



HARNESSING THE POLITICAL ECONOMY IN SUPPORT OF AN OPEN MULTILATERAL TRADING SYSTEM

Report on a special seminar at the 150th session of the Trade Committee

Background

The Trade Committee was originally established in September 1961, one of the first committees to be established after the signing of the OECD Convention. In light of the mission given to the Organisation by the Convention, which includes supporting a strong and open multilateral rules-based trading system, the Committee has always been seen to play a major role in OECD's work.

To mark the occasion of the 150th session of the Trade Committee, a special seminar was held in the new OECD Conference Centre on the afternoon of 6 May 2008. This seminar provided an occasion for Committee Members, Observers and a few guests to reflect on the continuing importance of the Committee's role. The theme of the seminar was "Harnessing the political economy in support of an open multilateral trading system". In this way, the seminar provided a forum for an exchange of views on the rapidly evolving challenges facing the multilateral trading system. Today, that system operates in quite different circumstances and must respond to a very different range of stakeholders' interests and concerns from those existing in 1961 when the Trade Committee was established.

- Progress in trade and investment liberalisation and rapid technological change have contributed to impressive economic growth characterised by globalisation and the intensification of international networks for production and marketing, which in turn have led to strong growth in trade and investment.
- At the same time, the benefits of open, multilateral rules-based trade are increasingly questioned by different stakeholders. Especially noticeable has been the growth in concern about trade-related risks (to employment, security, health and safety, environment, climate change, etc.). In addition, the distribution of benefits has evolved significantly, both internationally and domestically, but with the perception that some parts of the world and of national societies continue to be disadvantaged. Related to this is the institutional challenge of responding in a timely way to the needs of a dynamic multilateral trading system in which over 150 countries are now participating.

Opening statement

The seminar was opened by Angel Gurría, the Secretary General of the OECD. Stressing the importance of trade as an engine of growth, he congratulated the Committee on its past accomplishments and its current focus on new challenges. He recognised the extremely useful work recently done or planned by the Committee in such fields as trade relations with the BRIICS, trade and structural adjustment, horizontal analyses such as trade and environment or aid for trade, the evolving patterns of comparative advantage, the political economy of trade policy, the development of indicators of restrictions to trade in services, etc. Through such work, the Committee has been providing strong support to the international community by contributing to improved understanding of trade policy issues and options, with relevance both for and after the current round of multilateral negotiations. He expected that the seminar would provide further dynamism to this important process.

The Secretary General's introductory comments were followed by short presentations by four distinguished panellists:

- *Alejandro Jara*, Deputy Director General of the WTO
- *Simon Evenett*, Professor of International Trade and Economic Development, University of St. Gallen, Switzerland

- *Geza Feketekuty*, Distinguished Professor of Commercial Policy, Monterey Institute of International Studies, California, USA
- *Shujiro Urata*, Professor of Economics, Graduate School of Asia-Pacific Studies, Waseda University, Japan

Summaries of the presentations are provided below, followed by a short analysis of some of the major comments made by participants during the general discussion.

Panellists' presentations

Alejandro Jara: A future agenda

Recognising the vigorous efforts made to conclude successfully the DDA, Alejandro Jara noted that many challenges would remain after this Round.

In terms of issues actually negotiated in the DDA:

- Agriculture will remain a major issue for the future since this is the first time a serious attempt has been made in multilateral negotiations to liberalize trade in agriculture. Whatever progress may ultimately be made in this round, there will remain broad scope to further liberalize this sector in the future, e.g. because many tariffs will remain high.
- On NAMA, liberalization based on the “Swiss formula” will flatten the tariff profiles of many Members, although for some developing countries in particular they will remain relatively high.
- As for services, liberalization through trade negotiations remains elusive. Despite increasing recognition of the economic importance of the services sector, little progress in liberalisation has been made through trade agreements. Some perceived reasons for this include: an apparent absence of trade-offs among different services or between services and other fields; and the desire to exclude certain services sectors. In contrast, most progress has come through unilateral liberalization, although most of this so far is unbound multilaterally. Services will need intensive work in the future, probably on a sectoral basis.

Future multilateral negotiations will take place against this background and in the context of major new challenges that require strengthened international cooperation, as in fields such as climate change, energy, sustainable development and food prices and supplies.

A further important issue will be the institutional evolution of the WTO, including the disciplines and rules that constitute legal obligations. Questions arise concerning the quality of the rules: How good are WTO rules? Do they make economic sense? Are they abused? These questions will need to be addressed, e.g. with respect to antidumping measures; to export subsidies, where commitments are made in different areas, as through the OECD's work on export credits; to safeguards, where it has proven easy to circumvent the disciplines.

One particular institutional issue that deserves attention is WTO decision-making. Consensus should remain the basis of decision-making in the WTO but perhaps there should be more scope for flexibility. The possibility of plurilateral negotiations (though not plurilateral agreements) has been suggested, based on achieving “critical mass” among the negotiating countries. In this case, the decision to negotiate a particular area/issue should be made on the basis of multilateral consensus; there should be no barrier to any Member participating in the negotiations; and all benefits should be applied on an MFN basis.

Another institutional issue for future attention is likely to be the surveillance and monitoring of government measures. Governments frequently perceive that it is risky for them to be internationally transparent, and they therefore avoid notification. The 2006 World Trade Report detected an important lack of compliance with notifications on subsidies. In agriculture, some major trading partners have taken several years to provide data on domestic support expenditures. This is a serious issue because the complete or partial lack of notifications impairs ability to uphold Members' rights: if relevant information is not provided or is not publicly available, how can it be determined whether a measure is in breach of a WTO obligation?

Several possibilities exist for strengthening international disciplines with respect to transparency. One would be to generate disincentives or penalties when notifications are not made; in the fisheries subsidies negotiations it has been proposed that, in the absence of notification, there will be a rebuttable presumption that a subsidy is prohibited or otherwise in breach. Alternatively, the capacity of the Secretariat could be enhanced to collect factual information, as with respect to RTAs or through the TPRM. Such information could support more widespread peer reviews.

Finally attention will need to be paid to new issues, or issues that have not been well developed in the WTO system. Careful and open analysis is called for. For example: new rules/disciplines for foreign investment are in the making under bilateral/regional agreements, including in trade agreements. Yet this is without multilateral control. Although investment rules are usually applied on a non-discriminatory basis, partners to an international agreement covering investment enjoy more guarantees and rights, and this may have impact on investment flows and allocation of resources.

A particular issue that is not new but far from resolved is special and differential treatment for developing countries. So far, some SDT appears to work: e.g. the extended timeframe provided for implementation of TRIPS by developing countries. But because one size does not fit all, discussions of SDT have led to the emergence of sub-groups within the group of developing countries: countries that are least developed, small and vulnerable, net food-importing, highly indebted, small islands, landlocked, etc. In some circumstances, SDT can be *à la carte*, as envisaged in the DDA trade facilitation negotiations – where the extent to which a developing country implements an obligation would be linked to its individual capacity to do so, drawing as necessary on technical assistance and capacity building.

Simon Evenett: Changing trade policy landscape and future trade policy priorities

In his presentation, Simon Evenett examined four pervasive economic and corporate factors that are likely to reshape the trade policy priorities of OECD countries and their major trading partners. Against this framework, he outlined recommendations based on research findings, often very recent research. Some of these factors confirm the importance of existing trade policy initiatives, others point to new initiatives.

The first issue examined was the *determinants of export performance* by European and North American firms and economies. Recent studies have not emphasised the importance of tariff barriers as the critical determinant of corporate export behaviour. Instead the costs of entering a market (adapting a product to local needs, local regulations, etc), which are often borne up-front before exporting or paid on a recurring lump-sum basis, have been emphasised. These costs tend to be a lump-sum and have to be paid whatever the quantity of products that is eventually sold. The proper inference to draw here for policymaking is not that remaining tariff barriers are unimportant (especially in the emerging markets where average bound rates are still high), rather that potential exporters have an interest in measures that seek to reduce the uncertainty, burdens, and country-specificity of non-tariff measures and corporate standard-setting bodies. Further attention to strengthening the TBT, SPS, and Trade Facilitation rules in the WTO would, therefore, seem warranted. Moreover, the importance of a broad "behind-the-border agenda"

that strengthens trade rules on transparency, procedural fairness, and non-discrimination in domestic regulatory enforcement.

The second issue analysed was the *factors driving the overseas expansion of firms from the emerging markets*. The highest productivity European and North American firms have been found to be aggressive foreign direct investors abroad, taking their established commercial advantages abroad. This group of firms, which tend to be the largest exporters, have a strong interest in foreign policies that influence the profitability of overseas investments.

With respect to multinational firms based in emerging markets, their corporate strategies often look beyond low cost-based competition towards other sources of profitability. These firms seek to augment their cost advantages with the skills, brands, and products to compete with Western firms - a point that may have implications for the trade policy priorities of the OECD's emerging market trading partners. Rather than develop these traits internally many of the former have decided that the fastest way to break into Western markets is to buy the latter. Foreign acquisition, therefore, has become a priority for many successful emerging market firms. (Acquisition has also been the preferred strategy of many such firms when expanding in other developing countries too.) Confidence in the certainty and openness of national investment and competition (in particular, merger-related) regimes therefore becomes very important. Moreover, since these multinationals from the emerging markets tend to come from the largest developing countries, this suggests that a potential shift in the positions of Brazil, India, and China towards certain of the Singapore Issues could be possible over the medium term. Finally, presumably having acquired brands and research and development facilities, such emerging market firms will have a stronger interest in the protection of intellectual property (which provides much of the foundation for the basis upon which they expect to compete in the future.)

The third part of this presentation concerned the *rising price of energy*, in particular oil. No doubt firms in OECD countries will continue to react to higher prices of energy by adopting more energy-intensive production and distribution methods. However, there is likely to be some geographical reallocation of supply chains. For example, the proportion of parts and components sourced by European firms from Asia may fall and that to "near Europe" rise. In turn, this could alter the priorities of European firms and have implications for strengthening European commercial policy linkages with its "neighbours." Similar dynamics can be expected in other OECD nations. A simulation of this situation shows how very high oil prices would shorten the supply chains of a North American consumer products company, reducing the amount of outsourcing to (in this case) Mexico.

Finally, policymakers often worry about the *present state of global trade imbalances*. Very recently, however, three international trade economists have prepared a sophisticated analysis that sought to simulate the consequences for wages, GDP, and manufacturing sectors of each country eliminating its manufacturing goods trade surplus or deficit. This analysis has inadvertently revealed some information about which countries might have a strong incentive in the further opening up of foreign markets - so as to limit the downward adjustment in their countries' nominal wages and GDPs (relative to the respective world average) needed to expand exports and shrink trade deficits. Their analysis simulates the impact on national GDPs and wages if products that are currently being exported can only be shipped to existing export destinations and if those products can be shipped to new export destinations.

Greater access to foreign markets is found to cushion (reduce) the downward adjustment in nominal wages and relative GDPs in Australia, Canada, Greece, New Zealand, Portugal, Spain, and the United States. The magnitudes involved are significant. For example, with the opening of new export markets the downward pressure on U.S. nominal GDP and wages is halved. (The corresponding adjustments are smaller in the EU member states.) All of these industrialised countries, therefore, may have a strong stake in further opening of foreign markets if pressures to reduce global trade imbalances intensify. In contrast,

Brazil, China, and India see the extent to which their national incomes catch up with the world average reduced if new markets become available to the world exporters. (Mexico's catch up, however, is accelerated by new market opening.) This suggests that the unravelling of global trade imbalances could induce a North-South divide as to the merits of launching future trade initiatives to open up markets on a worldwide basis.

Geza Feketekuty: Lessons for future work of the Trade Committee

The globalization of economic activity -- the globalization of production platforms, the globalization of firms and the globalization of markets -- creates a powerful push for the globalization of economic governance. Globalization is no longer a matter of choice unless we want to roll back the productivity gains associated with technological change and global economies of scale. Global economic governance follows from the globalization of the production process.

In this perspective, how can the Trade Committee best contribute to the collective challenge faced by trade policy officials in smoothing the transition to a globalized economy and the development of global economic governance? Three particular questions were posed regarding the future work of the Committee:

- First, how can the Committee contribute to a better public understanding of the process of globalization: of the link between consumer products, the technology underlying today's goods and services, and the global economies of scale needed to develop and apply the technologies?

In this regard, Professor Feketekuty suggested that the Trade Committee might usefully build on past collaborative work in OECD to explain why national economies of scale are no longer sufficient to support the development and production of technology-intensive goods and services, and why global economies of scale and the resulting globalization of production are necessary for the production of the advanced goods and services that are being consumed around the world.

- Second, how can the Committee contribute to a greater public acceptance of the policy changes needed to support technology-intensive production and globalization?

Here, Professor Feketekuty suggested that the Committee should pursue its consideration of the fears that underlie public attitudes towards globalization. While most of these concerns need to be addressed by national governments through appropriate domestic policies, an open international dialogue could clarify a number of things: the extent to which public fears about economic adjustment are widely shared; best practices for domestic policies that respond to such concerns; and the socially acceptable pace of liberalization. Such a dialogue might also help to establish a better appreciation of the extent to which the economic challenges faced by developing economies are similar to or different from the challenges faced by developed economies, which would create a better understanding of the possibilities for collective global action in trade-related domestic policy areas.

- Third, how can the Committee contribute to a clearer understanding by trade officials of their role in global economic governance, in particular through trade agreements and the WTO?

Professor Feketekuty proposed that the Committee focus on developing a better understanding of how global economic governance is evolving. Among other things, this would involve taking stock of the range of issues being addressed in bilateral and regional free trade agreements; of how global standards and codes of conduct are being developed in different policy areas; of the extent to which liberalization and reform of national policy are proceeding today on an autonomous basis; and of how negotiations in the WTO relate to negotiations on the same set of issues in other forums. In regard to the latter issue, global economic governance today is based on a complex mosaic involving hundreds of organizations, initiatives

and ad hoc arrangements. The trade community needs to develop a clearer picture how trade negotiations, both inside and outside the WTO relate to the broader system of global economic governance.

In looking toward the future of global economic governance, two particular challenges were flagged:

- In what manner should the various bilateral and regional free trade agreements be consolidated, either outside or inside the WTO? To lay the foundation for such a future consolidation process, the trade community needs to obtain a better collective understanding of the content of these agreements. A large number of studies have been done, but it would be useful to pull together a comprehensive analysis.
- After most barriers at the border have been eliminated, what should be the future role of the WTO with respect to domestic regulations that hamper trade and the efficient functioning of the global economy?

The need for a comprehensive understanding of the role of global economic governance becomes particularly critical with respect to regulatory reform and the liberalization of trade in services. An analysis of what rules and standards are being developed where should lead to a better understanding of the role of the trade policy community beyond the Doha Round and how it should be linked to rule making in other international forums.

In summary, the world trade policy community is at a cross roads. The optimal and most practical path forward in trade negotiations is no longer clear. The Trade Committee, in cooperation with the Secretariat and other committees of the Organization, can play a very useful role in developing a clearer picture of the landscape, and the available options open to trade officials in most effectively supporting the global process of liberalization and reform of trade and investment and the development of a coherent system of global economic governance. Whatever happens with the Doha Round, the trade policy community will need to think carefully about the future direction of the WTO as an institution and as a negotiating forum, and this Committee is ideally suited to build the analytical foundation for a global dialogue.

Shujiro Urata: Future trade policy priorities

Shujiro Urata commented on future trade policy priorities by expanding on four basic points:

First, the importance of trade and investment for mature economies such as Japan. As economies need to adapt to a declining labour force, it is increasingly necessary to boost technical progress and to improve productivity. Essential policies in this regard include market openness for trade and investment and domestic reform. However, it often proves difficult to implement them, particularly simultaneously.

Second, the need to incorporate a political economy perspective in the making and implementation of trade policy. Incentives for policy reforms today are provided mainly by crises (unexpected developments) or external pressure. In such cases, strong political leadership is needed to ensure that reform can be successfully carried out and that there will be coherence between trade and domestic policies. In this light, Professor Urata thought it would be very interesting if OECD could conduct a study of the costs and benefits of trade policy pursued in the past.

Third, market openness can be improved not only through tariff liberalisation but also by strengthening the efficiency of customs and other border procedures. As tariffs have declined in recent years, the importance of trade facilitation is increasingly clear.

Fourth, while recognizing the great expansion in recent years of regional trade agreements, governments will want to be sure that the RTAs bring benefits to the multilateral trading system. Part of the benefits will come through enabling liberalization through little steps – letting local producers become accustomed to it before it is extended on an MFN basis. A further crucial element of the value added comes through the fostering of economic co-operation among governments. Given that there is by now a significant backlog of experience about RTAs, Professor Urata thought it would be enlightening if OECD could undertake a study of the impact of RTAs on the economies of different countries.

Discussion and conclusion

Participants in the seminar welcomed the panellists' presentations and followed them up by commenting on some of the points they contained and making additional points.

There was considerable interest in how best to underpin global governance by building a strong WTO system for the future. This would require stricter policy coherence within and between governments. One aspect of coherence has emerged from the interaction between trade and domestic policies, as is evident in regulation for both product markets and for services. Another aspect is the need to take into account the significant increase in recent years of inequality in wealth distribution. Efforts need to be made to address the problems of very poor countries, and of very disadvantaged parts of society, so that the benefits of globalisation can be more widely shared. It was not clear whether the WTO would be able to deal effectively with the complex social issues that arise today in the context of globalisation.

Participants in the seminar reflected on the shape of the future multilateral system and how to adapt trade rules so that they respond effectively to stakeholders' expectations in the evolving global economy. Several comments were made on how to ensure a well-functioning WTO in the future. One participant stressed that the WTO was working well today, especially as an institution to manage trade, where its role in dispute settlement was particularly successful. It is of course also a forum for trade negotiations, but that is only part of its mission. A number of questions were raised about the shape and nature of future trade agreements, e.g.:

- Would the single undertaking still be a useful approach in the future? In contrast, some interest was expressed in the idea of making greater use of plurilateral negotiations, as suggested by DDG Jara. Such negotiations would require a "critical mass" of participating countries and the results would be applied on an MFN basis.
- What is the future of consensus-based decision-making in the WTO? Can an OECD-style process of reflection, analysis and discussion contribute to the building of consensus in the WTO?
- Despite increasing protectionist feelings in many countries toward inward foreign investment, is it likely that an agreement on investment could be negotiated in the WTO?
- In light of the evolving nature of trade restrictions in a globalised world, should greater efforts be exerted to advance market openness through the convergence and harmonisation of regulation?
- Will there be a trend toward consolidating RTAs? Some OECD countries have begun considering this approach to multilateralising regionalism.

Considering the issues raised in the seminar overall, participants recognised that it is important for governments to understand and respond convincingly to economic change and to the expectations of stakeholders concerning the future trading system. Given increasing stakeholder perceptions of risk associated with international trade, governments need to face squarely the political economy challenges

inherent in designing and implementing trade policy and, more broadly, in achieving an effective system of global economic governance. This will be essential in order to ensure support for an open multilateral trading system that delivers benefits to all.

Most of the questions raised in the seminar were left open for future analysis and reflection in the Trade Committee, along with the suggestions for future work. In fact, this process has already begun, through the Committee's development of a medium-term strategy over the past year and its implementation through the 2009-10 Programme of Work and Budget. Contributing to this momentum is the development of more focused working methods, such as the "systemic policy discussions" now being organised at Committee meetings, and the keener emphasis on communicating the results of its work with stakeholders. Participants agreed that the Trade Committee, through study and reflection on questions such as those raised at this special seminar, should be able to make in the future a very significant contribution to the maintenance and strengthening of a well-functioning multilateral trading system.