



# The World Trading System

## The Road Ahead

Simon J. Evenett

All countries have much more to gain than to lose from opening up their markets. As a new round of trade talks begins, the international community should make a commitment to pursue further trade reforms.

**E**VEN though many aspects of globalization—capital flows, migration, and environmental problems—have captured worldwide attention in the 1990s, for more than a century the driving force behind global integration has been growing trade in goods and services. At the close of the twentieth century, however, the global trading system is at a crossroads. Will the momentum of trade reform be sustained in the agriculture and services sectors, which are critical to the future economic prospects of developing countries? Or will nations succumb to a growing backlash against reforms, retreating behind their borders and squandering opportunities for growth?

### Benefits of trade

Traditionally, trade liberalization has benefited developing countries through two important channels. First, when tariffs are lowered, relative prices change and resources are reallocated to production activities that raise national incomes. The tariff reductions implemented after the Uruguay Round of trade talks was concluded in 1994 raised national incomes by an estimated 0.3–0.4 percent. Second, much larger long-run benefits accrue as economies adjust to technological innovation, new production structures, and changing patterns of competition. These benefits will be as important in the future as they have been in the past.

In addition, new empirical research indicates that trade liberalization has powerful effects on the performance of firms:

- Increased imports were found to discipline domestic firms in Côte d'Ivoire, India, and Turkey, forcing them to bring prices closer to marginal costs, thereby reducing distortions created by monopoly power.

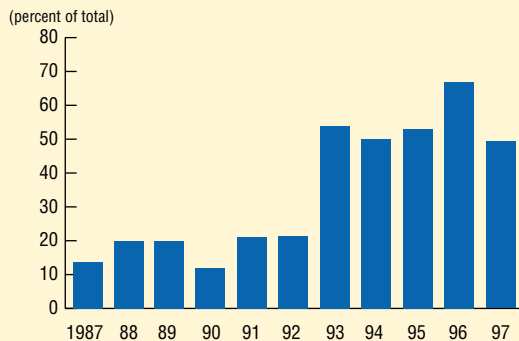
- Trade liberalization can permanently raise a firm's productivity, as the firm gains access to up-to-date capital equipment and high-quality intermediate inputs at lower prices. Some firms in Korea and Taiwan Province of China, for instance, increased productivity by diversifying their use of intermediate inputs.

- Productivity rises when businesses are exposed to demanding international clients and the "best practices" of overseas competitors. Domestic firms may also benefit from the opportunity to reengineer foreign firms' products. Indeed, differences in the productivity of exporting and nonexporting firms often diminish once the latter begin selling products abroad, as studies from Colombia, Mexico, Morocco, and Taiwan Province of China show.

### Promoting liberal trade regimes

World trade owes its robust development to the international institutions that have encouraged countries to remove or lower trade barriers. The General Agreement on Tariffs and Trade (GATT) carried out this

### New users initiated an increasing number of antidumping suits during 1987–97



Source: Jorge Miranda, Raul A. Torres, and Mario Ruiz, 1998, "The International Use of Anti-Dumping: 1987–1997" (Geneva, World Trade Organization). Reprinted from World Bank, *World Development Report 1999/2000* (Washington).

role for five decades, until its successor, the World Trade Organization (WTO), was established in 1995. The WTO, which has its headquarters in Geneva, serves the developing countries' interests by facilitating trade reform, providing a mechanism for settling disputes, strengthening the credibility of trade reforms, and promoting transparent trade regimes that lower transaction costs.

These benefits explain why developing countries have joined the WTO in increasing numbers. In 1987, 65 developing countries were GATT members. In 1999, WTO includes among its members 110 developing and transition countries whose exports account for approximately 20 percent of world exports.

The growing number and complexity of the issues negotiated at the WTO have prompted questions about the adequacy of the technical expertise available to developing countries in their national capitals and at their missions in Geneva, however. In 1997, industrial countries sent an average of 6.8 officials to follow WTO activities in Geneva; developing countries sent an average of 3.5. Because they are not as well represented in Geneva, developing countries have difficulties negotiating favorable trade agreements and using the dispute-settlement mechanism effectively. To tackle this problem, the World Bank, in conjunction with other multilateral institutions, has developed the Integrated Framework for Trade and Development in the Least-Developed Countries, which is described in the World Bank's *World Development Report 1999/2000*.

### Sustaining reform momentum

Policymakers now confront the task of maintaining the momentum toward trade reform created by the completion of the Uruguay Round trade negotiations and of many high-profile regional trading initiatives. Concerns about the effect of trade—particularly on income inequality, poverty, and the environment—and about financing social safety nets have

received much attention in recent years. Some observers fear that increased competition from imports is hurting domestic labor—and, in fact, may be the cause of the widening income inequality observed in some industrial economies—and are calling for trade liberalization to be slowed, halted, or even reversed. If this were to happen, the number and size of export markets open to developing countries would shrink.

The idea that increased imports are linked to rising income inequality is highly controversial. With a few exceptions, empirical research has found that imports from developing countries have minor effects on wages and employment in industrial countries. This research does not deny that income inequality is increasing, but it does suggest that erecting new trade barriers is unlikely to solve this pressing problem. Furthermore, there is little economic justification for treating workers affected by trade competition in a different way from workers affected by domestic competition, macroeconomic shocks, the adoption of new technology, or any other economic change that necessitates adjustment. Economic adjustment policies should aim to reduce the adverse impact of all shocks, whatever their source.

Although heightened competitive pressures—stimulated by trade reform—enhance national welfare, they are poorly received by import-competing firms. These firms are leading a backlash against trade liberalization in both developing and industrial countries. In addition to lobbying policymakers, import-competing firms use antidumping laws—which are still permitted by WTO rules—to allege injury from products dumped by foreign competitors (a good is said to be dumped if its export price is less than either the price in its home market or the average cost of production). Antidumping laws enable countries to impose duties on foreign products that are found to have been dumped and to have caused "material injury" to a domestic industry.

Until the early 1990s, the main users of these laws were Australia, Canada, the European Community, New Zealand, and the United States. Recently, however, a number of developing economies, such as Argentina, Brazil, India, Korea, Mexico, and South Africa, have also begun to use them. In the late 1980s, developing countries initiated less than 20 percent of all antidumping actions; by the late 1990s, that figure had climbed to about 50 percent (see chart). Developing countries have also become the targets of antidumping actions at close to the rate of industrial countries.

The growing use of antidumping actions against foreign firms threatens to undermine one of the key benefits of global trade rules: stable and predictable access to foreign markets. Even though there is no economic rationale for doing so, antidumping laws treat competition from foreign firms differently than competition from domestic firms. The parity between foreign and domestic firms could be restored by an international agreement to eliminate antidumping laws and to apply national policies governing domestic competition to competition from imports. In other words, if an

antitrust issue exists, it must be dealt with; otherwise, pricing decisions should be left to individual firms.

### The next 25 years

Should the global trading system succeed in overcoming these challenges, how can further reform stimulate growth? In the early decades of the twenty-first century, trade reform in two areas—agricultural products and services—in combination with the growth of international production networks and urban development, will transform global commerce.

**Trade in agricultural products.** Rising consumer incomes are shifting demand toward high-value-added agricultural products and away from frozen, canned, and processed homogeneous goods. Falling transportation costs enable firms to supply new markets with fresh products. Furthermore, by increasing the variety of agricultural products available, advances in biotechnology may have an important impact on developing countries whose climates sustain only a narrow range of basic agricultural crops. But exports can be constrained if a country's domestic infrastructure and trade regulations do not permit speedy delivery. Fears about product safety that lead to calls for banning imports of certain foods can also constrain export growth. The debate over agricultural trade policy is likely to encompass not just market access but also methods of production.

The Uruguay Round agreement on trade in agricultural products laid the foundation for future liberalization. Countries agreed to convert nontariff agricultural barriers into tariffs and to set the latter at or below a certain level (the "bound" tariff rate). Similar ceilings were agreed upon for export and domestic subsidies. The advantage of this approach is that it converts a wide range of trade distortions into three observable trade policies, with maximum levels that can be negotiated down over time. Unfortunately, many countries took advantage of this opportunity to convert their nontariff barriers into extremely high bound tariffs. For three widely traded commodities—rice, coarse grains, and sugar—many governments set the maximum tariffs well above the actual tariffs collected in 1986–88.

These tariffs are highly damaging. First, by raising domestic prices above world prices, they make food more expensive for consumers. Second, they increase the costs of domestic food-processing firms, making them less competitive in export markets. Third, the artificial expansion of the domestic agricultural sector boosts the demand for resources, making the latter more expensive for the rest of the economy. These economic costs must be added to those created by export subsidies for agriculture and the taxes that finance these subsidies. The next round of multilateral trade negotiations should seek substantial reductions of both agricultural trade barriers and market barriers created by state-owned

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monopolies that trade in agricultural products.

Advances in biotechnology have introduced a new factor into agricultural trade policy—sanitary and phytosanitary regulations. Sometimes these regulations are particularly blunt instruments, imposing restrictions on imports that go well beyond what is needed to protect human health. However, governments have legitimate concerns about protecting the well-being of their citizens. The Agreement on Sanitary and Phytosanitary Measures, negotiated during

the Uruguay Round, strikes a balance between these concerns and unnecessary restrictions by ensuring that regulations do not deliberately discriminate against foreign suppliers. A core requirement is that domestic standards be based on scientific evidence, and nothing prevents those standards from being higher than international norms. But even seemingly unobjectionable regulations based on scientific evidence can be disputed, and the implementation of this agreement will place further burdens on the WTO's dispute-settlement mechanism. The experts hearing the cases brought before the WTO may well have to assess each protagonist's scientific case as well as the implications for international trade.

**Trade and foreign investment in services.** Changes in technology, demand, and economic structure will make the exchange of services an increasingly important form of trade in the twenty-first century. Falling communication costs and the use of common international standards for some professional services contributed to the 25 percent jump in trade in services in 1994–97. The stakes in liberalizing trade in services are high because most industries use services as inputs to production. Manufacturing industries need cheap and reliable access to global communication and transportation networks to maintain export performance. With products becoming increasingly time-sensitive—the result of shorter product lives and “just-in-time” production—foreign buyers must be assured that a supplier can deliver needed goods on time. Inefficient transportation systems can prevent domestic industries from joining global production networks.

The same core principles underlie trade policy reforms in services and goods. Measures that give foreign firms increased access to domestic markets will enhance competition, lower prices, improve quality, and boost national welfare. But trade policy for services must take into account important issues that do not arise in goods trade. Trade in services generally involves the movement of people or capital across national boundaries, particularly when new subsidiaries are established. As a result, opening services to international competition may require changes in policies governing foreign direct investment and migration, both temporary and permanent.



Simon J. Evenett was a member of the team that produced the World Bank's *World Development Report 1999/2000*.

The Uruguay Round produced the General Agreement on Trade in Services (GATS), whose principal contribution was to establish a framework of trade rules across service sectors. Its coverage of service sectors and supply modes is limited, however. Under GATS, only 25 percent of the service sectors in industrial countries and a paltry 7 percent in developing countries will be fully exposed to international competition.

Restrictions in industrial nations on the temporary migration of people and the establishment of businesses currently impede the supply of certain labor-intensive services, such as construction services, in which developing countries have a comparative advantage. Looking forward, there is substantial room for the further liberalization of many service sectors in both developing and industrial economies. Because the competitiveness of these sectors differs across countries, negotiations that encompass a wide range of sectors, rather than just a few sectors in which one country (or group of countries) has an advantage, offer the most room for mutually beneficial agreements.

### Smoothing the path

The impressive trade reforms developing countries have undertaken in recent years have yielded substantial economic benefits. But sustaining the momentum of trade reform will be a key challenge for the next 25 years. The continued liberalization of the agricultural and service sectors, in particular,

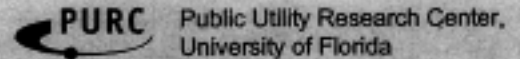
will deliver considerable benefits to developing economies.

The social consequences of the new openness to trade have been associated with a series of economic adjustments, such as regional and sectoral disparities and internal migration to cities. Labor market institutions, including schemes to enhance labor mobility and improve skills, need to be strengthened to smooth the adjustment to trade reform. Policymakers must ensure that the considerable gains from trade reform are widely shared by all segments of the population, reassuring those who suffer initially from the launch of reforms that their long-term welfare will be secure.

Maximizing the opportunities for development offered by expanding international trade will require a stable and predictable framework of institutions. Codifying the rights, responsibilities, and policies of all parties in broad-based institutions will smooth the path of trade liberalization and development reform over the next 25 years. The next round of trade negotiations provides an excellent opportunity to pursue such a wide-ranging approach to trade policy reform.

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