

## DO WE NEED THE WTO?

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The failure of the World Trade Organization ministerial summit late last year has thrown the future course of trade liberalization onto an uncertain track. Added to this uncertainty is increasing criticism of the WTO itself, and not just from the anti-globalization protesters who congregated in Seattle. Some of those who embrace the cause of trade liberalization also have questioned the efficiency of the multi-lateral negotiations approach, suggesting that either unilateral or regional trade agreements may be more efficacious in achieving lower trade barriers.

This article makes the case for the WTO, a limited case but (one hopes) a compelling one nonetheless. That case is in large measure political, and one needs a historical perspective on U.S. trade policy to appreciate that political case. The article then discusses the limits to what can be achieved through the WTO.

### Reciprocity and Unilateralism in U.S. Trade Policy

If economists' view of the world held sway among policymakers, there would be no need for the WTO. The economists' case for free trade is essentially a unilateral case—that a country is better off pursuing a policy of free trade regardless of the policies pursued by others. As the 19th-century French economist Frederic Bastiat put it, a country should not throw rocks in its harbors simply because other countries have rocks in theirs.

While the economic logic behind this proposition is impeccable, it has not proved politically palatable. Thus, we find ourselves in a world in which reciprocity comprises a big part of the trade policy game, and countries negotiate with one another about their trade barriers.<sup>1</sup>

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<sup>1</sup>See Krugman's (1997) discussion of what trade negotiators should negotiate about.

The mercantilist logic and language of international trade negotiations—that a reduction in our own trade barriers is a “concession” to others—can be jarring in terms of the underlying economics. But there is an important political logic behind reciprocity that makes the WTO an extremely useful institution. In the end, we should judge the WTO (or any public institution, for that matter) as good or bad only in relation to its alternatives—a very utilitarian standard. The WTO is far from perfect, of course, but we should ask the questions: What purpose does the WTO serve? and Would the world be a better place without the WTO?

In answering these questions, we have some historical experience to draw on—namely, 150 years of unilateral trade policy in the case of the United States. The Constitution grants the Congress of the United States authority over taxes and impositions on foreign commerce. Unilateral free trade in the United States therefore long has meant congressional trade policy—which was the case from 1789 until 1934 and the passage of the Reciprocal Trade Agreements Act. That system was hopelessly biased in favor of domestic interests seeking protection from foreign competition (see Schattschneider 1935). If you think the mercantilist logic of multilateral trade negotiations is lamentable, try reading the hearings held when Congress was considering the passage of any trade legislation in the 19th century, or the Smoot-Hawley tariff in 1929 and 1930. Try to sort out what is meant by a tariff that will “equalize the costs of production” between domestic and foreign producers. When I try to sort it out, I am reminded of Ross Perot, Pat Buchanan, and Michael Lind talking about a “social tariff” designed to equalize wage differences between countries. That is tantamount to throwing rocks in our harbors not because others have rocks in theirs, but because we like rocky coasts—we deliberately want to limit our trade. For the United States, I would suggest, historical experience indicates that a reciprocity-based trade policy in the hands of the executive beats a unilateral trade policy in the hands of Congress (see Irwin 1998).

The other piece of historical evidence comes from the interwar trade policy experience. That period demonstrated that there is, to some degree, a political interdependence—an externality or spillover effect—of one country’s trade policy on those of its trading partners. When the United States and the United Kingdom imposed trade barriers in the early 1930s in response to the economic recession that soon became the Depression, they made it harder for other countries to resist going down that path, too—in terms of either provoking retaliation, which Canada did to the United States, or setting an example that affects the political economy of tariffs in other countries.

Congress thought that trade policy was domestic policy, pure and simple, and did not take into account the international systemic effects of U.S. actions on the trade policies of other countries.

So the General Agreement on Tariffs and Trade was formed in 1947 to allow for the international negotiation of reductions in trade barriers. The built-in bias of the GATT is good from the economists' perspective—the freeing of international trade. No international organization is needed to coordinate the raising of trade barriers on each others' commerce—countries can do that quite nicely on their own. So the thrust and the purpose of the GATT since then has been mainly to the good because its mandate is mainly to the good.

## The Political Case for the WTO

The case for the GATT and the WTO that I have set out is mainly a political case—that the WTO is useful because it changes the political economy of trade policy in a way that tends to facilitate trade liberalization as an outcome.<sup>2</sup> But there are limits.

First, the WTO is a forum for the pursuit of trade liberalization, but it is not the only method of achieving that goal. Despite the historical difficulties of unilateral trade policy in the U.S. context, unilateral trade liberalization operating outside of the WTO is not only extremely important, but in many ways stronger and deeper when it is achieved outside the WTO. As Brink Lindsey mentions in his article, countries such as New Zealand, Chile, Mexico, and others have pursued trade policy reforms such as tariff reductions outside of multilateral trade negotiations. Such liberalization is based on a domestic political consensus about their national economic interest in such liberalization regardless of policies pursued abroad. The motivation is not reciprocity but an acceptance of the efficiency benefits that will accompany such liberalization.

Even in the United States, when public policy toward certain sectors is not viewed as falling under the rubric of “trade policy” (i.e., any non-U.S. Trade Representative or Commerce Department issue), deregulation effectively amounts to unilateral trade liberalization. When the United States deregulates the telecommunications industry, or changes its policy toward financial services, it generally does not discriminate against foreign firms. Those sectors are open to international competition regardless of the illiberal policies pursued in other countries. The benefits that arise from such unilateral U.S. actions

<sup>2</sup>Irwin and Kroszner (1999) show that the Reciprocal Trade Agreement Act system achieved bipartisan support around World War II because that system made members of Congress more sensitive to export-oriented interests.

have a positive demonstrative effect on the policies of other countries, just as there was a negative demonstrative effect in the 1930s. The dramatic price reductions and vast opportunities created by telecom deregulation have proved so compelling that other countries have been induced to follow the U.S. example. The United States was far ahead of the rest of the world in deregulation, and much would have been lost if the United States waited for other countries to agree to an international agreement on such matters. When global negotiations delay the enactment of inherently desirable liberalization by making it contingent on an international consensus, the value of those negotiations is brought into question (see Barfield and Irwin 1997).

The case for the WTO is also limited in that we should never confuse international trade rule-making with the objective of trade liberalization. The WTO can be a mechanism to codify and institutionalize bad trade policy, as J. Michael Finger has often pointed out. The Multifiber Arrangement is an example, and the Balance of Payments and other GATT-legal justifications for protection are bad exceptions to build into international trade rules.

So, although I believe that the WTO has proved to be an extremely useful institution for freer trade, and has certainly proved to be a more valuable international economic institution than the World Bank or the International Monetary Fund, there are qualifications to that belief.

Let me turn to the future of the WTO. At almost any point in time over the postwar period, one could be justified in having grave concerns about the future direction of the world trading system.<sup>3</sup> The main reflex of some trade policy analysts is to wring their hands and fret at the outlook for the world trading system. While this pessimism is often warranted, we should reflect on where the system stands today compared with the failure of the 1982 GATT ministerial meeting when all looked bleak. Since then, substantial progress has been made in reforming trade policies.

Perhaps we should temper our fears for the future. I wish I could say that because the United States now enjoys a period of low unemployment and stable growth, such concerns are not justified today. But I am afraid that both friends and foes of the WTO want to expand or distort its agenda in ways that will prove harmful to the central WTO mission.

Friends of the WTO want to see it expand its scope to set rules that will cover all sorts of new trade issues, ranging from investment

<sup>3</sup>Jackson (1978) reflects the deep-seated pessimism of many trade policy analysts in the late 1970s and early 1980s.

and competition policy to e-commerce and product standards. That push comes as part of the “bicycle theory” of trade liberalization, which illustrates that we must continually keep pedaling and move the agenda forward because if we ever stop, we will lose the momentum achieved by successive negotiations and fall prey to backsliding. I think this is a misreading of the history of the GATT negotiations, in which there have been several long pauses in GATT activities. Yet, when the leading contracting parties were ready, they once again resumed negotiations.<sup>4</sup> Those pauses are good in that they allow members to digest previous agreements and conserve energy for future multilateral trade negotiations. A case can be made that the United States is still digesting the North American Free Trade Agreement and the Uruguay Round. Sometimes it is good to stop the bicycle to rest and see where we are headed. If we just pedal merrily along, seeking agreements in this area and that, we run the risk of creating a regulatory WTO, not really liberalizing trade (after all, that is a tough thing to do) but writing regulations that may or may not move us in the direction of freer trade.

The last thing we should want to create is an international regulatory bureaucracy in Geneva that will provide full employment for trade lawyers rather than truly open up markets. As Margaret Thatcher complained years ago, she did not stop growth of the state in the United Kingdom only to see it reemerge from Brussels. The strength of the WTO (versus the World Bank or the International Monetary Fund) over the postwar period has been its relatively small size and narrowly defined agenda. The reason the proposed International Trade Organization was defeated in the late 1940s was that U.S. business feared that the ITO was as much about regulating resale price maintenance and other business practices as about cutting tariffs.

We should keep the WTO focused as much as possible on reducing border measures and not expand its agenda hastily by groping for new issues (many of which are going nowhere fast anyway) when there is plenty to do on the old issues. The next round, perhaps, should be a mini-round, a clean-up round, that focuses on ensuring that the Uruguay Round commitments have been fulfilled—particularly in agriculture and on eliminating the Multifiber Arrangement. Agriculture and textiles alone account for 20 percent of world trade and both are littered with trade restrictions. The world would have been done a great service if the WTO were able to liberalize restrictions in those areas and perhaps move toward zero tariffs on industrial products.

<sup>4</sup>Irwin (1995) discusses how multilateral negotiations were essentially dead in the water in the 1950s and early 1960s.

Foes of the WTO also want to overload the agenda with issues such as labor standards and environmental regulations. No compelling case exists for putting rules about labor standards in a trade liberalization forum. Developing countries are rightly suspicious that the attempt by Western nongovernmental organizations (NGOs) to foist rules and regulations on them will eventually provide the excuse for developed countries to hinder the ability of developing countries to export. The environmental issues are even more complex than labor issues, but the charges that have been leveled at the WTO by environmental NGOs are often completely misleading regarding the tension between environmental and trade policies.<sup>5</sup>

The vociferous hostility being vented on the WTO is astounding, especially since so much of it is based on ignorance of what the WTO actually does. Contrary to its critics' beliefs, the WTO is not some independent creature but is purely the creation of its members. Friends of the WTO face an enormous challenge in dealing with these groups and responding to the charges they make.

That case has not been made as strongly as it needs to be by the administration. The Council of Economic Advisers (1999) has issued a sound report on the U.S. interest in the WTO, but a forceful defense of the WTO is required by the actual policymakers. In light of the events in Seattle, the WTO is going to need all of the friends it can get in coming months.

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<sup>5</sup>The common complaint is that WTO rulings have undermined domestic environmental standards, as in the gasoline regulation case won by Venezuela. The issue in that case, however, was not the stringency of the U.S. regulations, but the Environmental Protection Agency's decision to apply one standard to domestic gasoline and another, more stringent standard to foreign gasoline. The WTO found that this was unfair discrimination, and most such cases hinge only on violation of the nondiscrimination, most-favored-nation clause in the WTO. The EPA complied with the ruling by relaxing its requirements for foreign refiners, but it could just as easily have tightened them for domestic ones. See Irwin (1999).

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