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The Truth About Trade

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Yesterday, the director general of the World Trade Organization, Supachai Panitchpakdi, released a report by a small expert group consisting of eight members (of which I was one). He had commissioned the group in June 2003 to offer an analysis of the WTO's working in the past and to offer a blueprint of where we ought to take the institution in the future.

The timing of the report could not be more appropriate: 2005 is the 10th anniversary of the WTO. At the same time, the Doha Round of multilateral trade negotiations under WTO auspices is at a critical juncture. Besides, Dr. Supachai's successor in September will need all the guidance he can get if he is to provide the leadership that the institution needs. With critiques and controversies plaguing the WTO from Seattle to Cancun, it has become necessary to separate the wheat from the chaff. The latter mostly relates to the mistaken rejections of the advantages of freer trade; the former to the legitimate concerns about the WTO's functioning.

The Chaff: Assaults on Freer Trade

Sadly, the critics who are most off the mark, and indeed off the wall, are to be found among the well-meaning NGOs. Enormously rich charities have now turned to agitating about trade issues with much energy but little understanding, prompting the witticism-when Oxfam agitators at the WTO meeting in Cancun in 2002 were parading with G-8 masks-that these were a bunch of dummies masquerading as another bunch of dummies.

Oxfam's annual spending is over $350 million; that of Action Aid nearly $140 million: these are now very big businesses. They are under the same pressure to diversify into new areas of public policy (regardless of expertise) as they pursue fundraising opportunities as are the corporations keen to diversify into new industries as they reach out for profits. These charities have unfortunately signed on to several fallacies about trade that do serious harm to the cause of the poor nations.

Thus, they regularly allege that poor countries suffer from systematic rich-country "hypocrisy" leading to "double standards" in trade policy, with rich countries having more trade barriers than poor ones. The facts, however, are exactly the opposite for the most part. There is greater tariff protection on manufactures in the poor countries: this has followed from the fact that they, not the rich ones, have long been given special and differential treatment in trade negotiations.

The charities also say that, while rich-country trade liberalization is good for the poor countries, poor-country trade liberalization is bad for them. What is sauce for the rich goose is not sauce for the poor gander. In this fallacy, they are arguing against a mass of empirical evidence which shows that infant industry protection is often counterproductive and costly. Moreover, what postwar trade analyses show, and what the charities do not understand, is that autarkic trade barriers make domestic markets more lucrative than exports, leading therefore to an incentive bias against exports. Therefore, even when the rich-country markets are opened further, one's own trade barriers can prevent the penetration of these markets.

Perhaps the greatest damage they have done is in their energetic campaign against agricultural subsidies in the rich countries. The removal of these subsidies is, of course, desirable as it promises aggregate income gains; and many economists have therefore argued for their removal for nearly four decades. But the charities, the heads of international aid institutions such as the World Bank, and the liberal media have now added the twist that the removal of these subsidies will also help the poorest countries known as the "least developed countries" (LDCs). Yet this is dangerous nonsense.

The economists Alberto Vales and Alex McCalla have shown that as many as 45 LDCs, out of 49, are net food importers; and as many as 33 are net importers of all agricultural products. As prices rise with the removal of subsidies, surely importers will be harmed, not helped, except in the singular cases where the importers switch to becoming significant exporters.

Are the rich-country subsidies to agriculture to be put down to hypocrisy? A substantial role in their continuance despite economists' complaints was simply that the poor countries themselves were not interested in agricultural development. They identified development with industrialization; and their own trade policies created a substantial bias against agricultural development. Thus, rich countries wanted to protect their agriculture; the poor countries wanted to decimate theirs. So a Faustian bargain resulted: hypocrisy is hardly the way to characterize it.

The Wheat: The World Trading System and the WTO

But if many criticisms of freer trade in the public domain today are to be dismissed, as the WTO report argues, there are also many concerns about the WTO itself, and the world trading system it presides over, that merit attention. There are threats to the WTO's-indeed the multilateral trading system's-well-being; and there are institutional features that require correction at the WTO.

The threats come from two directions: the escalating erosion of nondiscrimination and the steady encroachment by rich-country lobbies seeking to impose their trade-unrelated agendas on trade agreements and institutions. The institutional reform requires, in particular, a re-examination of the procedures by which contentious new issues are introduced into the WTO, and of ways to augment its minuscule resources to enable the WTO to play the role that is expected of it today.

Nondiscrimination was at the heart of the General Agreement on Tariffs and Trade that merged into the WTO in 1995. The most-favored nation (MFN) clause ensured that every GATT member faced the lowest tariffs that any other member enjoyed. The few exceptions were explicit: for instance, Art. 24 exempted countries entering into Preferential Trade Agreements (PTAs) such as a Free Trade Agreement or a Customs

Union, from having to extend their tariff cuts for one another within the PTA automatically to non-member countries despite the MFN commitment.

But today, this central principle of nondiscrimination has been virtually destroyed. Thus, PTAs have proliferated beyond imagination: they are close to 300 and are growing by the week. There is now a systemic problem: the PTAs which the architects of the GATT thought would be minor exceptions have now swallowed up the trading system.

At the same time, developing countries enjoy preferential access to rich-country markets, and to one another, under several exemptions; and the practice of discriminating yet further among LDCs and other poor countries has become widespread. In consequence, the EU's MFN tariffs now apply only to five countries, with all others enjoying politically driven lower-tariff access under different terms to the EU under multiple PTAs, differentiated GSP (Generalized Scheme of Preferences), EBA (Everything but Arms) and other schemes. Evidently, MFN in the EU has now become LFN-the least favored nation tariff.

Yet another threat to the multilateral trading system arises from the progressive capture by the rich-country lobbies, good and bad, of the trade liberalization process to advance their trade-unrelated agendas. These lobbies pretend, of course, that "fair trade" and what the European Commission under Pascal Lamy has been calling respect for "collective preferences"-both self-serving phrases that conceal the pernicious nature of the demands-require that their pet concerns such as labor standards be worked into FTAs and into the WTO .

This has pitted the major developing countries such as India and Brazil against the inclusion of such extraneous issues into trade negotiations and institutions. The Free Trade Agreement of the Americas has also been held up by Brazil which insists correctly on confining it to trade liberalization; the U.S. wishes otherwise. Revealingly, none of the many PTAs among the poor countries ever include these extraneous issues: their inclusion arises only when the U.S. and the EU, the major powers, are members.

These and other issues require a clear grasp of what tasks properly belong to the WTO. They also need a serious examination of the manner in which new issues may be introduced into the WTO, in particular when an overwhelming plurality does not endorse them. It also follows that, at this critical juncture requiring leadership, the next director general be examined carefully on his views on these matters.

It also means that, as he navigates the WTO over waters agitated by them, he has access to a world-class and substantial secretariat of his own. The WTO's current annual budget is less than $100 million: no, I did not forget a zero. As a result, the WTO essentially has to rely for trade analysis on the "foreign legions" at the World Bank, the OECD etc. At Seattle, Cancun, Doha and other WTO meetings, the world's media therefore focused, not on the WTO's analyses and economists, but on those at these other institutions, for whom world trade is scarcely a metier. This is a travesty. It needs to be put right.