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## The World Trading System

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## Symposium

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# The United States and the World Economy

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Jagdish Bhagwati

### *The World Trading System*

The Uruguay Round is closing this week after a marathon of negotiations stretching well over seven years; so the timing of this panel is exquisite, from my viewpoint. The ceremony, besides, is in Marrakech, an exotic place that sets our minds racing with thoughts of "Casablanca," Humphrey Bogart and Ingrid Bergman. Indeed, one can imagine a movie being made of this historic occasion that will transform the General Agreement on Tariffs and Trade (GATT) into the World Trade Organization (WTO), with Peter Ustinov cast as Peter Sutherland, the brilliant and portly new director general of the GATT who finally brought the round to successful conclusion, Dustin Hoffman playing our own inimitable Mickey Kantor, and perhaps Al Pacino as the elegant and suave Sir Leon Brittan of the European Union (E.U.): the three principal players in the closing days of the round.

In any event, the closure of the round puts the GATT, or its new version, WTO, right at the center of the world trading system. This is a triumph that should not be underestimated. It was only a few years ago that my good friend Lester Thurow, reading the mood around him, had pronounced at Davos that the GATT was dead. His colleague at the Massachusetts Institute of Technology, Rudiger Dornbusch, had urged that the GATT be killed. And their brilliant MIT colleague, Paul Krugman, before his celebrated return to the fold of free trade and multilateralism, had flirted

with both thoughts. Evidently, you are affected by the company you keep.

Fortunately, this anti-GATT school (christened by me the "Memorial Drive School", since MIT's famous economics department is located at Memorial Drive in Cambridge, while the phrase also evokes aptly the funereal view of the GATT that the school epitomized) seems to be more obviously silly than when some of us pronounced its demerits some years ago.<sup>1</sup> That school's demise and the GATT's success are a cause for celebration. So is President Bill Clinton's belated but strong support for the Round, though we must still see him take the agreement skillfully through Congress in the coming year.

All this is on the positive side of the ledger. But there are also problems that lie ahead that threaten the world trading system in varying degrees and warrant careful examination. I will touch on just two of the central problems confronting us today.

A first danger point we currently see is the increasing preoccupation in the European Union and in the United States with the *distributional* effects of freer trade with the developing countries. In consequence, a new North-South divide is opening up. Traditionally, economists have had to fight the "pauper labor" argument against free trade by the North with the South. This argument falsely asserts that trading with cheaper-labor countries will harm a country's overall economic welfare; in reality, the case for free trade is proof against this charge. But the new fear is not that trading with countries with paupers will harm oneself; rather it is that such trade will produce more paupers in one's own midst. In other words, the fear is that our proletariat, the unskilled, will be immiserized by freer trade with the poor countries of the South.

This fear comes from the experience of the 1980s when, in the E.U., unemployment increased and, in the United States, the real wages of the unskilled fell. While nearly all careful studies show that the causes were an overwhelmingly technical change that saved unskilled labor, and that North-South trade had very little

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1. See Jagdish Bhagwati, *The World Trading System at Risk* (Princeton, NJ: Princeton University Press, 1991) Chapter 1.

The GATT is similarly under pressure to adopt measures to harmonize up the environmental standards in developing countries, and attempts have begun in earnest, with the United States teaming up with France (that great ally of ours on trade, as you will recall from the disputes we had over E.U. agriculture and audiovisual services at the round) to push a social clause onto the GATT. The case for such upward harmonization, and its linkage to trade as well, is exceptionally weak, and developing countries have raised objections to it. But the capture of these issues by "green" and "blue" protectionists gives them great salience in the developed countries, while the ability to hide behind the umbrella of "social causes" in advancing these issues gives them the cachet of high moral ground. In short, one almost sees the white man's burden being used to advance the white man's interest. One also sees, in the selection of issues and the precise shape being given to them, the other cynical reality: that stones are (properly) thrown at other people's glass houses by people who (improperly) construct fortresses around their own.<sup>4</sup>

To put it yet another way, what one is beginning to see now is demands from developed countries to introduce special restrictions on trade of the developing countries. Ironically, just as Special and Differential (S&D) Treatment *in favor* of the developing countries has finally been virtually abandoned as a GATT principle after years of intellectual battle, we are now getting into *Reverse S&D*, designed to work *against* the developing countries!

It will be a major task for economists, and free-trade-oriented politicians, to confront these new problems. The main task will be

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4. Thus, the United States itself has serious problems with its children. Recent studies show that more than four million children live in great hazard, and black children's infant mortality rates and life expectancy are a matter of shame for a country of such relative affluence. Yet the focus of our unions is on children in developing countries, since that is where they think their competition comes from! Ironically, contrasting elements of hypocrisy are to be found in our policy positions on intellectual property protection regarding pharmaceuticals. While Hillary Rodham Clinton denounces these companies for the "high" prices charged for vaccines for our own children, President Bill Clinton had no qualms about asking for the last ounce of flesh from the developing countries for these companies (in form of greater patent protection) and thereby hurting the children of these countries. Developing countries can be forgiven for treating our often selective moralism with the cynicism it deserves. At the same time, they need to treat the moral issues seriously, sorting out the bad from the good ideas.

to do with this distressing reality, the fear that trade was the culprit has become widespread.<sup>2</sup> In fact, you will recall that the debate over NAFTA was particularly acrimonious precisely because the unions were petrified that it would lead to job losses and decline in the real wages of U.S. workers. In fact, one could plausibly argue that just because many Americans had this stark image of Mexico as a source of pauper labor that was illegally coming across in large numbers and depressing the wages of our unskilled workers, and because they intuitively felt that free trade with Mexico would simply be an *indirect* way in which this would happen via imports of goods made with cheap labor, a most unfortunate effect of NAFTA was to exacerbate these fears and to undermine the political case for free trade — an outcome that would not have happened with the Uruguay Round because freer trade with the developing countries would have been swamped by the many other issues negotiated at the round.<sup>3</sup> In fact, this debate has not surfaced in the same way, and with the same passion, in that context to date.

I suspect that this fear of freer trade with the South, no matter how exaggerated, will dominate trade policy through the rest of this millenium. The effect will be precisely what we observed in the case of NAFTA: attempts at linking cost-raising issues somehow with trade liberalization of the developing countries. Thus, attempts were made then, and conceded in spirit though without serious teeth, to raise Mexico's minimum wages, to raise its labor standards and to improve its industry's environmental standards as well.

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2. For a detailed analytical and empirical analysis of this question, see Jagdish Bhagwati and Vivek Dehejia, "Freer Trade and Real Wages of the Unskilled: Is Marx Striking Again?" in Bhagwati and Marvin Kosters, eds., *Trade and Wages* (Washington, DC: American Enterprise Institute, 1994).
  3. The British debate at the time of the enactment of the 1905 immigration quota legislation, the first of its kind, happened to divide the politicians and policy advocates into two camps: the free traders and free immigrationists on one side and protectionists and anti-immigrationists on the other, precisely because, as I argue in the text, free trade with the countries containing paupers was considered to be similar in effect to free immigration of the paupers themselves. In fact, free immigration was described as "free trade in paupers" in that debate! See the discussion in Jagdish Bhagwati, "Free Traders and Free Immigrationists: Strangers or Friends?" (New York: Russell Sage Foundation, 1991) mimeographed.

*aggressive unilateralism.*<sup>5</sup>

While free-trade areas and customs unions are GATT-legal, aggressive unilateralism is not. The strengthening of the GATT, and its Dispute Settlement Mechanism at the Uruguay Round, make the use of Section 301 to extract concessions unilaterally ever more difficult.

America's pursuit of free-trade areas, whether regional or worldwide, is bound to continue, despite the renewed multilateralism centered on the GATT, though that seems now wholly unnecessary and hence inappropriate (because one should not want to choose preferential trading agreements, particularly when nondiscriminatory free trade is possible). So is the U.S. attachment to aggressive unilateralism, somehow. For no matter why these policy options were arrived at earlier, U.S. policy makers cannot help but see them as useful instruments for advancing its self-interest. I think that we now confront a model of the "selfish hegemon," just as my former teacher Charles P. Kindleberger advanced the influential thesis of the "altruistic hegemon."

Kindleberger thought of the United States's backing of the GATT and the liberal international trading regime after the Second World War as a public good. Now the United States is in what Douglas Irwin and I have called the "diminished giant syndrome," where it finally wants to look after its own interest. It seeks therefore to redefine the trading system to reflect its own needs and priorities, defined increasingly by its own lobbies: seeking excessive intellectual property protection, exploiting environmental and labor issues to reduce competitive pressures, and so on. It then uses free-trade areas as an *incentive strategy* and 301 as a *punishment strategy* to bargain to great advantage with

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5. See, for instance, the essays in Jagdish Bhagwati and Hugh Patrick, eds., *Aggressive Unilateralism: America's 301 Trade Policy and the World Trading System* (Ann Arbor, MI: University of Michigan Press, 1991) and Bhagwati, *The World Trading System at Risk*.

to keep arguing that the fears of immiserization of the proletariat from freer trade with the South are misplaced, that the real problem has to do with technical change, that the policy that can help address the issue is not protectionism but rather encouragement of widespread skill formation to diffuse the benefits of the technological revolution that favors skills, and that such encouragement of environmental and labor concerns as we seek on other grounds should be done not by linking them to trade rights and access (which will inevitably be captured by protectionists and those seeking to rip off the developing countries instead of really wanting to improve and help them), but by suasion, as through subsidizing activity of non-governmental organizations.

The second question of some importance today is our attitude toward multilateralism, since we have come to embrace, and possibly get addicted to, both regionalism and aggressive unilateralism. Our embrace of NAFTA was largely inspired by the fact that the process of getting a multilateral negotiation started at the GATT had stalled in 1982, when the European Community (E.C.) refused to go along. In essence, we then served notice that we would try alternative ways of getting to worldwide freer trade, the chief one being the use of free-trade areas. The Canada-U.S. Free Trade Agreement did work to jump-start the GATT, as the E.C. did turn around and agree in 1986 to the Uruguay Round, and to the inclusion of several new issues such as agriculture and services. But the dynamic of regionalism has been such that we have now pushed it beyond Canada and, despite the success of the round and the GATT, to Mexico — and we now seek to push it to other countries.

Similarly, we have become addicted to the use of Section 301 of the 1974 and 1988 trade acts — the use of trade threats to extract concessions from other countries concerning all sorts of issues where we unilaterally define and determine these other countries to be indulging in “unreasonable” and “unfair” trading practices, regardless of whether any treaty-defined obligations exist on their part to do so. This is what economists have now come to call

individual countries, especially developing and smaller ones,<sup>6</sup> and then goes to the GATT, where these favorable bargains are codified by a divided, partially coopted and weakened opposition. Had U.S. negotiators gone straight to the GATT and tried to bargain directly with everyone, however, they would have extracted a much inferior bargain.

I suspect most lobbies, with their own agendas, are now aware of these advantages of the FTA-cum-301 Selfish Hegemon Strategy. I believe therefore that we are now saddled with these instrumentalities even though they are truly dissonant with the spirit of genuine multilateralism. Unless the United States regains confidence in its hegemony and the good sense and vision that the trading system must benefit all, traits that characterized U.S. political leadership for nearly half a century will be a matter only for nostalgia.



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6. Thus, facing the United States in a one-on-one bargain, Mexican President Carlos Salinas had to accept the worst possible terms on intellectual property protection, something that the United States could not extract at the GATT earlier. Then, the Mexican acceptance of these outrageous terms was touted by the United States as the "model" which others should follow, with Special 301 threats and actions leveled at particularly recalcitrant countries. In the end, the terms that the United States and other OECD countries alongside extracted from the developing countries on intellectual property protection were dramatically one-sided and certainly excessive from even a worldwide efficiency viewpoint, thanks to the strategy that I have identified in the text.