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## Reshaping the WTO

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On January 17, the director general of the World Trade Organization Dr. Supachai Panitchpakdi released a report by a small expert group consisting of eight members, of which I was one. Dr. Supachai 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. First because 2005 marks the 10<sup>th</sup> anniversary of the WTO. More importantly, the Doha Round of multilateral trade negotiations is at a critical juncture. Several of the contentious issues are intimately related to the scope and functioning of the WTO, and also to the proposition that the freeing of trade makes sense for all members of the WTO. In addition, when Dr. Supachai's successor takes up the reins in September, he will need all the guidance he can get if he is to provide the leadership that the institution and the world trading system clearly require.

With critiques and controversies plaguing the WTO from Seattle to Cancun, it has become necessary to separate the intellectual wheat from the chaff. The chaff mostly relates to the mistaken rejections of the advantages of freer trade; the wheat to the constructive concerns about the WTO's functioning.

#### The Chaff: Freer Trade under Fire

Sadly, the critics who are most off the mark, and indeed off the wall, are to be found among the well-meaning non-governmental organizations. Enormously rich charities have now turned to agitating about trade issues with much energy but little understanding. When Oxfam agitators at the WTO meeting in Cancun in 2002 paraded about wearing the masks of G-8 leaders, this prompted the witticism that here were a bunch of dummies masquerading as other dummies.

Oxfam's annual spending is over \$350 million; that of Action Aid is nearly \$140 million. These and others are now very big businesses, and like corporations they are under pressure to diversify into new areas of public policy in search of growth, regardless of expertise, as they pursue fundraising opportunities. But they are more dangerous when they speak from incompetence, since they wear halos that the corporations do not.

These charities have signed on to several fallacies that imperil the poor countries whose interests they claim to represent. Some are easily dismissed. For instance, they argue that free trade is not sufficient for growth; we also need other

supportive policies. By and large, yes; and every serious scholar of trade has understood this from as long ago as the 1960s when the trade policies of the developing countries were being studied. But then again, it does *not* follow that freeing trade is no better than not freeing it. But consider next some of the less shallow, but no less pernicious, fallacies:

*Poor countries suffer from systematic rich-country “hypocrisy” leading to “double standards” in trade policy, with the rich countries having more trade barriers than the poor ones.*

The truth is exactly the opposite: There is greater tariff protection on manufactures in the poor countries. This has followed from the fact that the poor countries, not the rich ones, have long been given Special & Differential Treatment in trade negotiations. They are also overtaking the rich countries in the number of anti-dumping filings. Moreover, few poor countries have undertaken significant commitments on services. The developing countries also are free not to sign the optional procurement code which all rich nations have signed.

What should we make of the fact that the rich-country tariffs are lower for rich-country exports of manufactures than for poor-country exports? Is that not hypocrisy? Not really. It is a simple consequence of the fact that the poor countries have conventionally been exempted from making tariff concessions to get tariff concessions. Rich countries then typically avoid making significant concessions on products of interest to the poor countries. If you want a free lunch, do not expect to eat at a banquet!

*While trade liberalization by rich countries is beneficial, for the poor countries trade liberalization does not bring benefits.*

In this fallacy, the charities are supported by a handful of economists who are repeatedly invoked against a mass of empirical evidence and a preponderance of trade experts. One may cynically remark that the market incentive to be in the dissenting group is greater—the fewer their number, the higher their scarcity value.

The protection of infant industries against imports much too often tends to be indiscriminate and creates strong incentives for the infant producers to remain inefficient and to continue demanding protection which then becomes politically difficult to remove. The result is that the infant does not learn and grows up wearing protectionist diapers into premature senility.

Besides, the notion that the poor countries need infant-industry protection to industrialize has always been indulged to excess whereas experience shows otherwise. India managed with its own native entrepreneurs to develop industries such as textiles, shipping and steel under British rule, without protection and even despite British hostility. There are other examples of growth without protection, at least of a sustained variety. Fear, not experience, is at the heart of protectionism here.

Moreover, postwar trade analyses show, and what the charities do not understand, is that autarkic trade barriers create a 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. To use a helpful analogy, even if the rich-country door is opened, the poor-country exporters may find that the poor-country door is closed and they cannot get out to get past the rich-country's open door. Studies of African trade policy by economists such as Alexander Yeats have underlined this important lesson which emerged from in-depth empirical studies of several developing countries' trade policies during the 1960s and '70s.

*Agricultural subsidies in the rich countries are keeping the developing world poor.*

The removal of subsidies is desirable, as it promises aggregate income gains, and many economists have therefore campaigned against them for nearly four decades. But Oxfam and the heads of several international aid institutions have now added the twist that the removal of these subsidies will also help the poorest countries known as the "least developed countries." 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 together. As prices rise with the removal of subsidies, surely the importers will be harmed, not helped, except in the singular cases where the importers switch to becoming significant exporters. The mistake on the part of Oxfam, the leadership at the World Bank and countless journalists who have followed in their wake is easily understandable but not to be condoned: They have simply assumed that what is true of cotton subsidies in the rich countries, because there are four African countries that rely on cotton exports, must be true more generally. This is the fallacy of using an unrepresentative sample!

Moreover, it is easy to see that the Cairns group of middle-income, large agricultural exporters such as Argentina and New Zealand, long frustrated by the inability to get rich-country agriculture liberalized, have found it politically

convenient to pretend that agricultural protection in the rich countries harms the poor nations of Africa.

Are the rich-country subsidies to be put down to hypocrisy? A major reason for their survival despite economists' complaints is simply that many poor countries themselves for decades 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. A Faustian bargain resulted. Hypocrisy is hardly the way to characterize it.

### The Wheat: The World's Trading System

But if many criticisms of freer trade in the public domain today should be dismissed, as the WTO report argues, there are also some serious threats to the WTO's well-being. The threats come from two directions: the escalating erosion of non-discrimination and the steady encroachment by rich-country lobbies seeking to impose their unrelated agendas on trade agreements. Institutional reform requires two main changes: relaxing the "tightness" of obligations that the WTO now incorporates and creates political waves, and augmenting its minuscule resources.

#### *The Erosion of Non-Discrimination*

Non-discrimination was at the heart of the General Agreement on Tariffs and Trade (GATT) that merged into the WTO in 1995. The most-favored nation clause ensured that every GATT member faced the lowest tariffs that any other member enjoyed. The few exceptions were explicit—for instance, Article 24 exempted countries entering into Preferential Trade Agreements such as a Free Trade Agreement or a Customs Union from having to extend their tariff cuts automatically to non-member countries.

But today, the central principle of non-discrimination has been virtually destroyed. Thus, PTAs have proliferated to close to 300 and the number is growing by the week. The agreements which the architects of the GATT thought would be minor exceptions have now swallowed up the trading system.

All economists now recognize the resulting "spaghetti bowl" problem, as I have christened it. The world trading system is characterized by a chaotic criss-crossing of preferences, with a plethora of different trade barriers applying to products depending on which countries they originate from. This is a fool's way of

doing trade—not only does it destroy the efficient allocation of resources, but it flies in the face of the fact that today it is becoming almost impossible to define which product is whose. It is hard to believe that sensible men in charge of trade policy today, including the USTR, the EU Trade Commissioner and other luminaries of trade are so unmindful of the fact that, in the name of free trade, they are damaging the world trading system through discriminatory PTAs as much as the protectionists did in the 1930s.

At the same time, non-discrimination has been undermined by discrimination in favor of developing countries in diverse ways. They enjoy preferential access to rich-country markets under the Generalized Scheme of Preferences (GSP), giving them market access at lower-than-MFN tariff rates. Moreover, they are allowed to reduce without any restrictions whatsoever trade barriers by any percentage and for any products preferentially among themselves under the Enabling Clause. This “Special & Differential” treatment sounds desirable; but its undermining of non-discrimination in the world trading system has serious downsides from the viewpoint of the developing countries as well.

The grant of one-way preferences to the developing countries under the GSP schemes turns out, on examination, to be full of holes. The product eligibility is limited, the preferences terminate when exports are successful, and reverse preferences for the rich countries are almost always built into these schemes. Both the EU and the U.S. have also used these schemes to extract not just preferential trade concessions (such as provisions favoring the import of the rich country’s intermediates) but also, as discussed below, a number of unrelated concessions. The EU has taken matters further by cynically differentiating, in pursuit of political agendas, among different developing countries in the grant of preferences.

That the Enabling Clause permits two or more developing countries to reduce any trade barrier among themselves, regardless of restrictions such as in Article 24 which requires chiefly the restrictions that the preferential tariff reductions for members of a PTA must be on “substantially” all products and that there must be a commitment to reaching full 100% reduction by a target date, is also an option that poses real harm to the developing countries by cluttering up their trade regime with a mass of inefficiencies. It is usually defended by its proponents on the ground that these countries need “policy space.” But this is like saying that the ability to shoot oneself in the foot gives one policy space.

Therefore, between the proliferation of PTAs and the spread of S&D, the centrality of non-discrimination has virtually vanished. Consider that the EU’s

MFN tariffs now apply only to five countries, with all others enjoying politically driven lower-tariff access to the EU under multiple PTAs, differentiated GSP (Generalized Scheme of Preferences), EBA (Everything But Arms) and other schemes. Evidently, the MFN tariff in the EU has now become the LFN, the least favored nation, tariff!

It is too late to put the genie back in the bottle. So the report concludes, along with many thoughtful observers, that the only way to kill the PTA-generated preferences, which are of course relative to the MFN tariff, is to bring the MFN tariff itself down to negligible levels. In short, conclude the Doha Round and go on to another multilateral trade negotiation until we get the MFN tariffs virtually down to zero—a U.S. aspiration, as it happens.

Yet another threat to the multilateral trading system arises from the ability of rich-country lobbies to capture, through use of PTAs and the design of S&D preference schemes, the trade liberalization process to advance their unrelated agendas. These lobbies pretend, of course, that “fair trade” and 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 trade agreements and institutions such as the WTO.

This has united the major developing countries such as India and Brazil, both led by democratically elected progressive leaders, against the inclusion of such extraneous issues into trade negotiations and institutions. The Free Trade Agreement of the Americas (FTAA) has also been held up by Brazil, which insists correctly on confining it to trade liberalization, while the United States wishes to corrupt the FTAA with several extraneous issues. 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 are members.

### *Variable Geometry*

Can this matter be resolved by introducing institutional change at the WTO, by admitting what the report calls “variable geometry”? Could we simply say that if the EU, U.S. and Norway want to include labor standards into the WTO, why not just let them do it and let the agreement apply only to themselves. This, however, will not do.

True, if member states agree that an issue is a WTO issue, then some nations could take on additional obligations and rights. But the issue here is that the major

developing countries with a modicum of power to resist the political play of the rich countries object to having the trade-unrelated issues in the WTO in the first place. Surely they would see through this variable geometry as a ploy to get the objectionable issues into the WTO, a foot-in-the-door strategy. The same applies to the sneaky way in which the EU, according to an EC document on its recent trade policy record, seems to have managed to get these issues into its Trade Policy Review Mechanism reports at the WTO while no one was looking.

These and other issues require that the proponents of free trade carefully examine the next WTO director general's views on them. It also requires that, as he steers 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—and 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 typically focus not on the WTO's analyses and economists, but on those from these other institutions. This is a travesty. It needs to be put right.