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Keynote Address: A Diplomat's Economics Falls Short: Lessons for Development from the Uruguay Round

J. Michael Finger

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KEYNOTE ADDRESS:

A DIPLOMAT'S ECONOMICS FALLS SHORT: LESSONS FOR DEVELOPMENT FROM THE URUGUAY ROUND

DR. J. MICHAEL FINGER*

Thank you very much for your kind invitation to speak to you today. Thanks particularly to Dean Bellacosa, Judge Carman, Judge Re, who are with us here in this room. If we look up toward heaven we can thank Judge DeCarlo as well. I compliment you on the spirit of family that you have nurtured here, I am sure it is an important part of the educational experience at St. John's.

Conferences such as this one are more than educational, they

* J. Michael Finger is a resident fellow at American Enterprise Institute for Public Policy Research (AEI) studying international trade policy, development, and the GATT/WTO system. He previously held the position of lead economist for the trade policy research group at the World Bank. He has served on the faculties of the University of Bern, Stockholm School of Economics, and Duke University. He has worked as an economist at the Treasury Department, the United Nations, and the U.S. Tariff Commission. His books include *Antidumping: How It Works and Who Gets Hurt; The Uruguay Round: A Handbook;* and more recently, *Institutions and Trade Policy.*

are fun. A good conference should go beyond answering the question it addresses, it should identify an issue for a next conference. I will leave the other speakers to resolve the issue of "Globalization's Impact on International Trade and Intellectual Property Law." In my few minutes I would like to call your attention to another problem. To me, the Uruguay Round[1] outcome is troubling because it suggests that the GATT/WTO[2] system has taken on more than its economics can chew. I will point to some grave mistakes we made at the Uruguay Round, I will however offer no solution other than the obvious one: "Do not make the same mistakes at the next round of negotiations."

Unlike the previous rounds of trade negotiations since World War II, the Uruguay Round had economic losers. Previous rounds were principally about reducing tariffs. Mercantilist economics and the process of reciprocal negotiations treats reduction of a tariff as a "concession" to be given only if other countries provide reciprocal concessions. But in real economics, removing a tariff leads to resources being more efficiently used in both the importing and the exporting country; when the policy action is to reduce tariffs both the exporting country and the importing country are winners. Within each country there will be winners and losers, but the gains will be larger than the losses. The argument for free trade is not that it helps everyone; it is that in each country it helps more than it hurts. Free trade may be politically incorrect, but its economics are impeccable.

Why did the failure to distinguish the real economics from the mercantilist economics matter at the Uruguay Round when it did not matter at earlier rounds? Because the Uruguay Round moved on from tariff liberalization to issues that demand a more sophisticated economics. The "grand bargain," as Sylvia Ostry has labeled it,[3] struck at the Uruguay Round was that the

[1] *See generally GATT's Uruguay Round; Blink for God's Sake*, THE ECONOMIST, Oct. 31, 1992, at 70 (referring to the 1986 conference round on international trade, held under the auspices of the earlier General Agreement on Tariffs and Trade (GATT), which established the World Trade Organization (WTO)).

[2] Refers to the General Agreement on Tariffs and Trade (GATT), which was first signed in 1947 and later evolved into the World Trade Organization (WTO) in 1994 at the close of the Uruguay Round. As of April, 2003, the WTO has 146 member states, which seek to trade internationally under a rule of law. More information can be found at the website of the World Trade Organization, http://www.wto.org (last visited Apr. 12, 2003).

[3] SYLVIA OSTRY, *The Uruguay Round North-South Grand Bargain: Implications for Future Negotiations*, *in* THE POLITICAL ECONOMY OF INTERNATIONAL TRADE LAW, 285-300 (Daniel M. Kennedy & James D. Southwick eds., Cambridge Univ. Press, Cambridge,

developing countries would take on significant commitments in "new areas," particularly intellectual property.

On one side, the bargain would deal with lax copyright and patent enforcement in developing countries. If these countries could be held to a higher standard, developed country owners of intellectual property could collect royalties on intellectual property that are now being "pirated."[4] The developed countries, in exchange, would open up in areas of particular export interest to developing countries: agriculture and textiles/clothing.

As to finally taking on textiles/clothing, from the beginning of the GATT negotiations the textiles industry in the United States and Europe had been able to fight off significant reductions of the tariffs that protected them. Moreover, in the 1960s the industry's political influence was so strong that it had forced the negotiation of special international regime for imports of textiles and clothing.[5] This regime, though a part of the GATT, was created not to facilitate reduction of import restrictions, but to sanction the continuing existence of import restrictions. Initially it covered only cotton products, it came in time to include all textiles – it became the Multi-Fiber Arrangement (MFA).[6] (Its origins lie in the power the "seniority system" under which Southern members controlled the U.S. Congress.) The MFA

2002) (referring to the concessions that are bargained for at the trade negotiations, where a nation will agree to alter one aspect of their market economy in exchange for a conciliatory alteration by another nation).

[4] Services was the other major "new area." I will not take up services here because the North-South economics of the new areas is dominated by intellectual property.

[5] After World War II, the developing countries that benefited from access to raw materials and relatively low production costs, especially wages, rapidly increased the volume of exports of cotton textiles and clothing to the U.S. and other developed country markets. This sharp increase in low value imports of cotton textiles hampered investment and employment in the developed countries, which faced the prospect of closure of production facilities (i.e., Southern U.S.) leading to serious social problems. To counter the problem, some developed countries negotiated agreements with individual governments that would limit the quantities of exports of cotton textiles. More information can be found at the website of the World Trade Organization, *at* http://www.wto.org/english/thewto_e/whatis_e/eol/e/wto02/wto2_28.htm (last visited Apr. 12, 2003).

[6] First put into effect in 1974, The Multifiber Arrangement (MFA) established import and export quotas for textiles. The MFA is a framework agreement, established by GATT, used by most of the world, which allowed participating states to establish restrictions on the importation of textiles on a country-by-country basis contrary to the GATT's most-favored-nation rule. The General Agreement on Tariffs and Trade of 1994 (Uruguay Round) requires that these agreements be phased out. More information can be found at the website of the World Trade Organization, *at* http://www.wto.org/english/thewto_e/whatis_e/eol/e/wto02/wto2_28.htm (last visited Apr. 12, 2003).

sanctioned a widespread system of import quotas – I will take up later the important difference between import protection by import quotas rather than tariffs.

The second sector that had evaded the GATT-facilitated reduction of trade restrictions was agriculture. Here, the protection was more complicated than simple tariffs as well. Each industrial country has in place an extensive system of production supports and subsidies. Import restrictions serve to protect not just agricultural production, but the agricultural support programs themselves. If imports could come in freely, it would be impossible to maintain, in the US or any other country, the higher prices that the agricultural support programs require. Particularly in Europe, governmental support for agricultural production was sufficient enough that agricultural production actually exceeded consumption. The surplus of production over consumption was sold on world markets, the effect being to drive down world prices for agricultural products as domestic support programs kept prices high internally.

In mercantilist economics, this sounds like a balanced deal: developed countries give on textiles and agriculture, developing countries offer market opportunities in services and intellectual property.

But the real economics of the deal is quite unbalanced for several reasons. For one, the obligations created to pay royalties on intellectual property dwarf the economics of the other parts of the package. For China, Korea and Mexico, for example, the obligations to pay royalties and copyrights created by the agreement on intellectual property are several times larger than the benefits of the liberalization of trade in industrial goods they will receive in exchange.[7]

Another reason, the economics of removing import quotas (the MFA-sanctioned restrictions on imports of textiles/clothing from developing countries) is different from the economics of tariff reduction. The major economic impact of a quota on the amount an exporter can ship is to maintain a higher price for the exporter. It is the same as the economics of an OPEC oil price increase; importers pay more for the same amount. A tariff that

[7] Figures are given in J. Michael Finger, *Implementing the Uruguay Round Agreements: Problems for Developing Countries*, 24 THE WORLD ECON. 1097-1108 (2001).

reduces imports to the same level would have the same efficiency effects but would avoid providing the exporter the windfall gain from a higher price. Consumers would pay a higher price, but the windfall would be taken away from the exporter in the form of tariff revenue – a transfer of wealth from consumers to the government, but not a loss to the country as a whole.

Removing an import quota will provide efficiency gains for both exporters and importers. Elimination of the transfer of wealth from the importer to the exporter will be an additional gain for the importer, but a loss for the exporter. Indeed, for many exporters of textiles/clothing the loss of the windfall gain from the quota is larger than the efficiency gain. Reliable analysis indicates that countries such as Korea and Taiwan who now enjoy protected access to U.S. and European market will be worse off after the MFA is removed.[8]

I know turn to agriculture. As I sketched above, agriculture programs in the developed countries lead to overproduction, the overproduction leads to the surplus being dumped on world markets, or sold under special programs to poor countries. For producers in other countries this is unfair competition, for consumers it is cheap food – whether through programs to donate such food or through the mechanism of the market price being pushed down when the overproduction is dumped. Getting rid of agricultural programs in the North will provide major benefits to the North, but it will deprive some of cheap food in the South. Much of Sub-Saharan Africa has a larger interest in this issue as a consumer than as a producer, the agricultural reform agreed at the Uruguay Round will bring them greater costs than benefits.[9]

At the Uruguay Round, the international community stepped forward to address problems of legal structure. They created a formal organization, the World Trade Organization, to administer the several trade agreements that were concluded. (Many of them were elaborations of previous agreements.) The also created a formal dispute settlement mechanism to replace the ad hoc system that had evolved over the fifty years of the

[8] Glenn W. Harrison, et al., *Quantifying the Uruguay Round*, 107 ECON. J. 1405-1430 (1997) (noting that the elimination of trade barriers will result in increased competition to nations that have more beneficial economies of scale).

[9] *Id.* (explaining that nations in Africa will derive no benefit from decreased competition, rather they rely on the cheap prices resulting from "dumping," as well as charitable food contributions from nations like the U.S.).

GATT.

At the Uruguay Round we got the jurisprudence right but we got the economics wrong. The next challenge is to find a way to bring into play a system of *economic* analysis sufficient to manage the *economic* issues the organization has taken on. The simple economics inherited from a simpler day, when the major economic challenge trade negotiations faces was to reduce tariffs, is not good enough. Diplomacy is more fun, but sometimes you have to get out the accounts and run the numbers. There is little in the early stages of the Doha Negotiations[10] (launched in November 2001) to suggest that the WTO community has yet realized that it must come to grips with this challenge, but it must. Economics cannot serve the function of jurisprudence. Likewise, jurisprudence cannot serve the function of economics. The challenge now is to shape the legal structure in a way that better identifies the economic issues at play, and that provides the possibility of reaching an outcome in which each country is indeed an economic, not just a diplomatic, winner.

[10] From November 9 to 14, 2001, the Fourth WTO Ministerial Conference, the latest round of trade talks among WTO members, was held in Doha, Qatar. Information regarding the conference can be found *at* http:// www.wto.org (last visited Apr. 12, 2003).