

**Course:** Poli Sci 2H03

**Subject:** Global Economy, Trade, and Finance

**Instructor:** Dr. Vermilyea

**Section:** Evening, T01

**Date:** Oct.3, 2012

### **Plan for the class**

- Discuss the world trade regime, with a focus on the transition from the GATT to the WTO
- Learn about the current international financial system, and its emergence from the Bretton Woods system
- Consider how this international financial system contributed to the 2007-2008 financial crisis

### **General Agreement on Tariffs and Trade**

- Post WWII, the GATT existed as the primary framework governing international trade relations
- This persisted until 1995 when the Uruguay round established the World Trade Organization (WTO), which effectively replaced the GATT and served as an indication of a further institutionalization of trade rules
- 3 key problems with GATT:
  - (1) failure to reverse the growth of protectionism (embedded liberalism; as opposed to neo-liberalism)
    - Embedded liberalism: foundational principle of GATT; aim to achieve 2 goals:
      - (1) promote free-trade/move into open market system of free-trade
      - (2) protect domestic economies from the negative effects of free-trade and protect them from unemployment
    - Theory of embedded liberalism stopped certain types of imports and created subsidies for others
      - Favoured developed countries and worked in their interest
      - Represented fusion of international power and dominant forms of power (US and UK)
    - Promoted market liberalization, but only if it was within the limits of the powerful states
    - The aim of the GATT was not to dismantle the state
      - State still important figure with GATT/embedded liberalism ideology
  - (2) the weakness of its dispute settlement procedures
    - If there was a dispute and there was a decision made on the dispute, if one member didn't like that decision they could veto
      - Not enforceable
      - Contracting parties could just block decisions of panels as they wish
    - GATT was just a contractual agreement among members, lacking institutional backing that was needed to make it enforceable
  - (3) uneven nature of its trade liberalization process
    - Something that has extended to the WTO
      - Further heightened with GATT
    - Certain sectors were liberalized, which worked in favour of developed countries
      - e.g., manufacturing
      - This is a problem because developing countries need to trade agriculture/textiles, but these industries were highly protected and received subsidies from developed countries to protect their markets from the developing countries
    - Only helped developed nations in areas where they had a comparative advantage

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### **WTO**

- Increased institutionalization and legalization of trade process
  - US pushed for legalization of dispute settlement process
  - Canada and Europe wanted a further institution as a whole structure of the international trade process itself
- Introduction of Appellate Appeal Body
  - If a dispute comes to the WTO, and the decision is made, people have the right to appeal it now
- Remodeling of the dispute resolution process
  - Intensified areas where trade regulation applied
  - Introduced new issue areas into domain of trade regulation
  - Resulted in a number of legally-binding agreements
    - The agreement on trade-related aspects of international property rights
    - General agreement on trade and services
  - Dispute settlement understanding provides a framework for a legalistic and orderly way
    - Panel of judication
    - Appeals process
- Move towards more unbiased, rules-based institution

### **Key principles of WTO**

- No discrimination
  - No preferential treatment
  - All countries treated as equal trading partners
  - Not to discriminate between its own and international products/services
- Freer than GATT
- Predictable
  - Tariffs/non-tariff barriers should not be raised arbitrarily
- More competitive
  - Discourages unfair practices
    - Export subsidies
    - Dumping (to gain market shares)
- More beneficial for developing countries

### **Key challenges and criticisms**

- Developing country interests
  - Agriculture and textile sectors continue to exercise high levels of protectionism from external markets
  - Developed countries continue to protect their markets, which is against free-trade principles
  - Results in higher production of agriculture in developing world, which lowers their prices (due to surplus of product)
  - Also issue with subsidies
    - Developed countries subsidize their own farmers, gaining an advantage over farmers in the developing world

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- Problems with the dispute settlement process
  - Developing countries don't have as many representatives to send to meetings
  - Also issue of power/knowledge, since the developing world lacks resources to keep up with rules
  - Very Americanized legalistic system that is set by Western countries
    - Many developing countries are not familiar with that system
  - High frequency of appeals is a draining effect on the legal resources of the WTO
    - In 53/73 of court proceedings, countries have adopted appeals
- Legitimacy issues (environmental concerns)
  - Argument is that trade rulings work in favour of business and trade and neglect any environmental concerns
  - Principle of liberal environmentalism embedded in WTO
    - Free trade and environmental protection are compatible, says WTO
    - WTO almost unanimously votes in favour of trade, so their claims are not true in practice

#### **The Routes of Trade [WTO video]**

- Trade helps people live more prosperously
- Everyone is selling is what they can do best/cheaper
- Trade has been international
  - Requires international laws
- Trade must be balanced and fair,
- Closing borders creates unemployment
  - Aggravated by protectionism
- More than \$15 trillion pass borders each year
  - About \$2 billion per hour
- Balancing trade and creating a level playing field are WTO's main goals
- WTO has rules to allow governments to protect their environment and health
- Every WTO has veto power, unlike UN which only has 5

#### **Why WTO is Bad for Developing Countries [Youtube video]**

- Developed countries control half of world trade
- Food crisis is experienced, and farmers are shouldering losses under WTO
- Import restrictions on rice destroy foreign agricultural economies
- Global competition is not fair because of subsidies

#### **Questions for discussion**

- Discuss the key differences between the GATT and the WTO
- Does the continued operation of the WTO help or hinder development? Why or why not?

#### **Bretton Woods**

- First example of a fully negotiated monetary order intended to govern monetary relations among independent nation-states

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- Rested on the principle of 'embedded liberalism' - shared ideology of the combination of a form of an open multilateral financial system with the new, more interventionist economic practices that had emerged from the Depression experience
- Created 2 new intergovernmental bodies - the IMR and IBRD
- Legalized, regulated system of international finance
- Currencies defined in relation to the US Dollar (pegged)
  - More regulated, controlled system of international transactions
  - When we talk about exchange rates, the USD was the standard to which other currencies were held
- Certain key factors were necessary for this system to emerge
  - Response to Great Depression in the 1930's
  - The existence of a dominated economic leader - the US
  - Shared commitment to 'embedded liberal' values
  - Wartime context - all countries invited by the US to Bretton Woods were military allies

#### **From Bretton Woods to Neo-Liberal Globalization**

- Characterized by move from fixed to floating exchange rate
- Deregulation of financial markets
  - In the 1980s/90s, we see an embracement of deregulation ushering in an era of highly integrated financial markets
- Ideological shift from 'embedded liberalism' to 'neo-liberalism' - freer financial markets and a more constrained role of the state
  - Key difference is the role government plays
  - Government seen as a cause of more harm than good
    - Should just step back and let market do its work

#### **Financial crisis (2007-2008)**

- Linked to deregulation of financial sector
- Financial system built upon lending money that wasn't there, creating endless amounts of debt, and the buying and selling of 'securities'
  - 'Securities' were groups of mortgages that were sold by banks to insurance companies, while at the same time receiving money on these loans
  - Essentially, bad loans would be the problem of whoever bought the securities, leaving the banks unaccountable
  - The problem began when the banks ran out of who to lend to
    - The banks continued to sell sub-prime mortgages to people who couldn't afford them
- Created a problem so deep that it affected virtually all parts of the world

#### **Consequence of the crisis**

- Legitimacy: crisis resulted in loss of faith in the neo-liberal globalized financial system
  - Loss of faith in US and British leadership
  - Highlighted a shift of power to emerging economies

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- Power shift from the North Atlantic region (US/Canada/EU) to more emerging markets (East Asia)
- International reform agenda:
  - G20 took over from G7 in the role of setting agenda for international financial reform
  - Nothing radical has been done - focus has been on strengthening and widening existing international prudential standards
- Globalization has not been confronted directly

**Questions for discussion**

- Discuss the differences between the Bretton Woods financial system and the current neo-liberal system
- Which system do you think is better to a globalized world? In particular, does the market 'correct itself' or does it require increased government regulation?
- Who should be held accountable for the financial crisis? Do we blame banks, governments, the international system?