

## New Trade Politics After the Doha Round

*Presentation by*

**Joost Pauwelyn**

Professor of International Law (HEID)

*Les Conférences de HEI avec le parrainage du quotidien Le Temps*

Geneva, 5 December 2007

My starting point for tonight's presentation is this. The multilateral trade system (then GATT) was negotiated, created and written exactly 60 years ago, in 1947. This was done in the political, economic and social context of the day. Just have a look at these pictures (*slides 2-3*). Today, 60 years later, the reality is that the trade system (now WTO) remains centred on the same basic text (GATT) and, more importantly, continues to follow the same negotiating technique and mechanics. It is worthwhile spending a minute on what this technique actually is (*slide 4*). The GATT/WTO's "magic trick" for achieving liberalized trade can be summarized as follows: "reciprocal exchange of market access concessions" (*slide 5*). Take the example of how to liberalize imports of chocolate into Switzerland. The conventional story is that if we leave Swiss domestic politics alone, it will lead to protectionism. More specifically: The special interest group of Swiss import-competing chocolate producers will manage to convince Swiss politicians to keep, for example, Belgian chocolate out. So, how do we achieve liberalization, that is, an outcome which may hurt Swiss chocolate producers but is in the overall interest of the Swiss economy (cheaper and, of course, better chocolate gets in from Belgium!)? Well, through international negotiations in Geneva where Swiss diplomats "concede" to liberalize chocolate imports in exchange for more exports of, say, Swiss watches, to Belgium. In other words, because of the GATT/WTO, Swiss politicians can overcome the pressure of Swiss chocolate producers (calling for protectionism) by opening markets for Swiss watch exporters (wanting free trade).

Three features stand out in this GATT/WTO “operating system”: First, it is entirely *producer* driven (“import politics”, that is, protectionist pressures from Swiss chocolate producers is replaced with “export politics”, that is, free trade pressures from Swiss watch exporters); Second, the system is entirely merchantillistic (the Swiss market opening for chocolate is called a “concession”, even though, as noted earlier, the Swiss economy overall benefits from chocolate imports); Third, the GATT/WTO’s operating system or magic trick is grounded in a deep mistrust of domestic politics (the assumption being that if we leave national parliaments alone, protectionism will be rampant; hence, “open politics” in domestic capitals must be replaced with “closed politics” in Geneva; this is why the GATT/WTO process is sometimes referred to as one where diplomats secretly meet in Geneva to “cheat” on their own parliaments).

This operating system of “reciprocal exchange of market access concessions” remained largely untouched during the last 60 years. It is the core mechanics also in the ongoing Doha Round.

In response to my claim that the WTO continues to run based on a 60 years old “operating system” (imagine how in 2040 a computer would perform with Microsoft software made in 1980!), three reactions are common. First, and this is true to some extent, the GATT negotiators of the 1940s were visionaries who foresaw today’s problems; hence, no reform is needed. A second conventional response which, again, is true to some extent, is that in the last 60 years the system has actually changed a lot: for example, dispute settlement has been strengthened and the rules have expanded from tariffs to non-tariff barriers and trade in goods to trade in services and the protection of intellectual property rights. Yet, the truth is that notwithstanding these changes the merchantillistic operating system of producer-driven “reciprocal exchanges of market access concessions” remains largely intact. Moreover, of the 79 Appellate Body reports issued between 1996 and 2006, the large majority remain centred on GATT 1947 (close to 50, see *slide 5*). A third response which is likely to be raised is that, yes, the WTO needs reform. Yet, such conventional reformers too often focus on what I would call “insider concerns”, such as improving the WTO institutions (e.g. decision making) or putting a brake on preferential trade agreements, which are often referred to by these “insiders” as the biggest threat to the trade system

(see, for example, the *Sutherland Report*). I am not saying that these insider concerns are not real or do not need attention. Instead, my point is that most of the reforms currently on the table are inward looking, ultimately boil down to business as usual and are likely to bring about change only at the edges.

What I would like to propose is a more radical alternative, an alternative that adapts the world trade system to changes in the outside world and provides a genuinely new “operating system”, in other words, a “new trade politics” for the 21<sup>st</sup> century. In the last 60 years the world has changed dramatically (just spot the difference on *slides 6-7*), and so should the trade system. The WTO is there to serve the world; not the world to serve the WTO. Reforms must be outward looking: As much as the context of the 1940s shaped the trade system created in 1947, the new political, economic and social context of today must shape the trade system of our generation.

Let me elaborate on these, what to many people may sound like empty, “slogans”. First, what is it precisely that has changed in the last 60 years and which may/should have an impact on the trade system? Second and, granted, more difficult: What consequences should we draw from these changes for the WTO (*slide 8*)?

### **What is it that changed in the last 60 years (1947-2007) ?**

Turning, first, to changes that occurred since 1947, let me start by summing up a few conventional ones. First, membership in the world trade system has exploded from 23 to 151, the large majority of whom today are developing countries or economies in transition (*slide 9*). Second, world trade has expanded enormously, with world merchandise trade in 2005 being at 25 times the level of 1950 (*slide 10*). Third, tariffs or customs duties on imports have been drastically reduced, especially in the developed world (in the USA, for example, from an average of 37 % in 1931 to an average of only 4.2 % in 2000; see *slide 11*). Fourth, and I already referred to this earlier, the number of preferential trade agreements, be they regional or bilateral, has exploded, especially since the 1990s, from just a few in the 1950s to close to 250 today (see *slide 12*).

Some less noted changes that took place since 1947 are the following. First, country shares in world trade have changed dramatically. When the GATT was created in the 1940s, the USA and the UK each represented around 25% of world trade (see *slide 13*). In other words, together they stood for half of world trade. Note also that in those days the Benelux had 11% of world trade. In 2006, however, the picture is drastically different (see *slide 14*). Illustrating that trade is far more diversified, 40% of world trade now falls in the “Others” category. The USA’s relative share has dropped to 16%, whereas the EU (25) represents “only” 17%. China’s and Japan’s share, in contrast, have grown tremendously (China now representing close to 10%). As Debra Steger put it in a recent article, GATT was “a bicycle built for two with the US in the front seat and the EC in the back”. The current WTO, in contrast, “is more like a bus careening down a hill with many drivers, none of whom are certain about where they want to go”.

A second less noted change has occurred in *what* is being traded and *how*, today as opposed to 60 years ago. Trade in agricultural products, for example, has dropped from a share of close to 40% of world merchandise exports to less than 10% (see *slide 16*). Moreover, unlike what was predicted in the standard “comparative advantage” theory of David Ricardo (who focused on England exporting wool to Portugal in exchange for wine), today (and for some time already) the lion share of actual trade flows are not *between* industries with one country specialising in some sectors and the other country focusing on others (e.g. England producing wool; Portugal, wine). Instead, most of today’s trade is *intra-industry* (e.g. the USA and the EU both specializing in the same sectors, yet still trading amongst them) and *intra-firm* (e.g., Nokia trading mobile phones and mobile phone components between its subsidiaries). Finally, and most importantly, rather than trade in raw materials or finished products, what we have witnessed in recent years is an unbundling or slicing up of the production chain where, for example, Nokia does not produce its mobile phones only in Finland, but out-sources the production of different components to units in a whole series of different countries, often in Asia (my colleague Richard Baldwin refers to this unbundling process as “Factory Asia”).

This slicing up of the production chain has huge consequences. For one thing, it goes hand in hand with increased flows of foreign direct investment (FDI) (see *slide 16*).

In addition, it requires high levels of liberalized trade as, in our example, Nokia wants to ship its components freely between its different factories set up across the globe. The flows of investment that come with unbundling, combined with the pressure to liberalize trade to attract such investments, has led to a genuine competition between, in particular, Asian countries who, as a result, engaged in competitive rounds of *unilateral* liberalization. In other words, unbundling in and of itself, and quite separate from the WTO process, has led to very import levels of trade liberalization.

A third, less conventional, change of note since the 1940s, is what I would call the international “flanking policies” that have accompanied the world trade system. Think only of the fact that in 1947, when the GATT was created, currencies were fixed, whereas today most are floating freely. This has potentially a huge impact on the actual value of tariff concessions. Similarly, in the 1940s, most countries had strict capital controls in place, whereas today, capital crosses most borders freely. Also, the boom in foreign direct investment (FDI) in the last decades is astounding (see *slide 16*). Finally, since 1947, a whole series of totally new international flanking policies have cropped up in areas not directly related to the world economy. Think only of the international human rights revolution, but also consider new international laws on labour or the environment. Hardly any of this (with the notably exception of the ILO, created in 1919) was around when the GATT was created in 1947.

Should all of these external changes, outside the trade system (summarized in *slide 17*), not have an impact on the WTO? One would think so. Yet, my claim is that these changes have not been sufficiently internalized into today’s trade system.

A fourth and final change since 1947 is perhaps the most important one for present purposes. It is the shift in the political forces that oppose free trade. As I outlined earlier when explaining the GATT’s “operating system”, the trade system was built on the idea that it is import-competing *industries* (in my example, Swiss chocolate producers) that block the adoption of free trade policies. Today, however, the biggest force against free trade is driven by what I would call non-trade values, namely concerns for the environment, cultural diversity, labour standards, rural populations or poverty-struck areas. It is, in other words, no longer just import-competing *producers* that call for protectionist policies (even though they continue to do so), but also

worried *consumer*, *workers* or plainly *citizens* who have doubts about free trade based on the earlier mentioned values of poverty-reduction, labour standards, culture or the environment. If the forces *resisting* welfare enhancing free trade policies have changed, one would think that also the mechanism for *enabling* freer trade should change. In my view, this has not happened sufficiently.

To illustrate this shift in the forces against free trade, consider US politics in the 1940s as opposed to US politics today. Which party in the USA was the big opponent of free trade in the 1940s? Right, the Republican Party. Why? Partly because they represent US business and industry which, as import-competing companies, may have feared competition. The Democrats, on the other hand, were generally supporters of free trade when GATT was created. Today, the tables have turned: Republicans (business) largely favour free trade; Democrats, on the other hand, speaking on behalf of workers, but also people concerned about the environment, labour standards and human rights largely oppose free trade or, at least, insist on what they often refer to as “fair trade”. Simply compare the leading Southern Democrat of the 1940s, to the leading Southern Democrat of today: in the 1940s the leading Democrat was Cordell Hull, the father of the GATT; today, it is John Edwards, one of the most protectionist sounding candidates for the US presidency in 2008 (see *slide 18*).

Having pointed at all of these changes that occurred in the last 60 years (summarized on *slide 17*), what now are the consequences that one should draw from these changes for the world trade system of the future? In other words, what impact should these changes have on the WTO?

**So what are the consequences to draw from these changes for the world trade system ?**

Let me attempt to answer this question by addressing three more specific questions: First, given all of the changes that occurred since 1947, do we still need the GATT/WTO? Second, given these developments does trade liberalization continue to require the “closed politics” inherent in the GATT’s operating system? Third, if one takes these changes seriously, in what areas of international cooperation can the biggest welfare gains be made?

## **Do we still need the WTO?**

First of all, is the WTO still needed? With tariffs down to an average of 4% (see *slides 11 and 20*) and non-tariff barriers largely under control, even in the fields of agriculture and textiles, has the WTO's mission been accomplished? In addition, with people across the globe, in both developed and developing countries, largely supporting the free market system and globalization, and realizing the benefits of international trade (see *slides 20-23*), can the WTO hand back authority to domestic parliaments which, this time, can be trusted and will result in generally free trade policies? Are we really witnessing, as Francis Fukuyama predicted in 1992, the "end of history", that is, the end of ideological divides over how national economies should be run?

In support, consider the following opinion polls. These are, of course, not conclusive but offer an interesting glimpse into where the world public opinion may be going. In an October 2007 poll conducted in 47 countries, including both developed and developing economies, the Pew Global Attitudes Project found that 82% of people have positive views about trade, and 66% have positive views about the free market (see *slide 20*). In a January 2006 poll, conducted by GlobeScan and the Program on International Policy Attitudes (PIPA) at the University of Maryland, similar conclusions were reached: In all but one country (France!), a plurality (and in most cases an absolute majority) of people agreed with the proposition that "the free enterprise system and free market economy is the best system on which to base the future of the world" (see *slide 21*). In an April 2007 World Public Opinion (WPO) Poll, conducted in cooperation with the Chicago Council on Global Affairs (a poll covering 56 % of the world's population), similar pluralities (and in most cases absolute majorities) were reached in support of globalization and economic integration (see *slide 23*). In the same poll, a majority or plurality of people in all 14 countries that were questioned, agreed that international trade is good for the country's economy, good for the country's companies and good for their own standard of living (see *slide 23*).

What should we make of these two elements, i.e., the fact that trade barriers are at historic lows, and that people across the globe seem to generally support, and realize the benefits of, international trade? In my view, it does not mean that the WTO can pack its bags. Yet, what it does imply is that the WTO's *role* as well as the WTO's *operating system* for achieving and maintaining liberal trade must change.

### **A new role for the WTO: From engine to stabilizer and clearing house**

First, given the historic success of bringing tariffs down to almost insignificant levels (with notable tariff peaks and tariff escalations, however, in, in particular, agriculture and continued high tariffs in many developing countries), there is no doubt that the *role* of the WTO, especially after the Doha Round (where, one would hope, tariffs and subsidies will be reduced to even lower levels), is bound to change. In my view, the WTO is, and must, gradually transform from being the driving "engine" that liberalizes trade, to becoming a "stabilizer" of the status quo, protecting against resurgent or new temptations of protectionism (see *slide 25*). If this is true, the core function of the WTO would no longer be consecutive rounds of trade negotiations but rather the WTO's dispute settlement system. Put differently, with this change from "engine" to "stabilizer" the conventional "bicycle theory" -- which says that trade liberalization must continue to move further over the years, if not the "bicycle" of freer trade will fall over -- can finally put to rest.

A second change in the WTO's role is this. Tariffs have, indeed, been brought down to historic lows. Yet, what is as notable is that in the last 20 years no less than 2/3 of tariff cuts were enacted *unilaterally*, that is, without the push of either GATT/WTO or preferential trade agreements (which account only for around, respectively, 25 and 10% of tariff reductions since 1983) (see *slide 25*). I already mentioned the trend of unilateral trade liberalization earlier, when explaining the process of unbundling and "Factory Asia". Many developing countries do, indeed, realize the benefits of opening their markets for the country's own economic development and have unilaterally liberalized trade (think only of Chile and India). Yet, unilateral liberalization is also seen in developed countries. Just consider what it is today that slowly brings down farm subsidies in the USA and Europe? Of course, the WTO puts some degree of pressure on these subsidies, but even more pressure seems to come

from people *within* these countries. In both the USA and Europe, people start to realize just how costly these subsidies are, and just how damaging they can be to people in developing countries. As a result, the EC, in 2003, *unilaterally* decided to phase out export subsidies. Within the USA as well, there is a lot of pressure against renewing, let alone expanding, the farm bill, not least because the US government is running a huge deficit (in addition, more and more Americans have realized that most of the subsidies, 80%, go to large farming businesses on a regular annual basis, whereas people generally support subsidizing only small farmers and this only in bad years). Put differently, given the sensitivity of the agricultural sector in both Europe and the USA, the GATT/WTO game of “reciprocal market access concessions” may have run its course. And very little additional liberalization can be expected to flow from the WTO. Instead, the biggest drive for agricultural liberalization is more likely to come from within these countries. If that is the case, rather than focus on finding appropriate reciprocal deals between, say, the USA and Europe, a more efficient track to follow may be to bolster the domestic forces in favour of unilateral liberalization.

Indeed, to continue the merchantillistic game of calling market openings a “concession” which any serious politician should only make if she gets “something in exchange”, may actually hinder, rather than promote, further liberalization: It puts unilateral liberalization in a bad light, as if it is an act of weakness or self-surrender without anything in return. If so, the 60 years old GATT “operating system” may not only be ineffective; it can even be counter-productive (in that it has a chilling effect on liberalization that would have materialized without the GATT/WTO).

Similar internal forces against protectionism have emerged also in US and European debates over whether or not to impose anti-dumping duties against, for example, Chinese textile imports. In the past, this debate used to be one between “us” (say, European textile producers harmed by Chinese imports) and “them” (say, Chinese exporters that would be harmed if Europe imposes extra duties). In those days, it was, therefore, relatively easy, politically, to impose the duties. Today, however, the line between “us” and “them” is blurred. “Us” now also includes foreign companies (including Chinese companies) that are invested in Europe. Similarly, “them” is no longer just the Chinese; it also includes European textile companies that transferred their production from Europe to China. As a result, the imposition of anti-dumping

duties against “Chinese” textiles harms both “them” (Chinese exporters), but also “us” (not just European retailers and consumers of textiles, but also European textile companies producing from China). In sum, because of the process of “unbundling” and the explosion in FDI, domestic forces against protectionism have seriously gained weight; to such extent that, in an increasing number of cases, these internal forces (without much help from the WTO) are enough to stop protectionism. Although there are other factors, this blurring of the lines between “us” and “them” helps explain why the number of anti-dumping cases keeps declining over the years. In October 2007, the WTO Secretariat reported, for example, that during the period 1 January-30 June 2007, the number of initiations of new anti-dumping investigations declined sharply, dropping by 47 per cent compared with the number during the corresponding period of 2006. The number of new measures also declined, by 20 per cent.

If liberalization is, indeed, achieved largely unilaterally and increasingly also in bilateral and regional agreements (although the 10% contribution of these preferential agreements, referred to earlier, is modest compared to the total numbers of such agreements, now close to 250), the WTO’s role must move from liberalizing “engine” to “stabilizer” and “clearing house” (see *slide 26*), where countries can notify, bind or secure the market openings that they enacted unilaterally or regionally (my colleague Richard Baldwin would refer to the need to “multilateralize regionalism”). For the WTO to become such “clearing house”, it would, however, need to move away from the orthodoxy of the “single package” (according to which all, or almost all, WTO agreements must be binding on all WTO members), and permit variable geometry (where, for example, regional parties can bind their mutual commitments at the WTO and, say, utilize the WTO system to enforce those commitments).

### **A new operating system for the WTO: From prisoners’ dilemma to stag hunt**

Besides a different *role* for the WTO -- from “engine” to “stabiliser” and “clearing house” -- low tariffs and increased levels of domestic support in favour of liberal trade must also change the WTO *process* or *mechanics* for achieving and maintaining trade liberalization (see *slide 26*). If it is, indeed, true that countries themselves have come to realize that opening their market is in their own benefit (be it to develop their economies, to bring consumer prices down or to strengthen the bottom line of

companies invested abroad), then the WTO's "operating system" must be revisited. In game theoretic terms, we may be moving from a Prisoners' Dilemma (PD) game to an assurance or Stag Hunt game. The current, merchantillistic operating system of "reciprocal exchange of market access concessions" clearly fits a PD: The premise is that countries, left alone, would favour protectionism as that is what they see to be in their interest; liberal trade is achieved only by mutual agreement not to do what would otherwise be in one's interest; a mutual agreement which, however, achieves an end result that offers ultimately the best outcome for both parties. In this PD situation, it is crucial also to have a strong enforcement mechanism as countries continue to be tempted to defect. In contrast, if, today, countries do see liberal trade as a policy that is in their own interest, we no longer face a PD, but rather a Stag Hunt situation. In a Stag Hunt all players realize that liberal trade is in their own interest (i.e., hunting a stag is much more beneficial than defecting and shooting a rabbit). In that situation, cooperation is easier to achieve and mostly involves the helping hand of assuring each other that all parties will, indeed, be patient and shoot only the stag (rather than go for the minor prize of shooting a rabbit and thereby scare away the stag). In such Stag Hunt games, also the level of enforcement can be reduced.

### **Do we still need "closed politics" to achieve trade liberalization ?**

Does free trade continue to require the "closed politics" of the 60 years old GATT operating system, that is, the idea that "open politics" in domestic parliaments leads to protectionism and that, as a result, liberal trade so as to enhance overall welfare can only be achieved in "closed politics" negotiations in Geneva (where diplomats "cheat" on their own parliaments) (see *slide 27*)?

In my view, the answer must be a resounding "no". To maintain and further enable trade liberalization (which, I repeat, is welfare enhancing) we need more, rather than less, involvement of domestic politics. In today's world, where the WTO not only deals with the dry, technical question of tariffs, but also decides on deeply sensitive questions of health and the environment, levels of intellectual property protection and openness of a country's telecom, education or energy sectors (spot the difference in *slides 27-28!*), it sounds terribly patronizing to say that domestic parliaments do not know what is good for the people (i.e. must be mistrusted as they would lead to

protectionism) and that, instead, the task is better left to technical negotiators in Geneva, pursuant to the tested process of “reciprocal exchange of market access concessions” (as in: Belgian chocolate in exchange for Swiss watches).

If it is, indeed, true that countries themselves, be they developed or developing, have come to realize that the free market, globalization and international trade are to their own benefit (what I referred to earlier as “the end of history”), should we not change the basic premise that domestic parliaments are inherently protectionist and cannot therefore be trusted? If so, rather than “cheat” on and avoid domestic parliaments through Geneva negotiations, what must be done is to engage with and convince governments and the people that specific trade liberalization policies are, indeed (as their own intuition now seems to tell them), good for them. If it is true that today the biggest force against free trade no longer comes from import-competing industries (although that force clearly remains), but rather from consumers, workers and ordinary citizens worried about poverty, the environment, culture or labour standards, should we not stop the producer-driven GATT/WTO game, according to which the (pro trade) voice of exporters must be amplified to overcome the (protectionist) pressure of import-competing industries (replacing “import politics” with “export politics”). Instead, could one not argue that, by now, the voice of exporters is already heard loud and clear in domestic parliaments, even without the help of the WTO, and that it is ordinary workers, consumers and citizens that need convincing of free trade, rather than import-competing industries (many of which have already gone under, moved abroad or got their act together and are now successfully competing with imports anyhow)?

More specifically, if it is consumer and citizen concerns (values) that resist free trade should the WTO’s contingency scheme of trade remedies not be revisited? Since 1947 and up to this day, the GATT/WTO’s contingency plan focuses on offering countries the possibility to re-introduce trade restrictions in case domestic *producers* are hurt by imports. Such contingency plan is what made trade liberalising commitments possible in the first place: Politicians agreed to liberalize trade but wanted a safety valve just in case the protectionist pressure against certain imports gets too much. If, today, the biggest protectionist force is not so much injury to *producers*, but injury or upsetting consumers or citizens (based on the values or

collective preferences that they hold), the WTO's contingency plan could be changed or expanded, not so much to permit arbitrary restrictions imposed to pursue values, but rather to offer politicians a safety-valve, under clearly defined conditions, that enables them to make deeper commitments in the Doha Round and beyond. Such safety valve, or taking into account of values, must obviously not be deployed only in favour of developed country concerns or values, but equally, and perhaps even more so, to offer policy space to developing countries. Such policy space could permit them, for example, to enact industrial policies to boost the economy or market interventions to protect the rural poor, or to share the gains from trade more equitably. This "harnessing" of globalization must obviously be adapted to the specific situation of each country. In developed countries it may focus on trade adjustment assistance for workers who lose their jobs because of import competition; in developing countries it could be aid-for-trade packages, subsidies or other capacity-building measures.

Paradoxically, under the current GATT/WTO operating system, trade liberalization is first defined as a "concession" but is then, strangely enough, turned into a one-size-fit-all straightjacket which claims that all trade liberalization is, by default, good for you (there are, of course, exceptions and trade remedies but the default rule favours free trade). In contrast, a "new trade politics" would portray trade liberalization not as a "concession" but as a "favour to yourself" to which a country should only commit in case it is convinced of the benefits, and to which a country should then stick albeit with sufficient policy space in the background to enable it to enact tailor-made policies.

### **A new form of "embedded liberalism"**

In sum, and this is once again something that crosses the developed-developing country divide, what we may be seeing is a new form of "embedded liberalism": broad support for the free market, globalization and trade (see *slides 20-23*) combined, however, with a shared need for policy space to address values ranging from poverty-alleviation and rural development to environment, labour and human rights protections. In the same Opinion Polls that I referred to earlier, the shared support for globalization is, indeed, strongly conditioned on more market intervention

to protect workers, consumers, the environment and, to a lesser extent, investors (for the exact percentages, see the results of the 2006 GlobeScan Poll on *slide 30*). In the 2007 WPO Opinion Poll, as well, people in both the developed and developing world expressed very strong levels of support for the inclusion of minimum labour and environmental standards in trade agreements. This includes people in countries like India, China, the Philippines, Mexico and Ukraine.

As explained with respect to liberalized trade, it seems, therefore, wrong to think of *minimum* labour or environmental standards (to be distinguished, of course, from *harmonized* standards) as a Prisoners' Dilemma (PD) game where the premise is that countries, if left alone, would love to restrict trade or to race to the bottom in terms of labour or environmental protection so as to obtain a competitive edge. Instead, it seems more and more the case that people and countries, developed and developing alike, realize that both free trade and protecting workers and the environment is what they want as something that is in their own interest. If so, the game moves from a PD game to an assurance or Stag Hunt game with, as explained earlier, the different negotiating and enforcement mechanics that comes with it.

John Ruggie coined the term "embedded liberalism" to explain the consensus that emerged after World War II: not *laissez-faire* liberalism, but liberalism "embedded" in domestic welfare and support programs. This "embedded liberalism", inherent in GATT 1947, according to many, narrowed down to the "economic straight-jacket" of the Washington consensus in the 1990s (free trade, fiscal austerity, no capital controls). What we see today, however, is the emergence of a new form of "embedded liberalism", that is, a consensus on the benefits of economic globalization conditioned, however, on a number of flanking policies (be they industrial or development policies or environmental, human rights or labour policies) that safeguard a country's policy space.

### **Where can the biggest gains be made ?**

This brings me to my third and last question: Given the changes that occurred in the last 60 years, where is it that countries, through cooperation at the international level, can achieve the biggest gains? The most optimistic calculation of the benefits to be

derived from full liberalization of global merchandise trade, offer a total, real income gain of 287.3 billion US\$ (or a % gain of baseline income in 2015 of 0.7) (see *slide 34*). These are, of course, non-negligible benefits. At the same time, Simon Evenett, in a recent paper, calculated that the estimated gain of full liberalization for, for example, China amounts to 1.7 billion US\$, a gain that China generates every three days through “ordinary” economic growth (see *slide 36*). In other words, it takes China just 3 days of economic growth to make what full liberalization of world merchandise trade would offer it (not to be confused with the much lower gains of a successful completion of the Doha Round). In India, Evenett offers the estimate of 24 days, for Brazil 82 days.

Put differently, are the Herculean negotiating efforts -- combined with the necessary inroads in a country’s sovereign decision-making -- that would no doubt be required to achieve full liberalized trade, worth it? Are they commensurate with the expected gains? Or should negotiators rather focus on other areas? Dani Rodrik, for example, writes that a full liberalization of labour flows would offer gains 25 times larger than a full liberalization of merchandise trade. Based on his calculations, if the developed world would only increase its foreign labour force with 3%, the gains for developing countries would be over 260 billion US\$, compared to a gain from the Doha Round for developing countries of, what he estimates, at just 30 billion US\$.

Other areas of cooperation where arguably bigger gains can be made than in the field of merchandise trade are currency cooperation. Indeed, a country may well have reduced its tariffs on imports by 30%; if it manipulates the value of its currency to undervalue it by 30%, the tariff reduction is not worth much. Other potential areas are increased cooperation on investment promotion and protection and, arguably, competition policy (the losses suffered by consumers world-wide of, for example, a cartel or price-fixing arrangement between competing companies can be enormous). Indeed, with the WTO running out of “market access fuel” (tariffs are low), to achieve further liberalization in merchandise trade (especially agriculture) as well as services trade (including labour force movements), these other areas of cooperation could offer interesting trade-offs and facilitate a deal across the field (think, for example, of a competition or minimum labour standards agreement combined with liberalization in agriculture and labour flows). This diffuse form of reciprocity (or trade-offs between

fields) must not be confused with the specific reciprocity inherent in the old GATT operating mechanism of “reciprocal exchange of market access concessions”. Diffuse reciprocity or trade-offs to strike will always be needed; not so for the specific reciprocity inherent in the GATT’s 60 years old operating mechanism.

## **Conclusion**

The world has changed dramatically since the GATT’s creation in 1947. Yet, 60 years later, the WTO has not adapted itself to these changes. Reform proposals too often focus on “insider concerns”. More important, however, are the external, real world changes that took place in the last 60 years. These changes range from historically low tariffs, an increased financial integration between countries, more diversification in world trade shares and proliferation of preferential trade agreements, to the process of unbundling, the prevalence of unilateral trade liberalization, the emergence of new flanking policies and, crucially, a shift in the forces opposing free trade (from import-competing industries to concerns over values in both developed and developing countries). These external shocks and changes are already leading to, and require, a “new trade politics”, both within countries and at the international level. These “new trade politics” are grounded in a new form of “embedded liberalism”, combining a world-wide, general support for free markets and globalization with calls for policy space to protect the environment, workers, consumers and citizen concerns at large, as well as to enact industrial and rural policies to boost economic development. This “new trade politics” must break with the GATT’s 60 years old operating system of “reciprocal exchange of market access concessions”, a system that is producer-driven, merchantillistic and premised on a mistrust of domestic politics. Instead, the operating system of “new trade politics” must be consumer/citizen driven (not producer driven), based on proven welfare gains that come with free trade (not merchantillistic) and be fuelled by more, rather than less, input by domestic parliaments (“open politics” rather than “closed politics”). This means that the WTO game can move from a Prisoners’ Dilemma game to an assurance or Stag Hunt game. Another consequence is that the WTO can gradually evolve from being the “engine” of trade liberalization to the “stabiliser” of free trade (focused on dispute settlement) and a “clearing house” where liberalization achieved elsewhere can be bound. Finally, to create global welfare, the world’s attention must

shift from merchandise trade (where enormous gains have been made, but where the low hanging fruit has now been picked) to cooperation in other fields, ranging from liberalizing labour flows and new rules on competition and currency policy, to minimum standards to protect the environment, labour and human rights.