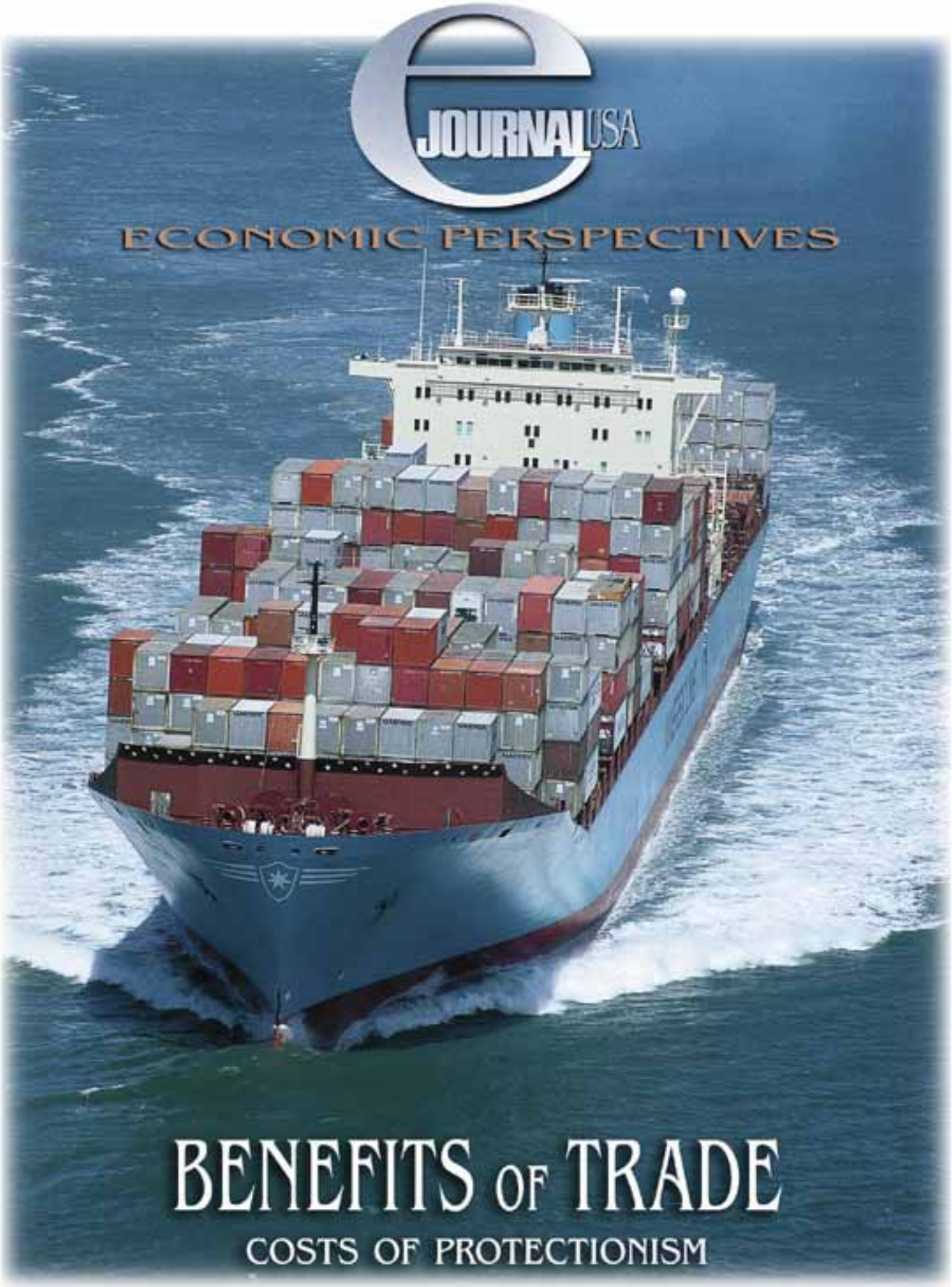

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Introduction

Ambassador John K. Veroneau

History and experience provide us with important insights as we look to the future of the international trading system. Particularly since the end of World War II, trade has been an integral engine of the world's economic progress. Successive rounds of multilateral trade liberalization under the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO), have helped rebuild war-devastated economies in Europe, provided a proven path to development for independent and modernizing nations in Asia, Latin America, Africa, and the Middle East, and lifted hundreds of millions of people out of poverty.

For the past seven decades, American presidents from Franklin D. Roosevelt to George W. Bush have steadfastly supported lowering trade barriers between the United States and our partners around the world. They have shared a belief in trade's central role in promoting rising standards of living, greater prosperity, and a broader range of choices for our citizens and those of other nations. As a result, the United States is the most open major economy in the world, and this openness is a clear source of strength. According to the Peterson Institute for International Economics, U.S. annual incomes are $1 trillion higher, or $9,000 per household, due to trade liberalization since 1945.

We are now witnessing a period of rapid transformation in the global marketplace. Just in the years since the Cold War ended, roughly 2 billion more workers and consumers have joined the international economy as political and technological barriers to market participation have fallen away. In order to empower more individuals to pursue their dreams and provide for their families, we must unleash trade's potential to promote further global economic growth and fuel better jobs.

The World Bank estimates that the full elimination of trade barriers can lift tens of millions more out of poverty; hence, the moral imperative to find a way forward on trade is clear. Moreover, while debt relief and foreign aid can make an important contribution to development in poor countries, trade and trade liberalization are likely to be even more powerful tools for alleviating poverty and providing societies with the economic resources to address their most pressing needs. Again according to the World Bank, the annual income gain to developing countries from the elimination of trade barriers to goods alone is $142 billion, conservatively measured. This amount exceeds the $80 billion in foreign economic assistance by the major industrialized countries in 2005 and the proposed $42.5 billion for developing country debt relief combined.

The potential gains from freeing trade in manufactured goods, services, and agriculture are truly substantial. The suspension of the Doha Round of WTO negotiations in 2006 was disappointing for all who believe in the power of trade to promote economic development, to expand opportunities, and to facilitate peaceful cooperation among nations. That is why President Bush has directed the Office of the U.S. Trade Representative to continue in the quest for an ambitious and balanced agreement that meets the development objectives of Doha.

The rapid pace of change in the international economy and its effects—both positive and negative—on regions, localities, and individuals breed understandable anxieties. Each society must find a way to address the needs of those who may be dislocated by change and cushion the transition. But backsliding and erecting walls and barriers to trade is not the answer: Trade barriers protect a few at the expense of the many, and countries that fail to resist protectionist actions risk slower growth, inefficient and noncompetitive sectors, greater unemployment, and increased inflation in the longer term.

Increased trade also has broad social benefits: Countries that are wealthier are more likely to devote resources to preserving their environment, and workers in export-related industries tend to earn higher wages than their domestic counterparts in non-exporting sectors. The gains from trade are real to the hundreds of millions of individuals today whose livelihoods and households depend upon it.

We hope that readers will take the time to review each of the articles in this volume and gain from them a greater understanding of the benefits of trade liberalization for improving the quality of life for all people throughout the world.

Ambassador John K. Veroneau
Deputy U.S. Trade Representative

Why Liberalize Trade?

Christina R. Sevilla

Courtesy of ACDI/VOCA

About half of the global benefits from freer trade in goods would go to people in developing countries, such as this Angolan fruit trader.

The evidence is clear. Opening trade creates wealth for societies to address their needs and promotes economic development; erecting barriers to trade leaves people and countries worse off overall. The United States learned this lesson after imposing the damaging Smoot-Hawley tariffs in the 1930s. Since then, the United States has led the world in opening international markets, which has fuelled countries' growth and development and helped raise millions of people out of poverty. But much more remains to be done to realize the benefits of freer trade in agriculture, manufactured goods, services, and other areas. Developing countries especially stand to gain if the impasse is broken in multilateral trade negotiations. World Bank studies have found that tens of millions more can be lifted out of poverty through increased trade.

Christina R. Sevilla is deputy assistant U.S. trade representative for intergovernmental affairs and public liaison.

"We will fight to lift the burden of poverty from places of suffering—not just for the moment, but permanently. And the surest path to greater wealth is greater trade."

President George W. Bush
September 14, 2005

The world of the 21st century faces enormous challenges. More than 1 billion of its people live in poverty, a condition that devastates families, communities, and nations. Developed and developing countries alike share the goals of alleviating poverty around the globe, achieving greater economic growth and higher standards of living, and generating new employment and opportunities for their citizens.

As governments seek to break the impasse in the current World Trade Organization (WTO) Doha Round of negotiations, it is worth recalling that economic theory and practical experience demonstrate that open markets and trade liberalization—dismantling tariff and nontariff barriers to trade—provide a proven path to wealth creation and development. Countries that are open to trade tend to have more wealth, healthier populations,

higher rates of education and literacy, stronger labor rights and environmental standards, and greater investment opportunities. Trade barriers, in contrast, may shield narrow special interests from competition, but ultimately they leave a nation as a whole worse off in terms of wealth foregone, slower growth, and, hence, fewer resources to address pressing societal needs.

Theory and Evidence

Why do countries trade? The intellectual underpinnings of free trade are well known to economists. Simply put, nations benefit by specializing in the production of goods and services that they can produce most efficiently, and exchanging these for the goods and services that other countries produce at higher quality and lower cost. In this arrangement, countries benefit from more efficient production, increased consumer choice, and better goods and services at lower prices. Dismantling government barriers to trade allows individuals access to the world's supermarket for food, clothing, and other manufactured goods, and for services that form the infrastructure of the modern economy, ranging from finance to telecommunications and transportation to education.

Competition also motivates businesses to innovate, to find new production processes and technologies to better serve customers, and to advance knowledge. For example, the development of advanced computer technologies and life-saving medicines in recent years has flourished under conditions of open markets and export opportunities for industry growth, coupled with enforcement of strong copyright and patent laws.

Barriers to competition produce the opposite effect—less efficient domestic industries; higher costs, poorer quality, and fewer choices of goods and services; less innovation; and slower economic growth.

The economic history of the 20th century provides a potent demonstration of the vast benefits of trade liberalization for hundreds of millions around the world and a dramatically painful lesson on the global costs of trade barriers. In 1930, the United States imposed unprecedented trade barriers in the mistaken belief that U.S. producers could not successfully compete against foreign producers due to lower foreign wages and production costs. At that time, the U.S. Congress passed the Smoot-Hawley Tariff Act, which erected high tariff walls to shield the U.S. market from foreign competition. The consequences were disastrous. Trading partners retaliated by protecting their own markets from foreign imports. World trade fell by 70 percent in the early 1930s, throwing tens of millions out of work, deepening the Great Depression, and fuelling the political tensions that helped give rise to World War II.

Since then, successive American presidents and Congresses have laid the foundations and forged consensus for peaceful economic cooperation and shared prosperity through the General Agreement on Tariffs and Trade (GATT) and its successor institution, the World Trade Organization. From its original 23 founding members under the GATT in 1947, today's WTO has 150 members at every level of development and representing every region of the globe, with more than two dozen countries seeking to join. The goal remains the same: to lower barriers to trade and spur new trade flows among nations, thereby unlocking the benefits of economic growth and development on the broadest basis. Trade rules also provide certainty, transparency, and predictability in international commerce, help foster the rule of law, and allow for countries to settle their trade disputes peacefully.

Trade Creates Wealth

Empirically, expanded trade has been essential to economic growth and wealth for both developed and developing countries.

The openness of the U.S. market to the world has been a cornerstone of this nation's strength and prosperity. The United States is the world's largest economy and largest importer and exporter. Since the 1990s, freer trade has helped raise U.S. national economic output by nearly 47 percent, and, over the same period, the U.S. economy added nearly 19 million jobs. Manufactured exports support more than one in six U.S. manufacturing jobs, an estimated 5.2 million jobs, and agricultural exports support an additional one million jobs. Jobs supported by exports pay about 13 to 18 percent more than the national average.

American households also benefit from the freedom to choose imports from around the world. It is estimated that the two major trade agreements of the 1990s—the WTO Uruguay Round and the North American Free Trade Agreement between the United States, Canada, and Mexico—generate increased purchasing power of $1,300 to $2,000 per year for the average American family of four.

For developing countries, the benefits of trade openness coupled with pro-market domestic reforms are also proven by experience, and the potential for greater

growth and poverty reduction through trade liberalization is substantial. The World Bank has reported that per capita real income grew nearly three times faster for the developing countries that lowered trade barriers (5 percent per year) than for other developing countries (1.4 percent per year) in the 1990s.

With respect to poverty, Columbia University economics professor Xavier Sala-i-Martin finds that global poverty rates have declined significantly over the last three decades, estimating between 250 million and 500 million fewer poor in 2000 than in 1970, coupled with reductions in global income inequality during the 1980s and 1990s. China, for example, has aggressively opened its market and expanded its trade, lifting more than 250 million people out of poverty. Chile, which has also actively opened its market to trade and commerce, has more than halved its poverty rate, which declined from 46 percent in 1987 to around 18 percent in 2004. On the other hand, in sub-Saharan Africa, a region that has been much less open to trade, countries are only now beginning to open markets and expand trade in a way that will alleviate increased poverty.

© AP Images/Amit Bhargava

Countries such as India that have begun opening markets to imports give their consumers many more choices in groceries and other goods.

Studies by the World Bank and the Peterson Institute for International Economics estimate that global free trade could lift tens of millions more out of poverty and inject $200 billion annually into the economies of developing countries. However, for developing countries to fully realize the benefits of liberalization, trade should be accompanied by other domestic reforms, assistance, and capacity building.

With regard to trade capacity building, the United States has made it a priority to provide developing countries with the tools to benefit from the global trading system. The United States is the largest single-country provider of trade-related assistance, which includes trade-related physical infrastructure. U.S. cumulative spending on such aid in 2001-2006 totaled more than $5.6 billion in grants.

Trade Liberalization and Development

Developing countries are potentially large beneficiaries of further multilateral trade liberalization in agriculture, manufactured goods, and services through the WTO Doha Round.

Agriculture: More than 70 percent of the poor in developing countries live in rural areas. World Bank and Organization for Economic Cooperation and Development (OECD) studies concur that the most important thing developed countries can do to benefit developing countries is to make deep cuts in agricultural tariffs. Eliminating agricultural distortions by developed and developing countries alike would deliver nearly two-thirds (63 percent) of the potential benefit to developing countries. World Bank studies indicate that 93 percent of the welfare gains from removing distortions to agricultural trade globally would come from reducing import tariffs, while only 2 percent of gains would come from reducing export subsidies and 5 percent from reducing domestic support. Virtually all of the welfare gains to developing countries from removing distortions to agricultural trade globally come from the removal of import tariffs.

Goods: According to the World Bank, roughly half of global economic benefits from free trade in goods would be enjoyed by developing countries. The estimated increase in developing countries' annual income by 2015 is $142 billion, or 49 percent of global gains. Taking dynamic changes to economies into account, that estimated increase rises to as much as $259 billion, or 56 percent of global gains. Trade barriers in developing countries are higher than in developed countries: The

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A Taiwan-made wrench for sale in Mexico City demonstrates the benefits of open trade for both of these advanced developing economies.

International Monetary Fund finds that trade restrictions in developing countries are four times higher than in high-income countries. Because roughly 70 percent of the tariffs on goods traded by developing countries are paid to other developing countries, low- and middle-income nations could benefit from eliminating their own barriers and stimulate further South-South trade flows.

Services: Services are now the major source of employment in developing economies, accounting for more than 50 percent of jobs in Latin America, the Caribbean, and East Asia. Services are the future of developing countries because they are the fastest-growing component of their total economic output and the largest component of foreign direct investment (FDI). Services account for more than 60 percent of global FDI, increasing from $870 billion to $5.9 trillion from 1990 to 2004. Because the barriers to trade in services are extensive, the payoff for reducing them is great. For example, a recent World Bank report indicates that countries with open financial services sectors have grown on average one percentage point faster than other countries. A University of Michigan study estimates that liberalization of services would produce more than two-thirds of the global economic welfare gain from the elimination of trade barriers.

Trade and the Environment

Trade liberalization can and should support sustainable development. Generally speaking, countries that are wealthier tend to devote greater societal resources to domestic environmental preservation. In the WTO, the Doha Round holds great promise for win-win situations with regard to trade and environment, whereby liberalization yields positive environmental outcomes. For example, many prominent environmental nongovernmental organizations, such as Oceana and World Wildlife Fund, have supported the efforts of trade ministers to eliminate harmful fish subsidies, which lead to overfishing of the world's oceans and depletion of fish stocks, as part of the Doha negotiations. Further, liberalizing trade in environmental goods and services can support sustainable development goals by providing greater access at lower cost to key environmental technologies in areas such as wastewater management, solid and hazardous waste management, remediation of soil and water, and protection of ambient air and renewable energy production.

The Wiser Path

Developing and developed countries alike face an important choice in the direction of their trade policy. In a rapidly shifting global economy, policy makers may be tempted to shield their domestic markets from competition and erect new barriers that advantage a relatively small group at the expense of the vast majority of producers, workers, and consumers. Theory and empirical evidence counsel a wiser path. Openness to trade has been the foundation for economic growth, prosperity, rising standards of living, and a better life for countless millions in countries around the world.

The United States stands ready to dismantle remaining trade barriers as others do the same and create real, new trade flows that will benefit businesses both large and small, workers, farmers, and families. The gains from trade yet to be realized for the hundreds of millions more who seek greater freedom, opportunity, and a path out of poverty mean that it is imperative to expand new markets abroad. ■

Protectionism and Politics

Bruce Stokes

Joseph Keppler and Frederick Opper, *Puck Magazine*, June 3, 1896

Protectionism has long been contentious. This cartoon makes fun of the protectionist platform of 1896 U.S. presidential candidate William McKinley.

Protectionism has a long history. Responding to political pressure, governments in developed and developing countries have protected their textile, auto, agriculture, and other producers from imports. In some places, farmers receive protection despite their small numbers because they hold disproportionate voting power. As the problem of protectionism is political, so must the solution be.

Bruce Stokes is international economics columnist for the National Journal.

Protectionism—government efforts to shield domestic producers from international competition—is deeply rooted in the politics of nations throughout the world. It is both the product of special interests and a reflection of general public anxiety about change. And it comes at great economic cost.

Resistance to trade liberalization and its political roots are hardly new. In the first half of the 19th century, Britain imposed import tariffs designed to "protect" British farmers and landowners from competition posed by cheap foreign grain imports. But these import taxes raised food prices in English cities, forcing reluctant industrialists to pay higher wages so that their workers could afford to eat. In 1846, after a protracted struggle in Parliament, these Corn Laws were repealed, marking the political ascendance of the new English middle class.

Similar fights over tariffs dominated much of 19th century American politics. In the run-up to the American Civil War (1861-1865), the northern, industrial states wanted high tariffs to protect their emerging manufacturing interests from European competition. The southern states wanted low tariffs because they imported much of what they consumed, from linens to farm machinery. One indication of just how important this issue was: When Jefferson Davis, the president of

the secessionist Confederate States of America, gave his inaugural address in 1861, he spent much of the speech talking about the need for low tariffs, not about slavery.

Three-quarters of a century later, politically inspired protectionism was a worldwide response to the Great Depression. During the 1928 U.S. presidential election campaign, Republican candidate Herbert Hoover pledged to raise tariffs on farm imports to aid American farmers, who had experienced years of declining commodity prices. Once Hoover's promised legislation began moving through the Congress, industrial-sector special interest groups added their own tariff protections.

© AP Images/Claude Paris

Farmers protest in France, where the political system gives them a disproportionate influence in elections.

The resulting Smoot-Hawley Tariff Act of June 1930 ended up raising all U.S. tariffs to historically high levels. Foreign retaliatory duties sent global commerce spiraling downward. By 1934, world trade was only one-third what it had been in 1929.

Textiles and Apparel

In the modern era, thanks to a half century of tariff-reducing global trade negotiations, protection is far less extreme. But it is no less political. Agricultural, industrial, and service industry interests still resist market liberalization because they have domestic market dominance to preserve and they fear the lower prices and technological innovations posed by foreign competition.

The protection afforded the textile and apparel industry in all parts of the world until recently is a classic case of such vested interests defending themselves against imports. Restraints on trade in cloth and garments first emerged in the 1950s as developing countries began to compete with producers in Europe and the United States. The multilateral 1974 Multifibre Arrangement imposed product-specific import quotas and tariffs on all such trade. This protection cost U.S. consumers more than $20 billion a year in higher prices for shirts, trousers, and underwear. And the World Bank estimated that every American or European job preserved by such import restraints denied jobs to 35 workers in poorer countries.

Nevertheless, thanks to the political influence of American and European textile and apparel makers and the unions that represented their workers, limitations on trade remained in place until 1993, when rich countries finally agreed to lift them. But even then, it took a decade to phase them out. So it was not until 2005, more than half a century after protection began, that trade in textiles and apparel was finally liberalized. And even now, such commerce faces some extremely high tariffs.

Protecting Automakers

Protection can also affect higher-value products such as automobiles, an industry that at various times has been protected by powerful political interests in Japan, Korea, China, and the United States.

In the 1970s and 1980s, the U.S. auto industry faced its first major challenge from foreign competition as Japanese automakers aggressively entered the American market. As Japan's share of the U.S. market grew, the Big Three U.S. automakers—Ford, Chrysler, and General Motors—convinced the federal government to impose a cap on the number of cars Japan could ship to the United States. In 1981, the Reagan administration agreed to impose such restraints, despite President Reagan's free market philosophy, because the auto and auto parts

industries were major employers in the United States. Moreover, such employment was largely concentrated in a number of politically pivotal states—Michigan, Ohio, and Illinois—that exerted a great deal of influence in Congress and in presidential elections.

The annual import limit had the perverse effect of encouraging Japanese car companies to change the product mix of vehicles they shipped to the United States, sending more upscale models, where the profits were greatest, and fewer smaller, cheaper cars. It is estimated that, at its peak in the early 1980s, the quota was transferring $5 billion a year in additional profits to Japanese automakers, who could sell their quota-limited cars at a premium. Despite this protection, the U.S. auto industry continued to lose market share to Japanese producers because Toyota, Nissan, and Honda simply jumped over the trade barrier and began manufacturing cars in the United States.

America is not alone when it comes to the imposition of protectionist policies as the result of political influence. In South Korea, for example, foreign car makers from Japan, Europe, and the United States sold only 30,000 cars in 2005, just 3.3 percent of the Korean market. That same year, Korean automakers sold more than 1.5 million vehicles abroad. The combination of an 8 percent tariff and taxes on engine size add about $9,000 to the price tag of a $30,000 imported car. Moreover, until recently, the Korean government audited the tax returns of anyone who bought an imported car, a sure way to discourage buying a foreign brand.

Disproportionate Voting

The ability of special interests to influence trade policy, and whether they can continue to exercise such influence, can best be explained by the constitutional structures in which such trade policies are formulated, the changing political-economic balance within modern societies, and the evolution of public opinion about trade issues around the world. Special interests can often manipulate political systems because they reflect economic and political realities that no longer exist.

In the United States, members of the U.S. House of Representatives represent people. There is one member for approximately every 650,000 citizens. Members of the U.S. Senate represent land. There are two senators from every state, no matter its population. This arrangement reflects a deal made in the 18th century at the time the U.S. Constitution was written to balance the interests of large and small states. In the 21st century, the effect has been to give agricultural interests disproportionate influence in the U.S. Senate, reinforcing support for American agricultural subsidies that can distort trade.

But America is not alone in its constitutional bias toward protectionism. Although active farmers make up less than 4 percent of the French electorate, their high turnout rate enables them to deliver 8 percent of the vote in national elections. And the French electoral system affords farmers a disproportionate chance to become elected officials. More than one-third of the country's mayors are active or retired farmers. And since members of the French Senate are indirectly elected by municipal councils, it is not surprising that farmers are overrepresented in that upper house. The disparity between the percentage of farmers in the Senate and the proportion of farmers in the overall population has nearly doubled in the past 40 years.

And the nature of the French presidential election system makes it hard for a presidential candidate to ignore farm interests. A runoff system, in which the top two vote-getters proceed to a second round, gives farmers—who overwhelmingly belong to parties of the political right—great influence in choosing the conservative candidate. In 1988, for example, farmers accounted for nearly one of every four votes given to Jacques Chirac, the conservative winner in the first round. It is little wonder that Chirac has often been considered a creature of organized agriculture.

These peculiarities of the French political system allow other strong, regionally based industries, such as textiles and electronics, to exert similar pressure. This contributes to the weakness of the Patronat—the leading French trade association for French industry—and effectively silences its opposition to the farm lobby and the forces of protectionism.

Similarly, in the South Korean National Assembly, rural voters are "overrepresented" by a margin of three to one. This disproportionate influence of farm voters has led to high tariffs on food imports, forcing Korean consumers to pay some of the world's highest prices for beef, fruits, and vegetables.

Experience in Japan, however, suggests that changes in constitutional arrangements can transform the politics that drive protectionism. Up until the 1980s, apportionment of electoral districts for the Japanese Diet reflected the distribution of the population in the years following World War II, when only one-third of the people lived in urban areas and two-thirds lived in rural areas. But by the 1980s, three-quarters of the Japanese population lived in cities. As a result, it took five times as

© AP Images/Itsuo Inouye

Japanese farmers resist trade agreements opening the country's agricultural markets to any more foreign competition.

many urban votes as rural votes to elect a Diet member. By-products of this rural influence were a 700 percent tariff on rice and one of the world's most protected agricultural sectors.

But in 1994, electoral reform in Japan dramatically narrowed rural-urban differences in legislative representation. This change in the balance of voting strength led the Liberal Democratic Party, which had dominated Japanese politics after World War II, to transform itself from a rural-based party to an urban and suburban party, with new policy priorities. Japanese government subsidies have been redirected from farmers to urban residents, and while Japan is far from being an open economy, it now imports far more than it ever did before.

Public Ambivalence

The politics of trade are also driven by the public's profound ambivalence toward international commerce.

In principle, people worldwide think globalization is good for their families and for their countries. In 25 of the 44 nations surveyed by the Pew Global Attitudes Project in 2002, majorities of at least 60 percent thought that globalization was a good thing. Africans, who live on the poorest continent, were the most upbeat. Seven in 10 respondents in Uganda said greater international commerce was good for their nation. Roughly two-thirds of Nigerians agreed. Meanwhile, more than half the Vietnamese, whose economy is the second-fastest growing in Asia, thought that internationalization had been good.

A more recent survey by the German Marshall Fund found ambivalence about trade in Europe and the United States. Seven in 10 Americans favored international trade in 2006, up from two-thirds in 2005. And even more Europeans, three out of four, supported trade, up from two in three. But more than half the French and nearly one-third of Americans do not favor freer trade. And half the Germans and three-fifths of the Americans and the French think freer trade costs more jobs than it creates.

Overall, it would seem that Americans and Europeans are free traders in principle and protectionists in practice. The same people endorse free trade as a philosophical concept and also support tariffs on steel imports, for example, if those tariffs will protect local jobs.

The tragedy of protectionism is the economic cost it imposes on national economies, especially poor ones. Recent studies by the World Bank conclude that removal of protectionist barriers in developing countries has increased growth between 1.2 and 2.6 percent. Moreover, trade liberalization has been followed by acceleration in investment and exports of goods and services.

These economic benefits notwithstanding, the political roots of protectionism and its long history suggest that barriers to trade will remain an impediment to economic well-being for some time to come and that protectionism will have to be addressed politically if it is to be overcome. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

Developing Countries Need to Open Markets to Each Other

David Dollar

© AP Images/Teh Eng Koon

Auto shoppers in Malaysia have more choices since the country opened its markets to imports from neighboring Southeast Asian countries.

Fully half of the benefits to developing countries from stalled multilateral trade negotiations would come from getting better access to each other's markets. They would gain more by lowering their own barriers to agricultural trade than they would by wealthy countries lowering their barriers, although the latter also must happen.

With two-thirds of the industrial goods tariffs paid by developing countries going to other developing countries, further trade liberalization could attract foreign investment and advance developing country growth. Completing the Doha Round trade negotiations will require real leadership on the part of the developing world, especially the big developing countries that have benefited so much from globalization.

David Dollar is World Bank country director for China and Mongolia.

The Doha Round of multilateral trade negotiations is stalled and may very well fall apart. This round of trade liberalization was supposed to be the World Trade Organization's "development round" that would provide benefits in particular to developing countries, which are home to 1 billion people living on less than $1 per day and 2.6 billion living on less than $2. How would a new round of trade liberalization help poor countries?

Opening Agricultural Markets

The most obvious issue—and the one that has received the most attention—is the ongoing agricultural protection of rich countries. Japan protects rice and other markets. The United States and Europe subsidize and protect farmers. Completely liberalizing agricultural markets in rich countries would provide an immediate annual benefit to developing countries of $26 billion,

according to a recent World Bank estimate. To put this number in context, it is about one-half of the annual flow of foreign aid from rich countries to poor ones. Thus, opening agricultural markets in rich countries is one important issue.

Less well publicized is the fact that opening the agricultural markets of developing countries would provide to these countries a similar—even slightly larger—gain of $28 billion per year. This gain comes partly from the fact that trade liberalization will enable each country to expand production of goods and services that the country makes efficiently and sell them at better prices. Another benefit from trade is that consumers will buy at lower prices goods and services that their country does not produce so well.

In addition, developing country liberalization would stimulate South-South trade—trade among developing countries—providing benefits to other poor countries. Where it can be achieved, liberalization of markets for staple foods can particularly help reduce poverty, since these goods account for a large share of expenditure of poor households in developing countries.

Cutting Industrial Tariffs

While a lot of attention in trade discussions focuses on the agriculture issue, there is an equally strong case for further liberalizing markets for industrial products. Many developing countries are now efficient producers of manufactured products, especially labor-intensive ones such as textiles and electronics. In fact, 80 percent of the exports of developing countries are manufactured products.

The largest markets for industrial goods are in the rich countries, but their import tariffs are already relatively low. Right now, about two-thirds of all industrial tariffs paid by developing-country producers are paid to other developing countries because import tariff rates for industrial products tend to be higher in developing countries.

Developing countries thus have a lot to gain from better access to each other's markets. This will enable more efficient firms to expand production and achieve scale economies and will encourage more specialization, as has been seen during European integration over recent decades.

The phrase "development round" may suggest to some that the key objective of the current round is to get rich countries to drop their barriers against goods from poor countries. But that move alone would provide only half of the potential benefit that developing countries could gain from a more open trading system. Fully half of the potential benefit to developing countries of trade liberalization comes from better access to each other's markets.

Dynamic Benefits

The benefits that I have discussed so far are what economists call "static benefits"—gains that could come quickly based on current production capabilities. Full trade liberalization would lead to the developed countries reducing production of certain agricultural products, while such production expanded in developing countries having adequate land and water. Developing countries would also expand production and export of labor-intensive manufactures, whereas developed country production would tend to shift into heavy machinery, technology-intensive products, and services. But beyond these static gains, there are also important dynamic benefits. The dynamic effects are hard to quantify, but they are arguably more important than the static gains.

What we mean by dynamic benefits is that connecting to a large, global market tends to stimulate innovation and productivity growth at the firm level. Innovation is not just major technological breakthroughs; it is most commonly small changes in the process or products of a firm. Firms in protected markets tend to become complacent, whereas a large competitive market provides a significant outlet for good ideas and high-quality production.

The large market also provides for a finer division of labor. A developing country that lowers its own import barriers against manufactured products will typically find that its firms become part of global production networks in which different components and activities that feed into one final product originate in different countries.

For developing countries to take part in sophisticated global production networks, they need to have investment climates in which it is relatively easy for firms to start up and expand. They need good transport links to the wider world and efficient customs administration.

A final point about the Doha Round is that it is also trying to take up issues of liberalizing trade in services. Many modern services contribute to a good investment climate: finance, insurance, logistics, port management, and transport services, to name a few. Liberalizing imports of these modern services can help developing countries build a stronger investment climate so that their firms can more easily take advantage of global market opportunities.

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This apparel factory in Lesotho stands to gain from the elimination of tariffs on trade with its neighbors in the Southern African Customs Union.

Political Leadership Needed

A comprehensive round of trade liberalization will provide benefits to all the countries that are members of the World Trade Organization. If that is true, then why is it so difficult to strike a deal?

The well-known political problem with trade liberalization is that a more open market provides diffuse benefits to the whole population, but also imposes large adjustment costs on some specific industries. Of course, the protected farmers in the rich countries lobby against trade liberalization in their sectors. The protected industrial firms and service industries in developing countries likewise lobby. So it takes real political leadership from each country to bring about a deal.

It is also both smart and humane to be aware of the losers and to design as much as possible compensation schemes to ease the adjustment. Many countries have adjustment assistance programs to help workers retrain or relocate so that they can take advantage of the opportunities opened up by expanded trade.

Previous trade liberalization rounds have appeared close to collapse before an eleventh-hour deal emerged. So for the sake of poor countries, let's hope that political leadership is found all around. A Doha deal will require significant movement on the agricultural protection issue from the United States, Europe, and Japan. But it will also require real leadership on the part of the developing world, especially the big developing countries that have benefited so much from globalization. Further trade liberalization for industrial products and services is very much in the interest of the developing world, but developing country leaders will have to convince their populations of this and find smart ways to help the people who are temporarily hurt during the adjustment. ■

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Calming Workers' Fears About Trade

David H. Feldman

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Workers in developing countries, such as this one in Nicaragua, need not only a basic social safety net but also an education system that trains them for rapid change.

Even though the global economy has been expanding, workers and the governments that represent them show increased anxiety about trade. Most changes in the workplace leading to job displacement can be attributed to advances in technology, but it is increasing imports that attract more blame. Protectionism is the wrong response. Better solutions have been proposed for governments to address workers' anxiety.

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Pascal Lamy, director-general of the World Trade Organization, has called on the international community to reinvigorate the moribund Doha Round of negotiations because he fears that failure could put at risk the rules-based multilateral trade regime. The real difficulty goes beyond the specific negotiating issues at Doha. In developed and developing countries alike, the idea that global economic integration brings social benefit is increasingly controversial. As a result, many countries show a growing appetite for using discriminatory and trade-distorting practices as discretionary policy tools.

Anti-dumping actions, temporary tariffs or quotas in response to import surges, production subsidies, and trade-distorting regulations are easy to understand when economic growth is stagnant. Unless a growing economy can create easy opportunities for other industries to absorb labor quickly, then trade concessions and economic shocks, or both, can create clear losses in import-competing industries, especially for workers whose skills and experience are tied to their existing employment. Such policies can be used to preserve the status quo.

Rapid contraction within any sizable sector of the economy exacts a political toll. But the erosion of faith in open global markets and multilateral rules seems surprising in an era of robust overall economic growth. The answer to the conundrum lies in the quickened pace of technological change.

Technological Change and Job Anxiety

We have witnessed significant labor-saving technological change in manufacturing over the past 60 years. In most developed economies, productivity growth in manufacturing has averaged 3 to 5 percent per year since 1950. At the same time, manufacturing employment has grown little or has actually declined. This has reduced the share of employment in manufacturing and has led to a corresponding rise in the share allocated to services.

At the same time, falling global transport costs have contributed to a rising share of manufactured output that is traded internationally. More recently, service-sector outsourcing has led companies in many countries to restructure the way they do business.

Structural change is equally rapid in many developing countries as cities expand and traditional agriculture and small-scale cottage industries give way to greater specialization for the global market.

All of these shocks mean that more sectors of the economy feel threatened by actual or potential international competition, and this view is common in countries at different levels of economic development.

A second and related issue is the fear that growing trade between more-developed and less-developed regions of the world is the main cause of increased income inequality in the United States and high unemployment in Europe. Yet as Princeton University economics professor Paul Krugman and others have argued, the probable cause is falling internal demand for unskilled labor, which is likely generated by technological change that is biased toward highly skilled workers. International economic integration may have had some small influence on the timing of these labor market changes, but they would have occurred in any case.

Nonetheless, public anxiety about job insecurity focuses on trade liberalization in part because job displacement is often quite costly in industries that face strong competition from imports. Yet governments should not respond to this sense of insecurity by abandoning a principled commitment to open engagement with the world market or by relying more heavily on administrative protection and other policies that favor particular domestic companies or sectors of the economy.

The Problems With a Protectionist Remedy

The most important competition that takes place within any country is not between domestic companies and foreign rivals, but among domestic companies for scarce labor and capital at home. Trade barriers and domestic subsidies may raise output, employment, and profit in certain domestic industries, but they do this by disadvantaging other domestic companies not favored by subsidies or protection. And if the source of profit in favored industries is higher domestic prices instead of higher productivity, then that profit represents lost income to someone else in that country. It is not a gain in national income.

These policies pit domestic consumers as well as companies that use imported intermediate inputs against often politically well-connected producers of import-competing products. Because the protective policies often are opaque and the process that leads to them hidden from view, they expand the scope for special-interest lobbying. This socially unproductive excessive profit seeking often redistributes income away from society's most needy citizens and diverts scarce resources away from sectors likely to produce high levels of economic growth.

One advantage of trade openness is that world prices usually provide better information about scarcity than prices distorted by interest group pressure. World prices provide better incentives to domestic consumers and companies to use resources in a way that maximizes the value of national income. Companies and consumers in more open economies often have a wider choice of higher-quality goods, and these economies may experience a faster rate of technological diffusion if technology is embodied in imported inputs or foreign investment.

Yet another advantage of trade openness is that it diminishes the market power that highly concentrated domestic industries have within their home country. Openness is a very effective competition policy. This is especially true for smaller developing economies in which many domestic industries have only one or two major companies.

How Best to Respond?

In nations with a well-developed public sector, job insecurity among workers can be addressed using a number of targeted programs. Older tools such as expanded trade adjustment assistance (TAA), which is money spent on retraining workers laid off as a result of trade, can help make trade agreements more palatable to skeptical legislatures. Unfortunately, TAA systems are administratively complex, and they do not always reach the workers who most need the assistance or who are most adversely affected by trade. Programs that are more likely to restore vitality to trade liberalization are ones that

directly address the causes of worker anxiety and that reach more people.

In a policy paper for the Peterson Institute for International Economics, Peterson senior fellow Lori Kletzer and Brookings Institution senior fellow Robert Litan advocate a new safety net for all displaced workers. The two pillars of the proposal are wage insurance and subsidies for health insurance for qualifying workers upon reemployment. Though their argument is directed at the U.S. experience, the idea of providing social insurance against the things people fear most about job loss has great appeal. Existing unemployment insurance does nothing to allay the fear of wage loss upon reemployment, and paying the benefit only upon reemployment would tend to shorten unemployment duration and hasten the development of new skills on the job.

Another approach involves expanded use of tax advantages for retraining. Companies could spread the costs over years for qualifying forms of worker training, and individuals could receive tax deductions or credits for individual educational expenses in qualifying programs.

In many developing economies, the public sector's effective reach is much shorter, and there are clear government priorities that should rank much higher than industrial policy or managing trade. One such priority should be to build a sound fiscal architecture of clear tax codes enforced by independent and impartial judiciaries so that revenue can be collected efficiently and fairly. In addition, broadening the tax base would permit governments to collect more revenue while reducing high tax rates—including high taxes on imports and income—that breed tax evasion and public corruption.

A sound revenue base would permit governments in developing economies to perform many tasks that only they can do. Young people need a basic framework for educational advancement, especially at the primary and secondary levels. Comparative advantage is a moving target, and, given the rapidity of change in the recent past, workers will need transferable skills that will permit them to work in many industries over their working lives. Basic health care needs to be extended to more people so that productive lives are not compromised by easily prevented chronic illness. And lastly, every citizen should be able to rely on a basic social safety net so that anxiety about employment does not translate into a phobia about the changes the world market is bringing.

Pascal Lamy may be right. There is some risk that a failed Doha negotiation could trigger a round of inward-looking policies or even "beggar-thy-neighbor" tactics such as competitive currency devaluations and increased protective barriers. On the other hand, the real future of global economic integration may be decided less at the global negotiating table and more by how countries respond to domestic job anxiety. ■

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Learning the Correct Lesson About Protectionism

Gary Hufbauer and Costantino Pischedda

War-ravaged East Asian economies briefly used protectionist policies to revive their economies. Developing countries today should not misinterpret history, however. Only when Japan, South Korea, and Taiwan opened their markets to imports did their economies realize enduring rapid expansion. The remaining protectionist barriers only detract from those huge successes.

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Economists can show that Japanese productivity has gone up as imports increased and protectionist barriers decreased.

After the Second World War, East Asia rose from grinding poverty to spectacular prosperity. In retrospect, Japan, South Korea, and Taiwan are sometimes depicted as historical posters for fostering growth through protection. Indeed, to varying degrees, all these countries adopted protectionist policies in the first decade of their postwar ascent. If protection worked for them, free-trade skeptics ask, why should the poorest countries of Africa, Asia, and Latin America not adopt the same approach today?

The Theory

The theoretical case for trade protection rests on market failures that can be corrected by government intervention. Here are a few examples:

- If the activities of firm A benefit firm B at no cost—for example, by creating a trained labor force that firm B can hire—firm A will likely invest too little in training. Government subsidies to help pay for firm A's training efforts could benefit the entire production system.
- If learning-by-doing is critical for success, a firm can become internationally competitive only by acquiring extensive production experience. However, during its learning period, the firm may sustain large financial losses. Unless far-seeing capital markets provide ample credit, government help may be necessary to give the firm a start.
- Firm A (for example, a mining enterprise) will be profitable only if firm B (for example, a railway) is established, and vice versa. The government could help coordinate the two firms' business relationship.

These three examples illustrate market failures that potentially justify policy intervention. The real question, however, is whether such theoretical possibilities are important in practice. After all, plenty of theory can

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South Korea's boom in technology-intensive production followed the country's shift away from high trade barriers.

be cited on the other side of the protection debate: economist David Ricardo's theory of comparative advantage, the proven power of competition to boost efficiency, and the widely recognized danger that protection will foster corruption.

Case: Japan

In the first phase of its economic recovery, between the end of the Second World War and the Korean War (1945-1955), Japan enjoyed rapid growth. The government protected key sectors as part of a wider industrial policy aimed at restoring pre-war industrial levels. Government policy concentrated on heavy industries that were badly damaged, such as steel, chemicals, and transportation equipment.

In retrospect, Japan's recovery was easy because pre-war know-how, managerial talent, and industrial networks were largely intact. Missing were domestic savings and foreign exchange to reconstruct the stock of physical capital and to buy inputs and technology from abroad. Government intervention undoubtedly increased savings and marshaled foreign exchange. Achievement of these goals likely accelerated, rather than generated, the postwar recovery process.

In the second phase (mid-1950s to mid-1980s), the Japanese economy was gradually liberalized (except for agriculture) yet continued to enjoy rapid economic growth, and Japan soon became an international leader in technology. Trade restrictions played little role in sustained Japanese success. In fact, on an industry-by-industry basis, economists can show a negative relationship between effective protection and export performance in Japan.

Similarly, for 1955 to 1990, economists can show a negative relation between effective protection rates and changes in productivity. The same scholars find a positive association between the level of imports and the growth of productivity. At least two mechanisms explain this finding. Imports of new and improved intermediate inputs increase the efficiency of local firms. Further, imports expose local firms to competition, stimulating management to improve performance. Japanese growth, good as it was, would have been even better if government had given less protection to domestic firms.

Case: South Korea

The Korean War (1950-1953) devastated South Korea's plant and equipment, but surviving workers carried their skills into the postwar era. For the following decade, the government maintained a protectionist outlook, not only imposing high trade barriers but also maintaining an overvalued exchange rate. Starting in the mid-1960s, Korean leaders shifted the policy mix toward outward orientation. A combination of trade, tax, credit, and exchange-rate incentives gave the Korean economy a pro-export tilt.

During 1961-1980, Korean exports grew by almost 24 percent per year in real terms, while the share of exports in Korea's economic output soared from about 5 percent to 33 percent. While the initial phase of industrial development focused on labor-intensive sectors, in the early 1970s Korea moved to a second phase of capital-intensive and technology-intensive production. Today, of course, Korea has become a premier exporter of electronics, machinery, steel, and autos.

But residual protection detracted from overall Korean performance. Data for 38 Korean industries over 1963-1983 demonstrate a negative correlation between protection and productivity growth. "The Korean data present evidence that less intervention in trade is linked to higher productivity growth," says economist Jong-Wha Lee of Korea University in Seoul. In fact, plain old special interests better explain the pattern of Korean protection than calculations of economic gain.

Case: Taiwan

Taiwan's economic renaissance can be divided into two phases. In the first phase, extending from the end of the Chinese civil war in 1949 until the late 1950s, the Taiwanese government erected high tariff and nontariff barriers to limit imports and promote domestic industrial expansion.

In the second phase, during the 1960s and 1970s, Taiwan's leaders shifted to outward-oriented policies, significantly liberalizing imports and correcting an overvalued currency. Leaders realized that Taiwan's inward orientation limited the country's growth prospects, owing to the small size of its domestic market.

During its outward-orientation phase, Taiwan's exports increased very rapidly. The export share of economic output exploded from 8.5 percent in 1952 to 44.5 percent in 1976; manufactured exports accounted for less than 8 percent of total exports in 1955, but more than 91 percent in 1976.

During the second phase, Taiwan retained some trade barriers (particularly important in agriculture), but residual protection was a concession to special interests, not a contribution to economic growth. Taiwan's growth took place in spite of, not because of, restrictive measures. Several studies found that the Taiwanese trade protection was driven by political considerations rather than by market failures.

Lessons Learned

The lesson emerging from the postwar experience of Japan, South Korea, and Taiwan is clear: The prolonged era of remarkable growth was associated with progressive liberalization, not enduring protection. After an initial phase of inward orientation, all three countries opened their economies to international competition. By doing so, they achieved rates of economic growth rarely seen in world history. Protection was not eliminated overnight, and evidence suggests that residual protection detracted from stunning overall performance.

Those who embrace high barriers to trade may argue that East Asian growth began under protectionist policies. While true, the argument fails to distinguish between the start of the growth process and its continuation over long periods. In all three cases, development began in the aftermath of destructive war. Economic growth in the earliest phase simply returned the East Asian economies to their pre-war levels.

A leading advocate of export-led growth, the late Béla Balassa of Johns Hopkins University, recognized the positive role played by import substitution in the early years of Korean and Taiwanese growth. However, the positive role for protection was limited to a short phase when domestic production was substituted for imports of consumer goods. Once this process was completed, the East Asian economies needed to open to world markets—both to acquire intermediate inputs and to sell on a much larger scale. In terms of per capita growth in economic output, the years of outward orientation outperformed the years of import substitution. In the case of Korea, for example, the annual growth of per capita economic output was 2.2 percent between 1955 and 1965 and 8.2 percent over the following 10 years.

Virtually all developing countries have long since passed the stage of easy import substitution. The clear lesson of the East Asian experience for developing countries in 2006 (not 1946) is that sustained growth requires progressively lower barriers to world trade. ■

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A Clear Model for Reform

Jonathan Kimball

The difference in economic development between the many former Soviet bloc countries that have opened their markets on the way to joining the European Union (EU) and the few that have not done so is sharp and revealing.

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This Audi plant in Gyor, producing 50,000 autos annually, reflects Hungary's embrace of foreign investment.

Seventeen years after the fall of the Berlin Wall, liberal, free market democracies have firmly taken root in Central and Eastern Europe, including in the Baltic States of the former Soviet Union. The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia are all members of the European Union, which Romania and Bulgaria also joined on January 1, 2007. While EU membership demonstrates international recognition of the region's monumental transformation, the trade liberalization that was a critical part of the accession process will have an even greater impact on the well-being of the region's population over the long term.

In contrast, the former Soviet states of Belarus, Moldova, and Ukraine, geographically the most western of the non-EU members of the former Soviet Union, have not adopted trade-liberalizing policies to the same extent, and thus they have not reaped the same rewards. In fact, while their economies have grown during the past 15 years, they have not benefited from the same influx of capital and foreign investment as their neighbors to the west. This can be partly explained by differing historical circumstances, a lack of political commitment for reform, and, maybe most importantly, the nonexistence of a persuasive outside force pushing for trade liberalization, such as the likelihood of EU membership. But what has been most missing is a serious commitment to eliminate the nontariff barriers that greatly inhibit the growth of trade and foreign investment. These nontariff barriers act as a protectionist wall, favoring local companies with the knowledge and connections that lead to increased market share.

Only after Romania and Bulgaria, for example, began seriously addressing nontariff barriers—such as weak intellectual property rights enforcement, bloated bureaucracies that inhibited the ability of companies to work with the state, nontransparent procurement systems, and widespread corruption—did their economies turn around, foreign investors flood into the markets, and export-led growth take off.

The model to be followed for countries like Moldova, Ukraine, and Belarus is very clear. It is that of Central and Eastern Europe. The Central and East European economies have expanded specifically because they have opened their economies to foreign competition, reduced the state's influence on the economy, and introduced far-reaching structural reforms. Examples of key reforms implemented in the region include the following:

- **Tariff reductions:** Reducing tariffs was an important means of injecting competition into

the market. Higher-quality and less-expensive goods force inefficient companies out of the market and demand innovative and efficient production methods from companies that remain.

- **Price liberalization:** Although politically difficult, freeing prices was critical to implement market pressures on producers of everything from consumer goods to energy. Eliminating subsidies also allowed foreign products to enter the market without having to face additional barriers to free competition.
- **Privatization:** Reducing the state's role in controlling the means of production allowed companies to respond effectively to the cyclical nature of the market. Privatization also allowed the state to rid itself of loss-making companies that placed a significant strain on the state budget, and it attracted foreign investors to the region's economies.
- **Establishment of independent regulatory bodies:** Reducing the state's influence over regulatory decisions was critical to the establishment of a predictable market economy. Corruption and political influence are too easily exercised when the state has significant input in the market. This is especially important in the financial, telecommunications, and energy sectors.
- **Sound fiscal and monetary policies:** Controlling inflation has been critical to developing a market that is predictable and stable. At the same time, limited, effective, and accountable government expenditures have been highly important to direct and soften the effect of the introduction of market principles.

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Economic expansion has proceeded more slowly in Belarus than in its neighbors that have opened their markets to trade and investment.

The results have been highly impressive. According to the International Monetary Fund's *World Economic Outlook* database for September 2006, the average gross domestic product (GDP) per capita (in purchasing power parity terms) in Central and Eastern Europe increased by 112 percent between 1993 and 2005. In contrast, the average growth of GDP per capita in Belarus, Moldova, and Ukraine during the same period was 48 percent.

In addition, foreign investors have been attracted by these far-reaching reforms. Whether entering the economies via privatization, joint venture, or "greenfield" investment in new sites, foreign investors have brought jobs, know-how, and significant tax revenue to the transitional economies. As a result, during the same time that bloated state-owned industries were streamlined or liquidated, foreign investors, attracted by the predictability of a transformed economy, have helped fill the employment gap. While some of the above-mentioned reforms have been implemented in Belarus, Moldova, and Ukraine, the lack of a true commitment to the enforcement of the new laws and regulations has led to lower levels of foreign investment.

The economic transitions of the new members of the European Union are far from over. Throughout the region, corruption still needs to be reduced, bureaucracy must be trimmed, public procurements must be made more transparent, and other nontariff barriers must be tackled. However, trade liberalization and the extensive structural reforms implemented since 1989, which have resulted in strong, impressive economic growth, are unlikely to be reversed. This predictability—lacking in Belarus, Moldova, and Ukraine—creates a business climate that attracts domestic and foreign capital, leading to jobs, economic growth, and a stronger, wealthier middle class. These are all prerequisites for a modern, global economy. ■

How the WTO Fights Protectionism

Carla A. Hills

The World Trade Organization (WTO) fights protectionism in a number of ways. Member countries agree to abide by WTO trade rules aimed against protectionism. From time to time, they try to negotiate more agreements and rules, eroding even further protectionist barriers to trade. They use the WTO dispute settlement system in enforcing those agreements and rules. And they make sure new members start with commitments to shed protection.

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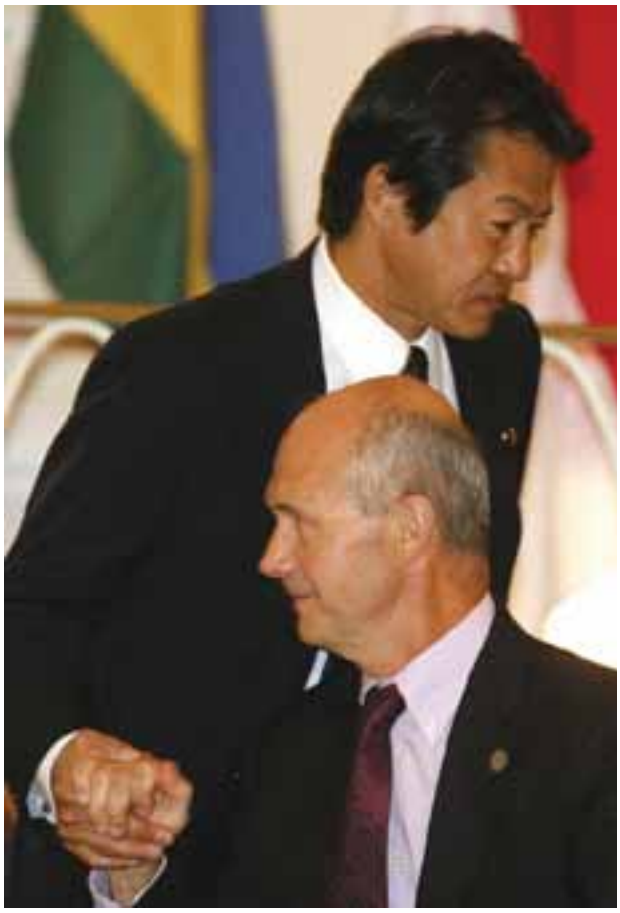

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Japanese Agriculture Minister Shoichi Nakagawa clasps the hand of WTO Director-General Pascal Lamy at a meeting in Brazil aimed at breaking the impasse in the long-stalled Doha Round of negotiations.

The World Trade Organization does much more than simply regulate global trade. It encourages trade liberalization and fights against protectionism through:

- principles and rules
- ongoing rounds of trade negotiations
- dispute settlement
- accession process.

Together, these four elements make the WTO the most successful of the postwar multilateral institutions and our greatest bulwark against trade protection.

Trade Rules

Today, the WTO manages trade through its 400 pages of detailed trade agreements, including the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS), supplemented by 22,000 pages of schedules of commitments agreed to by its 150 members.

When the GATT was negotiated in the late 1940s, it set out various rules and principles for governing international trade. At its heart were two fundamental principles of nondiscrimination—national treatment and most-favored-nation (MFN) treatment.

- National treatment requires WTO members to treat the goods and services of other WTO members as favorably as similar goods and services produced domestically.
- Most-favored-nation treatment says that WTO members must grant the same advantage (such as a lower tariff) to all members as that given to other WTO members.

Commitment to these central principles helps to keep global markets open. National treatment means that a country cannot block the import of a product if it allows the production and sale of the same product domestically. And MFN means that when a World Trade Organization member agrees to lower its tariffs on imports from one WTO member, it must do so for all WTO members.

Trade Rounds

The GATT's founders agreed not only to certain rules for conducting global trade, but also to progressive trade liberalization through what has become a series of multilateral trade negotiating "rounds." The current round—the Doha Development Agenda—is the ninth.

Since the GATT was established in 1947, membership has broadened from 23 member governments discussing tariffs on industrial goods to today's 150 members negotiating rules covering agricultural trade, industrial goods, nontariff trade barriers, services, subsidies, and intellectual property rights.

When nations agree to reduce their tariffs, they also commit not to raise them above that agreed, or "bound," level on pain of paying compensation to an affected exporting country or facing retaliation from that country. To date, developed countries have bound 99 percent of their tariffs, and developing countries 73 percent. The result creates a bulwark against protection through tariff increases.

Commitments to adhere to rules covering an expanding universe of trade by most of the world's trading nations have enhanced clarity and predictability in international commerce, enabling global exports to rise from $58 billion in 1948 to $8.9 trillion in 2004. World trade volume today is more than 23 times that of 1948. This opening of global markets has boosted standards of living worldwide.

Dispute Settlement

Even with clear trade rules, protectionist pressures may arise in disagreements over whether certain actions violate the agreed rules. Hence, there also must be a fair, timely, and effective mechanism for settling trade disputes.

For much of the postwar period, dispute settlement was a weak link in the GATT system. The GATT dispute resolution system permitted a party to a dispute to block indefinitely the adoption of a final determination in the case. As a result, disputes could remain unresolved for years, generating protectionist sentiment as countries grew frustrated over the system's failure to resolve trade disagreements.

In a particularly egregious case, the United States complained for more than a decade that subsidies provided by the European Community (EC) to its oilseed processors encouraging their use of domestic seeds nullified the EC's zero tariff commitment on imported oilseeds made in the 1961 Dillon Round. The EC repeatedly blocked formation of a GATT panel. Finally, the U.S. Congress passed a provision in the Omnibus Trade and Competitiveness Act of 1988 requiring that the U.S. trade representative take unilateral action under section 301 of the act to raise U.S. tariffs on an equivalent amount of EC exports if the case were not resolved by 1989. A trade war was avoided when the EC agreed to a panel that ruled for the United States.

In January 1995, when the WTO came into being, members strengthened the dispute settlement mechanism by removing the right to block the formation of a panel. Under the new rules, if a dispute cannot be resolved through the required consultations, a WTO panel will hear the case and a final ruling will be issued within 12 to 15 months of the formal case filing (including time for a possible appeal). A member found to be in violation of its WTO obligations is required to bring itself into compliance, generally within 18 months after a final ruling.

The improved system has encouraged WTO members—both developed and developing countries—to use the dispute settlement system to resolve differences. Since 1995, more than 55 countries have initiated cases and more than 120 dispute settlement panels have been formed. Because the process begins with mandatory consultation, hundreds of disputes have been settled before a panel is established. In addition, this stronger WTO dispute settlement system has helped members to manage domestic anger about perceived unfair trade practices by other members and to use WTO panel findings as reason for bringing their own nonconforming practices into line with their WTO obligations.

Accession

Another way the WTO has helped limit protection is through accession agreements. When a nonmember country applies for WTO membership, there is a rigorous examination of that country's trade regime, followed by bilateral negotiations with WTO members in areas of their interest. The process can take years. For example, China spent 15 years in negotiating bilaterally the terms of its accession prior to becoming a WTO member in 2001. Vietnam, the WTO's newest entrant, just completed 11 years of bilateral negotiations.

After the bilateral negotiations, an agreement is drawn up stating what the applicant commits to do when it joins the WTO. In China's case, it agreed to phase out all quantitative restrictions on industrial products; remove such mandates on foreign investors as requiring

their production to be exported; enforce property rights for intellectual property; and open a range of services, including telecommunications and financial services, to foreign providers. Vietnam has agreed to cut tariffs, quotas, and agricultural subsidies and to open up a range of services to foreign providers.

Finally, the entire WTO membership must approve the package of market-opening commitments, typically covering hundreds of pages, which constitutes the country's accession agreement. Failure of the new member to abide by its commitments can become the basis for bringing a WTO case against it. In 2006, the United States, joined by six other members, brought a case against China charging that fees it applied to imported auto parts violated its accession agreement.

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The WTO's Pascal Lamy (right) meets with Foreign Minister Pham Gia Khiem of Vietnam, which in 2007 joined the organization dedicated to opening markets.

The Doha Round

Through negotiations, rules, dispute settlement, and accession, the WTO has fought off protectionism. The system is not perfect. Agreements have not been reached in key areas where they are sorely needed. For example, there is no international agreement outlawing export subsidies or tariff rate quotas—in which prohibitive tariffs are imposed on imports exceeding a quota—in agricultural trade.

Every new round of multilateral trade negotiations aims to expand members' commitment to open their markets and to improve the functioning of the trading system. Experts calculate that the last round—the Uruguay Round—created hundreds of billions of dollars of new economic opportunity.

A successful Doha Round, launched in 2001, could do the same, for it seeks to reduce or eliminate agricultural subsidies, cut tariffs on goods, expand market openings in services, and increase transparency within the WTO system (including dispute settlement). Experts predict that such an agreement could lift millions of people out of poverty, contribute hundreds of billions of dollars annually to global growth, and correct some egregious inequities in our trading system. It is something we should all strive to achieve. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.

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Internet Resources

Online resources on trade and protectionism

U.S. GOVERNMENT

Federal Reserve Bank of New York
http://www.newyorkfed.org/education/fx/free.html

Office of the U.S. Trade Representative
http://www.ustr.gov/index.html

U.S. Department of Agriculture
Economic Research Service, WTO Briefing Room
http://www.ers.usda.gov/briefing/Wto/

U.S. Department of Commerce
U.S. International Trade Administration
http://trade.gov/index.asp

U.S. Department of State
Bureau of Economic and Business Affairs, Trade Policy and Programs
http://www.state.gov/e/eb/tpp/

Bureau of International Information Programs, Trade and Economics
http://usinfo.state.gov/ei/

OTHER RESOURCES

CATO Institute, Center for Trade Policy Studies
http://www.freetrade.org/index.php
The mission of the Cato Institute Center for Trade Policy Studies is to increase public understanding of the benefits of free trade and the costs of protectionism.

Economic Strategy Institute (ESI)
http://www.econstrat.org/
The Economic Strategy Institute is dedicated to assuring that globalization works with market forces to achieve maximum benefits rather than distorting markets and imposing costs.

Globalisation Institute
http://www.globalisationinstitute.org/index.php
The Globalisation Institute is a think tank founded in 2005 with the aim of examining how globalization can be harnessed to work for the world's poorest.

The Library of Economics and Liberty
http://www.econlib.org/index.html
The Library of Economics and Liberty is dedicated to advancing the study of economics, markets, and liberty. It offers resources for students, teachers, researchers, and aficionados of economic thought.

National Foreign Trade Council (NFTC)
http://www.nftc.org/
The NFTC is a U.S. business organization that advocates the international and public policy priorities of its members on international trade, investment, tax, and export finance.

Peterson Institute for International Economics
http://www.iie.com/research/researcharea.cfm?ResearchTopicID=5
The Peterson Institute, formerly the Institute for International Economics, is devoted to the study of international economic policy. Since 1981 the institute has provided timely, objective analysis and concrete solutions to key international economic problems.

United States Council for International Business (USCIB)
http://www.uscib.org/index.asp
Founded in 1945 to promote free trade and represent business in the newly formed United Nations, USCIB presents businesses' views directly to U.S. policy makers and officials in the United Nations, the European Union, and a host of other governments and groups.

World Trade Organization
http://www.wto.org/

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