

SIMULATING SOME SOCIAL BENEFITS OF WTO'S TRADING SYSTEM

**Syed Adnan Haider Ali Shah Bukhari*

Abstract

From the money in our pockets and the goods or services that we use, to a more peaceful world --- the WTO's trading system offer a range of benefits, some well-known, others not so obvious. Here in this paper, we try to simulate some useful social benefits for WTO's trading system. Since the world is complex. This paper is brief, but it tries to reflect the complex and dynamic nature of trade. It highlights some of the benefits of the WTO's trading system, but it doesn't claim that everything is perfect --- otherwise there would be no need for further negotiations and for the system to evolve and reform continually. Nor does it claim that everyone agrees with everything in the WTO. That's one of the most important reasons for having the system: it's a forum for countries to thrash out their differences on trade issues. That said, there are many over-riding reasons why we're better off with the system than without it.

Keywords: WTO's trading system, dynamic nature, goods & services

Introduction

Simply put: the World Trade Organization (WTO) deals with the rules of trade between nations at a global or near-global level. But there is more to it than that. *Is it a bird? Is it a plane?* There are a number of ways of looking at the WTO. It's an organization for liberalizing trade. It's a forum for governments to negotiate trade agreements. It's a place for them to settle trade disputes. It operates a system of trade rules. (But it's not Superman, just in case anyone thought it could solve --- or cause --- all the world's problems!)

Above all, it's a negotiating forum ... Essentially, the WTO is a place where member governments go, to try to sort out the

* *Lecturer, Department of Computer Sciences, GC University, Faisalabad.*

trade problems they face with each other. The first step is to talk. The WTO was born out of negotiations, and everything the WTO does is the result of negotiations. The bulk of the WTO's current work comes from the 1986–94 negotiations called the Uruguay Round and earlier negotiations under the General Agreement on Tariffs and Trade (GATT). The WTO is currently the host to new negotiations, under the “Doha Development Agenda” launched in 2001. Where countries have faced trade barriers and wanted them lowered, the negotiations have helped to liberalize trade. But the WTO is not just about liberalizing trade, and in some circumstances its rules support maintaining trade barriers --- for example to protect consumers or prevent the spread of disease.

It's a set of rules ... At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations. These documents provide the legal ground-rules for international commerce. They are essentially contracts, binding governments to keep their trade policies within agreed limits. Although negotiated and signed by governments, the goal is to help producers of goods and services, exporters, and importers conduct their business, while allowing governments to meet social and environmental objectives. The system's overriding purpose is to help trade flow as freely as possible — so long as there are no undesirable side-effects. That partly means removing obstacles. It also means ensuring that individuals, companies and governments know what the trade rules are around the world, and giving them the confidence that there will be no sudden changes of policy. In other words, the rules have to be “transparent” and predictable. *And it helps to settle disputes ...* This is a third important side to the WTO's work. Trade relations often involve conflicting interests. Agreements,

including those painstakingly negotiated in the WTO system, often need interpreting. The most harmonious way to settle these differences is through some neutral procedure based on an agreed legal foundation. That is the purpose behind the dispute settlement process written into the WTO agreements.

Key Benefits

There are many over-riding reasons why we're better off with the system than without it. Here are 10 of them.

1. The system helps promote peace
2. Disputes are handled constructively
3. Rules make life easier for all
4. Freer trade cuts the costs of living
5. It provides more choice of products and qualities
6. Trade raises incomes
7. Trade stimulates economic growth
8. The basic principles make life more efficient
9. Governments are shielded from lobbying
10. The system encourages good government

The system helps to keep the peace

This sounds like an exaggerated claim, and it would be wrong to make too much of it. Nevertheless, the system does contribute to international peace, and if we understand why, we have a clearer picture of what the system actually does.

Peace is partly an outcome of two of the most fundamental principles of the trading system: *helping trade to flow smoothly*, and providing countries with a constructive and fair outlet for *dealing with disputes over trade issues*. It is also an outcome of the *international confidence and cooperation* that the system creates and reinforces. History is littered with examples of trade

disputes turning into war. One of the most vivid is the trade war of the 1930s when countries competed to raise trade barriers in order to protect domestic producers and retaliate against each other's barriers. This worsened the Great Depression and eventually played a part in the outbreak of World War II. Two developments immediately after the Second World War helped to avoid a repeat of the pre-war trade tensions. In Europe, international cooperation developed in coal, and in iron and steel. Globally, the General Agreement on Tariffs and Trade (GATT) was created. Both have proved successful, so much so that they are now considerably expanded—one has become the European Union, the other the World Trade Organization (WTO).

HOW DOES THIS WORK? Crudely put, sales people are usually reluctant to fight their customers. In other words, if trade flows smoothly and both sides enjoy a healthy commercial relationship, political conflict is less likely. What's more, smoothly-flowing trade also helps people all over the world become better off. People who are more prosperous and contented are also less likely to fight. But that is not all. The GATT/WTO system is an important *confidence builder*. The trade wars in the 1930s are proof of how protectionism can easily plunge countries into a situation where no one wins and everyone loses. The short-sighted protectionist view is that defending particular sectors against imports is beneficial. But that view ignores how other countries are going to respond. The longer term reality is that one protectionist step by one country can easily lead to retaliation from other countries, a loss of confidence in freer trade, and a slide into serious economic trouble for all --- including the sectors that were originally protected. Everyone loses. Confidence is the key to avoiding that

kind of no-win scenario. When governments are confident that others will not raise their trade barriers, they will not be tempted to do the same. They will also be in a much better frame of mind to cooperate with each other. The WTO trading system plays a vital role in creating and reinforcing that confidence. Particularly important are negotiations that lead to agreement by consensus, and a focus on abiding by the rules.

The system allows disputes to be handled constructively

As trade expands in volume, in the numbers of products traded, and in the numbers of countries and companies trading, there is a greater chance that disputes will arise. The WTO system helps resolve these disputes peacefully and constructively.

There could be a down side to trade liberalization and expansion. More trade means more opportunities for disputes to arise. Left to themselves, those disputes could lead to serious conflict. But in reality, a lot of international trade tension is reduced because countries can turn to organizations, in particular the WTO, to settle their trade disputes. Before World War 2 that option was not available. After the war, the world's community of trading nations negotiated trade rules which are now entrusted to the WTO. Those rules include an obligation for members to bring their disputes to the WTO and not to act unilaterally. When they bring disputes to the WTO, the WTO's procedure focuses their attention on the rules. Once a ruling has been made, countries concentrate on trying to comply with the rules, and perhaps later renegotiating the rules --- not on declaring war on each other. Around 300 disputes have been brought to the WTO since it was set up in 1995. Without a means of tackling these constructively and harmoniously, some could have led to more serious political

conflict. The fact that the disputes are based on WTO agreements means that there is a clear basis for judging who is right or wrong. Once the judgment has been made, the agreements provide the focus for any further actions that need to be taken. The increasing number of disputes brought to GATT and its successor, the WTO, does not reflect increasing tension in the world. Rather, it reflects the closer economic ties throughout the world, the GATT/WTO's expanding membership and the fact that countries have faith in the system to solve their differences. Sometimes the exchanges between the countries in conflict can be acrimonious, but they always aim to conform to the agreements and commitments that they themselves negotiated.

A system based on rules rather than power makes life easier for all

The WTO cannot claim to make all countries equal. But it does reduce some inequalities, giving smaller countries more voice, and at the same time freeing the major powers from the complexity of having to negotiate trade agreements with each of their numerous trading partners.

Decisions in the WTO are made by consensus. The WTO agreements were negotiated by all members, were approved by consensus and were ratified in all members' parliaments. The agreements apply to everyone. Rich and poor countries alike have an equal right to challenge each other in the WTO's dispute settlement procedures. This makes life easier for all, in several different ways. Smaller countries can enjoy some increased bargaining power. Without a multilateral regime such as the WTO's system, the more powerful countries would be freer to

impose their will unilaterally on their smaller trading partners. Smaller countries would have to deal with each of the major economic powers individually, and would be much less able to resist unwanted pressure. In addition, smaller countries can perform more effectively if they make use of the opportunities to form alliances and to pool resources. Several are already doing this. There are matching benefits for larger countries. The major economic powers can use the single forum of the WTO to negotiate with all or most of their trading partners at the same time. This makes life much simpler for the bigger trading countries. The alternative would be continuous and complicated bilateral negotiations with dozens of countries simultaneously. And each country could end up with different conditions for trading with each of its trading partners, making life extremely complicated for its importers and exporters. The principle of non-discrimination built into the WTO agreements avoids that complexity. The fact that there is a single set of rules applying to all members greatly simplifies the entire trade regime. And these agreed rules give governments a clearer view of which trade policies are acceptable. |

Freer trade cuts the cost of living

We are all consumers. The prices we pay for our food and clothing, our necessities and luxuries, and everything else in between, are affected by trade policies.

Protectionism is expensive: it raises prices. The WTO's global system lowers trade barriers through negotiation and applies the principle of non-discrimination. The result is reduced costs of production (because imports used in production are cheaper) and reduced prices of finished goods and services, and ultimately a lower cost of living. There are plenty of studies showing just

what the impacts of protectionism and of freer trade are. These are just a few figures.

Food is Cheaper

When you protect your agriculture, the cost of your food goes up --- by an estimated \$1,500 per year for a family of four in the European Union; by the equivalent of a 51% tax on food in Japan (1995); by \$3 billion per year added to US consumers' grocery bills just to support sugar in one year (1988). Negotiating agricultural trade reform is a complex undertaking. Governments are still debating the roles agricultural policies play in a range of issues from food security to environmental protection. But WTO members are now reducing the subsidies and the trade barriers that are the worst offenders. And in 2000, new talks started on continuing the reform in agriculture. These have now been incorporated into a broader work program, the Doha Development Agenda, launched at the fourth WTO Ministerial Conference in Doha, Qatar, in November 2001.

Clothes are Cheaper

Import restrictions and high customs duties combined to raise US textiles and clothing prices by 58% in the late 1980s. UK consumers pay an estimated £500 million more per year for their clothing because of these restrictions. For Canadians the bill is around C\$780 million. For Australians it would be A\$300 annually per average family if Australian customs duties had not been reduced in the late 1980s and early 1990s. The textiles and clothing trade is going through a major reform—under the WTO—that will be completed in 2005. The program includes eliminating restrictions on quantities of imports. If customs duties were also to be eliminated, economists calculate the result could be a gain to the world of around \$23 billion, including

\$12.3 billion for the US, \$0.8 billion for Canada, \$2.2 billion for the EU and around \$8 billion for developing countries.

The same goes for other goods

When the US limited Japanese car imports in the early 1980s, car prices rose by 41% between 1981 and 1984—nearly double the average for all consumer products. The objective was to save American jobs, but the higher prices were an important reason why one million fewer new cars were sold, leading to more job losses. If Australia had kept its tariffs at 1998 levels, Australian customers would pay on average A\$2,900 more per car today. In 1995, aluminium users in the EU paid an extra \$472 million due to tariff barriers. One of the objectives of the Doha Development Agenda (DDA) is another round of cuts in tariffs on industrial products, i.e. manufactured and mining products. Some economists (Robert Stern, Alan Deardorff and Drusilla Brown) predict that cutting these by one third would raise developing countries' income by around \$52 billion. Similar French restrictions added an estimated 33% to French car prices. TVs, radios, videos are, or were, all more expensive under protectionism.

... And Services

Liberalization in telephone services is making phone calls cheaper—in the 1990s by 4% per year in developing countries and 2% per year in industrial countries, taking inflation into account. In China, competition from a second mobile phone company was at least part of the reason for a 30% cut in the price of a call. In Ghana the cut was 50%. The group of economists led by Robert Stern also estimates that lowering services barriers by one third under the Doha Development Agenda would raise developing countries' incomes by around \$60 billion. And so it goes on. The system now entrusted to the WTO has been in

place for over 50 years. In that time there have been eight major rounds of trade negotiations. Trade barriers around the world are lower than they have ever been in modern trading history. They continue to fall, and we are all benefiting.

It gives consumers more choice, and a broader range of qualities to choose from

Think of all the things we can now have because we can import them: fruits and vegetables out of season, foods, clothing and other products that used to be considered exotic, cut flowers from any part of the world, all sorts of household goods, books, music, movies, and so on.

Think also of the things people in other countries can have because they buy exports from us and elsewhere. Look around and consider all the things that would disappear if all our imports were taken away from us. Imports allow us more choice—both more goods and services to choose from, and a wider range of qualities. Even the quality of locally-produced goods can improve because of the competition from imports. The wider choice isn't simply a question of consumers buying foreign finished products. Imports are used as materials, components and equipment for local production. This expands the range of final products and services that are made by domestic producers, and it increases the range of technologies they can use. When mobile telephone equipment became available, services sprang up even in the countries that did not make the equipment, for example. Sometimes, the success of an imported product or service on the domestic market can also encourage new local producers to compete, increasing the choice of brands available to consumers as well as increasing the range of goods and services produced

locally. If trade allows us to import more, it also allows others to buy more of our exports. It increases our incomes, providing us with the means of enjoying the increased choice.

Trade raises incomes

Lowering trade barriers allows trade to increase, which adds to incomes --- national incomes and personal incomes. But some adjustment is necessary.

The WTO's own estimates for the impact of the 1994 Uruguay Round trade deal were between \$109 billion and \$510 billion added to world income (depending on the assumptions of the calculations and allowing for margins of error). More recent research has produced similar figures. Economists estimate that cutting trade barriers in agriculture, manufacturing and services by one third would boost the world economy by \$613 billion — equivalent to adding an economy the size of Canada to the world economy. In Europe, the EU Commission calculates that over 1989–93 EU incomes increased by 1.1–1.5% more than they would have done without the Single Market. So trade clearly boosts incomes. Trade also poses challenges as domestic producers face competition from imports. But the fact that there is additional income means that resources are available for governments to redistribute the benefits from those who gain the most—for example to help companies and workers adapt by becoming more productive and competitive in what they were already doing, or by switching to new activities.

Trade stimulates economic growth, and that can be good news for employment

Trade clearly has the potential to create jobs. In practice there is often factual evidence that lower trade barriers have been good for employment. But the picture is complicated by a number of factors. Nevertheless, the alternative --- protectionism --- is not the way to tackle employment problems.

This is a difficult subject to tackle in simple terms. There is strong evidence that trade boosts economic growth, and that economic growth means more jobs. It is also true that some jobs are lost even when trade is expanding. But a reliable analysis of this poses at least two problems. First, there are other factors at play. For example, technological advance has also had a strong impact on employment and productivity, benefiting some jobs, hurting others. Second, while trade clearly boosts national income (and prosperity), this is not always translated into new employment for workers who lost their jobs as a result of competition from imports. The picture is not the same all over the world. The average length of time a worker takes to find a new job can be much longer in one country than for a similar worker in another country experiencing similar conditions. In other words, some countries are better at making the adjustment than others. This is partly because some countries have more effective adjustment policies. Those without effective policies are missing an opportunity. There are many instances where the facts show that the opportunity has been grasped—where freer trade has been healthy for employment. The EU Commission calculates that the creation of its Single Market means that there are somewhere in the range of 300,000–900,000 more jobs than

there would be without the Single Market. Often, job prospects are better in companies involved in trade. In the United States, 12 million people owe their jobs to exports; 1.3 million of those jobs were created between 1994 and 1998. And those jobs tend to be better-paid with better security. In Mexico, the best jobs are those related to export activities: sectors which export 60 per cent or more of their production, pay wages 39% higher than the rest of the economy and maquiladora (in-bond assembly) plants pay 3.5 times the Mexican minimum wage. The facts also show how protectionism hurts employment. The example of the US car industry has already been mentioned: trade barriers designed to protect US jobs by restricting imports from Japan ended up making cars more expensive in the US, so fewer cars were sold and jobs were lost. In other words, an attempt to tackle a problem in the short term by restricting trade turned into a bigger problem in the longer term. Even when a country has difficulty making adjustments, the alternative of protectionism would simply make matters worse.

The basic principles make the system economically more efficient, and they cut costs

Many of the benefits of the trading system are more difficult to summarize in numbers, but they are still important. They are the result of essential principles at the heart of the system, and they make life simpler for the enterprises directly involved in trade and for the producers of goods and services.

Trade allows a division of labour between countries. It allows resources to be used more appropriately and effectively for production. But the WTO's trading system offers more than that. It helps to increase efficiency and to cut costs even more because

of important principles enshrined in the system. Imagine a situation where each country sets different rules and different customs duty rates for imports coming from different trading partners. Imagine that a company in one country wants to import raw materials or components --- copper for wiring or printed circuit boards for electrical goods, for example --- for its own production. It would not be enough for this company to look at the prices offered by suppliers around the world. The company would also have to make separate calculations about the different duty rates it would be charged on the imports (which would depend on where the imports came from), and it would have to study each of the regulations that apply to products from each country. Buying some copper or circuit boards would become very complicated. That, in simple terms, is one of the problems of discrimination. Imagine now that the government announces it will charge the same duty rates on imports from all countries, and it will use the same regulations for all products, no matter where they come from, whether imported or locally produced. Life for the company would be much simpler. Sourcing components would become more efficient and would cost less.

The system shields governments from narrow interests

The GATT-WTO, system which evolved in the second half of the 20th Century helps governments take a more balanced view of trade policy. Governments are better placed to defend themselves against lobbying from narrow interest groups by focusing on trade-offs that are made in the interests of everyone in the economy.

One of the lessons of the protectionism that dominated the early decades of the 20th Century was the damage that can be caused if

narrow sectoral interests gain an unbalanced share of political influence. The result was increasingly restrictive policy which turned into a trade war that no one won and everyone lost. Superficially, restricting imports looks like an effective way of supporting an economic sector. But it biases the economy against other sectors which shouldn't be penalized --- if you protect your clothing industry, everyone else has to pay for more expensive clothes, which puts pressure on wages in all sectors, for example. Protectionism can also escalate as other countries retaliate by raising their own trade barriers. That's exactly what happened in the 1920s and 30s with disastrous effects. Even the sectors demanding protection ended up losing. Governments need to be armed against pressure from narrow interest groups, and the WTO system can help. The GATT-WTO system covers a wide range of sectors. So, if during a GATTWTO trade negotiation one pressure group lobbies its government to be considered as a special case in need of protection, the government can reject the protectionist pressure by arguing that it needs a broad-ranging agreement that will benefit all sectors of the economy. Governments do just that, regularly.

The system encourages good government

Under WTO rules, once a commitment has been made to liberalize a sector of trade, it is difficult to reverse. The rules also discourage a range of unwise policies. For businesses, that means greater certainty and clarity about trading conditions. For governments it can often mean good discipline.

The rules include commitments not to backslide into unwise policies. Protectionism in general is unwise because of the damage it causes domestically and internationally, as we have

already seen. Particular types of trade barriers cause additional damage because they provide opportunities for corruption and other forms of bad government. One kind of trade barrier that the WTO's rules try to tackle is the *quota*, for example restricting imports or exports to no more than a specific amount each year. Because quotas limit supply, they artificially raise prices, creating abnormally large profits (economists talk about "quota rent"). That profit can be used to influence policies because more money is available for lobbying. It can also provide opportunities for corruption, for example in the allocation of quotas among traders. There are plenty of cases where that has happened around the world. In other words, quotas are a particularly bad way of restricting trade. Governments have agreed through the WTO's rules that their use should be discouraged. Nevertheless, quotas of various types remain in use in most countries, and governments argue strongly that they are needed. But they are controlled by WTO agreements and there are commitments to reduce or eliminate many of them, particularly in textiles. Many other areas of the WTO's agreements can also help reduce corruption and bad government. Transparency (such as making available to the public all information on trade regulations), other aspects of "trade facilitation", clearer criteria for regulations dealing with the safety and standards of products, and nondiscrimination also help by reducing the scope for arbitrary decision making and cheating. Quite often, governments use the WTO as a welcome external constraint on their policies: "we can't do this because it would violate the WTO agreements."

Conclusion

This paper highlights some of the social benefits of the WTO's trading system. The first benefit of this system is that it helps promote peace. This sounds like an exaggerated claim, and

it would be wrong to make too much of it. Nevertheless, the system does contribute to international peace, and if we understand why, we have a clearer picture of what the system actually does. Secondly, Disputes are handled constructively; it means that, as trade expands in volume, in the numbers of products traded, and in the numbers of countries and companies trading, there is a greater chance that disputes will arise. The WTO system helps resolve these disputes peacefully and constructively. Thirdly, the rules of that system make life easier for all. The WTO cannot claim to make all countries equal. But it does reduce some inequalities, giving smaller countries more voice, and at the same time freeing the major powers from the complexity of having to negotiate trade agreements with each of their numerous trading partners. Fourth simulated benefit explained like that, as we are all consumers. The prices we pay for our food and clothing, our necessities and luxuries, and everything else in between, are affected by trade policies. Fifthly, it provides more choice of products and qualities. Sixthly, Trade under WTO's system raises incomes. Seventhly, Trade under WTO's system stimulates economic growth. Eighthly, The basic principles of this system make life more efficient. The second last benefit of this system is that, the GATT-WTO, system, which evolved in the second half of the 20th Century helps governments, takes a more balanced view of trade policy. Governments are better placed to defend themselves against lobbying from narrow interest groups by focusing on trade-offs that are made in the interests of everyone in the economy. Finally, under WTO rules, once a commitment has been made to liberalize a sector of trade, it is difficult to reverse. The rules also discourage a range of unwise policies. For

businesses, that means greater certainty and clarity about trading conditions. For governments it can often mean good discipline.

Many of the benefits of the trading system are more difficult to summarize in numbers, but they are still important. WTO's trading system tries to reflect the complex and dynamic nature of trade but it doesn't claim that everything regarding to this system is perfect. However it simulates the major beneficial properties of this system by which we may conclude that it is superlative among all others.

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