

Learning Objectives

- After having examined different economic tools that can be used to analyze trade policies, we now turn our attention to the organizations and legislations that govern trade policies. The World Trade Organization (WTO) is the main international institution that sets trade laws.
- Begin with examining some common misconceptions (to a certain extent) of the WTO.
- Conclude by looking at some of the goals, accomplishments and challenges of the WTO.

7.1 Motivation

From previous chapters, we have seen theoretical arguments for and against trade restrictions. While freer trade can increase total surplus due to cheaper products and better production allocation, trade will also create unequal income redistribution effects. Countries continuously face lobbying pressure from various interest groups for import restriction and export promotion policies. If a country imposes such policies, other countries are likely to retaliate and result in a trade war. In order to prevent trade disputes caused by policies such as the Smoot-Hawley Act to reoccur, we need an international trade organization that could set trade regulations and assist in settling trade disputes should they arise. The World Trade Organization (WTO) plays this role. However, the WTO often faces criticism, and the sources of the criticisms come from both proponents and opponents of free trade. Proponents argue that the WTO has failed in promoting freer trade, while opponents argue that freer trade under the WTO has led to world poverty, pollution and violation of labour rights. In this chapter, we would begin with looking at the origins and principles of the WTO, what it does, and what it does not do. We would discuss some of its accomplishments, as well as the areas in which it could improve upon.

7.2 Features of the WTO

On January 1, 1995, GATT was succeeded by a formal organization called the World Trade Organization (WTO). Recall from Chapter 3, GATT was an informal vehicle that offered signatory countries a forum to gather and discuss trade issues. Even though GATT did succeed in slashing tariffs over the decades, it did not have enforcement power when it came to settling trade disputes. The last round of GATT negotiations, the Uruguay Round, led to the creation of the WTO that has (some) enforcement power.

As of November 2014, the WTO has 160 member countries. These countries account for over 90% of world trade. The WTO¹ is based in Geneva, Switzerland, with over 600 staff members, a director general that is appointed every two years, and an operating annual budget of approximately US\$200 million. The member countries should meet every two years in ministerial meetings, with past meetings held at Geneva, Seattle, Doha, Cancun, Hong Kong and so on.

¹ The WTO official website is <http://www.wto.org>.

The WTO sets and regulates a code of international trade conduct, with three main principles in mind: most favoured nation clause (similar to GATT), a general prohibition of import quotas and subsidies (except agriculture), and a requirement that tariffs cannot be increased without being offset by a reduction in tariffs elsewhere. The WTO has special clauses that deal with the needs of developing countries. For example, developing countries can impose quotas and offer subsidies, and they are also granted extended time to adapt to and comply with trade rules. Also, if developed countries cut their tariffs imposed on developing countries, the developing countries do not have to reciprocate with similar tariff cuts for developed countries.

A main objective of transforming GATT into the WTO was to strengthen the WTO's power in settling trade disputes. Under the old GATT system, disputes were examined under long delays, and the countries could block decisions of GATT panels that went against them. Unlike GATT, WTO decisions are reached within a set of time limits (usually six months), and the decision reached by the panel is legally binding. Once a country is found to have broken a trade rule (such as illegal subsidies, tariffs or quotas), it is up to the country to decide how to respond. It can stop the offence, continue the offence but compensate its trading partner by lowering its trade barriers in another sector, or do nothing and let the trading partner retaliate by an equivalent amount on the products the trading partner imports from the offending country. The strength of this new dispute settlement procedure is evident from the number of cases brought to the WTO. The WTO has examined over 360 cases since 1995, while GATT has investigated around 300 cases in its entire existence from 1947 to 1994. Some of the WTO's most widely publicized cases include the US-EU disputes on hormone-treated beef and banana exports, as well as the US' tariffs on steel imports.

7.3 Some Common Misconceptions of the WTO

There are as many opponents to the WTO as there are proponents. Some of the most commonly quoted accusations against the WTO include its policies (or lack thereof) on the environment and labour standards, its threat on a country's sovereignty, its policies being dictated by multinational corporations, and its role in homogenizing global culture. We would use economic arguments to examine the validity of such accusations.

"The WTO Ignores Environmental Standards"

The WTO Agreement on Technical Barriers to Trade establishes rules on methods of process and production. Under this agreement, the method by which the goods are produced cannot be used as a reason or justification for imposing trade restrictions. The rationale for this rule is simple. Developed countries, with higher income, can afford to require higher environmental standards from their firms. Developing countries, in contrast, focus on production and economic growth, with environmental concerns playing a secondary role. The WTO does not let developed countries use their own environmental standards as justifications for restricting imports from developing countries. For example, the US tried to ban tuna imports from Mexico because dolphins are killed when tuna are caught.² The WTO ruled that such a ban is illegal. Another example is the US' ban on shrimps harvested in Indonesia and Malaysia because rare turtles were killed in the process.³ The ban was also ruled illegal. The developing countries are naturally suspicious of the US' concerns because protectionism can be easily disguised as environmental concerns.

² <http://www.intfish.net/cases/other/gatt1994/index.htm> and http://are.berkeley.edu/courses/EEP131/old_files/studentpresentations05/Tuna%20Dolphin%20Case.pdf

³ http://www.ictsd.org/html/shrimp_turtle.htm and <http://www.sunsonline.org/trade/process/followup/1998/04090098.htm> .

“The WTO Ignores Labour and Human Rights”

The center of this argument is the lack of labour unionization and the use of child labour in some developing countries. While it is true that developing countries do not offer wages and benefits that are comparable to those offered by firms in western industrialized countries to their workers, the economic rebuttal is that bad jobs are better than no jobs at all.⁴ Economist Paul Krugman, a likely candidate for a Nobel Prize in economics in the coming years, has an interesting article on such accusations.⁵ Also, we cannot compare hourly wages across countries by using exchange rate conversions. The more accurate conversion is through purchasing power comparison that reflects cost of living differences across countries. Also recall from Chapter 2 that wages are correlated with productivity differences across countries. Developing countries are suspicious of western countries' concern about labour benefits, knowing that their comparative advantage is driven by relative labour abundance, as discussed in the Heckscher-Ohlin model. Imposing strict labour regulations would raise production costs in developing countries, while the import-competing workers in western countries would gain via the Stolper-Samuelson theorem. Developing countries are vehemently opposed to the demands from developed countries that labour rights should be governed by the WTO and be allowed to affect trade policies. They believe that labour regulations, similar to environmental regulations, can easily be used as disguised protectionism.

Critics also argue that the WTO should have legislation that allows countries to ban imports if “under-age” workers produced such products.⁶ The first difficulty is to determine what is “under-age”. In industrialized countries, children often receive free, public education up to high school graduation, but this is a luxury in many developing countries. Economists often argue that the most effective way to eliminate child labour is through increased trade and production. It may take a couple of generations to accomplish this goal, but as history shows, western industrialized countries have gone through a similar process over the past century but now they can afford to legislate minimum working age. Recently, a handful of Southeast Asian countries such as Japan, Korea and Singapore have also reached a similar stage in economic development. Studies have also found that banning child labour in export firms does not lead to reduced hiring in children, but rather these children would go underground or work in rural areas in which they are less likely to be caught. In short, the WTO does not allow any country to use trade restrictions to enforce its own environmental, labour, health and safety standards when such standards have selective and discriminatory effects against their trading partners.

“The WTO Threatens a Country’s Sovereignty”

Critics argue that the WTO threatens a country’s sovereignty because its rulings could force a country to comply with rules that could damage domestic interests. For example, if a country is found to have imposed tariffs illegally, the country may be forced to stop. This is simply not true. As discussed in previous pages, the offending country does not have to respond to the WTO’s ruling, but this means the affected trading partner can legally impose retaliations.

Another example that is often quoted is related to food safety. Critics claim that WTO rulings force countries to import products that are unsafe. This is not true. For example, the WTO ruled that the EU could impose import bans on US hormone-treated beef or genetically modified food based on food safety concerns, but the US could retaliate. This is because the EU could not provide scientific evidence to

⁴ <http://www.slate.com/id/1918> .

⁵ <http://www.slate.com/id/56497> .

⁶ http://sitemaker.umich.edu/varanasidecember2005/files/child_labour_and_wto_rules_-_kishor_sharma.doc,
<http://www.cid.harvard.edu/cidtrade/issues/labor.html> and <http://webjcli.ncl.ac.uk/2004/issue2/mansoor2.html> .

convince international experts on food safety that such products are unsafe. The WTO's Agreement on Sanitary and Phyto-Sanitary Measures allows countries to set their own safety standards, and they can restrict imports if such products do not meet their tests. However, in order to avoid trade retaliation, these countries need to provide scientific evidence to support their claims and tests. If such criteria are not met, the countries can still restrict imports, but the trading partners could retaliate with their own trade restrictions. For example, the US has in place tariffs of 100% on a number of EU products, including French mustard, Roquefort cheese and truffles.⁷

"The WTO (or Globalization) Creates a Global Monoculture"

Opponents of the WTO, or globalization in general, argue that world trade will homogenize global culture into "every place is like every place else".⁸ The Turning Point Project is probably one of the more vocal opponents of globalization.⁹ Economist Paul Krugman offers a quite humorous article on this topic.¹⁰ The main criticism of the Turning Point Project is that cities in developed and developing countries are increasingly similar in appearance, such as paved streets, skyscrapers and traffic jams. The appearance of McDonald's and Starbucks is also a sore point. From the postings of this Project, there seems to be confusion between "monoculture" and modernization. The fact that modern adults wear western-styled suits and ties rather than kimonos does not mean that such people have adopted western cultural values. Also, people who live in cement houses rather than straw huts do not mean they have "converted" to western culture. Interestingly, multinational companies that conduct business internationally are very conscious about global cultural diversity. The detested symbol of the invasion of American culture, McDonald's, designs its menus around the world differently to suit domestic culture. Barbie dolls, produced by Mattel, are shaped differently depending on the market of destination.

"Multinational Corporations Dictate the WTO"

Non-governmental organizations (NGOs) often criticize the WTO as being run by corporations and greed.¹¹ In reality, only countries, not companies, can bring trade disputes to the WTO for settlement. While it is true that the inclusion of patent protection in the WTO Agreement on Trade Related Intellectual Property Measures (TRIPS) could have been the result of active lobbying efforts from the pharmaceutical industry in industrialized countries, the WTO has since allowed developing countries in need of life-saving drugs to override patent protection and manufacture cheaper generic drugs (to be discussed in Section 7.4). Economist Jagdish Bhagwati has an interesting article on such issues.¹²

Studies have found that while some multinational corporations (MNCs) have behaved badly, such companies as a group have been offering more benefits than harm to developing countries. A study by the Economist has found that MNCs have four features¹³: they pay more to their workers than the domestic firms in the developing countries; they create jobs faster; they invest more in research and development, and they also export more of their products than domestic firms. Perhaps in fear of negative publicity, the MNCs actually have better working benefits and conditions than those offered by domestic firms in the

⁷ Cooper, Helen, "US Imposes 100% Tariffs on Slew of Gourmet Imports in War over Beef", *The Wall Street Journal*, July 20, 1999, p. A6.

⁸ <http://bss.sfsu.edu/fischer/IR%20305/Readings/global.htm>.

⁹ http://www.activistcash.com/organization_overview.cfm/oid/209.

¹⁰ <http://www.slate.com/id/56497>.

¹¹ <http://www.globalissues.org/TradeRelated/Corporations.asp>.

¹² <http://www.columbia.edu/~jb38/FEER%20Final%20Edited%20by%20Restall%20and%20Bhagwati.pdf>.

¹³ "Foreign Friends", *The Economist*, January 8, 2000.

developing countries.¹⁴ MNCs also tend to use cleaner production technology than the domestic firms simply because the MNCs have access to such technology. It is often more cost effective for these firms to operate under similar environmental standards regardless of whether they produce in developed or developing countries.

7.4 Some Economic Issues of the WTO: Accomplishments and Challenges

The main goals of the WTO negotiations are summarized under the Doha, Qatar ministerial meetings. During the last round of GATT negotiations, the Uruguay Round 1986-1994, some results have been obtained. These include across-the-board tariff cuts by developed countries averaging 40% in industries such as steel, medical equipment, pharmaceuticals and paper, abolition of quotas and slashing tariffs in textiles and clothing products, prohibition of the use of quotas, and the protection of intellectual property with patents. Main outstanding issues include drug patent protection versus life-saving drugs, agricultural subsidy cuts by developed countries, abuse of antidumping policies, and tariff cuts by developing countries. Due to the fact that developing countries were not required by GATT to reciprocate tariff cuts undergone by developed countries over the past few decades, average tariff rates in developing countries have remained high. For example, India and Brazil have average tariff rates of 30%, while developed countries such as Canada and the US have tariff rates of around 5%. Developed countries have since been requesting tariff cuts from emerging developing countries, especially on manufactured imports and agricultural products. These issues are set out in the Doha Round agenda for negotiations.¹⁵

The Doha Round, also called the Doha Development Round, is different from previous GATT and WTO negotiations because developing countries will play a larger role in its outcome. Developing countries have increased their international clout, especially with the entry of China into the WTO and the memberships of India and Brazil. Developing countries mainly want to gain wider market access to developed countries in agriculture and textiles. Former Secretary General of the United Nations Kofi Annan's article in the Wall Street Journal summarizes their concerns succinctly.¹⁶ In contrast, developed countries face strong domestic political pressure to protect these declining, import-competing industries. Studies have estimated that if Doha Round were to be successful, the world GDP would rise by \$355 billion in the year 2015 when all transition steps are completed.¹⁷

Drug Patients Trump Patents

Advocacy groups have often criticized the WTO's TRIPS as it requires all member countries to adopt parallel standards with respect to corporate patents, trademarks and copyrights. They argue that it is through this agreement that perfect competition is destroyed and monopoly ownership emerges over patents that protect such things as pharmaceutical products. The result is a clamp in the interest of public health issues.

How would a person who has taken an introductory microeconomics course respond to this accusation? From firm theory, we know that firms that are perfectly competitive earn zero abnormal economic profits. This means the owners of the factors of production are paid their fair market price, or their opportunity

¹⁴ "The World's View on Multinationals", The Economist, January 29, 2000.

¹⁵ The complete list of issues is found at http://www.wto.org/english/thewto_e/whatis_e/tif_e/doha1_e.htm.

¹⁶ Annan, K., "Help the Third World Help Itself", The Wall Street Journal, November 29, 1999.

¹⁷ Economic Report of the President, February 2004 (Washington, DC: US Government Printing Office, 2004), p.236.

cost. Since firms do not earn abnormal profits, such firms will not have the resources or money to invest in research and development. For example, we would not expect a small Manitoba farmer to develop new farming technology, and neither do we see owners of neighbourhood convenience stores design new products. In other words, we require a market structure of monopoly or oligopoly in order to invest in new technology. For example, pharmaceutical firms need to invest millions of dollars to develop a new drug that may or may not work. In order for them to undertake such a project, they need to have some abnormal profits to begin with, and the protection of patents if the drug is a success in order to recuperate their initial investment. The presence of abnormal profits over the patent-protected years is needed to encourage the firms to undertake such risky projects in the first place.

However, who can say no to poor, dying patients when life-saving drugs are available, but too expensive for them to purchase? On August 30, 2003, the WTO countries reached an agreement that would allow developing countries to bypass patent protection on expensive drugs to manufacture or import the cheaper generic versions. These generic drugs, however, could only be used domestically and not re-exported to a third country for profit. Countries will now be able to break patents on drugs if they are being exported to developing countries. This promises to stimulate the generic drug industry in South Africa, as well as expand the current ones in Brazil and India.¹⁸ However, non-governmental groups criticize the deal as requiring developing countries to repackage the drugs under different labels and in bulk. They argue that this could raise drug prices!¹⁹

In November 2006, the Clinton Foundation, founded by former US President Bill Clinton, and two Indian drug companies have reached an agreement to cut the price of 19 AIDS and HIV drugs for children by a further 45% to an average price of 16 cents (US\$) a day. The low-priced drugs will be available to 62 developing nations and will result in the treatment of an additional 100,000 young HIV/AIDS patients in 2007, according to the Clinton Foundation.²⁰

Agricultural Subsidies

Developing countries that export agricultural products request cuts to the agricultural subsidies paid by the US, the EU, Japan and other developed countries to their own farmers. They claim that these subsidies, which amount to over US\$250 billion a year, hinder their ability to compete in the global market. The WTO has made little progress on this front. Trade ministers met in September 2003 in Cancun, Mexico, but the talks broke down. The EU denied any promise to cut back on subsidies, and Japan simply rejected any cuts in rice tariffs. Countries were to reach an agreement on subsidy cuts by the Hong Kong Round in 2005, but no substantive agreement was reached. Instead, countries agree to a “pledge” to eliminate subsidies by 2013. Any moves to increase agricultural imports are often met with widespread protests in countries such as Japan and Korea.²¹ A recent lifting of US beef imports in Korea had led to protests of over 80,000 people.²² Developed countries also want developing countries to cut back their tariffs on agricultural imports.

¹⁸ http://www.medindia.net/News/View_news_main.asp?t=ph&x=2238

¹⁹ <http://www.indymedia.org.uk/en/2003/09/276532.html>

²⁰ <http://www.healthfinder.gov>

²¹ <http://news.bbc.co.uk/2/hi/asia-pacific/4009571.stm> and <http://news.bbc.co.uk/2/hi/asia-pacific/7491482.stm> .

²² http://www.usatoday.com/news/world/2008-06-29-skorea_N.htm .

Antidumping Legislation

In Chapter 4 we have discussed the increasing popularity of using antidumping (AD) policies to impose import restrictions by developed and developing countries. AD duties are simply tariffs under a different name. In an attempt to curb AD usage, countries including Canada, Brazil, Japan, Korea, Taiwan, Thailand, Singapore, Hong Kong, Mexico, Chile, Costa Rica, Israel, Norway, Switzerland, India and Colombia have formed a coalition called the “Friends of AD”. This group requests the WTO (especially the US) to rein in the usage of AD policies as well as increase its transparency. They request six negotiating objectives: mitigating the 'excessive effects' of AD measures (AD duties much higher than the necessary values to eliminate dumping and injury); preventing such measures from becoming permanent (to expire after five years); strengthening the due process and transparency of dumping proceedings (calculations of margins); reducing the cost of AD cases (firms require to cooperate with government officials with firm visit, shipment delays, etc.); ensuring a quick end to unjustifiable investigations (terminate cases as early as possible); and improving and clarifying rules on what constitutes 'dumping' and 'injury' (low dumping margins should be ignored).²³

In reaction to the requests, the US was willing to engage in deeper discussions on the key issues. India, and supported by Egypt, are frequent users of AD policies. Both countries said they are not prepared to discuss a written agreement for changes, and emphasized the need for more attention to developing country issues such as special and differential treatment. The EU said it sought to find a middle ground between the 'Friends' and others.

Technical Assistance for Developing Nations

Of the 160 members of the WTO, over two-thirds are developing countries with per capita GDP of less than US\$11,000 per year. The WTO provides technical and legal assistance such as training programs for staff from developing countries. Each year, it offers various preparatory and policy training workshops for different countries.²⁴ The number of participants averaged 30,000 per year. However, the WTO budget is severely limited at US\$6 million.²⁵ This amounts to roughly \$60,000 per country per year for training, or \$200 per participant. In view of such shortage of funding, developed countries such as France, Denmark, Norway and others have collectively contributed another \$24 million for a training trust fund.²⁶ Even with this additional fund, the total training budget is still rather limited.

²³ <http://www.ictsd.org/weekly/05-03-02/story5.htm>.

²⁴ http://wto.org/english/tratop_e/devel_e/train_e/course_details_e.htm.

²⁵ http://www.wto.org/english/tratop_e/devel_e/teccop_e/ta_factsheet_e.htm.

²⁶ <http://www.ictsd.org/weekly/01-12-12/story3.htm>.