

Thinking Ahead on International Trade (TAIT)

The Multilateral Trading System: A Response to its Challengersⁱ

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In order to avert the risk of total financial collapse and global depression, monetary and fiscal policies have been activated in many countries in ways not seen in a long time. However, it is yet to be known whether those massive policy interventions will suffice to avoid the worst declines in output and employment suffered since the 1930's. Suddenly we realize that we lack the conceptual and empirical frameworks to prescribe with a reasonable degree of confidence what and how long it will take to overcome the most dangerous phase of this crisis. Neither do we know what the exit strategy will be once the emergency has been overcome. Quite frankly the economics profession has been deeply embarrassed by recent events.

What we do know with certainty is that protectionism could derail all those efforts applied on the fiscal and monetary fronts. Despite the multitude of statements against protectionism made by leaders and their finance and trade ministers in recent months, it would be irresponsible not to recognize that the mercantilist spectre is knocking at everybody's door. It hasn't taken long to confirm again that pledges and actions are not necessarily consistent in this crisis. Interest groups everywhere are already working the system to take advantage of the global recession and advance their protectionist agendas, something they haven't been able to do for a full generation.

Unfortunately, as the recession gets worse, protectionist forces will become even stronger. A perverse cycle of feedback between recession and protectionism is no longer an historical reminiscence of the 1930s but a possible scenario now – hopefully still with a low probability – in the months and years to come. We could soon find ourselves regretting how little, or in fact nothing, states have done to improve the institutions created mostly in the second half of the 20th century to manage the process of global integration. For it is a fact that in the last ten years as globalization accelerated dramatically, the process of international reform stalled.

the opportunities that globalization has provided to fight poverty in the developing world are at stake

Sadly, the multilateral trading system has been a major victim of states' indifference to international reform. Given how much global trade and investment has propelled world economic growth over the last decade, it is hard to believe how little effort has been applied to updating the multilateral trading system. For years the multilateral trading system has been challenged, almost under siege, on many fronts.

It has been challenged in the first place by the failure to honour the Doha Agenda and conclude the Round successfully. The story of unaccomplished deadlines and the repeated collapse of the talks are so well known that doesn't need to be repeated here.

The system has been challenged not only by what countries have failed to do, but also by the damage they have done through the proliferation of discriminatory trade agreements (DTAs) that for the most part run head on against the essential principles of reciprocity and non-discrimination upon which should rest the entire system. DTAs have taken attention and



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political capital that could have been used to improve the multilateral system and, by aggravating the discrimination instilled in trade preferences, they have made the hurdles to achieve multilateral agreements much higher. Furthermore, DTAs have introduced unnecessary and costly complications to the practice of international trade through the rules of origin that unavoidably accompany them.

The multilateral trading system's value and suitability for pursuing effective trade reform has been questioned even by true free traders. Observing both the rather low proportion – one-fourth -- of total trade liberalization achieved multilaterally over the last quarter of a century as well as the failure to conclude the Doha Round, a few otherwise unquestionable supporters of globalization concluded some time ago that the WTO should be deemphasized as an instrument of trade liberalization and, rather, that this liberalization should be allowed to proceed along unilateral or preferential routes. In this vision, instead of helping to build a liberal international order, the WTO, with its complicated agenda and institutional architecture could, in fact, be retarding its completion.

This view is wrong. It's true that a country should not need to expect reciprocity to harvest the benefits of freeing its own trade. But unilateral liberalization is not sufficient to provide trade partners with the certainty and stability offered by market openings delivered through the multilateral system. Nor does it help to solve commercial disputes. It has also failed to provide reform in sectors, like agriculture, of great interest to producers of developing countries and consumers of developed ones. Furthermore, it should not be ignored that sometimes creating the domestic political conditions for trade reform truly does require the reciprocity supplied by multilateral negotiations, particularly in the presence of powerful domestic vested interests that are against the liberalization policies.

a credible pledge to legally retaliate for others' protectionism does not need to be the result of collective action – all you need is one major trade partner to commit to retaliation for others to follow suit

The present crisis will give ample evidence, for better or for worse, that multilateral liberalization is irreplaceable. The fact that it has not made significant progress since the conclusion of the Uruguay Round is not proof that it is not needed - or that it is not possible.

I reject the idea that it was pre-ordained that the Doha Round should fail as it has failed so far. It is unfortunate that after the July 29, 2008 Geneva collapse of the negotiations, some commentators rushed to explain this outcome not as a consequence of the key players' incompetence to deliver a global

public good important for their own national interest, but rather as a consequence of the Doha Agenda's irrelevance for addressing present and future challenges. They based their argument on a comparison between the conditions that prevailed at the time of the Round's launching and those prevailing seven years later. The evolution of commodity prices, particularly those of food, provided their favourite illustration of how substantially conditions had changed since late 2001.

Leaders playing with the idea of going protectionist within the limits of their countries' WTO commitments should be aware that others also have ample "legal" margin, not only in tariffs but also in an arsenal of other instruments still insufficiently disciplined at the WTO

Yet, I find the argument about the irrelevance of the Doha Agenda outright unwarranted. To use the detractors' favourite example, just look at what really caused the surge in food prices, once proper account is taken of the rather modest growth in global demand and the effect of exceptional droughts. The real culprit can be found in the protectionist policies used to foster the production of grain-based ethanol and also in the wrongheaded – again protectionist - reactions to the rise in prices on the part of some grain producing and consumer countries. Preventing the adoption of these kinds of policies is exactly what paragraph 13 of the Doha Ministerial Declaration and the comprehensive negotiations thereby committed were supposed to achieve.

One may think that the Doha Agenda was too ambitious and even overloaded; that its promises of delivering on development were exaggerated. But there is no way to claim that the Doha Declaration did not comprise the issues that to this day continue to be crucial for advancing towards a rules-based global liberal trade regime. Can we advance towards that regime without solving the agricultural reform outlined in the Doha Declaration? Can we advance without completing meaningful negotiations on manufactured goods, or without disciplining the use of anti-dumping and countervailing actions? Without improving the DSU? Hardly, and probably impossible! More important in the short run is to acknowledge how less worried we all would be now about the risk of a protectionist explosion as a result of the ongoing global recession.

The sceptics of the Round's value should make a proper recollection of the negotiation commitments solemnly adopted by all country members at Doha in November of 2001. Checking this would be useful to understand better what the failure has been, by whom and to whom. This exercise is not about fuelling anew

any blame game. We have had too much of that already. It is rather about avoiding hurried judgments on the relevance of the WTO and the Doha Agenda and being able to reason with cooler heads on what can be done realistically to avoid having our worst fears come to life.

For sure, one thing we should not believe is that it is realistic or convenient at this time to undertake a reinvention of the WTO in order to introduce further complexities into its mandate.ⁱⁱ It is somewhat ironic and contradictory, as some authors have done, to recommend on the one hand that the Doha Round should not be revived and on the other to submit that what is needed is a more ambitious agenda for the WTO. Most likely it was premature to charge the institution with not strictly trade issues at the time of the Uruguay Round and insist on such a route in the Doha Agenda. But it would be dead wrong to make the same mistake again in the face of the present crisis.

It looks disingenuous to suggest that, in lieu of finishing Doha, the WTO should now be asked to perform tasks such as enforcing the IMF's exchange rate policy recommendations, overlooking the sovereign wealth funds, being an important player in global financial regulation and fighting climate change with trade sanctions. In all sincerity, with friends like the ones who propose such new responsibilities for the WTO, the institution does not need enemies!

More seriously, proponents of extending the WTO's mandate are both naïve –for thinking that a major overhaul is now feasible- and inconsistent –for wanting to add more goals to one instrument already overloaded with too many objectives. Clearly and regrettably, the DSU -a great asset of the multilateral system- continues to be the “forbidden fruit” desperately desired by every advocate of every conceivable global governance cause.

I am all in favour in reforming, strengthening and, when needed, creating new multilateral institutions. In fact, I am absolutely convinced that we are in the present mess, in no small measure, because of a lack of global governance of essential phenomena inherent to our increasing interdependence. Yet I am opposed to attempting to fill this gap by doing something that would end up crippling one of the few institutions that continues to deserve high marks for accomplishment of mission, the WTO.

This criterion seems equally pertinent in thinking about how to deal with the spectre of a protectionist avalanche. In my view, the only realistic option is to use, to the maximum extent possible, the instruments that are already available. Of course, pledges to avoid protectionism by leaders or other high-level officials are always welcome, but as recent events have shown, sooner rather than later, those pledges are blown away by the wind of domestic political pressures and there

remains little of practical value. The only thing that will make leaders think twice about whether or not to fall into the temptation of pleasing a particular constituency with protectionism will be the possibility that, as a consequence of such an action, another of its political constituencies will end up being seriously hurt. This possibility will make dubious the net political benefit of walking the protectionist tightrope.

What I am suggesting is that pledges by countries to use whatever legal means they have at their disposal to retaliate against others for protectionist actions that harm their exports will prove far more effective than their own pledges not to introduce new trade barriers. Interestingly, a credible pledge to legally retaliate for others' protectionism does not need to be the result of collective action, unlike the case of a pledge to avoid new trade barriers. All you need is one major trade partner to commit to retaliation for others to follow suit.

If a leader of a trading power is convinced that worldwide protectionism will make of this crisis an even worse disaster, then, in addition to resist domestic pressures for higher trade barriers, that leader should firmly declare that any new action restricting access of his country's exports to any foreign market shall lead to retaliation against the export sectors of the trade transgressor.

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We need tough love, not sweet words in our present circumstances. Pledges by leaders not to increase tariffs -- and asking others to follow suit -- will be ineffective. The only way to go is to say whoever moves first will be severely punished, and the system has instruments to apply that punishment. This would be far more effective than sweet words.

Some may think that this approach has hardly any chance to be effective simply because there is so much “water” in tariffs as well as lots of latitude in other WTO sanctioned instruments so that tons of additional legal protection is possible. This is true, but the argument cuts both ways. Leaders playing with the idea of going protectionist within the limits of their

countries' WTO commitments should be aware that others also have ample "legal" margin, not only in tariffs but also in an arsenal of other instruments still insufficiently disciplined at the WTO, to hurt their export sectors at least temporarily.

Needless to say, I am not arguing for the convenience of a nasty trade war. What I am submitting is that if you want to prevent one, it's better to make the potential contestants aware of the full cost of their own folly starting from day one. In other words, let's use whatever tools the system has in order to make clear to whoever decides to ride the protectionist wagon that there will be no such a thing as a free ride, but rather that there shall be blood. In short, let the WTO's teeth bite!

Obviously, the approach I am suggesting is not consistent with other proposals that have been put forward by some esteemed colleagues, including Simon Evenett and Richard Baldwin's idea of a global safeguard mechanism.ⁱⁱⁱ This safeguard would be counterproductive for it will encourage even more the protectionist forces already unleashed and will weaken seriously and permanently the WTO's authority. Any institutional accommodation to protectionism will be fatal under the present circumstances where most players are keen to free ride the system more than ever.

It is true that the aggressive deterrence approach I favour could conceivably put unbearable strains on the DSU. My expectation, however, is that in practice this would not happen as long as the key trade players formulate credibly and firmly their intention to retaliate legally for whatever protectionist action that affects their exports. Besides, reinforcing the DSU to be more expeditious is not a task that needs to wait for a comprehensive Doha deal; nor does the necessary sharpening of the WTO's surveillance capabilities. No effort should be spared to empower the WTO to fulfil its surveillance responsibilities to an unprecedented scale, even at the expense of irritating some of its members. Furthermore, if the leaders of the major trading countries are truly convinced that a protectionist surge would be in nobody's interest, then they should finally get serious about concluding the Doha Round by putting their political will and capital where their mouth is.

I don't share the idea that leaving the Round on hold for the time being is a necessity.^{iv} True, a Doha final outcome as it was envisioned by many of us in November of 2001 will hardly ever happen, but a compromise delivering a deal that approaches what looked feasible in July of 2008 should be sufficient to keep the system moving forward, rather than backsliding into suicidal protectionism. It's not only about sending a precise rejection of the mercantilist menace. It's also about preparing the recovery that one day, hopefully not too far into the future, will come.

Yet with all due respect to ambassadors in Geneva and their immediate bosses in the capitals (the trade or foreign ministers) finishing Doha is not really within their capacities. It's up to leaders to get the job done. Leaders need to descend to the lowly task of deal making. They should go to the upcoming G20 meeting better informed about the most contentious pending issues and right then and there use some time to advance a solution, followed by an unequivocal commitment to re-launch the negotiations, do whatever necessary to have their ministers deliver the so-called modalities by early Summer, and conclude the whole Round by year's end.

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It is not only the trading system that is being challenged now. More fundamentally, the opportunities that globalization has provided to fight poverty in the developing world are dangerously at stake. If we cede the economic interdependence we have achieved in the last few decades, we will be living in a much more dangerous world. That is why we must do whatever is in our capacity to protect the multilateral trading system. It is one of humanity's greatest assets.

The **Thinking Ahead on International Trade** (TAIT) programme is devoted to the analyses of medium-term challenges facing the international trade system in general and the WTO in particular.

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ⁱ This Policy Brief is based on the TAIT Inaugural Lecture delivered at the Graduate Institute (Geneva) on 24 February, 2009.

ⁱⁱ As suggested in Mattoo, Aaditya and Subramanian, Arvind, "From Doha to the Next Bretton Woods: A New Multilateral Trade Agenda," Foreign Affairs, January/February 2009.

ⁱⁱⁱ Baldwin, Richard, and Evenett, Simon J., "Restoring the G20s credibility on trade: Plan B and the WTO trade talks," VOX, December 13, 2008.

^{iv} As my admired mentor Jagdish Bhagwati suggested in his January 8, 2009 FT Op-ed.