



# TRADE AND DEVELOPMENT SYMPOSIUM

## Perspectives on the Multilateral Trading System

A Collection of Short Essays

# The Challenging Opportunities for the Multilateral Trade Regime

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## Introduction

The seeds of the multi-lateral trading system were planted in 1944 at the United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire as World War was dwindling and the Great Depression still loomed large in memory. The Bretton Woods process was very much embedded in what was then referred to as “New Deal” thinking whereby nation states mandated leeway to improve the welfare of their citizens but to such an extent that it did not unduly impose on the welfare of other nations (Helliener, 2011). Over the past two decades the multi-lateral trading system has lost sight of that balance and the WTO could now hardly be seen as a New Deal institution. The current crises that plague the world economy are a challenging opportunity for the WTO to regain that balance.

Preserving and enhancing the multi-lateral trade regime is of utmost importance in order to foster growth and prosperity in the world economy. Over the past decade, rather than refining the global set of rules and norms at the World Trade Organization (WTO) to that end, negotiations have solely focused on further trade liberalization--despite the fact that the gains from further liberalization are relatively low and the costs can be significant.

The fact that this approach has produced a standstill at the WTO need not be seen as a failure. Rather, the standstill in negotiations for further liberalization are an opportunity for actors in the world trading system to reflect on some of the new challenges in the world trading system and reform the WTO in such a manner that it can become the premiere institution governing the trading system.

The alternative is not optimal: a splintering system of preferential trade agreements (PTAs) that can distort trade, accentuate discrimination, and allow private actors to “shop” for the forum that best advances their interest. The world needs a WTO that has accepted norms, enforceable rules, and a legitimate forum for the settlement of disputes at the multi-lateral level. Of all the multi-lateral institutions the WTO has the most promise to play this role because of its unique one-country, one-vote consensus structure. Can the WTO turn challenge into opportunity?

This sort exercise outlines four challenging opportunities facing the WTO. If the WTO is reformed into a more modest, flexible, and equitable organization that it can gain the legitimacy and importance hoped for by those who originally recognized the need for a coordinated multi-lateral trading system in Bretton Woods almost 80 years ago.

## Four Challenges for the Multilateral Trade Regime

At least four challenges to the WTO have stopped negotiations for further liberalization in their tracks: the limits of further liberalization, the rise of emerging market developing countries; the food and climate crises; and the instability of the global monetary system. As depression and war challenged the global financial architecture in the 1940s, these trends challenge the WTO today.

### 1) Shrinking gains and rising costs of liberalization

Trade liberalization has brought significant benefits to the world economy over the past forty years, yet with real winners and losers. However, the benefits of further liberalization are shrinking, and the costs of deep integration can be significant.

The World Bank’s 2005 projections of gains from a ‘likely’ Doha deal were met with much surprise because they showed how little is to be gained from further global trade liberalization (see Ackerman and Gallagher, 2008). The World Bank estimated that the global gains from trade liberalization

in the year 2015 would be just US\$96 billion, with only US\$16 billion going to the developing world. In other words, the developing country benefits represent a one-time increase in income of just 0.16 percent of GDP. This is often misconstrued as an increase in the annual growth rate; it is a one-time increase in GDP. In per capita terms, it amounts to US\$3.13, or less than a penny per day per-capita for those in developing countries.

Studies like these only examine the potential benefits of trade liberalization, while downplaying the costs. Total tariff losses for developing countries under proposed NAMA liberalization were estimated to be as high as US\$63.4 billion. Many developing countries rely on tariffs for more than one-quarter of their tax revenue. Most models also predict declines in terms of trade for developing countries. In the long run, declining terms of trade undermine developing country efforts to diversify and develop. They can also accentuate balance of payments problems in developing countries and deepen the impacts of crises (Wise and Gallagher, 2008).

What is more, the gains from adopting industrialized country-style intellectual property rules and financial regulation are also questionable from a development perspective. The World Bank estimates that the amount of South-to-North profit transfers due to patent rents under the WTO’s intellectual property rules are \$41 billion annually (World Bank, 2002). The IMF recently estimated that those nations that liberalized foreign investment in the financial services sector were among the most hard-hit during the financial crisis (Ostry et al, 2011).

As industrialized nations have become frustrated with lack of integration at the global level, they have pushed PTAs with nations more willing to negotiate. PTAs cause costly trade diversion—perhaps between \$6.6 and \$21.5 billion according to the World Bank (World Bank, 2005; see also Bhagwati, 2008). What is more, PTAs have non-trade provisions in areas such as intellectual property and financial services that constrain the ability of nations to deploy adequate development policy (Gallagher and Thrasher, 2008). Finally, many PTAs tip the balance in favor of powerful interests where disputes can be settled where private firms directly file claims on governments, rather than the state-to-state dispute system that governs the WTO.

### 2) The rise of the rest

Developing countries have been growing faster than their industrialized counterparts since the turn of the century. And in the aftermath of the global financial crisis the developing world has proved more resilient. This has been due to a hybrid approach to economic development that recognizes the importance of global markets but also realizes that markets need to be embedded in the proper institutions in order to maximize the welfare for national societies. The latter approach has meant that many of the most successful emerging powers—China, Brazil, South Africa, and India have accentuated the role of the state in economic affairs. This has led to a “clash of globalizations” at the WTO (Gallagher, 2012).

We could call this variety ‘developmental globalization’. All of these nations have been slow to open their capital accounts to foreign investment. All engage in industrial and state-led innovation policy to some degree. And together these nations form the heads of significant coalitions in global trade talks that have pushed back on industrialized country proposals aimed at making developing countries look more like industrialized economies. They have clout because these nations are fast growing markets to which firms and investors want greater access. They have clout because (in purchasing power parity terms) they lead an emerging market world that has a larger share of GDP in the world economy than Western nations.

The theoretical underpinning of the WTO is to aid nations in maximizing their static comparative advantage. Yet many of developing countries have sought to globalize in order to achieve a dynamic comparative advantage (Amsden 2001, Wade 2004). In many cases that has meant favoring domestic firms or industries over foreign ones, and thus at least in spirit such an approach violates the principle of national treatment. Tariffs in the world economy are relatively low by historical standards and therefore this clash is often not seen to occur in discussions over goods tariffs. What has gone unrecognized by some is that trade treaties are no longer about trade in goods, but rather are about domestic regulations that could be seen as violating the two principles.

As China, India, Brazil, South Africa and others have continued to grow their economies at a significant pace since the turn of the century, they (and their domestic constituents) have fought hard to maintain at minimum the level of policy space they have at the WTO. At the WTO, this meant rejecting the proposals by the developed world to deepen international investment rules, intellectual property rules, government procurement, and financial services (the so-called 'Singapore Issues' and others).

Moreover, the developing world turned the tables on the narrative of the talks. Whereas past rounds were pitched as the developing world being riddled with protections that are bad for growth and prosperity, the developing world flipped that on its head and accused the north of the same. Almost immediately into the negotiations the developing world made an issue of industrialized country subsidies and tariffs benefiting agricultural producers, and intellectual property rules that prevented developing countries from break patents to serve ailing and diseased populations. In effect, this put the developing world on the moral high ground. Rather than the North getting their Singapore issues at the 2003 WTO Cancun meetings, the North had to abandon those issues but also amend the WTO agreements on intellectual property rules to allow for public health exceptions - a key victory for developing countries. Turning away from a 'deep integration' agenda, from 2003 on then, the negotiations were mostly about market access in agriculture, manufacturing goods, and some services. In addition, special attention was to go to the poorest nations in the form of relieving cotton subsidies and 'aid for trade' packages.

### 3) Food and Climate Crises

Two other major challenges to the trading system are the food and climate crises. Since 2008 the world has entered a new era of highly volatile food prices and a renewed sense of urgency regarding the need to combat climate change. Both these crises require urgent and sometimes drastic attention. It is not clear that the WTO as currently structured has the flexibility necessary for the world to combat these challenges. A 21st Century WTO would allow nations to respond to contemporary challenges like these.

Since 2007 global food prices have been increasing and volatile, reaching levels not seen since 1990 in 2011. This has adversely affected the livelihoods of many of the world's poorest. These tragic events have triggered a new set of policy responses to ensure food security across the globe. The United Nations Special Rapporteur for the Right to Food (2011) has identified five sets of policies for food security in the 21st Century: "(1) reinvestment in agriculture and general support schemes to small-scale farmers; (2) safety-nets and income-insurance for the urban and rural poor; (3) the establishment of food reserves at national or regional levels to allow governments to cushion the impact of price shocks and to limit volatility of prices for agricultural commodities; (4) orderly market management, including marketing boards and supply management schemes, as another measure to combat volatility; and (5) limiting excessive reliance on international

trade in the pursuit of food security." (De Schutter, 2011). A preliminary "compatibility review" of these measures alongside WTO rules conducted by the FAO reveals that these policies are seen as derivations from the WTO rather than as principle objectives of agricultural trade policy.

With respect to the climate crisis, the climate regime is urging the world's nations to rapidly deploy and diffuse technological and process innovation in green technology. A particular emphasis has been on China—which has been told that it needs to deploy such technologies and reduce emissions with little or no financial help from the industrialized world.

China, as an example, has deployed policies to create world class technologies (such as solar power where they lowered the global price by 40 percent) but through means that are also not "compatible" with current WTO rules. By 2009, China added more wind power than any other country, including the United States. China already has the largest solar thermal capacity in the world and now leads the world in installed renewable energy capacity. Yet the same industrialized nations that are telling China to deploy clean technology and clean up its act are now taking China to the WTO for violating its rules, particularly rules about subsidies.

What is lost sight of is that the use of climate-altering fossil fuels distorts trade. Subsidising alternatives can correct those distortions. Oil and coal prices seldom reflect their environmental costs and are thus overproduced. The World Bank's 2010 world development report reckons that fossil fuel subsidies amount to at least \$300bn per year. If prices reflected true costs, then much less polluting trade would occur and renewable energy would be on a more even playing field.

Subsidies to renewable energy, such as wind power, can help correct the distortions in the energy market and allow the world to climb the learning curve for renewable forms of energy.

### 4) Instability of the global monetary system

From 1944 to the Tokyo Round the Bretton Woods agreement ensured exchange rate stability and the swift payment of current account transactions. Exchange rate stability therefore became taken for granted in multi-lateral trading system. Without stable exchange rates global trade markets are not sent the right signals and global trade transactions will not be a function of factor abundance, productivity, and comparative advantage. Since the Tokyo Round the monetary system has become increasingly unstable, and never moreso than in the aftermath of the global financial crisis. The multi-lateral trading system will continue to be jeopardized until the monetary system is reformed.

Exchange rate instability may be the key reason why the Doha Round is permanently stalled given that key nations like India, Brazil, and South Africa have been sacked with exchange rate volatility ever since the crisis began. Take Brazil, for example. Brazil was supportive of the last ditch 2008 deal at the WTO. Brazil's soy and beef industries stood to gain significantly from a WTO deal and many manufacturing firms stood to gain in terms of providing machinery, transport, and other inputs. Finally - and this is important - the Brazilian real was relatively undervalued during the first years of the Doha Round. A weak currency is implicitly import-substituting and a subsidy to exports. Thus, Brazilian industry was more open to negotiating. All this changed after the global financial crisis, as Brazil and many other emerging markets have seen their currencies appreciate by more than 40 per cent. Brazilian industrialists became very averse to a deal because they lacked competitiveness and saw more concessions as being out of the question. At this point Brazil would never agree to the 2008 deal. According to some calculations Brazil's currency appreciation has effectively amounted

to a 25 percent reduction in import tariffs for that country (Thornstein et al, 2011).

Not only has the misalignment of the monetary and trading system distorted trade flows, many of financial regulatory measures that nations deploy to manage the exchange rate are not permitted under the WTO if a nation has listed them under its General Agreement on Trade and Services commitments (Gallagher, 2011).

## Toward a More Responsive Multi-lateral Trade Regime

The WTO is poised to be one of the most important of the institutions in the global financial architecture. Unlike the G-20, the International Monetary Fund, and even the United Nations, the WTO has the potential to be the most legitimate of these bodies. The WTO operates on a one-country, one-vote consensus level, whereas the G-20 and IMF decisions are made by the size of a nation's economy and UN decisions can be overridden by the Security Council. Indeed, the WTO has been undersold as a legitimate global economic governance institution.

In general, the WTO should conduct a thorough 'compatibility review' regarding the extent to which its principles and rules are compatible with policies for growth, food security, environmental protection, and financial stability. To that end:

**Institution Building:** Rather than focusing on further liberalization the WTO should focus on building its institutional capabilities in order to serve as the global governance structure for world trade. As nations do so they will need to think about their interests further into the future. What we have learned in the past ten years is that some nations that were once LDCs are now among the largest in the world. In a rapidly changing and uncertain world where nations do not what their place will be, it is in the interest of actors to adhere to the 'maximin' principle of attempting to establish rules that will maximize the position of those who are worst off in the current system. There should also be a moratorium on north-south preferential trade agreements. These deals exploit the asymmetric nature of bargaining power between developed and developing nations, divert trade away from nations with true comparative advantages and curtail the ability of developing countries to deploy effective policies for development.

**Food:** The WTO should take seriously the proposals by many African nations to tame highly concentrated global commodities markets, dominated by agribusinesses that suck most of the value out of these value chains. Rich nations should also grant poorer countries extensive rights to exempt staples of their local economy such as corn, rice and wheat - so-called "special products" - from tariff cuts, and allow them to raise duties when imports surge. Moreover, policies to create food reserves, marketing boards, and supply management schemes should be seen as advancing world trade, not distorting it.

**Climate:** the WTO needs to leave ample room for the transfer of clean technology to developing countries. Otherwise the diffusion of new technologies and mitigation strategies will get bogged down in global rules over intellectual property, investment and goods trade. There is room for creative thinking whereby specific collaborative efforts between say, the United States and China could be granted immunity for a specific period under the WTO in order to meet certain emissions and technology targets—in a manner analogous

to but much broader than the Article 8 exceptions to the subsidies agreement to the WTO.

**Finance:** National and global financial authorities will be the ones to determine what a new global monetary system looks like in the wake of the financial crisis. In the meantime, the WTO should conduct a thorough review of the extent to which its principles and rules are compatible with various measures that nations can deploy to prevent and mitigate financial crises. In the absence of a stable monetary system nations will have to resort to measures such as capital account regulations that at present seem to be incompatible with the WTO.

Upon the reflection outlined here, the WTO will become a more modest global institution, but one with more legitimacy and a stronger mandate. More importantly, it will allow nations the flexibility to improve and maintain the welfare of their citizens at present and in future generations—and to an extent that the actions of individual nations do not unduly impose on the welfare of other nations—as the founders of the global economic architecture had hoped for in 1944.

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