a full spectrum of opinion is consulted when considering policy options. It is important to remember however, that NGOs are another form of special interest group, just like business and labour lobbyists. They all have a right to be heard and should be encouraged to do so. But, at the end of the day, it is the responsibility of elected politicians to determine where the national interest lies.

Zero Sum Game

Besides the alleged unfairness of the negotiating process, the second major and perhaps more telling criticism of trade liberalization, is that the outcome is unfair. In the critics' mind there is a clear causality: the flawed process leads to inequitable results. Underpinning this conclusion is their assessment that trade liberalization is a zero sum game. There are winners and there are losers. The former gain at the expense of the latter.

This view is flatly contradicted by classical economic theory, which holds that all countries benefit from trade because it allows them to specialize in what they do best. Specialization improves productivity which drives economic growth. Recent thinking highlights the dynamic benefits that trade brings through access to new technologies, enhanced competition and lower costs for consumers. By generating economic growth, trade creates wealth, and wealth creation is pre-requisite to tackling social issues such as

poverty, education, healthcare and institution building. How to allocate wealth among competing priorities is the realm of politics, not economics.

Is the theory supported on empirical grounds? Most economists agree there is convincing evidence that openness to trade is a significant, if not sufficient, spur to economic growth. In a much cited study for the Brookings Institution, Jeffrey Sachs and Andrew Warner concluded that trade liberalization leads to higher growth rates in developing countries and that by establishing direct links to the world economy precipitates other structural reforms necessary for development. They found that developing countries with open economies grew by 4.5 percent a year in the 1970s and 1980s, while those with closed economies grew by 0.7 percent a year. At that rate, open economies would double in size every sixteen years, while closed economies would take a hundred⁶.

Dan Ben-David of Tel Aviv University and Alan Winters of Sussex University obtained similar results in a study for the WTO. They found that the developing countries that are catching up to the rich ones are those that are open to trade; the more open they are, the faster they are converging⁷. In an attempt to quantify the relationship between trade and growth, Jeffrey Frankel and David Romer estimated that a one-percentage increase in the ratio of trade to GDP would result in an equivalent rise in national income⁸. The message has not been lost on the developing world. Since 1986, more than sixty developing countries have unilaterally lowered their barriers to trade and thirty-one countries, representing 1.5 billion people, have applied for membership in the WTO.

Inequitable Distribution of Benefits

Critics respond that even if, as proponents of freer trade claim, a rising tide lifts all boats, some boats are lifted more than others. They argue that the benefits of liberalization are distributed unevenly, both between and within countries. According to the OECD, there is some truth to this. They estimate that the Uruguay Round resulted in a welfare gain of between \$235 to \$274 billion. Of this, only one quarter to a third went to developing countries⁹. Work done by the WTO and the World Bank suggest a similar skewing of results in favour of industrialized countries. This outcome should not be surprising however, given that the developed countries have the largest economies, account for more than two-thirds of world trade and are the most integrated economically.

The OECD study found that, to an important degree, welfare gains resulting from the Uruguay Round are proportionate to each country's liberalization efforts and degree of openness. Another explanation is that the first eight rounds of multilateral trade negotiations focussed on goods and services of primary interest to developed countries. Consequently, they stood to gain the most from the reductions in trade barriers. For example, agriculture did not figure prominently on the agenda in until the Uruguay Round. Even after this so-called breakthrough, peak tariffs remain high. In fact, protection for agriculture in OECD countries actually rose between 1997 and 1998.

Six years after the completion of the Uruguay Round, the developing countries are disillusioned. They accepted obligations in new areas such as intellectual property; financial services and information technology which were of principal interest to the industrialized countries. In return, they expected to win greater access for their

agricultural, textile and clothing exports. This did not happen. When the restrictive provisions maintained by developed countries on textiles and clothing are finally phased out, it will have been over a period of forty-five years. Contrast this with the fact that the developing countries have only five years to implement the intellectual property agreement.

Another concern is that the costs of implementation and adjustment are more onerous for developing countries. This is because most industrialized countries have already made many of the reforms needed to implement the new obligations. This is not the case in the developing world. Many are fledgling democracies where economic disruptions have political ramifications. Increasingly the public holds their political leaders accountable. They therefore insist on playing a prominent role in future rounds of negotiations. It behooves the industrialized countries to recognize this imperative and to allow greater reciprocity in setting the agenda and strengthening WTO governance.

The second criticism, that the benefits of trade liberalization are unevenly dispersed within states, is frequently heard. It is argued that even if developing countries do gain from a more open economy, most of the benefits accrue to the political and business elites, not to the poor. In certain cases, their situation may in fact deteriorate. Open economies are more vulnerable to economic shocks, such as the financial contagion that shook several emerging markets in 1997 and 1998. Since typically their safety nets are weak, poverty can actually increase.

A recent paper by David Dollar and Aart Kraay of the World Bank sheds some light on this question. Looking at data from eighty countries over four decades, the authors conclude that openness to foreign trade benefits the poor to the same extent it

benefits the entire economy. In fact, their incomes rise one- for- one with overall growth. Nor do they fall disproportionately during times of crisis¹⁰. Other economists point to the Kuznets curve effect whereby income inequality may get worse at early stages of growth before improving at later stages. The explanation is that societies tend to increase their welfare spending and income redistribution programs as they can afford to do so. The East Asian economies are a striking example of success in achieving both high growth rates and declining inequality. It is a question of enlightened leadership and good policy. Trade liberalization is a means to an end, not an end in itself.

In developed countries, the worry is the impact of greater openness on labour markets. In the United States the wage gap between skilled and unskilled workers rose by eighteen percentage points between 1973 and 1995. At the same time, real wages have fallen for large segments of the work force. In Europe, where wages are less flexible, the unemployment rate jumped from three percent to nearly four percent in approximately the same period¹¹.

The consensus among economists seems to be that trade accounts for about ten to twenty percent of rising wage inequality in the United States and roughly the same percentage of increasing unemployment in Europe. The rest is primarily attributable to the new technology-based economy raising demand for skilled workers and flattening business hierarchies. This analysis is buttressed by the fact that industrialized countries trade primarily with each other. While imports from emerging economies have grown over the past three decades, their value amounts to less than two percent of OECD countries combined output. Also, developed countries derive around seventy percent of their output and employment from the services sector, most of that are non-tradable¹².

Be that as it may, the fact remains that in both developed and developing countries, more open markets have had an adverse impact on labour markets in some sectors. If governments hope to maintain the progress already achieved in dismantling barriers to trade, let alone win popular support for further liberalization, they must use some of the net economic gains to ease the adjustment of workers who have been negatively affected. This can be done in the context of a comprehensive social safety net as in Europe or through specific trade adjustment legislation as in the United States. The point is that the objective of freer trade is to stimulate growth and create wealth. Governments are responsible for seeing that it is equitably distributed.

Loss of Sovereignty

This is one of the most emotive issues raised by opponents of multilateral trade liberalization since it deals with the power of the nation state to regulate its own affairs. WTO rule making in areas affecting the environment, consumer safety, cultural diversity and other social issues generates considerable angst. However, judging from the demonstrators in Seattle, there is no agreement on the appropriate response. Some decried the WTO's intrusion into subjects which they perceive to be of exclusive national jurisdiction. Others clamoured for the trade organization to adopt and enforce global standards. Still others demanded both. Underlying these contradictory positions is confusion about two questions: whether the WTO has usurped the regulatory authority of member governments and to what extent the dispute settlement process can override domestic regulations.

The answer to the first question is no. The WTO has not become the regulator of last resort. Members are free to regulate in support of trade and non-trade objectives. For example, they can enact environmental, labour and food safety standards. The only constraints are that such regulations be transparent, non-discriminatory and not unnecessarily trade restrictive. Recent cases suggest that, in practice, this means they should not be implemented arbitrarily without prior notification and consultation with affected partners. Exceptions to the core WTO value of non-discrimination are allowed in the case of overriding public policy objectives, but the requirement to minimize trade-distorting effects is maintained.

Why do countries accept even these minor restrictions on their sovereignty? The answer is that they believe to be in their collective interest to do so. Trans-border issues require trans-border solutions. The same rationale underpins all international agreements, whether they relate to international security, criminal justice, climate change or trade. In the case of the WTO, member countries have adopted trade liberalization as a common goal because of its important contribution to economic growth and development. This in turn expands a government's policy options which enhances sovereignty rather than reducing it.

Concern about the regulatory override power of the WTO stems from the fact that it alone among international institutions has a binding dispute settlement mechanism. As described above, the new process agreed in the Uruguay Round provides clear rules for the adjudication of disputes and the implementation of panel decisions. It is important to note that throughout the process, the WTO remains neutral. A dispute is initiated by one member alleging that another has infringed rules that both have agreed to and

incorporated in their domestic law. When a panel decision is rendered, the WTO has no power to enforce it. The decision to comply or not rests with the respondent who must balance the political implications of doing so against its international obligations. When the stakes are high, the outcome is by no means certain. At each step along the way however, the discretion whether and how to proceed rests with the members. Their sovereignty is preserved.

That being said, there is one aspect of the dispute settlement process where restraint is called for to avoid inflaming the sovereignty argument. There are many gaps and ambiguities in the WTO rules. These frequently mask points of disagreement in the negotiations where “creative ambiguity” was the alternative to deadlock. In interpreting the rules, dispute panels should resist the temptation to substitute their insight for lack of precision in the text. They should not arrogate the rule-making responsibility which belongs to the member states.

The issue is most acute when economic and non-economic values collide. It must be clear that global standard setting is not the prerogative of the WTO. If they are to be established, global standards for labor and the environment should be debated and agreed in specialized international agencies. In their absence, the WTO should not fill the void. Member countries can choose their own social objectives and supporting regulations. The WTO’s mandate is to determine, at the behest of its members, whether specific measures breach the rules that have been agreed multilaterally. Governments need to show leadership in creating the requisite specialized institutions and engaging the debate. They also need to refrain from blaming the WTO when a dispute panel finds they have infringed their own rules.

CONCLUSION

What conclusions can be drawn from this analysis? Is free trade fair? The first response is that it is an exaggeration to talk about “free” trade. Industrial tariffs have indeed been significantly reduced and a start made at dismantling barriers in new sectors such as agriculture and services. But, peak tariffs are still high and other less transparent forms of protectionism exact a heavy cost on consumers. Despite the enormous expansion of trade flows, the degree of global economic interdependence is less than most people think. The ratio of trade to world output is, in fact, not much greater than it was at the end of the nineteenth century. So the relevant question is whether the more open trading system produced by eight rounds of multilateral negotiations is fair or not.

As the focal point of the world trading system, the WTO is at the center of the debate. Are the criticisms leveled against it valid? I think not. By establishing a body of trade rules that apply equally to all members, the WTO, and the GATT before it, have replaced the law of the jungle with the rule of law. The rules have been agreed multilaterally, by consensus, and ratified by national legislatures. Disputes are settled by an impartial process accessible to any member who believes that the rules have been breached. The WTO’s core value is non-discrimination and it applies both to participation in the organization and to trade between member countries. My conclusion is therefore, that the process is fair, especially when compared to what preceded it.

There is room for improvement however. More needs to be done to respond to worries about legitimacy. Efforts to de-mystify trade policy and to make it more inclusive must continue at the national and international levels. Citizens demand to be

heard on issues that affect their quality of life; issues like the environment and food safety that are now being addressed by the WTO. Non-governmental organizations can bring valuable technical expertise to the debates, but should be equally transparent as they expect other special interest groups to be. With developing countries accounting for two-thirds of WTO membership, governance is an issue. The developing countries made this abundantly clear in Seattle. A formula must be found which ensures that every member is equitably represented in the decision-making process.

Are the results of trade liberalization fair? Economic theory, supported by empirical research, indicates that open markets generate growth and that this growth benefits all segments of society. The more open the economy, the faster it grows. Moreover, by strengthening links with the global economy, trade acts as a catalyst for other economic and social reforms that are needed for sustained development.

Other studies suggest that the results of the Uruguay Round were skewed in favour of the industrialized countries and that labour markets in some sectors were adversely affected. If governments hope to maintain the progress already achieved and to build support for further liberalization, these results must be addressed. The most valuable assistance that developed countries can give to the developing world, is better access to their markets. Within states, governments must use some of the net gains accruing from trade liberalization to ease the adjustment of workers who have suffered.

Has trade liberalization gone too far? In my opinion, the answer is no. In economic terms, there has been an immense increase in global welfare which is shared by all countries that have embraced open markets. Further liberalization will expand these gains. The problem is that for many people the perception is otherwise. The politics of

freer trade has not kept pace with the economics. There is a political deficit, which needs to be addressed before proceeding further. Political leaders must make the case for freer trade by actively championing the benefits and responding to legitimate critiques.

NOTES

1. OECD p.19
2. Frankel p.2
3. *The Economist*, December 11, 1999, p. 21
4. OECD p.61
5. Spar p.10
6. Sachs and Warner
7. Ben-David and Winters
8. Frankel and Romer
9. OECD p.106
10. David Dollar and Aart Kraay
11. André Sapir p.1
12. OECD p. 50

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- ¹ OECD p.19
² Frankel p.2
³ *The Economist*, December 11, 1999, p. 21
⁴ OECD p.61
⁵ Spar p.10
⁶ Sachs and Warner
⁷ Ben-David and Winters
⁸ Frankel and Romer
⁹ OECD p.106
¹⁰ David Dollar and Aart Kraay
¹¹ Andre Sapir p.1
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