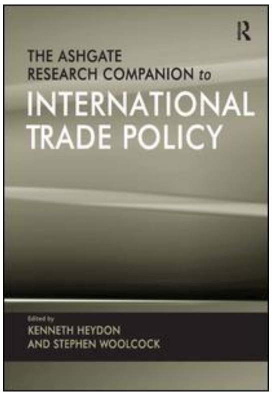

The Ashgate Research Companion To International Trade Policy

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Trends in Trade Policy and Challenges Ahead

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PART VIII
Conclusions

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Trends in Trade Policy and Challenges Ahead

Kenneth Heydon and Stephen Woolcock

The initial chapters of this volume identified a number of key questions concerning international trade policy that also constitute the main challenges facing the international trading system. This chapter first revisits these key questions and then summarizes how the preceding chapters have answered them.

Key Questions

The first key question is the *ideological or ideational basis for trade policy*. Chapter 1 discussed the historical debate on free trade versus protection or more interventionist policies. This showed how the issue has been debated over centuries. At various times over the decades there have been periods in which one could argue there was a broad consensus on trade, whether this was the 'embedded liberalism' of the early GATT years, or more recently the general shift to a liberal paradigm during the 1980s and 1990s. But the ideological debate on free trade versus more interventionist or mercantilist policies has not been settled. There are still actors who believe that a positive balance of trade is an essential national aim. Despite evidence – including in this book – that trade openness favours development, there remains a persistent view that infant industry protection and state intervention are essential if developing countries are to be able to share ultimately in the benefits of the global economy.

The second question, introduced in Chapter 2, concerns the *political economy* of trade policy and why pressures for protection and intervention persist given the evidence and the strength of the economic argument for open markets. This question goes to the heart of the functioning of the trading system and it is essential that any discussion of trade policy takes proper account of it. An analysis of the political economy of trade enables an assessment to be made of the benefits and costs of trade opening, and thus the likely distribution of interests in any debate on trade policy. Chapter 2 also stressed that trade policy must be seen in the context of other policies. Viewing trade policy in isolation can lead to unrealistic expectations that trade policy can address non-trade goals. Equally, trade policy could be said to be effective in promoting sustainable economic development only when it is supported by a range of other policies.

The third question, raised in Chapter 3, concerns the *balance between multilateral and preferential approaches to trade policy*. There is a need to be clear that there have always been elements of preferential approaches or bilateralism in trade policy, even during the period of a US-led GATT that is generally characterized as multilateralist. But the trend since around the mid-1990s has clearly been towards a greater emphasis on preferential approaches to trade policy. The alarmist view of this trend is that the open liberal system is under threat, but even the more sanguine views on the growth of bilateral trade agreements must recognize that a continued growth of bilateral agreements and no progress multilaterally could ultimately undermine the credibility of the multilateral system of the WTO.

The fourth question is closely linked to that of preferential versus multilateral trade policy and concerns *the scope of the multilateral regime*. Should this be narrowly defined to primarily cover measures at the border, or should it extend to include topics such as investment and competition policy, that are clearly central to a global economy? This question is linked to that of the balance between preferential and multilateral trade policy in the sense that more comprehensive multilateral trade policy, meaning that more and more trade-related issues are covered, is often seen as becoming increasingly difficult to manage. Preferential approaches may then come to be seen as a means of dealing with such issues.

The final question of course is *how to proceed in trade policy*? What policy implications can be drawn from the chapters of this book?

The Ideological Basis for Trade Policy

Chapter 1 set out a strong intellectual case for free trade. It illustrated how the arguments were synthesized in eighteenth-century Britain by Adam Smith and David Hume who placed open markets in a classical-liberal trinity of freedom, prosperity and security. Smith and Hume developed a dynamic analysis based, for Hume, on 'emulation as the source of every excellence' in which they anticipated later arguments about technology transfer, rent-seeking and government failure. In doing so, Smith and Hume effectively rebutted earlier zero-sum assumptions embodied in mercantilist thinking. This is not to say, however, that free trade advocacy has gone unchallenged. Even in the golden age of free trade in Britain in the second half of the nineteenth century, protection was the norm elsewhere, including in the United States where Alexander Hamilton developed the infant industry protection argument.

The infant industry argument, and support for government intervention, has proved remarkably resilient and remains so today especially in developing countries. Despite empirical support for outward orientation, there remain proponents of infant industry protection from developing countries that would otherwise, it is argued, have little to offer in terms of exports or would remain dependent on raw materials. The case for infant industry protection has invoked support from the growth of the Newly Industrializing Countries that are said to have industrialized thanks to government support for industry and trade protection in the early phases of development. But as Chapter 17 in this volume argues there is a case based on the experience of Taiwan that success depends on governments following the lead of the private sector, reinforcing what the market equilibrium under neutral trade policies would have produced in the first place and that Taiwan's experience supports rather than challenges neoclassical precepts.

Individual chapters bring particular insights to the case for open markets. The discussion of tariffs in Chapter 4 observes that the tariff prevents trading nations from capturing the gains associated with their comparative advantage and that a tax on imports is also tax on exports. This explains the estimates of large potential gains from unilateral liberalization not least for developing countries whose tariff and other barriers tend to be higher than those of the industrialized countries. Chapter 11, which deals with the complementary links between trade and investment, argues that, in the context of global supply chains, the case for tariffs is further weakened because they increase the costs of inputs for domestic producers within such chains. The global supply chain thus serves to lower the 'optimal tariff' of countries. It follows that opening markets to foreign investors from a partner country should also reduce tariff barriers faced by the domestic firms exporting to that country because the 'optimal tariff' of the partner country becomes lower. In the discussion of commercial instruments in Chapter 6 it is seen that antidumping action, by far the most popular trade remedy, is likely to raise domestic prices and reduce welfare, while also leading to collusive behaviour. At the same time Chapter 7 points out that tariffs are only part of the picture and that practical measures to reduce the costs of trade in the form of trade facilitation, a topic in the current Doha Development Agenda (DDA), can also have considerable economic benefits.

Each of the chapters on the different sectors of production highlight further aspects of the economics underlying the case for free trade. In agriculture, we see in Chapter 8 that because of the low income elasticity of demand for food – expenditure on food lags behind overall economic growth – protection is powerless in seeking to negate the secular adjustment process going on in the farm sector. At the same time however, agricultural protection is highly damaging to the interests of developing country farmers and inimical to the pursuit of food security. In manufacturing, as discussed in Chapter 10, while the forces of competition have virtually eliminated Japanese manufacturers from the production of finished electronics products, they have helped foster Japan's underlying comparative advantage enabling it to become an overwhelming presence in the production of skill-intensive raw materials such as the lead frames and silicon wafers on which chips are built or the chemical surface coating for flat-panel TVs. Chapter 9 on services points out that services constitute such an important element in manufacturing that retaining closed services markets is likely to undermine the ability to compete in manufactures.

More generally, opening service markets helps countries – both developed and developing – to realize more effectively their underlying competitive strengths, to create jobs, to help downstream users and to benefit more from the lower demand cyclicality and greater resilience of services, compared with manufactures, to economic downturns.

In short, the preceding chapters support the argument that trade has a key place in the continuum trade–innovation–growth. Trade openness makes markets more competitive, reducing prices and raising incentives to innovate, while also boosting productivity.

The General Trend Towards Open Markets

There is ample evidence of past moves towards trade liberalization, often on a unilateral basis, in each of the regions examined in this book. This is evidenced by the fact that global trade grew three times faster than GDP in the five decades after 1945. In Asia, South Korea and Taiwan began to liberalize trade policy in the 1960s, and China, India and Vietnam in the 1980s and 1990s. In Africa, trade policy became more export-oriented in the 1980s and liberal trade policies generally became dominant in the 1990s. And in Latin America, Chile led the way, by abandoning import-substitution industrialization (ISI) in the mid-1970s, followed by a more general shift triggered by the crisis of 1982 when the reduction of the anti-export bias of ISI was made more pressing by the need to increase export income to service the region's high foreign debt.

In the United States, we have seen that from 1934 until the 2000s, a span of some 70 years, trade policy sought and delivered reciprocal market opening at home and abroad. As a result of unilateral, bilateral and multilateral commitments, the US tariff level was reduced from 20 per cent in 1930 to 3.5 per cent in 2008. At the same time, there was a marked shift towards intra-industry trade and trade in services. And in the European Union, though common external trade policy was defensive in the early years of European integration, the underlying principle of trade policy, as set out in the Treaty, is liberal. As European integration has advanced so has EU support for a multilateral, rules-based system, with the EU aspiring to a leadership role in the run up to the DDA.

We thus see from a broader perspective, strong evidence of past liberalization. A series of multilateral negotiations under the GATT reduced industrialized countries' average tariff on manufactures from close to 40 per cent in 1947 to less than 5 per cent at the close of the Uruguay Round in 1994. In agriculture, trends in the OECD countries in both decoupling (breaking the link between support and producer decisions) and support-reduction have been moving in the right direction. The DDA holds the promise of market opening in manufactures and agriculture. In trade facilitation, concerns to promote supply chain security have boosted efforts to make cross-border goods movements more effective and transparent. And while progress in services liberalization in general has been disappointingly slow, a successful WTO Agreement on Basic Telecommunications and a sector agreement in financial services have been completed and a framework for broader liberalization agreed upon.

This progress has been mirrored by changes in the international trading system itself as it has evolved from a US-led system to one shaped by an OECD club into, now, a more inclusive, heterogeneous arrangement. This heterogeneous structure in trade relations has been emerging for some time and has preceded similar developments in financial and summit diplomacy such as in the emergence of the G20 at summit level in response to the 2007–8 financial crisis. In trade the US-led system gave way to a club model already in the 1970s and became more inclusive around the time of the conclusion of the Uruguay Round in the mid-1990s thus ending the Atlantic-dominated system that prevailed until then. As Chapters 3 and 21 discuss, the system of trade governance has been arguably more flexible and able to accommodate shifts in the balance of economic power than that of financial governance, but this does not make the pressures any less real.

In the process of evolution, the international trading system has also adapted to a much broader notion of market access as behind-the-border issues of domestic regulation have increasingly come under scrutiny. As described in Chapter 3 the scope of agreements has expanded in line with the contemporary preferences of major players concerning what constitutes trade, rather than on the basis of any objective criteria. The evolution of the international trading system has also seen a shift towards a more rules-based approach, not least with the strengthening of the dispute settlement mechanism of the WTO.

Signs of Backsliding

Notwithstanding these moves towards greater liberalization and institutional adaptability – or perhaps in some cases because of them – there are now, as Chapter 1 and the country chapters show, clear signs that support for liberalization has been draining away, which has resulted in a halt to trade opening at the multilateral level and some signs of general backtracking.

In the United States, since 2005 the political system has balked at fresh liberalization. As discussed in Chapter 23, both the Congress and the president are responsive to a trade angst fuelled by high unemployment, a huge trade deficit, the seemingly inexorable rise of China and India and, as inequality has grown, a deep unease among America's vast middle-class, a familiar precursor to protectionism. US trade policy has emphasized a degree of reciprocity in market opening that is seen as excessive by the major emerging markets, a situation that has contributed to the stalemate in the DDA. The US response to the global financial crisis saw increased resort to antidumping measures and robust Buy-American provisions as part of the stimulus package. These responses may moderate. More worrying is the provision for border adjustments on imports from countries judged not to have taken comparable action to the United States in climate legislation which made its way into the Waxman–Markey bill approved by the House in 2009. In the European Union, it has been argued in Chapter 24 that the involvement of the European

Parliament – strengthened by the 2009 Lisbon Treaty – could fuel protectionism, especially in traditionally sensitive sectors, as well as prompting greater emphasis on the relationship between trade and other policy areas, particularly social issues, environmental concerns and respect for human rights. For example, it is suggested in Chapter 24 that it was the influence of the Parliament, together with alliances with specific Member States in the Council and lobbying by a few powerful NGOs that saw a ban on fish imports without any measures to curtail overfishing by the heavily subsidized EU fishing fleet.

In China, we have seen that following WTO accession in 2001, during which China believes it made considerable concessions, there is resistance to further liberalization on the grounds that China is a Recently Acceded Member (RAM) in the WTO. As explained in Chapter 27, in agriculture, farm interests are forming alliances with protectionist elements in the Ministry of Agriculture, as officials seek to reap personal benefit from the rents of protection. And in services – particularly in telecommunications and cultural activities – protection is being sought on national security grounds. And, again, vested interests are anxious to retain their share of the huge monopoly profits being generated by these partially reformed industries. These tendencies are compounded by the Chinese government's promotion of national champions – a move that is conducive to the growth of monopoly state-owned enterprises – the principal beneficiaries of the stimulus package during the global financial crisis.

Parts of Latin America too have seen disenchantment with trade liberalization over the past decade, as discussed in Chapter 25. Though this is not the case in Mexico, Chile, Peru or Central America, in other countries there is resentment that large segments of the population have failed to benefit from the gains from trade. The erosion of support for trade liberalization has not led to tariff increases allowed by high ceiling bindings, but rather has seen increased resort to non-tariff barriers such as non-automatic import licenses and increased use of managed trade.

In East Africa, discussed in Chapter 26, it may be too early to talk of backtracking though it has been observed that the dual nature of trade policymaking – national and regional, via the Ministry of East African Community Affairs – is leading to poor coordination in policymaking. And the Economic Partnership Agreements being signed with the EU bring an inevitable risk of trade diversion at the expense of third parties.

The Political Economy of Trade

The widespread signs of weakening support for or backtracking from liberal trade are occurring in institutional frameworks that differ fundamentally from one country to another, such as in the complex interplay between the Congress and the administration in the United States, the evolving relations between the institutions of the EU or the tensions and fears underlying China's fragmented authoritarianism. But the checks on further liberalization share two things in common.

First they are occurring in an international institutional environment that still reflects the post-1945 GATT–Bretton Woods system of 'liberalization from above' based on reciprocal market opening, with admitted safety valves and an effective decoupling of free trade from laissez-faire in domestic politics.

Second, the checks on further liberalization or backtracking are all shaped by the political economy of trade – in other words, as discussed in Chapter 2, the fact that trade liberalization involves both winners and losers and that while overall gains can be expected to exceed losses, the costs of liberalization tend to be concentrated and easy to measure while the benefits are often highly dispersed and hard to measure. The concentrated costs of market opening thus means that political influence tends to be greater for those seeking continued government assistance or protection because those who stand to lose from liberalization have more at stake than those who stand to gain.

It is this characteristic of costs and benefits that fuels the drop in US poll numbers supporting free trade, the concerns of Europe's 'Club Med' countries about foreign competition in specific sectors and the growing view in China that domestic food companies need protection. The political economy of trade also helps explain the protracted process of the Doha Development Agenda and the steady scaling down of reform ambition to the point where the game is seen to be hardly worth the candle.

The conclusion that might therefore be drawn is that it is an inability or unwillingness to address the political economy of trade that is weakening support for trade liberalization. This point is addressed below in terms of the way ahead: making a more persuasive case for liberal trade while acting directly through complementary measures to ease the cost of adjustment for those that feel the strains of open markets.

The Balance Between Preferential and Multilateral Trade Policy

The political economy of trade can also help explain the growth of reciprocal preferential trade agreements – whether Free Trade Agreements (FTAs) or Customs Unions – insofar as these arrangements enable countries to focus on a narrow range of partners making it easier to exclude politically sensitive sectors, to avoid MFN commitments that open them to major competitors and to secure reciprocity from other signatories.

In the space of the past 20 years the number of preferential trade agreements (PTAs) notified to the WTO has grown from a mere 30 to over 200, with an additional 100 agreements signed by non-members.

As discussed in Chapter 22, horizontal intra-industry trade, which has also been growing strongly, may be particularly conducive to preferential rather than non-discriminatory liberalization in that governments can reduce adjustment costs by trading off bilaterally opportunities to specialize within an industry. The way in which PTAs have become a springboard for Asia-wide value chains in the automotive industry is an illustration of this point.

We have also seen that the motivations for signing PTAs differ from country to country and often have an important foreign policy dimension: for China in demonstrating its great power style; for the United States in asserting its presence in areas of strategic importance; and for the EU in consolidating its relations with prospective growth markets. Developing countries themselves have used PTAs as a way of fostering regional cooperation and strategic goals while also underpinning domestic reform, often linked to the shift from policies of import substitution.

And so today, PTAs are seen – by business – as a way of obtaining improved market access more quickly than through multilateral negotiation, whether by addressing issues such as investment that have been excluded from the multilateral agenda but are increasingly seen as a complement to trade, by pushing for more ambitious market opening such as the 'negative list' approach to services liberalization or by including more ambitious rules on non-tariff measures that assume greater importance when tariffs are eliminated.

At a time when there is no progress at the multilateral level in the DDA, negotiation of preferential market opening can be seen as offering a second-best alternative. As explained in Chapter 22, even without net trade diversion, any preferential tariff agreement that influences trade must have a negative effect on some exporters outside the agreement, and thus be second-best to multilateral liberalization. Moreover, while PTAs do have some building-block attributes, such as by promoting transparency or regulatory best practice so that their distorting effects should not be exaggerated, there is little doubt that, on balance, they weaken rather than strengthen the incentive to engage in multilateral trade negotiation. As we have seen, as PTAs move ahead with tariff reductions and beyond WTO commitments in services and investment, the multilateral trade regime is saddled with the apparently intractable problem of liberalizing agricultural trade, but left with nothing that market opening in protectionist countries could be traded off against. WTO-plus does not necessarily mean 'better', as seen by the TRIPS-plus provisions in many US and EU-centred agreements. And the fact remains that PTAs are not the optimal way of liberalizing trade. The dynamics of the interaction between multilateral and preferential go beyond the scope of this volume, but as Chapter 22 implies, what is required is a division of labour between the WTO and preferential agreements that does not undermine the WTO (see Heydon and Woolcock 2009).

The Scope of the WTO

Lack of Consensus on the Trade Agenda

As Chapter 3 argued the scope of the multilateral trade regime has evolved over time and the agenda has been largely shaped by the interests of the predominant trading nations at any point of time. The debate on trade during the twenty-first century has to date shown a clear difference between the views of the advanced developed economies, and in particular the European Union, on the one hand, and the now powerful emerging markets on the other. The developed economies tend to favour a comprehensive agenda that addresses their interests in dealing with global externalities, such as those related to the environment or public health. The emerging markets tend to favour a more limited agenda that reflects their interests, which are geared to development and growth through improved market access rather than addressing issues of global externalities.

There is also the unresolved issue of 'fair trade'. This very slippery concept has numerous, conflicting, interpretations. It can be seen as a way for developed countries to impose their standards (whether environmental, labour, or health and safety) on developing countries in order to negate the latter's comparative advantage. It is used as an argument for a form of reciprocity in which liberal countries expect exporting nations that have benefited from access to their markets to assume equivalent liberal policies as they develop. It is invoked as a way of increasing the returns to developing country raw material exporters, such as coffee producers. And it is drawn on to justify greater discipline on the use of government intervention or national industrial policies.

With no consensus on a trade agenda, protectionist policies in the advanced economies are likely to be rationalized on the basis that trade partners are, allegedly, gaining an unfair competitive advantage through noncompliance with international standards dealing with the environment (see Chapters 13 and 14), public health (Chapter 14), social conditions (Chapter 15), or respect for intellectual property rights (Chapter 16).

As noted in earlier chapters, it is becoming increasingly clear that trade measures will be part of the international effort to combat global warming, whether by border tax adjustment, preferential treatment of climate-friendly goods and services, renewable energy subsidies or product labels indicating carbon content. The challenge will be to prevent such policies sliding into green protectionism – or more broadly, 'clear conscience protectionism' (Chapter 24) – as countries seek to enforce the extraterritorial application of domestic regulations through restrictive trade measures.

The challenge is likely to be particularly acute as it bears on global supply chains. Fragmented global production is a recurring theme in many chapters of this book and is seen to be major source of growth in world trade and investment and a disincentive to protection, including via resort to trade remedies. But the future of the global supply chain is not assured. As discussed in Chapter 11, as coordination costs increase along the supply chain an optimal level of fragmentation is ultimately achieved. The risk is that protective trade policies linked to environmental concerns about trade and offshoring will cause this optimal level to be reached earlier than might otherwise be the case.

Compounding these dangers will be the risk that developing countries will seek to avoid or delay market opening whether by forgoing *absolute* gains from their own liberalization in the pursuit of a greater *share* of the gains on offer or by invoking the need for policy space, such actions risk being to the detriment of other developing countries. There is thus evidence, seen in Chapter 6, that antidumping and other commercial instruments are increasingly a South–South phenomenon.

The risk of protective trade policy in the absence of an agreed agenda is all the more real because numerous instruments exist to make protection possible. One such instrument comes from the tariff overhang and the ample scope that exists for many countries to raise their applied tariffs up to the higher level of their tariff bindings. Another comes from the plethora of non-tariff instruments, as discussed in Chapter 5, and the potential for substitution among them depending on their relative capacity to provide protection and the respective costs in doing so.

And the protective danger is likely to be augmented as WTO jurisprudence becomes more attuned to environmental objectives and as differences persist about the definition and use of precaution and the appropriate balance between a sound-science criterion for policymaking against a broader interpretation of the evidence basis for risk assessment.

Trends in WTO Jurisprudence

The relative slowing of the WTO's negotiating, or legislative, function has been matched by a corresponding increase in the relative importance of the organization's litigation function embodied in the dispute settlement system – a system that was greatly strengthened as a result of the Uruguay Round. This shift is all the more important because of the change that has been taking place in WTO jurisprudence that begins to reach beyond GATT or WTO law to include other elements of international economic law. As a consequence of three particular cases of WTO dispute settlement, *US Gasoline, Shrimp Turtle* and *Brazil Retreaded Tyres*, the WTO has come to accept that while trade-restricting measures should not constitute an arbitrary or unjustifiable discrimination, they can be justified on the grounds of environmental protection. Underpinning this shift, as discussed in Chapter 21, is the view of the Appellate Body, as expressed in *Shrimp Turtle*, that not balancing any non-trade policies could ultimately lead to the inability of the organization to maintain a degree of legitimacy that would enable it to carry out its broader objectives relating to trade liberalization.

There is a danger that the predominance of the WTO's litigation function will increase the tension between, on the one hand, the claims of authority by individual nation-states and, on the other hand, the assertions of the WTO as an international legitimate authority requiring control of certain issues in order to carry out its responsibilities. The risk of disenchantment with the dispute settlement system is likely to increase if countries feel that the collective legislation of new rules and disciplines is not keeping pace with the legal process. The ruling of the WTO Appellate Body in March 2011 that the United States could not simultaneously impose both countervailing duties and antidumping duties against imports of Chinese steel pipes and off-road tyres stood in sharp contrast to the failure to address rules issues in the Doha Round.

How to Proceed: Some Policy Implications

This final section addresses some of the policy implications arising from the themes and challenges identified in this book, before returning briefly to the conundrums of trade identified in the introduction.

For the foreseeable future, trade policy will be conducted under global conditions particularly challenging to growth and stability, as countries face a complex set of problems: the fiscal consolidation needed in the aftermath of the global financial crisis; the adjustment occasioned by policies to counter climate warming; the budgetary burden imposed by ageing populations; and the uncertainties inherent in persisting global imbalances. The last problem is especially challenging. It should not be forgotten that current account imbalances that had built up during the preceding decade were a key factor in the global financial crisis of 2008–9 as major outflows from surplus countries helped fuel the rapid credit expansion in deficit countries, allowing them to postpone hard policy choices (Obstfeld and Rogoff 2009). Looking ahead, as the chapter on US trade policy has put it, feeding the appetite of countries such as China and India for US, EU and Japanese financial assets through large export surpluses seems sure to provoke protective responses in deficit countries. Trade liberalization cannot move forward when current account imbalances are large and growing.

Opening Markets in Support of Innovation and Growth

In coming years there will thus remain a compelling case for open markets as a stimulus to the innovation and growth that will be needed to cope with fiscal consolidation, demographic change and the challenge arising from policies to address climate warming. Given the scale of potential gains on offer, the liberalization of trade in services deserves particular attention.

Care will be needed to ensure that market opening in pursuit of innovation and productivity growth is not frustrated by unnecessary restrictions in areas of trade that directly embody innovation and technological improvement. A case in point here, discussed in Chapter 14, is that of SPS measures taken to restrict trade in genetically modified seeds and crops, notwithstanding the need for technology that can increase crop yields and food production. At the same time democratic states must respond to consumer demands. With new techniques such as nanotechnology coming up, how can the benefits of trade be achieved whilst retaining the right to regulate? What are needed are effective multilateral rules defining what is a legitimate or necessary regulation. Another example concerns the risk that the exclusion from liberalization of 'services supplied in the exercise of government authority' will inhibit skills transfer in areas such as health and education.

Trade liberalization will be particularly important in helping to counter the constraints facing global supply chains. It can do so by: promoting harmonization around international technical standards to which firms in fragmented markets can conform; addressing the danger that restrictive rules of origin will disadvantage low-cost suppliers; encouraging trade facilitation, enabling suppliers to respond quickly to developments further down the chain; and by fostering the liberalization of environmental goods and services and so, perhaps, helping to allay environmental concerns linked to trade.

Demonstrating Gains and Dealing with Losses

Actually opening markets may not be sufficient in winning public support without complementary efforts to better evaluate and demonstrate the gains from trade and to support those who lose from market opening.

Four related aspects of demonstrating-the-gains are of particular importance – all associated with common misperceptions. First, where protection is being sought it should be assessed in terms of the overall national interest, as a way of dealing with the political economy issues discussed above. An example is the mandatory public interest clause that some policymakers are seeking in antidumping investigations to prevent regulatory capture, to increase transparency and to demonstrate the costs and benefits of protection. Second, the case for liberalizing one's own barriers needs to be more clearly articulated, recalling that some 80 per cent of the developing country gains from worldwide agricultural liberalization would come from opening up developing countries' own highly protected markets and that gains in manufacturing and services increase with countries' commitment to their own liberalization. Third, it needs to be stressed that infant-industry protection has a questionable track record and that the information demands of government in pursuing such policies are, with the advent of the global supply chain, more complex than ever. And fourth, it needs to be more effectively articulated that it is technological change and not trade that is leading to widening income inequality within countries.

But there will be losers from market opening and they will need help. Where it is considered necessary to target assistance to particular sections of the workforce, support should be forthcoming. Such support should be time-bound, with a clear exit strategy; decoupled from production, with incentives to adjust and innovate; aimed at re-employing displaced workers; compatible with general safety net arrangements; and transparent and accountable.

Fostering International Cooperation through the WTO

The key forum for efforts to foster international cooperation should be the WTO. Several chapters of this book have stressed the importance of realizing the promise of the Doha Development Agenda: to bolster the legitimacy, stability and predictability of the system of pooled sovereignty; to reap the gains of liberalization and the opportunities it brings for growth, development and poverty reduction; and to reduce the risk of backsliding. Attention also needs to be devoted to the post-Doha agenda, including what to do about issues such as investment, competition and government procurement and how to strengthen the multilateral rules in a manner that facilitates and promotes complementarity between PTAs and the multilateral trading system. More progress also needs to be made in services where there are large potential benefits from market opening that far exceed those in agriculture and manufacturing combined.

It has also been recognized (Chapter 21) that while the protracted nature of the DDA shows a dysfunction in the WTO's legislative branch, it is important not to assume that the exclusive legislative output of the WTO is completed trade rounds based on a Single Undertaking. Apart from the crucial role of dispute settlement, other important ongoing activities include accession, the administration of all the existing WTO agreements and the review of national trade policies.

In addition to trade and the environment, which we have already touched on, this volume has covered some of the key trade related issues. Chapter 11 suggests that while there is a compelling case for discussing investment issues in the WTO, the success or failure of any such negotiations depends, *inter alia*, on the tradeoffs and cross-issue linkages between investment and other policy areas. Chapter 12 suggests that the WTO is unlikely ever to be the venue for a multilateral agreement on competition policy given EU unwillingness to see disciplines imposed on the behaviour of its own firms in the rest of the world, US satisfaction with the extraterritorial reach of its own laws and developing country suspicion of a hidden market-access agenda. But the WTO could be the focus for a codification of best practice as it emerges from bilateral accords, which, paradoxically, developing countries seem prepared to sign. Such a codification could bring particular benefits to developing countries, given their relative lack of competition culture and low market contestability, and their exposure to the import of cartelized products.

Another important ongoing dimension of international cooperation involves the links between the WTO and other bodies such as the ILO, with respect to core labour standards that are discussed in Chapter 15. Concerns about protectionist capture and the fact that there is no general economic justification for the sanction-driven promotion of labour standards, suggests that this issue is unlikely to become core business of the WTO.

The links between trade and development are covered in a number of chapters, such as that on special and differential treatment (SDT) for developing countries. As discussed in Chapter 18, the provision of special and differential treatment of developing countries, including the principle of less than fully reciprocal market opening, has been a key element of the GATT/WTO for over 50 years. It is also firmly enshrined in the Doha Development Agenda, driven in part by a widespread view among developing countries that the results of the Uruguay Round were biased against them. Nevertheless, as we have seen, in the evolution of SDT, the Uruguay Round represented a watershed in that, under the Single Undertaking, developing countries became more engaged in multilateral negotiation. They did so in recognition that earlier limited engagement had led to a two-tier trading system (with higher barriers on exports of interest to them) in which developing countries failed to gain the full benefits of their own liberalization.

But many of the underlying concerns of developing countries persist – the fragility of domestic industry, the costs of implementing institutional reform and the reliance on tariffs for revenue. If the increased engagement of developing countries is to be maintained a number of measures will be called for. Continuing aid for trade will be needed to address supply-side deficiencies and to help in reducing the recourse of poor countries to defensive policies. SDT will need to be better targeted to those in genuine need, including through the graduation of the more advanced countries and perhaps by issue-specific approaches that automatically identify the beneficiary. And there may also be scope for some variable geometry whereby plurilateral agreements are negotiated among the more advanced developing countries.

The granting of non-reciprocal preferences to developing countries will continue to be part of the development agenda. As different chapters have shown, however, this is a complex area with mixed blessings. Perhaps most importantly, for the majority of developing countries, MFN liberalization by preference-giving countries, by opening up new opportunities for trade, brings positive welfare gains, notwithstanding the effects of preference erosion. Consistent with this finding is the observation in Chapter 19 that over the past two decades, the EU has managed its market opening in a way that, at least initially, maintains greater restrictions on more competitive countries. Preference schemes also complicate the trading environment and raise transaction costs; collectively, the United States, EU, Japan and Canada have no less than 23 different preference agreements with Africa. And as countries' preference status changes, within schemes, there is a bewildering combination of discriminatory effects on other trading nations.

We have seen that the construction of the international trading system has been an iterative process. The system has progressively adapted to wider membership and to shifts in economic power – it will need to continue doing so in future.

Encouraging Regional and South–South Cooperation

Regional cooperation, particularly between developing countries, can be a useful stepping stone to international cooperation. We have seen that in the context of services development in East Africa in Chapter 20, deeper regional integration through regulatory cooperation with neighbouring partners who have similar regulatory preferences can usefully complement non-preferential liberalization. Regional integration can also enhance competition among service providers, enable those providers to exploit economies of scale and produce a wider variety of services. Regional integration brings further benefits in that a larger market is able to attract greater domestic and foreign investment.

In Latin America, it has been observed in Chapter 25 that agreements within the region and with other developing countries need to enforce stricter compliance with the obligations established, in order to create more legal security and predictability. In particular, the lack of effective regional competition remedies has contributed to the degrading of the free trade schedules of the MERCOSUR agreement.

South–South goods trade, more generally, has been growing strongly in recent years, at an annual rate of some 12 per cent, compared with 7 per cent for North–North trade (OECD 2006). However, trade in manufactures between developing countries still represents only 6 per cent of world trade. While encouragement can be taken from the fact that South–South tariff barriers are now lower than tariffs imposed by developing countries on goods from high income countries, the emergence of trade remedies as an increasingly South–South phenomenon is less encouraging.

Putting Trade Policy in an Economy-wide Setting

While cooperation at the international and regional level is important, the key to successful trade policy is to place it holistically in a framework of sound domestic economic management so that in the course of trade-related structural adjustment labour and capital can move from declining to expanding areas of activity. The Taiwan case study of outward orientation, while stressing the need for tailored, country-by-country policy application, vividly demonstrates the policies that need to accompany trade liberalization: a flexible labour market; a stable macroeconomic environment; expanding infrastructure; vocational education support for an adaptable workforce; and liberal rules governing foreign direct investment. The message is underscored in the study of education services in East Africa, showing that the reduction of trade barriers needs to be accompanied by reforms to the education system and the regulatory framework. In the study of Latin America, it is recognized that participating more fully in global value chains will involve meeting challenges beyond trade policy narrowly defined, requiring changes in a wide range of policies dealing with innovation, science and technology, education and training, environmental management and the attraction of FDI. The discussion of trade and competition policy in Chapter 12 makes clear that trade liberalization is necessary but not sufficient. The reduction of trade barriers needs to be accompanied by a strengthening of competition laws, and competition culture, to help ensure that markets are genuinely contestable and that there are no barriers to the entry of new suppliers when market prices, and therefore profits, rise above normal levels.

Put differently, trade cannot do it all. Arguably the biggest challenge facing the international trading system, the persistence of global macroeconomic imbalances and attendant protectionist threats, can only be met by domestic action quite distinct from trade policy. Global imbalances stem from a discrepancy between domestic savings and investment. Rebalancing will therefore require a closer alignment between savings and investment in the big surplus as well as the big deficit countries. Exchange rate realignment may be part of the adjustment process but exchange rate changes alone would do little to reduce current account surpluses in, for example, China as long as household savings are motivated by weak and shallow financial markets and inadequate social security nets.

Similarly, the risk of green protectionism will be best addressed by tackling environmental problems directly at their source, that is, by dedicated environmental policies not by the threat of trade sanctions that serve only to distort resource allocation and prompt retaliation. This is the same underlying logic that we saw in Chapter 8 in relation to the reform of agriculture in the advanced developed economies. Positive contributions of farmers to improving the environment and biodiversity are better encouraged through specific payments based on the service desired rather than by support of farm output that may or may not provide the required service as a by-product.

In short, we are reminded of the Tinbergen (1956) principle that in order for a policy regime to be effective there must be as many independent policy instruments as there are targets to be pursued.

A number of chapters have referred to the global financial and economic crisis of 2008–2009. While care has been taken throughout the book not to dwell on transient issues, whether phases of the negotiation cycle or shifts in the economic cycle, the global financial crisis of 2008–2009, and its aftermath, serve as a stark illustration of the importance of seeing trade policy in its wider setting. The linkage works in both directions: external shocks impact on the domestic economy but domestic imbalances, and domestic political imperatives, permeate the international economy. The crisis also serves to highlight the critical importance of the service economy, as being less cyclically vulnerable than manufacturing but acutely sensitive to the regulatory environment – domestic and international. Finally, the crisis has illustrated the complex link between trade reform and international economic conditions. Slower growth increases the need for the competitive boost of open markets, but also makes the trade-related adjustment process more difficult. In the words of a former WTO Director-General, Mike Moore, the roof is more likely to get fixed when it is raining, but it is easier to do when the sun is shining.

Coming back to the conundrums outlined in the introduction to this book, we find that all of them are better understood, if not totally resolved, when trade liberalization is viewed as an exercise in enlightened self-interest – liberalization from below – within the framework of multiple, mutually supportive domestic economic policies. A holistic approach to trade policy will thus help in a number of ways:

- promoting both *accountability* and *efficiency* in trade policy by addressing directly the social, public health and environmental concerns of non-governmental organizations, in a way that is distinct from but complementary to trade liberalization, so that the pursuit of increased efficiency in the WTO is not compromised by giving non-state actors a role in the WTO that would be inconsistent with the organization's responsibilities as an inter-governmental body;
- facilitating both the *entry* and *exit* of firms and workers as part of trade-related structural adjustment through complementary policies that facilitate the movement of factors of production from declining to expanding areas of activity;

- matching *ends* and *means* such as when tariff reductions bring budgetary strains so that rather than forgo the benefits of liberalization action is taken to tackle the budget problem directly through reform of the tax system;
- resolving tensions between *present* and *future* benefits. For example, the paradox of patents – restricting access to knowledge now in order to have more in the future – may never be totally resolved, but it becomes less of a puzzle, or less of a constraint, in a broad policy environment, including open markets, that is conducive to innovation;
- promoting *complementarities* such as by liberalizing both trade and investment in a mutually reinforcing way, by bringing some of the spirit of unilateral liberalization, as an element of sound domestic management, to multilateral market opening, or by multilateralizing certain elements of preferential trade agreements;
- fostering both *cooperation* and national *sovereignty* by recognizing that international cooperation in the pursuit of trade liberalization does not mean abandoning the sovereign right to regulate. Indeed as the global financial crisis has shown, the liberalization of trade in financial services may call for more – or certainly better – rather than less domestic regulation; and
- tackling *market failures* such as environmental externalities directly at source – via environment policies – in a way that complements the pursuit of market opening and reduces the risk of protectionist capture inherent in sanctions-driven promotion of non-trade goals.

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