



WORLD TRADE  
ORGANIZATION



**WTO POLICY ISSUES  
FOR PARLIAMENTARIANS**

# FOREWORD

## BY THE WTO DIRECTOR-GENERAL

*Promoting, openness, fairness and predictability in international trade for the benefit of humanity...*

We all now know that no nation alone can ensure clean air, an efficient tax system or face the great challenges of our age without the cooperation of others. That's why we created international institutions and agreements such as the United Nations, the World Bank, the International Labour Organization, the Antarctic Agreement and the World Trade Organization.

As the nation state is responsible for negotiating and ratifying these agreements, there is an urgent need for governments to ensure there is accountability and ownership of these institutions by governments. This is a complex challenge.

The WTO is a government-to-government organization. We don't tell governments what to do. They tell us. We operate by consensus, thus every member government has veto power. Our agreements are negotiated by ambassadors or ministers who represent their governments and who, in turn, are responsible for advancing their government's agenda. That's why it is important for parliamentarians and legislators to know about the institutions they own and fund. It is important for them to also know that they have access to an invaluable resource at the WTO Secretariat to help them pass the right rules for their country and for their people.

To me one of the measurements of an ordered society is how we manage differences. Is it by the rule of law or by force? Ours is an imperfect rules based system in need of constant attention. There is growing controversy about the benefits of 'globalization'. It is a vast subject and the focus of a growing debate amongst governments, elected officials and their constituents. In this debate, the role of trade is both praised and criticized. It is defended as the best way forward by governments which see it as a way of achieving greater economic prosperity for their citizens, and yet shunned by the same when the competitive forces of trade hit too close to home and when citizens blame trade for the rapid change in their environment.

It is fine to debate the benefits of trade. But one must not forget the international instruments and rules already in place to control what some call rampant economic expansion at the expense of the weakest and to ensure that trade produces benefits for large and small countries alike.

Governments created the WTO's Agreements for a reason. This guide explains why they did so. It also provides explanations about the important role individual governments play in the WTO and just how much freedom they have to protect their people, their morals, their food and their environment and still benefit from trade. All institutions are imperfect and each can be improved. History and progress is about constant analysis, examination and improvement. We welcome scrutiny and the benefits it brings. I hope you find this short guide useful.

*Mike Moore  
Geneva, Switzerland  
May 2001*

# **WTO POLICY ISSUES FOR PARLIAMENTARIANS**

## **A GUIDE TO CURRENT TRADE ISSUES FOR LEGISLATORS**

The benefits of openness

Non-discrimination

Dispute settlement

Trade and poverty reduction

Sovereign states and international cooperation

Domestic coherence ✓

Citizens and democracy ✓

Governments and civil society ✓

Exceptions, the environment and food safety

Trade-Related Aspects of Intellectual Property Rights (TRIPS)

Trade in Services (GATS)

Trade problems and trade rounds

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## WHY

### HAVE A WORLD TRADE ORGANIZATION?

Trade is central to human health, prosperity and social welfare. Many of the goods we buy, the services we use and the foods we eat depend on foreign trade. Examples of trade in daily life are so abundant they sometimes go unnoticed: people drive to work in a car made in Japan which runs on fuel imported from the Middle East. Others ride bicycles made in China with tyres from Malaysia. A computer might have come from Korea and may run on software from the United States and a morning cup of coffee was most likely imported from Kenya, Colombia, Tanzania or Ecuador.

Trade enriches our lives through greater choice and opens our minds to new ideas and cultures. It binds people together in a dynamic and complex network of mutually beneficial commercial relations. It is a key engine of economic growth. The prosperity trade brings gives people the opportunity to buy the things they value most: an education, access to health care, proper housing and food for their families. It is the job of the World Trade Organization to establish the rules and preserve and nurture this web of commercial activity.

But trade is not entirely a natural phenomenon, it depends on political will. Compare, for example, the starkly different policy responses to two of the most major economic and financial disasters of this century. When crisis set in during the 1930's, the knee-jerk reaction was economic nationalism. As one country raised its tariff barriers, so too did others in retaliation. Trade plummeted, unemployment became entrenched, cooperation between nations broke down and guns, sol-

*Trade is central to human health, prosperity and social welfare.*

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*Exports of manufactured goods by Bangladesh grew at the rate of 10.9% between 1990 and 1998, almost two times faster than the world average of 5.8%. During the same period, the country's GDP per capita grew at 2.8% per annum.*

*Source: WTO Annual Report 2000.*

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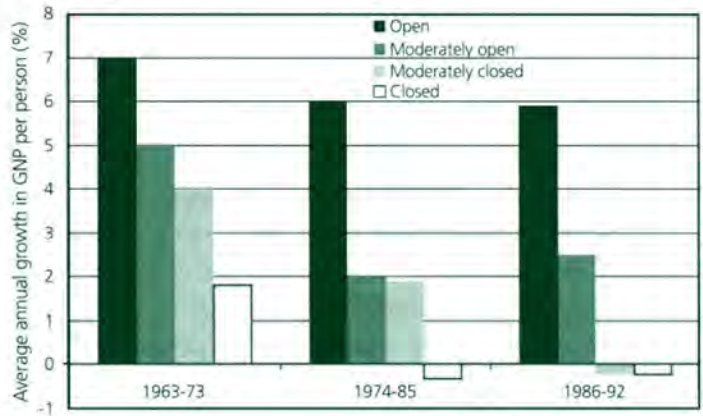
*As average tariffs of GATT and WTO member countries were reduced from 43% in the late 1940s to under 5% today, there has been a 15-fold rise in world trade, representing the biggest boost to economic welfare in the history of the world.*

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*In 1999, developing-country merchandise exports rose by 9%, increasing their share in world exports to 27.5%. The share of developing countries in world exports of manufactures reached nearly 25%, a marked increase since 1990 when it stood at 17%.*

*Source: WTO Annual Report 2000.*

The rewards of openness in developing economies are higher rates of growth



Source: Adapted from APEC Open Economies Delivers to People, 2000.

*Cutting barriers to trade in agriculture, manufacturing and services by a third would boost the world economy by an estimated \$613 billion, according to a new study by Robert Stern of the University of Michigan. That is equivalent to adding an economy the size of Canada to the world economy.*

*The most dynamic exporters of automotive products in 1999 were not the large traditional producers, but rather more recent suppliers like Mexico, the Republic of Korea, the Czech Republic, Hungary and Poland. These countries expanded their exports by double-digit rates not only in 1999, but also throughout the 1990-99 period.*

Source: WTO Annual Report 2000.

diers and tanks took over. The human and economic costs were catastrophic. In stark contrast, when the Asian economies experienced a financial crisis in the late 1990s, markets were kept open and sensible but tough economic policy decisions were taken. This helped contain the crisis and it allowed the Asian nations to export their way out of difficulty. Within a relatively short period of time, these countries were on the road to recovery and fears of worldwide recession were proven unfounded.

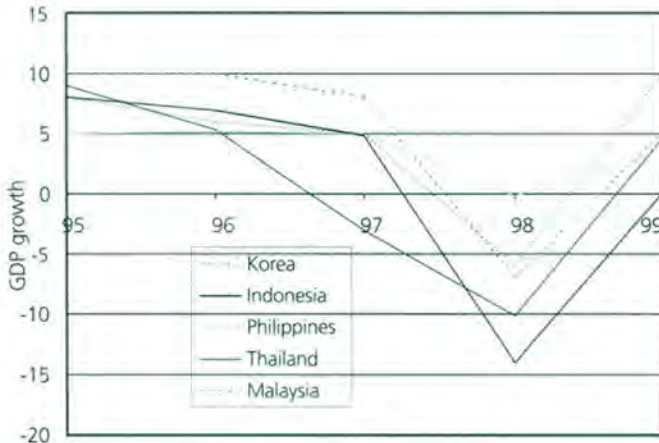
Restoring international economic growth and stability through the promotion of trade was crucial to securing a lasting peace after World War II. It was this vision that led to the creation of the multilateral trading system in 1948. At first this was a provisional agreement between 23 countries called the General Agreement on Tariffs and Trade (the GATT). In 1995, the GATT became the WTO, a fully-fledged international organization with stronger and broader authority. Its membership includes 140 member countries today, each at its own level of economic development and with its own set of economic priorities. Another 30 or so countries—from the Russian Federation, Saudi Arabia and China to Ukraine, Viet Nam and Yemen—are in the process of negotiating their accession to the WTO. Even though the trading system and its membership have changed so much over the years, the underlying goals of the multilateral trading system have remained unchanged to promote openness, fairness and predictability in international trade for the benefit of humanity.

## Openness, fairness and predictability ... the WTO's core functions

Trade, when it is allowed to flow freely, generates economic growth. It encourages specialization which leads to greater gains in productivity and efficiency. It means countries can concentrate their resources on producing the goods they make best and importing goods which are more efficiently produced elsewhere. A more open world trading system means all countries benefit from access to the 6 billion customers in the global marketplace.

Trade can help bring technology and materials needed to create exports and offers consumers a wider range of personal choice in everything from oranges, to cars, to medication and clothes. It encourages competitive pricing and stimulates technological advances. This is why one of the main thrusts of the multilateral trading system is to encourage the removal of barriers to trade. This has taken place through what have become known as "rounds of negotiations" in which participating countries give better access to their markets in return for better access to the markets of other countries. There have been eight trade rounds since the GATT was created in 1948. These initially concentrated on lowering customs tariffs on goods at the border, but have since expanded in scope to address a broader range of measures.

Asian economies rebound after financial crisis



Source: WTO Secretariat

No WTO member government disputes the benefits of freer trade, that is clear. The efforts of 30 governments to join the WTO from China to Vanuatu are a sure signal. So too is the fact that 'self-reliant' development policies or centrally planned 'command' economies have been tried, failed and abandoned. Only those markets which are more open have produced significant and sustained economic growth and prosperity.

"By initiating the procedure of accession to the WTO, the Federal Republic of Yugoslavia wishes to point out and stress the importance it attaches to membership in the WTO, especially having in mind the role of the WTO in the world economy and its contribution to the promotion of international trade as the main pillar of world development."

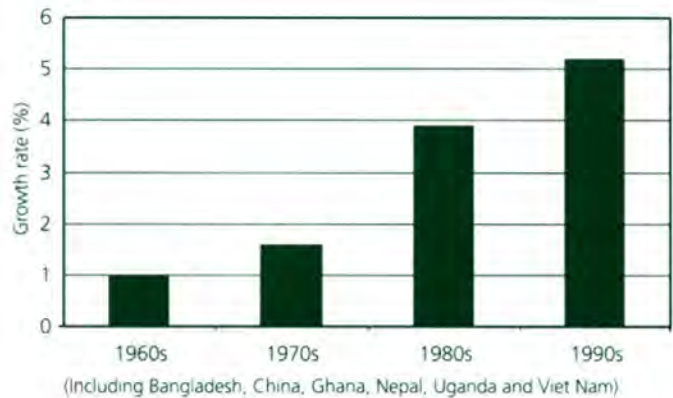
Dr. Zoran Sami, Federal Minister of Transportation, Federal Republic of Yugoslavia, Feb. 2001.

When the WTO members take decisions, it has to be without dissent. Consensus reigns and voting, although provided for, has never been invoked.

A recent study by Jeffrey Sachs and Andrew Warner of Harvard University found that developing countries with open economies grew by 4.5% a year in the 1970s and 1980s—while those with closed economies grew by 0.7% a year. At that rate, open economies double in size every 16 years, while closed ones must wait a hundred.

MFN is a simple but very effective principle; it eliminates differences in economic and political weight between nations and dispenses with favouritism. It provides a self-perpetuating dynamism to the process of trade liberalization. In effect, it means that whenever two trading partners get together to open up trade between themselves, all WTO members benefit.

## Open economies grow faster: 18 rapidly opening developing countries



Source: Dollar and Kray, Trade, Growth and Poverty (forthcoming)

During the Uruguay Round (1986-1994), agriculture and textiles were brought into the multilateral trading system and GATT provisions which discriminated against the interests of agriculture-exporting countries were reformed. Participating countries also agreed to phase out quantitative limits on trade in textiles during a 10 year period. The scope of the WTO's rules was widened to include trade in services, one of the fastest growing and dynamic sectors in the international economy, and trade-related aspects of intellectual property rights (TRIPS). These sectors are now subject to trade liberalization and dispute settlement in the WTO.

## Committed to fair and non-discriminatory trade

The WTO treats all countries alike, be they rich or poor, big or small, strong or weak. The WTO is a system based on rules not power. The rules apply to everyone, even the most powerful economies in the world. Many WTO rules are specifically designed to ensure that fair

trade conditions prevail between trading partners. Central among these are obligations to ensure that trade is non-discriminatory the so-called "most-favoured nation" and "national treatment" rules. The most-favoured nation (MFN) obligation prevents WTO members from discriminating between foreign goods or treating products from one WTO member country better than those from another. For example, if the European Union decides to lower its customs tariff on imports of cocoa from Ghana from 10% to 5%, it must immediately extend this 5% customs tariff on cocoa to all other WTO members which might wish to export cocoa to the EU.

The national treatment obligation prevents governments from treating foreign and domestically produced products differently.<sup>1</sup> This, for example, means that if Venezuela exports the same kind of gasoline into Norway as Norway produces itself, Norway may impose the same high (but not higher) standards on gasoline from Venezuela as it imposes on gasoline of domestic origin.

But there are other obligations designed to ensure that countries are not given unfair advantages over their trading partners. These include rules on dumping and subsidies which can make exports artificially competitive. The issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by taking action to compensate for damage caused by unfair trade.

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*It is clear from all the evidence that the biggest risk for the poorest developing countries does not come from the potential losses that globalization or market opening may pose: the biggest risk is that they may be excluded from the opportunities for growth by continuing barriers to their exports or the maintenance of protected domestic markets.*

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*In a group of 18 developing countries that became much more open to trade after 1980, as measured by rising shares of exports and imports in GDP, the average growth rate accelerated. This group includes most of the world's poor people—among the 18 countries are Bangladesh, China, India, Ghana, Nepal, Uganda and Viet Nam.*

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*A wide range of policies and circumstances contributed to the better performance of the 18 countries, but the association between their increased openness and their faster growth is striking, and is confirmed by detailed statistical analysis.*

*David Dollar and Aart Kraay: Growth is Good for the Poor; World Bank (forthcoming).*

<sup>1</sup> The national treatment obligation does not prevent countries from imposing tariffs (on an MFN basis and not higher than maximum levels bound in tariff schedules) and applies only after goods have been cleared in customs. However, it is treated slightly differently under other different WTO agreements. For example, under the General Agreement on Trade in Services (GATS), it is not unconditional and exceptions to the national treatment principle can be written into country schedules. Special and differential treatment for developing countries in the form of tariff preferences is also allowed as are preferences extended to countries which are part of regional trade agreements.

## Making trade rules predictable and enforceable: the dispute settlement system of the world trading system

Settlement, of course, is the key principle here. During the period 1995-1999, for example, 77 disputes were resolved of which 41 were solved without going to adjudication. Without this system, it would be virtually impossible to maintain the delicate balance of international rights and obligations. Disputes could drag on much longer and have a destabilizing effect on international trade, which, in turn, could poison international relations in general.

The WTO brings stability and predictability to international trade because its rules are legally binding. So too are the schedules of market-access commitments in goods and services that each WTO member negotiates. These set clear ceilings on levels of protection. This encourages trade because it allows exporters to develop and grow their businesses. They have full knowledge of the terms of access and can act and invest with confidence knowing that markets which are opened will remain open.

### Countries involved in WTO disputes since 1995

February 2001

Disputes involving	as complainant	as respondent
United States	69	52
EU	54	31
Japan	8	12
Developing countries	66	82

*The Understanding on Dispute Settlement says the purpose of the dispute settlement system is: "...to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law."*  
(Article 3.2)

The vast majority of international trade goes on smoothly and without dispute. There are, however, rare occasions when members consider that one or more countries have broken their WTO commitments and that this has negatively affected their national industries. It is then that members have the option of using the WTO's dispute settlement system.

Dispute settlement procedures play a central and invaluable role in ensuring that trade conflicts are settled fairly, in accordance with the rule of law and on a timely basis.

Once a dispute is notified to the WTO an established timetable of 'automatic' steps is set in train. The immediate priority is for disputes

to be settled through consultations. If not, then members assembled in the WTO Dispute Settlement Body (DSB) refer a dispute to a panel of experts. Panelists are appointed by agreement between the parties, and by default, by the WTO's Director-General. A panel's recommendations are automatically adopted unless there is a 'consensus against' adoption by all WTO members who together comprise the Dispute Settlement Body. A first instance panel report may be appealed, but the decision by the second instance Appellate Body is final.

The long-term outcome of the dispute settlement process must be complete restoration of full compliance with WTO rules. However, if a country fails to implement a WTO ruling there are two temporary measures which can be taken. Either the offending member can offer 'compensation' for the harm done to the trade interests of another member or the DSB can authorize a level of retaliatory sanctions. But this rarely happens. The vast majority of the more than 220 disputes brought to the WTO so far are settled without fanfare or public contention. Since a main aim of WTO dispute settlement is to contain unilateral imposition of trade sanctions, unilateral retaliation by powerful trading entities is subject to multilateral WTO control.

No one can claim that the WTO's dispute settlement system compensates for an unequal distribution of economic power in the world, but it must be emphasized that this system gives small countries a fair chance they otherwise would not have to defend their rights. By February 2001, developing countries as a group initiated 66 of the 224 disputes. India, Brazil, Mexico and Thailand were the most active. The United States and the European Union have used the system the most, 69 and 54 times respectively, and are also the most frequently challenged by other governments as not being in compliance with the WTO's rules.

#### **WTO agreements cited in disputes since 1995**

SPS/TBT	Agriculture	Textiles	TRIMS	TRIPS	GATS
28	29	15	16	24	11

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*Between 1994 and 1998, 1.3 million new jobs supported by exports of goods and services were created in the United States. Over the same period, total US employment increased by 11.7 million jobs, and the unemployment rate declined from 6.1% to 4.5%. Jobs supported by goods exports pay 13 to 16% above the average wage.*

*Source: "America and the WTO", United States Trade Representative.*

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*Total annual gains to New Zealand from the Uruguay Round were estimated at \$370 million in 2000.*

*Source: "Towards Free Trade" Ministry of Foreign Affairs and Trade, (New Zealand, June 1998).*

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*In East Asia, the poverty rate was almost halved between 1990 and 1998: the largest and most rapid reduction in poverty in history. Though much of the reduction in poverty occurred in China, most countries in the region shared in the steep fall. Poverty rose in 1998 in those East Asian countries hit by financial crisis, but by less than initially feared. A very strong rebound in growth in 1999 and 2000 suggests that the region's prosperity will be quickly reestablished. Per capita GDP for East Asian countries in 2000 exceeded the precrisis level.*

## Isn't the high level of WTO disputes worrying?

Not really. The higher rate of notification of disputes can be interpreted in several different ways. For example:

- as an expression of greater confidence of member governments in the efficacy of the new dispute settlement system. In fact, the dispute settlement system is more predictable, more certain and faster than the former GATT disputes system;
- as a reflection of the wider range of WTO rules and their greater specificity. There is now a much wider range of issues covered by WTO Agreements—including Services and Trade Related Intellectual Property—all of which are governed by the same dispute mechanism;
- as a result of the larger number of WTO member countries, increasing levels of trade and the greater importance of trade in the economies of member countries;

It is true, however, that smaller and poorer countries have capacity constraints. They often do not have the resources to take their trade disputes to the WTO. That is why the WTO has actively endorsed the creation of the Geneva-based Advisory Centre on WTO Law, an independent centre which provides developing countries with legal counsel at reduced costs.

## Trade and jobs and poverty reduction

Trade can be a powerful force for creating jobs and reducing poverty. But liberalization does not always impact favourably on everyone in the labour market. Just as new export opportunities create new jobs in some areas, pressure from foreign competition can sometimes result in jobs being lost in previously protected sectors. One of the most difficult challenges facing legislators, governments and policy-makers is to ensure their citizens cope with readjustments in the labour market and acquire the necessary new skills. These pressures, however, do not just come from greater competition but also from factors such as technological change.

The temptation to resist change is high—particularly as the voices clamouring for protection tend to shout louder and are more emotionally charged than those supportive of trade liberalization. But change is not only inevitable, it is the key to economic growth.

The way in which markets are opened, especially the speed and sequence of market liberalizing steps, can make a big difference to these adjustment pressures.

Economic studies consistently show that market liberalization is associated with higher growth<sup>2</sup> and that growth contributes to the alleviation of poverty.

## Does global trade benefit everyone?

National income growth is the key to a permanent reduction in the level of poverty. But experience confirms that the most likely outcome is that national growth will have a positive effect on the incomes of the poorest parts of a population; possibly because it is generally easier for the government to increase its poverty alleviation efforts if incomes are higher or growing.<sup>3</sup>

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*A recent World Bank study of growth in 80 countries over 40 years shows that, on average, growth in the income of the poor—the poorest fifth of the population—rises about one-for-one with the growth rate of overall per capita income in a developing country. This has been demonstrated by the trade-oriented policies that helped transform East Asia, which represents over a third of developing-country population, from one of the world's poorest regions 40 years ago to the prosperous and economically resilient region it is today.*

*Source: David Dollar and Aart Kraay. Growth is Good for the Poor; World Bank. (forthcoming).*

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*The Tinbergen Institute of Rotterdam, the Netherlands, estimates developing countries would gain \$155 billion a year from further trade liberalization—over three times the \$43 billion in average annual overseas aid.*

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*In East Asia and the Pacific between 1987 and 1998 the number of people living on less than 1 US\$ a day fell from 418 million to 278 million. This was paralleled by a four-fold increase in the ratio of exports of goods and services to GDP.*

<sup>2</sup> MF Issues Brief: Globalization, Threat or Opportunity. Available at <http://www.imf.org/external/np/exr/lb/2000/041200.htm>

<sup>3</sup> Winters, L A *ibid*

*The Irish economy has notched up five straight years of stunning economic performance. No other OECD Member country has been able to match its out-standing outcomes in a variety of dimensions. Output growth has averaged over 9% per year on a GDP basis in the period 1994-98, bringing GDP per capita in purchasing power parity terms to a higher level than the European Union average. This is a far cry from the Ireland of the first half of the 1980s. The reasons for this successful take-off are multiple. An open trade regime, a generally liberal, conducive and transparent regulatory framework, and competitive labour costs were among the factors which transformed Ireland into one of the premier host countries for US foreign direct investment in Europe in the 1990s.*

*Source: Adapted from OECD Economic Survey of Ireland, May 1999.*

Despite the clear plausibility of such a link, open trade alone has not yet been unambiguously and universally linked to subsequent economic growth. It has certainly not, however, been identified as a hindrance. Trade liberalization has a positive role as part of a package of measures promoting greater use of the market, more stable and less arbitrary policy intervention, stronger competition and macro economic stability. Taken as a whole, trade liberalization is a major contributory factor in economic development. <sup>4</sup>

Conversely, when countries close themselves off to global markets, poverty becomes intractable. Inward looking policies in Africa and Latin America depressed growth and squandered opportunities to reduce poverty in the 1970s and 1980s. The centrally planned economies of Eastern Europe and North Asia also performed poorly in part because they were relatively closed.

<sup>4</sup> Winters, L. Alan (2000) "Trade, Income Disparity and Poverty" WTO Special Study No.5 This study is available from the WTO web site at [http://www.wto.org/english/news\\_e/pres00\\_e/pov3\\_e.pdf](http://www.wto.org/english/news_e/pres00_e/pov3_e.pdf)

# GOVERNMENTS

## ACTING TOGETHER CONSTITUTE THE WTO

*The organization is only as strong as the will of its members to abide by the rules*

Member governments agree to be "bound" by WTO Agreements because they see it to be in their own self interest to do so. The success of the WTO depends largely on the willingness of its member governments to abide by its rules and rulings. A pre-condition for this willingness to be "bound" is the negotiation of agreements which are sufficiently clear in their rules and scope, and whose disciplines are workable and mutually accepted.

### Do governments loose sovereignty when they join the WTO ?

"Sovereignty" is a word that connotes different things to different people. It conjures up a wide spectrum of ideas of national pride and independence. In the WTO, sovereignty is understood in several ways. All WTO member governments are "sovereigns" over their "customs territory" By joining the WTO, member governments undertake to make laws that comply with WTO Agreements and to change laws that do not.

Compliance with WTO Agreements does not in any way reduce the right of a government to make laws for its own territories. Most WTO Agreements make no attempt to guide governments on the content of their laws: they concern only the 'external' effects of the laws or regulations. There are some WTO accords, however, such as the Agreement on Trade-Related Aspects of Intellectual Property Rights, the Sanitary and Phytosanitary Agreement and the Agreement on Technical Barriers to Trade, which encourage the harmonization of policies in specific technical areas. But even here, there are exceptions available. Ultimately, WTO Agreements are the result of the exercise of sovereign trade powers by WTO member governments.

*Compliance with WTO Agreements does not in any way reduce the right of a government to make laws for its own territories.*

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*All WTO member governments are treated equally. No matter how great or small an economy may be, a WTO member government enjoys exactly the same rights under the agreements as every other member.*

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*The WTO is not a world government and its members do not wish it to be one. The WTO cannot force compliance upon unwilling governments. A dispute arises only when a member government claims that another member has failed to live up to its WTO obligations.*

The concept of "sovereignty" should be distinguished from that of "interdependence" Sometimes international cooperation on a regime of rules requires governments to make the choice to set limits to their own behavior, with certain exceptions, in the interest of the common good. However, this is not about losing sovereignty but about ensuring that everyone abides by rules which have been mutually agreed. This is not peculiar to the WTO but is the norm for all multilateral rule making organizations. Without such a willingness to set commonly agreed limits on unilateral action, the international system would not be able to function effectively.

### **Does the WTO interfere with domestic policy objectives ?**

The WTO does not make rules about the domestic policy objectives of governments. But it does make rules about the way in which these objectives are achieved. That sometimes limits the sort of things governments can do in domestic policies. But whatever measures a government might choose, one thing is certain: national policies should not discriminate between nationals and foreigners or between foreigners of different origin.

The WTO is only concerned with international trade but some WTO Agreements—like the GATT Agreements that preceded the WTO—have rules about the national regulations of member governments. But such rules are agreed first by all members and then adopted and implemented at the national level.

Why are trade rules required for member governments' regulations? Part of the reason lies in the emergence of non-tariff barriers as a form of disguised protectionism. Some examples of such non-tariff barriers could include domestic regulations on the sale of goods, labelling, pricing, storage and value-added taxation, etc. Member countries negotiate commitments to ensure the transactions which take place at the border are as fair and as open as possible. It would be pointless if the benefits of these commitments were nullified by transactions which re-introduce the protection or discrimination which WTO rules seek to eliminate.

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*"I come from a small country. I see interdependence, and treaties and the great global institutions as guarantors of our sovereignty and safety."*

*"The realities of a more global world make it harder for governments to act independently of each other. Global challenges call for shared and cooperative solutions."  
Mike Moore, April 2001*

## What flexibility is there in the WTO Agreements?

Drawing the line between domestic policy objectives and non-tariff barriers can be difficult. That's why the WTO Agreements are flexible enough to permit member countries to pursue policy objectives other than trade. Reference is always made to international standards whenever appropriate. Also, regulations are covered in WTO rules only to the extent that they apply to traded goods and services.

### WTO Agreements take into account different levels of development and different trade and economic policies

- 1) by the inclusion of longer time-frames for implementation of the rules by developing countries or by allowing developing countries to make lower liberalization commitments, as provided for in the Agreement on Agriculture;
- 2) by the provision of some lower thresholds of compliance by developing countries—particularly the least developed countries; and
- 3) by allowing members time-limited 'waivers' of specified obligations for particular purposes. A number of developed countries (US, Canada, EU) have granted trade concessions to developing and least-developed countries on a unilateral basis and have been granted limited 'waivers' to enable them to maintain these agreements. Other waivers relate to technical deficiencies in the tariff schedules of some member countries.

## Governments, their citizens and the WTO

Some say governments only represent the interests of the leaders, or of the "executive" arm of government, or of the elite members of a society or big business. Governments, so this argument goes, do not really represent the interests of citizens. But this is more about the relationship between governments and citizens than about the relationship between the WTO and citizens. Some advance arguments that the WTO is "not democratic" because it "overrules" legislation passed by democratically elected governments. But this is a misunderstanding. The WTO does not "overrule" national laws, because it has no constitutional powers to do so in any country. The WTO rules, which every member government has agreed in advance, deal with the trade

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*If the claim that "governments do not represent the interests of citizens" were true, then it is something that citizens need to correct at home. It is not something that an inter-governmental body like WTO can deal with. Some form of parliamentary assembly represents citizens under most constitutions. That is where citizens need to exercise their democratic rights.*

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A "democratic deficit" in the

WTO? What exactly is understood by "democracy" in the context of the WTO?

Some say the WTO is "not democratic" because citizens do not participate directly in the work of the WTO. But does this mean the WTO is "not democratic"? After all, the WTO is a treaty among governments and, like other treaties, does not directly include citizens. Only governments can negotiate trade rules for countries. Citizens are expected to be represented at the WTO through their governments.

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Over 90% of all WTO doc-

uments are now available from the WTO website. In addition, a monthly list of

NGO position papers received by the Secretariat is compiled and circulated for the information of WTO member governments. Since April 2000 a monthly electronic news bulletin—with more than 1,300 subscribers—has been available to NGOs, facilitating access to publicly available WTO information.

effects of laws. These decisions are made by consensus, approved by each government and ratified by their respective national parliaments. Parliaments, therefore, have a responsibility to ensure that the legislation they pass or have passed is in conformity with the treaties they approve. WTO member governments are, after all, duty bound to observe their obligations under the WTO Agreement.

And what about a "democratic deficit" in decision-making amongst WTO member governments? The argument that small and poor developing countries are disenfranchised from the decision-making process of the organization is unfounded. All WTO member governments have exactly the same rights under the agreements. All decisions in the WTO are taken by consensus (although voting is legally possible under the WTO treaties) and every member government can potentially veto decisions it does not agree with. This means the least powerful members of the organization can have strong leverage powers. After the Seattle Ministerial Conference, all developing countries, especially the least-developed, unanimously agreed the consensus principle was the best way of safeguarding their interests. Also, if this charge were true, why are there so many small developing countries, from Bhutan to Viet Nam, actively seeking accession to the WTO?

Of course, not all member governments participate in the WTO as effectively as they would like. Some governments, especially from least-developed countries, need assistance to increase their capacity to participate in the WTO. For instance, there is a group of least-developed countries which cannot afford to maintain offices in Geneva. The WTO Secretariat makes extensive efforts to keep these governments informed about WTO activities. And twice a year representatives of governments with no offices in Geneva are invited to the WTO for a week of detailed briefings. However, without additional financial resources, the WTO Secretariat's ability to assist is limited.

## The WTO and NGOs

WTO members have often discussed the possible role of NGOs in WTO meetings. Several submissions by WTO member governments address this issue and WTO members have explained often that gov-

ernments are the ones which represent the interests of all their respective citizens. But that does not mean there is no contact between the WTO's members and representatives of NGOs. The WTO Secretariat, within the mandate given by the member governments, has taken several steps to enhance the dialogue and flow of information to NGOs.<sup>5</sup> The WTO Secretariat organizes symposia for NGOs, provides regular briefings and has a special NGO section on its website with specific information for NGOs. Since the WTO was established, NGOs have attended all WTO Ministerial Conferences.

Throughout the Seattle Ministerial Conference more than 160 meetings (workshops, seminars, private meetings) took place in the NGO centre. As in the case of previous Ministerial Conferences, NGOs were briefed on a daily basis by the WTO Secretariat on the progress of the working sessions. Additionally, NGOs had full access to the press centre located in the official Conference venue. Regardless of the outcome of the Seattle Ministerial Conference and the tumultuous protests accompanying its proceeding, these features have all been welcomed by NGOs as genuine signs of transparency.

Violent outbreaks by demonstrators at both the Geneva (May 1998) and Seattle (November 1999) Ministerial Conferences has made it harder for some NGOs to win the support of the WTO's member governments to do more. WTO members are concerned that NGOs themselves are not directly accountable to the public. And some critics claim that many NGOs do not publish their accounts or make their internal documents available for public scrutiny. Although NGOs may fairly claim to represent a point of view, even a widely held point of view, it would be difficult to agree that NGOs represent citizens in the same way as elected members of a parliament. Nevertheless, many WTO member governments actively seek NGO involvement and encourage them to follow the work of the organization. Representatives of NGOs

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*Many well known international NGOs are global players with more resources than the WTO*

*The WTO budget for 2001 was 134 million Swiss Francs. That's about \$US 91 million. By that measure, the WTO has fewer resources than many well-known international NGOs such as:*

*World Wildlife Fund: SFr 470 million, \$US 305 million.*

*Greenpeace International: EUR 126 million, about \$US 123 million.*

*Source: <http://www.globalpolicy.org/finance/tables/assess.htm> (Dec. 2000).*

*Growing interest of NGOs in the work of the WTO:*

*1st WTO Ministerial Conference in 1996 in Singapore, 108 NGOs were registered.*

*2nd WTO Ministerial Conference in 1998 in Geneva, 128 NGOs were registered.*

*3rd WTO Ministerial Conference in 1999 in Seattle, 686 NGOs were registered.*

<sup>5</sup> Relations with Non-Governmental Organizations (NGOs) are specified in Article V.2 of the Marrakesh Agreement and further clarified in a set of guidelines (WT/L/162) which were adopted by the General Council in July 1996.

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*But just because the WTO has been very effective in ensuring compliance to trade rules does not mean it should now shift its focus towards achieving other policy goals. Most WTO member governments believe that it should not. They agree that the WTO is only a forum for negotiating trade rules and nothing more.*

will again be able to attend the next WTO Ministerial Conference, this time in Doha, Qatar from 9 to 13 November 2001.

Nothing in the WTO's Agreements tells governments how to prepare for negotiations or the consultations they undertake with their citizens. Member governments have repeatedly re-affirmed that they consider themselves responsible for dialogue with their citizens and for determining how best to represent the interests of their countries. Member governments can and often do have wide ranging national-level consultations on trade policy. In some countries NGOs exert considerable pressure at the national level and their views are often included in the trade policy positions taken up by many WTO member governments.

# TRADE VALUES

## DO NOT CONFLICT WITH OTHER VALUES

*If the WTO works for trade, then why not use it to achieve other policy objectives?*

Many look to the WTO to secure further progress on environmental policy, labour standards, human rights, health, culture and social marginalization. They want the WTO to use its rules to enforce 'core labour standards' or to sustain trade sanctions against environmentally damaging production methods.

The WTO simply has no competence in many of the global issues brought to its doorstep. Each global issue has to find its own best policy path. Otherwise, problems are only transferred from one forum to another. It is not optimal to solve all non-trade issues through the WTO.

We do not need to make the WTO the substitute for the international system. After all the UN family of agencies and programmes already exists to fulfil exactly this role. In some cases, the UN's agencies might be strengthened with better enforcement mechanisms so they can act according to their area of institutional jurisdiction. This would be far better than using the WTO to enforce policies outside its competence.

### It's not just about trade ...

Trade is not an end in itself—and neither is trade liberalization. Several important human welfare goals underpin the WTO Agreements: improving employment opportunities and productivity, improving food supply and food prices, ensuring better access to health education and information services. But it is up to governments to decide how to meet such objectives. Trade can help provide the means. Trade and other non-economic values can be mutually complementary provided that governments abide by the rules. For example, a government's

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*"Some have suggested using trade rules to achieve goals with respect to labour, the environment and human rights. I believe instead that full use should be made of the United Nations system to pursue such goals. To attempt to use the multilateral trading system to solve problems in these and other areas would place it under great strain, and would be much less effective than adopting policy solutions in the sectors themselves"*  
*Opening statement by Kofi Annan, Secretary-General of the United Nations to the 1998 ECOSOC meeting.*

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*"Trade does not provide a "one size" fits all solution and seeking answers to a wide variety of problems is as unrealistic and inefficient in the international sphere as it is in the national setting where one government Ministry might be doing the work of another."*

*The WTO simply has no competence in many of the global issues brought to its doorstep.*

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*General exceptions—such as those in Article XX of the GATT 1994—allow governments to do what is necessary to achieve certain policy goals to safeguard health, the environment and public morals.*

*And there are specific exceptions. The Sanitary and Phytosanitary (SPS) Agreement takes into account the need to protect human, animal or plant life or health.*

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*The WTO has not made any rulings that limit the rights of governments to make laws to protect their environment or to safeguard their citizens from safety or health risks.*

food and health standards can be the strictest in the world but they should not discriminate against foreign imports by imposing higher standards on foreign products than those applied to domestic suppliers.

The globalization of markets makes the interaction between trade regulations and other health and environmental regulations very common. The WTO Agreements provide governments with the appropriate flexibility they need to meet their objectives.

Governments do not want to be prevented from restricting imports that may pose unacceptable risks to health or to their environment. But that does not mean they are willing to accept protectionism in the name of protecting health. There is a difference between the two stances. All member governments agree it is possible to avoid both protectionism and policies that could cause harm to human health.

But the path between the two is very narrow. So agreements are usually very carefully worded to say how, and in what circumstances, an exception may be used. At the same time, we should not forget that the benefits of trade can lead to the attainment of desired non-economic objectives.

Governments may resort to the WTO's Sanitary and Phytosanitary Agreement to protect human, animal or plant life and health but should do so only if:

- there is a sound scientific reason for the restriction (if not, they may take provisional measures while seeking additional information necessary for a more objective assessment of risk);
- the government uses the minimum level of import restriction necessary to achieve its goals; and
- the government does not apply the import restrictions in a way which discriminates between the exports of other WTO member countries.

These rules are about ensuring the lowest possible level of trade restrictions and avoiding discriminatory import regulations. Why? Because discrimination disrupts trade, creates conflict between governments and is costly for producers and consumers.

## SOME DIFFICULT QUESTIONS

### Environmental issues

There is a lot of misunderstanding of recent WTO disputes involving government environmental or health regulations.

In fact, in its decision on the case brought by India and others against the United States' laws prohibiting certain imports of shrimp (the 'shrimp-turtle' case), the Appellate Body of the WTO explicitly ruled that governments have every right to protect human, animal or plant life and health and to take measures to conserve exhaustible resources. The WTO does not have to "allow" them this right. It is a given, ensured by Article XX.

The rulings do not attack environmental policies. The dispute arose because the protection measures concerned treated foreign suppliers less favourably than domestic suppliers, or discriminated among foreign suppliers or were more trade restrictive than necessary to achieve the desired environmental objective. Article XX clearly states that measures taken to protect exhaustible natural resources, for example, should not be applied arbitrarily or cause unjustifiable discrimination between countries where the same conditions prevail. Nor should they serve as a disguised restriction on international trade. This is clearly contrary to the fundamentals of fair and open markets—and the rules of the WTO.

The WTO does have rules about the trade impact of policies that protect animal, human and plant health. It also has rules about the trade impact of product labeling. But these rules do not specify which policies governments should have; they specify only that regulations and policies should not discriminate and that any trade measures—such as import barriers—should be no more restrictive than necessary to achieve credible policy objectives.

An example of an environmental issue which involved fundamental WTO principles concerns a WTO dispute which arose because the United States, in an effort to improve its air quality, applied stricter rules on

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*Of course, most governments which have signed an MEA are also members of the WTO, so it would be reasonable for members of civil society to expect governments which are members of both Agreements, to ensure the provisions negotiated in each domain do not conflict.*

*This distinction between decisions directed at the trade impact and decisions directed at the policies themselves is important. The WTO has no rules on the impact of environmental regulations on trade—unless you count the requirement that no government regulations or policies should lead to trade discrimination among members.*

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*Charlene Barshefsky, the former United States Trade Representative, acknowledged in October 1999 that "the United States has not relaxed any environmental law or health or safety law in order to comply with any WTO ruling" (several of the cases were 'lost' by the US). She explained that where changes to US laws were made, this was to remove any discrimination in the treatment of foreign companies and US companies.*

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*The WTO, like its predecessor the GATT, does not permit its member governments to distinguish between products that have the same characteristics ('like' products) based on differences in the way they were produced. Why? Because to do so would bring the rules into conflict with the very basis of the gains from trade: differences in comparative advantage.*

*But a recent ruling by the Appellate Body in early 2001 concerning asbestos and products which contain asbestos found health risks to be relevant in the determination of the likeness of products under the national treatment clause.*

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*"The WTO puts no restrictions on the power to create or enforce such laws. In fact, its basic charter says member countries can take any trade measures they like to "protect human, animal or plant health". All the WTO says is that members should not use trade as a weapon when other issues, such as the environment, are at stake."*

*The Globe and Mail,  
Toronto, Canada  
1 March 2001.*

the chemical characteristics of imported gasoline than it did for domestically-refined gasoline. Venezuela (and later Brazil) said this was unfair because US gasoline did not have to meet the same standards—it violated the "national treatment" principle and could not be justified under exceptions to normal WTO rules for health and environmental conservation measures. The dispute panel agreed with Venezuela and Brazil. The appeal report upheld the panel's conclusions (making some changes to the panel's legal interpretation). The United States agreed to amend its regulations.

**Multilateral Environmental Agreements and the WTO**

The WTO does cooperate with the MEAs and the relationship between the WTO and the Multilateral Environment Agreements (MEAs) has been remarkably smooth. The WTO includes MEA representatives as observers in its meetings and the Secretariat has been mandated by member governments to develop close cooperation with them. No dispute has so far arisen as the result of a conflict between a member's obligations under the WTO and under an MEA. But the potential for conflicts should not be underestimated and WTO member governments continue to study potential implications. Also, most MEA's do not contain trade provisions, so it would be reasonable to hope that the opportunity for conflict between the trade organization and the environmental organizations would be minimal.

It seems possible, then, that trade measures that are required by MEAs in pursuit of environmental objectives that are—by multilateral consensus—'legitimate' and not merely a disguised restriction on international trade would be found to fall within the exceptions of Article XX. In the shrimps dispute, for example, no party questioned the WTO-consistency of measures taken by member governments to honor their obligations under the CITES Treaty (to protect endangered species). The consistency of such MEAs with exceptions allowed under Article XX is therefore not only possible, but very likely.

## Risk assessment and food safety:

Complex scientific and technical issues frequently need to be taken into account when making decisions in the areas of environment, health and many other areas of public policy. In such cases assessments are needed to identify the potential outcomes of a decision—for example, whether to approve or not approve a class of drugs for public use—but also of the different risks that are associated with alternative outcomes—for example, whether the risk of harm from unintended side effects is greater than the risk of harm from the disease.

In globalizing economies it is inevitable that there are trade impacts from some of these policy decisions. The WTO will probably face more and more requests for dispute resolution in matters that involve difficult decisions about scientific evidence, risk and public policy. Already, in cases such as the EU ban on beef treated with hormones, or Australian bans on salmon that could contain fish parasites, WTO panels were asked to rule on whether a policy took account of sound scientific evidence and appropriate assessments of risk. In the two cases cited, the governments were found to have acted without proper scientific justification.

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*Eco-labeling: Some have suggested that one way around the 'production processes' problem is to have countries use 'eco-labeling' to allow consumers to make informed choices. This is already the case in some countries which label products containing genetically modified organisms (GMOs).*

*But the labeling option is not as straightforward in practice as it seems: developing countries in particular are strongly opposed to measures that allow rich countries to pass national trade rules to impose on them production standards or processes as a condition of accessing export markets.*

*While countries have every right to use the highest standards, developing countries increasingly ask to be consulted before such measures (which can have devastating effects on their exports) are passed by national parliaments.*

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*How could a conflict, if it arises, be dealt with? Since there has been no Panel recommendation or Dispute Settlement Body decision on a case involving such a conflict, the WTO has not been asked to decide on this issue. But there is a clue. In the decisions on the 'Shrimp-turtle' case, the Appellate Body said the legitimate environmental objectives of the US regulation—protection of an endangered species—would justify an exemption from WTO obligations under Article XX of GATT (the 'General exceptions' clause)<sup>1</sup>. The Appellate Body made it as clear as possible that a member is free to frame its own environmental laws or to act in accordance with plurilateral or multilateral agreements in pursuit of 'legitimate' environmental objectives. If a member's laws are not unjustifiably discriminatory or a disguised restriction on international trade, then laws that are necessary to achieve these environmental objectives are likely to be covered by the General Exceptions of Article XX.*

<sup>1</sup> *The US lost the case, not because it sought to protect the environment but because it discriminated between WTO members and thus failed to meet the full requirements of Article XX.*

## **Precautionary principle**

This principle of administration can be used by governments when there is no readily available science to guide a decision in matters such as health, safety or the environment and where the risks appear to be great.

The UN Convention on Biodiversity—a multilateral environment agreement (MEA) with which WTO cooperates—formally endorsed in 2000 the 'precautionary principle' as an approach to dealing with novel genetic materials. It is not difficult to see that there is a potential for conflict over whether a decision is truly 'precautionary' or is merely disguised protectionism: the difference between 'precaution' and 'protection' may well depend on what is an 'acceptable' level of risk associated with the decision.

## Intellectual Property Rights (TRIPS)

Ideas and knowledge are an increasingly important part of trade. Most of the value of new medicines and other high technology products lies in the amount of invention, innovation, research, design and testing involved. Many products that used to be traded as low-technology goods or commodities now contain a higher proportion of invention and design in their value—for example brand name clothing or new varieties of plants.

The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is an attempt to narrow the gaps in the way these rights are protected around the world, and to bring them under common international rules. The areas covered by the agreement include copyright and related rights, trademarks, including service marks, geographical indications, industrial designs, patents and the layout designs of integrated circuits. The agreement addresses how member governments are to give adequate protection to intellectual property rights and how countries should adequately enforce those rights. It also states how disputes over intellectual property rights are to be settled at the WTO and contains special transitional arrangements.

### Striking a Balance ...

The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) attempts to strike a balance between the long term social objective of providing incentives for future inventions and creation, and the short term objective of allowing people to use existing inventions and creations.

The balance works in three ways:

- Invention and creativity in themselves should provide social and technological benefits. Intellectual property protection encourages inventors and creators because they can expect to earn some future benefits from their creativity. This encourages new inventions, such as new drugs, whose development costs can sometimes be extremely high.
- The way intellectual property is protected can also serve social goals. For example, patented inventions have to be disclosed, allowing others to study the invention even while its patent is being protected. This helps technological progress and technology dissemination and transfer. After a period, the pro-

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*For something to be patentable, it has to be an invention—which includes meeting tests of novelty and inventive step. The scope of the patent right only extends to the invention and not to any underlying genetic material.*

tection expires, which means that the invention becomes available for others to use. All of this avoids "re-inventing the wheel".

- The TRIPS Agreement provides flexibility for governments to fine tune the protection granted in order to meet social goals. For patents, it allows governments to make exceptions to patent holders' rights such as in national emergencies, anti-competitive practices, or if the right-holder does not supply the invention, provided certain conditions are fulfilled.

### **Access to medicines**

Under the TRIPS Agreement, governments can make limited exceptions to copyright, trademark and patent rights, provided certain conditions are met. For example, the exceptions must not "unreasonably" conflict with the "normal" exploitation of the patent.

In addition, some countries allow manufacturers of generic drugs to use the patented invention to obtain marketing approval—for example from public health authorities—without the patent owner's permission and before the patent protection expires. The generic producers can then market their versions as soon as the patent expires. This provision is sometimes called the "regulatory exception" or "Bolar" provision.

The TRIPS Agreement says governments can also act, again subject to certain conditions, to prevent patent owners and other holders of intellectual property rights from abusing intellectual property rights, "unreasonably" restraining trade, or hampering the international transfer of technology.

An issue that has received a lot of public attention is the question of how people in low income countries can have access to patented or trademarked drugs, which are often expensive. Proposed answers cover a wide range of issues involving entire healthcare systems. As far as intellectual property is concerned, the TRIPS Agreement allows governments to take actions to improve access to drugs, provided certain conditions are met. Two that are often discussed in public are compulsory licensing and parallel or grey-market imports.

### **Compulsory licensing in general:**

The TRIPS Agreement also allows WTO member governments to authorize use by third parties (compulsory licenses) or for public non-commercial purposes (government use) without the authorization of the patent owner. The grounds on which this can be done are not limited by the agreement, but the agreement contains a number of conditions that have to be met in order to safeguard the legitimate interests of the patent owner. Briefly, two of the main conditions are:

- an effort must have been made first, as a general rule, to obtain a voluntary license on reasonable commercial terms and conditions;
- adequate remuneration must be paid to the right holder in each case, taking into account the economic value of the license.

### **TRIPS and the Convention on Biodiversity (CBD)**

A main concern about the preservation of biodiversity is the enormous potential that genetic resources have for enhancing the welfare of mankind through their use in biotechnology.

Intellectual property rights are an important part of providing the incentives for research and development in biotechnology, in both developed and developing countries, and thus for the realization of these benefits. Intellectual property rights can also be the subject of benefit sharing arrangements with countries or communities that have supplied the underlying genetic material.

Some recent proposals by a number of WTO member governments seek to use the TRIPS intellectual property regime to make the principles of the CBD more effective, for example by requiring patent applicants to disclose the geographical origin of any genetic material used in the invention in question and also to demonstrate that the necessary prior informed consent was obtained from the competent authority in the country of origin.

In regard to the relationship of the TRIPS Agreement to the preservation and sustainable use of biodiversity, it should be emphasized that for something to be patentable under the TRIPS Agreement, it must be an invention. This means that the patenting of biological material in its natural state, so-called "bio-piracy", is inconsistent with the principles of the TRIPS Agreement.

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*While the TRIPS Agreement deals with the intellectual property side, it is silent on the issues addressed in the Convention on Biodiversity (CBD) of the rights of countries to regulate access to biological resources in their territories on the basis of the principle of prior informed consent and of arrangements for benefit-sharing. This silence means that the TRIPS Agreement leaves governments free to legislate in accordance with the requirements of the CBD on these matters.*

### **Traditional knowledge of indigenous peoples**

A related problem that is sometimes raised is that of the patenting of traditional knowledge. Because traditional knowledge is not new, this would be inconsistent with the principles of the TRIPS Agreement. However, it can happen by error because much traditional knowledge is not recorded in databases that can be consulted by patent examiners when they decide whether or not to grant a patent. Efforts are being made, both at national and international levels to remedy this problem by drawing up appropriate databases. One organization undertaking this work is the World Intellectual Property Organization (WIPO) in Geneva. Another concern is that the intellectual property system does not provide sufficient opportunities for the communities where the knowledge originated to protect it from use by others. This concern relates to other traditional cultural manifestations, such as folklore.

The debate also focuses on whether the existing intellectual property system should be complemented with forms of protection directed to issues relating to traditional knowledge, especially of indigenous and local communities. The study of these matters has begun in WIPO and proposals for WTO action were made in the preparations for the Seattle Ministerial Conference. It is recognized that this issue gives rise to complex and difficult questions. For example, while some intellectual property rights are potentially indefinite in duration, such as trademarks and geographical indications, a key feature of the main intellectual property rights relating to creations and inventions is that, after a temporary period of protection, such creations or inventions fall into the public domain and become freely usable by mankind.

### **Geographical indications**

Geographical indications are place names (and sometimes words closely associated with a place) that are used to describe the origin and characteristics of a product. Examples include Bordeaux wine, champagne and Roquefort cheese. Terms that are now used generically (such as cheddar cheese) outside their original locality do not have to be protected.

The TRIPS Agreement says that normally countries have to protect geographical indications in order to prevent consumers from being misled. For wines and spirits, the agreement provides a higher level of

protections, i.e. even where there is no danger of the public being misled.

Some countries want the higher level of protection extended beyond wines and spirits to include such products as Parma ham, Darjeeling tea, basmati rice, beers, other agricultural products and handicraft. Countries which propose extending the higher level of protection to other products say it is illogical to treat wines and spirits as special. Some of them have said they may be even more willing to negotiate actively in the current agriculture talks (which began in 2000) if they see progress in extending higher-level protection to these products. Some other countries oppose extending this protection to other products. They say the present agreement reflects a delicate balance of interests both within TRIPS and between TRIPS and the previous agriculture negotiations in the 1986-1994 Uruguay Round negotiations.

## Services, the GATS

The General Agreement on Trade in Services (GATS) is the first and only set of multilateral rules governing international trade in services. It was developed by WTO Member governments in response to the huge growth of the services economy over the past 30 years and the greater potential for trading services brought about by the communications revolution.

When the idea of bringing rules on services into the multilateral trading system was floated in the early to mid 1980s a number of countries were sceptical and even opposed. They believed such an agreement could undermine governments' ability to pursue national policy objectives and constrain their regulatory powers. The agreement which was developed, however, allows a high degree of flexibility, both within the framework of rules and also in terms of the scheduling of commitments. This is one of the reasons why, of all the WTO agreements the GATS has been the least controversial among Member governments. New negotiations to liberalize trade in services began on 1 January 2000 and the working atmosphere has been extremely positive with agreement being reached in late March 2001 on a set of broad guidelines and procedures for the negotiations ahead.

Paradoxically, however, as concerns among governments have diminished, the GATS has recently come under the spotlight of often hos-

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*The Agreement which covers trade in services is called the GATS and its origins date back to the Uruguay Round. Services represent the fastest growing sector of the global economy and account for 60% of global output, 30% of global employment and nearly 20% of global trade.*

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*Exports of commercial services by all countries rose by 1.5% in 1999 to reach \$1,350 billion annually. Even developing countries profited from services trade. In Africa for example, commercial services exports expanded by 8.5% in 1999 (mainly due to improved tourism revenues in Egypt) and represented the strongest increase anywhere in the world.*

tile public attention. Most of the criticisms and concerns expressed essentially revolve around three key issues; the status of public services, the right to regulate and the developmental dimension of the GATS.

### **The GATS does not threaten the right of governments to maintain public services**

It has been claimed that the GATS jeopardizes the right of governments to maintain public services such as health and education services. This, however, is simply not the case. Governments remain free to chose those services sectors on which they want to make binding commitments to liberalize. Governmental services are explicitly carved out of the agreement and there is absolutely nothing in the GATS which forces privatization of services industries or outlaws governmental or indeed private monopolies.

The GATS "bottom-up" approach to scheduling of commitments means that governments are not obliged to make commitments on the whole universe of services sectors, but retain the right to specify the sectors on which they will take commitments. This means that governments who do not want to bind levels of foreign competition in a given sector, because they consider it to be a core governmental function or indeed for any other reason, are free not to include it in their schedule. In this event only the minimal obligations such as transparency and the obligation to not discriminate between foreign suppliers<sup>6</sup> apply. But even when commitments are made on particular services sectors, the GATS allows governments to exercise a great deal of control over the operation of foreign suppliers in the domestic market. These take the form of limitations to market access and national treatment which are written, often in great detail, into country schedule of commitments.

The existence of a carve-out for services supplied in the exercise of governmental authority is an explicit commitment by WTO member governments to allow publicly funded services in core areas of their responsibility. Governmental services are defined in the agreement as those supplied neither on a commercial basis nor in competition with other suppliers. These services are not subject to any GATS disciplines, they are not covered by the negotiations and commitments on market access and national treatment do not apply to them.

<sup>6</sup> One-off exemptions to the MFN obligation have been taken by Members on entry into force of the WTO Agreement, and can be taken by acceding members. These should, in principle not exceed a period of 10 years.

## **Liberalization under the GATS does not mean deregulation**

Equating services liberalization with deregulation is a common misperception. The GATS does not require the deregulation of any service. Commitments to liberalize do not affect the right of Governments to set levels of quality, safety, price or introduce regulations to pursue any other policy objective as they see fit. A commitment to national treatment, for example, would only mean that the same regulations would apply to foreign suppliers as to nationals. It is out of the question that 140 governments would have signed up to an agreement which undermined their right to set qualification requirements for doctors or lawyers or their ability to set standards to ensure consumer health and safety—and WTO members have not done so.

The development of rules on domestic regulation across all services sectors is currently in progress. The intention of these rules once they are agreed, will be to ensure that qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services. The objective of this exercise is to prevent the use of disguised restrictions.

Already disciplines<sup>7</sup> have been developed for the accountancy sector and these provide a good example of a possible outcome of future work. These are essentially about transparency and fair process. They do not say anything about the level of professional qualifications or standards for accountants except that they should not be more trade-restrictive than necessary to achieve the legitimate objective they seek. This means that if two or more measures exist which can achieve the same objective, one should choose the measure with the least trade restrictive impact on trade. It does not mean that governments would have to compromise the level of quality or consumer protection they are seeking to achieve through the regulation in question.

## **The development dimension of the GATS**

Concerns about the development implications of the GATS are essentially focused on the investment aspect of the agreement. Many critics appear, however, to be confused about the scope of the GATS and the Multilateral

<sup>7</sup> The accountancy disciplines only apply to accountancy commitments and will come into force at the end of the current round of negotiations.

Agreement on Investment which was negotiated but never agreed in the OECD and which was quite fiercely opposed by some NGO and civil society groups.

These two agreements, however, are completely different. The GATS does not address policies for foreign direct investment *per se*. It simply makes it possible for governments, if they so wish, to make commitments on the supply of services through establishment, subject to whatever conditions they may wish to apply. Any legal obligations that members undertake in relation to certain aspects of their investment regimes are only incidental to the supply of the service in question.

Some critics have suggested that investment in the supply of services in developing countries may be to their disadvantage in holding back the development of domestic service industries. This view, however, has never been echoed by developing countries in the WTO, who are perhaps in a better position to judge what is in their best interests. Certainly the prevalence of developing-country commitments on the supply of services through foreign establishment suggests that they are keen to attract foreign investment rather than shield themselves from it. Many developing countries have also used the agreement to advance their development agendas by stipulating that foreign establishment must be tied to criteria such as local employment quotas, universal service provision, training requirements and the transfer of technology.

# NEGOTIATIONS

## THE WTO'S FUTURE

The world is changing faster than we realize. Technology, transportation and communication systems allow thoughts, people, goods and services to travel thousands of miles in seconds or hours. This stimulates business flows and development and inventions.

The role of the WTO's Agreements is to make sure that trade flows freely and that possible conflicts are resolved by the parties involved or by the WTO's dispute settlement mechanism. But what about new forms of business now being conducted over the internet? And what about new ways of manufacturing or growing food and concerns over consumer health and safety. Such issues need to be addressed at the national and international level and in a rules-based framework, especially since they may have implications and repercussions the world over.

That is why new rules to address these issues must be negotiated by governments. The WTO, with its role as a forum for negotiation, is seen by its members as the place to conduct such talks. And many have called for these issues and older ones in need of greater clarification to be included in a new trade round. The world moves ahead and governments see it as necessary to address today's critical issues before they become obstacles to international trade.

There is a problem, however, when it comes to which issues should be addressed first. Each country has its own list of concerns. This is a result of each country's differing economic interests and level of development. Negotiating new rules for sustainable development might be a valid goal for an industrialized country but poorer countries view such moves differently. They can often not afford to adapt their production methods to higher standards. Nor are they in agreement about negotiating new international rules in this area.

*The role of the WTO Agreements is to make sure that trade flows freely and that possible conflicts are resolved.*

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*Douglas and McIntyre's export sales have increased from 23% of total sales two years ago to 31% in 2000. More than 80% of their exports go to the United States, 16% head to Europe, and 3% to Japan and Australia. "There has been a subtle shift in emphasis in the last five years to exports being critical and central to what we do. We have changed our publishing program to focus more on the international market." Scott McIntyre, President, Douglas and McIntyre Publishing Group, Vancouver, British Columbia.*

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*The WTO puts some basic limits on subsidies that interfere with international trade. But the existing rules cannot adequately deal with subsidies that cause overfishing—and even rules that simply require subsidies to be reported to the WTO are widely disregarded. Fortunately, momentum is building for the WTO to take a serious look at agreeing new fishery subsidies rules in the next few years.*

*WWF-World Wide Fund for Nature brochure issue summary no. 19/99.*

### **Further trade liberalization can help governments meet environment and development objectives**

Citizens the world over worry about their future and the future of their children. What will the world's environment be like in 25 years and how safe will our food be in a quarter of a century down the road? How many people will have risen out of poverty? Many feel these international problems require international solutions. But this is not always the case. As most of us know, achieving good environmental policies often starts at home. But there are actions taken by national governments which have international consequences. For example, subsidies for farmers in many industrialized countries result in over production and an increased use of fertilizers which endanger ground water supplies. The same subsidies and other barriers to food imports in those countries which can afford to subsidize their farmers decreases chances for developing countries to be competitive in their food exports. This is a situation where national policies do little to improve the environment and make it even harder for poorer agriculture export nations to realize the benefits of trade and to use the earnings for improving their social welfare.

What happens in farming is also applicable to fishing, forestry and mining. Correcting these policy positions is central has been at the forefront of discussions ever since the Uruguay Round of multilateral trade talks was launched in 1986. Policies which harm the environment or do little or nothing to foster economic development are also regularly discussed by member governments in the WTO's Councils and Committees. They are also the subject of campaigns led by such organizations as the World Wide Fund for Nature, Greenpeace and Oxfam which advocate the achievement of win-win situations—with positive benefits for the environment and development objectives.

# ANNEX I

## WILL THE NATION-STATE SURVIVE GLOBALIZATION?

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Author: Martin Wolf

### Defining globalization

A specter is haunting the world's governments—the specter of globalization. Some argue that predatory market forces make it impossible for benevolent governments to shield their populations from the beasts of prey that lurk beyond their borders. Others counter that benign market forces actually prevent predatory governments from fleecing their citizens. Although the two sides see different villains, they draw one common conclusion: omnipotent markets mean impotent politicians. Indeed, this formula has become one of the clichés of our age. But is it true that governments have become weaker and less relevant than ever before? And does globalization, by definition, have to be the nemesis of national government?

Globalization is a journey. But it is a journey toward an unreachable destination—"the globalized world." A "globalized" economy could be defined as one in which neither distance nor national borders impede economic transactions. This would be a world where the costs of transport and communications were zero and the barriers created by differing national jurisdictions had vanished. Needless to say, we do not live in anything even close to such a world. And since many of the things we transport (including ourselves) are physical, we never will.

This globalizing journey is not a new one. Over the past five centuries, technological change has progressively reduced the barriers to international integration. Transatlantic communication, for example, has evolved from sail power to steam, to the telegraph, the telephone, commercial aircraft, and now to the Internet. Yet states have become neither weaker nor less important during this odyssey. On the contrary, in the countries with the most advanced and internationally inte-

grated economies, governments' ability to tax and redistribute incomes, regulate the economy, and monitor the activity of their citizens has increased beyond all recognition. This has been especially true over the past century.

The question that remains, however, is whether today's form of globalization is likely to have a different impact from that of the past. Indeed, it may well, for numerous factors distinguish today's globalizing journey from past ones and could produce a different outcome. These distinctions include more rapid communications, market liberalization, and global integration of the production of goods and services. Yet contrary to one common assumption, the modern form of globalization will not spell the end of the modern nation-state.

### The past as prologue

Today's growing integration of the world economy is not unprecedented, at least when judged by the flow of goods, capital, and people. Similar trends occurred in the late nineteenth and early twentieth centuries.

First, the proportion of world production that is traded on global markets is not that much higher today than it was in the years leading up to World War I. Commerce was comparably significant in 1910, when ratios of trade (merchandise exports plus imports) to GDP hit record highs in several of the advanced economies. Global commerce then collapsed during the Great Depression and World War II, but since then world trade has grown more rapidly than output. The share of global production traded worldwide grew from about 7% in 1950 to more than 20% by the mid-1990s; in consequence, trade ratios have risen in

almost all of the advanced economies. In the United Kingdom, for example, exports and imports added up to 57% of GDP in 1995 compared to 44% in 1910; for France the 1995 proportion was 43% against 35% in 1910; and for Germany it was 46% against 38% in the same years. But Japan's trade ratio was actually lower in 1995 than it had been in 1910. In fact, among today's five biggest economies, the only one in which trade has a remarkably greater weight in output than it had a century ago is the United States, where the ratio has jumped from 11% in 1910 to 24% in 1995. That fact may help explain why globalization is more controversial for Americans than for people in many other countries.

Second, by the late nineteenth century many countries had already opened their capital markets to international investments, before investments, too, collapsed during the interwar period. As a share of GDP, British capital investments abroad—averaging 4.6% of GDP between 1870 and 1913—hit levels unparalleled in contemporary major economies. More revealing is that the correlation between domestic investment and savings (a measure of the extent to which savings remain within one country) was lower between 1880 and 1910 than in any subsequent period.

Historical differences exist, however. Although current capital mobility has precedents from the pre-World War I era, the composition of capital flows has changed. Short-term capital today is much more mobile than ever before. Moreover, long-term flows now are somewhat differently constituted than in the earlier period. Investment in the early twentieth century took the form of tangible assets rather than intangible ones. Portfolio flows predominated over direct investment in the earlier period (that trend has been reversed since World War II); within portfolios, stocks have increased in relative importance to roughly equal bonds today. And finally, before 1914, direct investment was undertaken largely by companies investing in mining and transportation, whereas today multinational companies predominate, with a large proportion of their investment in services.

Today's high immigration flows are also not unprecedented. According to economists Paul Hirst and Grahame Thompson, the greatest era for recorded voluntary mass migration was the century after 1815. Around 60 million people left Europe for the Americas, Oceania, and South and East Africa. An estimated ten million voluntarily migrated from Russia to Central Asia and Siberia. A million went from Southern Europe to North America. About 12 million Chinese and 6 million Japanese left their homelands and emigrated to eastern and southern Asia. One and a half million left India for Southeast Asia and Southwest Africa.

Population movement peaked during the 1890s. In those years, the United States absorbed enough immigrants to increase the U.S. population from the beginning of the decade by 9%. In Argentina, the increase in the 1890s was 26%; in Australia, it was 17%. Europe provided much of the supply: the United Kingdom gave up 5% of its initial population, Spain 6%, and Sweden 7%. In the 1990s, by contrast, the United States was the only country in the world with a high immigration rate, attracting newcomers primarily from the developing world rather than from Europe. These immigrants increased the population by only 4%.

As all of this suggests, despite the many economic changes that have occurred over the course of a century, neither the markets for goods and services nor those for factors of production appear much more integrated today than they were a century ago. They seem more integrated for trade, at least in the high-income countries; no more integrated for capital—above all for long-term capital—despite important changes in the composition of capital flows; and much less integrated for labor.

So why do so many people believe that something unique is happening today? The answer lies with the two forces driving contemporary economic change: falling costs of transport and communications on the one hand, and liberalizing economic policies on the other.

## The technological revolution

Advances in technology and infrastructure substantially and continuously reduced the costs of transport and communications throughout the nineteenth and early twentieth centuries. The first transatlantic telegraph cable was laid in 1866. By the turn of the century, the entire world was connected by telegraph, and communication times fell from months to minutes. The cost of a three-minute telephone call from New York to London in current prices dropped from about \$250 in 1930 to a few cents today. In more recent years, the number of voice paths across the Atlantic has skyrocketed from 100,000 in 1986 to more than 2 million today. The number of Internet hosts has risen from 5,000 in 1986 to more than 30 million now.

A revolution has thus occurred in collecting and disseminating information, one that has dramatically reduced the cost of moving physical objects. But these massive improvements in communications, however important, simply continue the trends begun with the first submarine cables laid in the last century. Furthermore, distances still impose transport and communications costs that continue to make geography matter in economic terms. Certain important services still cannot be delivered from afar.

Diminishing costs of communications and transport were nevertheless pointing toward greater integration throughout the last century. But if historical experience demonstrates anything, it is that integration is not technologically determined. If it were, integration would have gone smoothly forward over the past two centuries. On the contrary, despite continued falls in the costs of transport and communications in the first half of the twentieth century, integration actually reversed course.

Policy, not technology, has determined the extent and pace of international economic integration. If transport and communications innovations were moving toward global economic integration throughout the last century and a half, policy was not—and that made all the difference. For this reason, the growth in the potential

for economic integration has greatly outpaced the growth of integration itself since the late nineteenth century. Globalization has much further to run, if it is allowed to do so.

## Choosing globalization

Globalization is not destined, it is chosen. It is a choice made to enhance a nation's economic well-being—indeed, experience suggests that the opening of trade and of most capital flows enriches most citizens in the short run and virtually all citizens in the long run. (Taxation on short-term capital inflows to emerging market economies is desirable, however, particularly during a transition to full financial integration.) But if integration is a deliberate choice, rather than an ineluctable destiny, it cannot render states impotent. Their potency lies in the choices they make.

Between 1846 and 1870, liberalization spread from the United Kingdom to the rest of Europe. Protectionism, which had never waned in the United States, returned to continental Europe after 1878 and reached its peak in the 1930s.

A new era of global economic integration began only in the postwar era, and then only partially: from the end of World War II through the 1970s, only the advanced countries lowered their trade barriers. The past two decades, by contrast, have seen substantial liberalization take root throughout the world. By the late 1990s, no economically significant country still had a government committed to protectionism.

This historical cycle is also apparent in international capital investments. Capital markets stayed open in the nineteenth and early twentieth centuries, partly because governments did not have the means to control capital flows. They acquired and haltingly solidified this capacity between 1914 and 1945, progressively closing their capital markets. Liberalization of capital flows then began in a few advanced countries during the 1950s and 1960s. But the big wave of liberaliza-

tion did not start in earnest until the late 1970s, spreading across the high-income countries, much of the developing world, and, by the 1990s, to the former communist countries. Notwithstanding a large number of financial crises over this period, this trend has remained intact.

In monetary policy, the biggest change has been the move from the gold standard of the 1870-1914 era to the floating currencies of today. The long-run exchange-rate stability inherent in the gold standard promoted long-term capital flows, particularly bond financing, more efficiently than does the contemporary currency instability. Today's vast short-term financial flows are not just a consequence of exchange-rate instability, but one of its causes.

Yet governments' control over the movement of people in search of employment tightened virtually everywhere in the early part of the last century. With the exception of the free immigration policy among members of the European Union (EU), immigration controls are generally far tighter now than they were a hundred years ago.

The policy change that has most helped global integration to flourish is the growth of international institutions since World War II. Just as multinational companies now organize private exchange, so global institutions organize and discipline the international face of national policy. Institutions such as the World Trade Organization (WTO), the International Monetary Fund (IMF), the World Bank, the EU, and the North American Free Trade Agreement underpin cooperation among states and consolidate their commitments to liberalize economic policy. The nineteenth century was a world of unilateral and discretionary policy. The late twentieth century, by comparison, was a world of multilateral and institutionalized policy.

## Tradeoffs facing states

Ironically, the technology that is supposed to make globalization inevitable also makes increased surveillance by the state, particularly over people, easier than it would have been a century ago. Indeed, here is the world we now live in: one with fairly free movement of capital, continuing (though declining) restrictions on trade in goods and services, but quite tight control over the movement of people.

Economies are also never entirely open or entirely closed. Opening requires governments to loosen three types of economic controls: on capital flows, goods and services, and people. Liberalizing one of the above neither requires nor always leads to liberalization in the others. Free movement of goods and services makes regulating capital flows more difficult, but not impossible; foreign direct investment can flow across national barriers to trade in goods without knocking them down. It is easier still to trade freely and abolish controls on capital movement, while nevertheless regulating movement of people.

The important questions, then, concern the tradeoffs confronting governments that have chosen a degree of international economic integration. How constrained will governments find themselves once they have chosen openness?

## Three vital areas

Globalization is often perceived as destroying governments' capacities to do what they want or need, particularly in the key areas of taxation, public spending for income redistribution, and macroeconomic policy. But how true is this perception?

In fact, no evidence supports the conclusion that states can no longer raise taxes. On the contrary: in 1999, EU governments spent or redistributed an average of 47% of their GDPs. An important new book by Vito Tanzi of the IMF and Ludger Schuknecht at the European Cen-

tral Bank underlines this point. Over the course of the twentieth century, the average share of government spending among Organization for Economic Cooperation and Development (OECD) member states jumped from an eighth to almost half of GDP. In some high-income countries such as France and Germany, these ratios were higher than ever before.

Until now, it has been electoral resistance, not globalization, that has most significantly limited the growth in taxation. Tanzi claims that this is about to change. He argues that collecting taxes is becoming harder due to a long list of "fiscal termites" gnawing at the foundations of taxation regimes: more cross-border shopping, the increased mobility of skilled labor, the growth of electronic commerce, the expansion of tax havens, the development of new financial instruments and intermediaries, growing trade within multinational companies, and the possible replacement of bank accounts with electronic money embedded in "smart cards."

The list is impressive. That governments take it seriously is demonstrated by the attention that leaders of the OECD and the EU are devoting to "harmful tax competition," information exchange, and the implications of electronic commerce. Governments, like members of any other industry, are forming a cartel to halt what they see as "ruinous competition" in taxation. This sense of threat has grown out of several fiscal developments produced by globalization: increased mobility of people and money, greater difficulty in collecting information on income and spending, and the impact of the Internet on information flows and collection.

Yet the competitive threat that governments face must not be exaggerated. The fiscal implications of labor, capital, and spending mobility are already evident in local jurisdictions that have the freedom to set their own tax rates. Even local governments can impose higher taxes than their neighbors, provided they contain specific resources or offer location-specific amenities that residents desire and consume. In other words, differential taxation is possible if there are at least some transport costs—and there always are.

These costs grow with a jurisdiction's geographic size, which thus strongly influences a local government's ability to raise taxes. The income of mobile capital is the hardest to tax; the income of land and immobile labor is easiest. Corporate income can be taxed if it is based on resources specific to that location, be they natural or human. Spending can also be taxed more heavily in one jurisdiction than another, but not if transport costs are very low (either because distances are short or items are valuable in relation to costs). Similarly, it is difficult to tax personal incomes if people can live in low-tax jurisdictions while enjoying the amenities of high-tax ones.

Eliminating legal barriers to mobility therefore constrains, but does not eliminate, the ability of some jurisdictions to levy far higher taxes than others. The ceiling on higher local taxes rises when taxable resources or activities remain relatively immobile or the jurisdiction provides valuable specific amenities just for that area.

The international mobility of people and goods is unlikely ever to come close to the kind of mobility that exists between states in the United States. Legal, linguistic, and cultural barriers will keep levels of cross-border migration far lower than levels of movement within any given country. Since taxes on labor income and spending are the predominant source of national revenue, the modern country's income base seems quite safe. Of course, although the somewhat greater mobility resulting from globalization makes it harder for governments to get information about what their residents own and spend abroad, disguising physical movement, consumption, or income remains a formidable task.

The third major aspect of globalization, the Internet, may have an appreciable impact on tax collection. Stephane Buydens of the OECD plausibly argues that the Internet will primarily affect four main areas: taxes on spending, tax treaties, internal pricing of multinational companies, and tax administration.

Purely Internet-based transactions—downloading of films, software, or music—are hard to tax. But when the Internet is used to buy tangible goods, governments can impose taxes, provided that the suppliers cooperate with the fiscal authorities of their corresponding jurisdictions. To the extent that these suppliers are large shareholder-owned companies, which they usually are, this cooperation may not be as hard to obtain as is often supposed.

It is also sometimes difficult to locate an Internet server. If one cannot do so, how are taxes to be levied and tax treaties applied? Similar problems arise with multinational companies' ability to charge submarket prices to their subsidiaries abroad (so-called "transfer pricing" within multinationals), which leaves uncertain the question of how and in which country to levy the tax. This scenario suggests that classic concepts in the taxation of corporations may have to be modified or even radically overhauled.

The overall conclusion, then, is that economic liberalization and technology advances will make taxation significantly more challenging. Taxes on spending may have to be partially recast. Taxation of corporate profits may have to be radically redesigned or even abandoned. Finally, the ability of governments to impose taxes that bear no relation to the benefits provided may be more constrained than before.

Nevertheless, the implications of these changes can easily be exaggerated. Taxation of corporate income is rarely more than ten% of revenue, whereas taxes on income and spending are the universal pillars of the fiscal system. Yet even lofty Scandinavian taxes are not forcing skilled people to emigrate in droves. People will still happily pay to enjoy high-quality schools or public transport. Indeed, one of the most intriguing phenomena of modern Europe is that the high-tax, big-spending Scandinavian countries are leading the "new economy."

Governments will also use the exchange of information and other forms of cooperation to sustain revenue and may even consider international agreements on mini-

num taxes. They will certainly force the publicly quoted companies that continue to dominate transactions, both on-line and off, to cooperate with fiscal authorities. But competition among governments will not be eliminated, because the powerful countries that provide relatively low-tax, low-spending environments will want to maintain them.

The bottom line is that the opening of economies and the blossoming of new technologies are reinforcing constraints that have already developed within domestic politics. National governments are becoming a little more like local governments. The result will not necessarily be minimal government. But governments, like other institutions, will be forced to provide value to those who pay for their services.

Meanwhile, governments can continue the practice of income redistribution to the extent that the most highly taxed citizens and firms cannot—or do not wish to—evade taxation. In fact, if taxes are used to fund what are believed to be location-specific benefits, such as income redistribution or welfare spending, taxpayers will likely be quite willing to pay, perhaps because they either identify with the beneficiaries, fear that they could become indigent themselves, or treasure the security that comes from living among people who are not destitute. Taxpayers may also feel a sense of moral obligation to the poor, a sentiment that seems stronger in small, homogeneous societies. Alternatively, they may merely be unable to evade or avoid those taxes without relocating physically outside the jurisdiction. For all these reasons, sustaining a high measure of redistributive taxation remains perfectly possible. The constraint is not globalization, but the willingness of the electorate to tolerate high taxation.

Last but not least, some observers argue that globalization limits governments' ability to run fiscal deficits and pursue inflationary monetary policy. But macroeconomic policy is always vulnerable to the reaction of the private sector, regardless of whether the capital market is internationally integrated. If a government pursues a consistently inflationary policy, long-term nominal interest rates will rise, partly to compensate for infla-

tion and partly to insure the bondholders against inflation risk. Similarly, if a government relies on the printing press to finance its activity, a flight from money into goods, services, and assets will ensue—and, in turn, generate inflation.

Within one country, these reactions may be slow. A government can pursue an inflationary policy over a long period and boost the economy; the price may not have to be paid for many years. What difference, then, does it make for the country to be open to international capital flows? The most important change is that the reaction of a government's creditors is likely to be quicker and more brutal because they have more alternatives. This response will often show itself in a collapsing exchange rate, as happened in East Asia in 1997 and 1998.

## The continuing importance of states

A country that chooses international economic integration implicitly accepts constraints on its actions. Nevertheless, the idea that these constraints wither away the state's capacity to tax, regulate, or intervene is wrong. Rather, international economic integration accelerates the market's responses to policy by increasing the range of alternative options available to those affected. There are also powerful reasons for believing that the constraints imposed on (or voluntarily accepted by) governments by globalization are, on balance, desirable.

For example, the assumption that most governments are benevolent welfare-maximizers is naive. International economic integration creates competition among governments—even countries that fiercely resist integration cannot survive with uncompetitive economies, as shown by the fate of the Soviet Union. This competition constrains the ability of governments to act in a predatory manner and increases the incentive to provide services that are valued by those who pay the bulk of the taxes.

Another reason for welcoming the constraints is that self-imposed limits on a government's future actions enhance the credibility of even a benevolent government's commitments to the private sector. An open capital account is one such constraint. Treaties with other governments, as in the WTO, are another, as are agreements with powerful private parties. Even China has come to recognize the economic benefits that it can gain from international commitments of this kind.

The proposition that globalization makes states unnecessary is even less credible than the idea that it makes states impotent. If anything, the exact opposite is true, for at least three reasons. First, the ability of a society to take advantage of the opportunities offered by international economic integration depends on the quality of public goods, such as property rights, an honest civil service, personal security, and basic education. Without an appropriate legal framework, in particular, the web of potentially rewarding contracts is vastly reduced. This point may seem trivial, but many developing economies have failed to achieve these essential preconditions of success.

Second, the state normally defines identity. A sense of belonging is part of the people's sense of security, and one that most people would not want to give up, even in the age of globalization. It is perhaps not surprising that some of the most successfully integrated economies are small, homogeneous countries with a strong sense of collective identity.

Third, international governance rests on the ability of individual states to provide and guarantee stability. The bedrock of international order is the territorial state with its monopoly on coercive power within its jurisdiction. Cyberspace does not change this: economies are ultimately run for and by human beings, who have a physical presence and, therefore, a physical location.

Globalization does not make states unnecessary. On the contrary, for people to be successful in exploiting the opportunities afforded by international integration, they need states at both ends of their transactions. Failed states, disorderly states, weak states, and cor-

rupt states are shunned as the black holes of the global economic system.

What, then, does globalization mean for states? First, policy ultimately determines the pace and depth of international economic integration. For each country, globalization is at least as much a choice as a destiny. Second, in important respects—notably a country's monetary regime, capital account, and above all, labor mobility—the policy underpinnings of integration are less complete than they were a century ago. Third, countries choose integration because they see its benefits. Once chosen, any specific degree of international integration imposes constraints on the ability of governments to tax, redistribute income, and influence macroeconomic conditions. But those constraints must not be exaggerated, and their effects are often beneficial. Fourth, international economic integration magnifies the impact of the difference between good and bad states—between states that provide public goods

and those that serve predatory private interests, including those of the rulers.

Finally, as the world economy continues to integrate and cross-border flows become more important, global governance must be improved. Global governance will come not at the expense of the state but rather as an expression of the interests that the state embodies. As the source of order and basis of governance, the state will remain in the future as effective, and will be as essential, as it has ever been.

Martin Wolf is Associate Editor and Chief Economics Commentator at the Financial Times. This paper is based on "The Nation State in a Global World," presented at the Harry Oppenheimer Colloquium on Globalization, funded by the Ernest Oppenheimer Memorial Trust, in Stellenbosch, South Africa, in February 2000. Excerpts will appear in the winter 2001 issue of the *Cato Journal*.

## ANNEX II

### TRADE, DEVELOPMENT AND DEMOCRACY: THE NEED FOR REFORM OF THE WTO

Mike Moore's address to the European Parliament, April 2001

A big debate is raging about how to promote, some say preserve, democracy in a globalizing world. Whereas democracy remains rooted in local communities and nation states, a growing number of issues require global attention and action. Governments know they cannot effectively serve their people and their peoples' interests without the cooperation of others. They cannot ensure clean air and a clean environment, run an airline, organize a tax system, attack organized crime, solve the plagues of our age; AIDS, cancer, poverty, without the cooperation of other governments and international institutions.

Too much of the last century and the century before was ruled by coercion. But I believe we are now in a better world of persuasion. To be sure, it remains an imperfect world. But it is a vast improvement on earlier times. And it is due to wise men and women of vision who established international institutions and negotiated important treaties like the UN Charter, Law of the Sea, the Antarctic Agreement; all the better to advance civilized behaviour. Let me add that far from diminishing the authority of the nation state, these institutions and mechanisms advance and guarantee the sovereignty of nations - by stopping the unilateral aggressive behaviour of states, especially the more powerful ones. Perhaps I see things a little differently - as a non-European and a citizen of a small nation, New Zealand. But for me, international institutions do not threaten the authority of the state. They guarantee that authority. Let me add also that small players need the law and systems of rules the most.

The current WTO drive to better relate to Parliamentarians reflects my personal experience and beliefs. Elected public servants are the measurable, accountable, dismissable representatives of civil society. There are a few, mostly NGOs from wealthy societies, academics

and some international bureaucrats who challenge this proposition. They claim their lobby group, their pressure group, has more members than the ruling party. Sometimes this is true. (But that tells us something else). Some have claimed as well that we live in a post-industrial, post-representative age. One international bureaucrat, at a meeting I attended recently, said they are now the true representatives of the people, through their contacts with civil society (he cited low voter turn-out and the low opinion so many people have of politicians). I said that is very unhealthy and dangerous. But this is a profound debate that must be had. The UN Charter says "We the peoples" not "We the Governments". In some countries, which lack the democratic impulse and democratic institutions, it is true that some Governments have been repressive and a few, fewer and fewer over the past 20 years, have been the enemies of their true owners, the people. And it is also true that heroic individuals and their supporters, NGOs, have been punished for their belief in freedom and choice. But when people are free, they choose to set up political parties and seek power through elections. This is the true essence of civil society.

Political systems and political parties function best when they are open and transparent and when they encourage the widest participation in policy creation, whether it be on WTO or domestic priorities. Most mature democracies and successful Governments and political parties operate in this manner.

As Governments have gradually contracted out certain limited functions to international institutions, treaties and agreements, there has not been a corresponding evolution and focus of political oversight. We need a comprehensive and cohesive response to international governance because many people feel alienated from

power and ownership. Their feelings of anxiety have been made more stark by the process of globalization. Globalization is not new. It is not a policy. It is a process that has been going on since the beginning of time. Some historians claim trade is now at about the same level as it was at the turn of the last century. Certainly there was a greater movement of people across borders 100 years ago than today.

What is different? Overall, globalization has accelerated. And the information and technological explosion has ensured people are aware of the increased pace of globalization and are aware as well of its implications. That is a good thing. We live in an age where democracy has flourished, where voters and consumers want more information and control, greater accountability and greater ownership.

The challenge is how to work together internationally for the benefit of ordinary people everywhere. The WTO is at the very heart of this debate.

That is not surprising. International trade is an important cross-border issue. Even more so nowadays, since trade policy touches on sensitive issues like the environment and food safety, which are becoming the very stuff of politics in the post-Cold War era. And the WTO, with its many ambitious and wide-ranging agreements and its uniquely binding dispute settlement mechanism, is a particularly advanced instrument of international co-operation.

I have no doubt that the WTO is a force for good in the world. A glance at history tells us that the past 50 years of trade liberalization are incomparably better than the protectionist nightmare of the 1930s. Indeed, the last 50 years has seen unparalleled prosperity and growth and more has been done to address poverty in these last 50 years than the previous 500.

Let me give some important examples. Since 1960, child mortality rates have halved in developing countries; malnutrition rates have declined by 33%; and the proportion of school children who do not go to school has dropped from around half to a quarter. Further,

the number of rural families without access to safe water has fallen from nine tenths to one quarter. Over 150 million people have been taken out of extreme poverty in China alone in the past 10 years.

Let me add; experience shows, and studies confirm, that countries that are more open to trade grow faster than those that aren't, and so have less poverty, better jobs, better hospitals, and better schools. Thirty years ago, Ghana had the same living standards as Korea. Now Korea is in the OECD. Thirty years ago, Japan had developing country status. What a tribute to openness, democracy and free trade. That is why over the past 15 years, developing country after developing country has unilaterally made liberalization the keystone of their economic policies.

The multilateral trading system proved its worth again only a few years ago when it helped keep markets open in the wake of the financial crisis that started in Asia and then swept the world, thus helping to prevent a global recession.

The question is: are we paying for the undoubted benefits of the WTO with an unacceptable loss of democracy? Honestly, I don't think so.

For one thing, all WTO agreements are reached by a consensus of our 140 member governments. We have no security council. Every country has a veto, and they are not afraid to use it. In most countries, WTO agreements are then ratified by elected national parliaments.

Of course, this means deals sometimes take a long time to broker. With so many stakeholders (140 members), the processes are difficult and laborious. It is like trying to run a Parliament without a speaker, without whips, without parties and without speaking limits. But it is democratic and it does ensure all our members participate fully. When a member government feels that another is not playing by the rules to which it has previously signed up, it can ask an impartial WTO panel to arbitrate. It is quite similar to asking a commercial court to rule on whether or not parties are sticking to a contract they have agreed. Again, nothing

undemocratic there. I am sure Kofi Annan would like a binding disputes mechanism he could use in world trouble spots.

The WTO is above all an intergovernmental organization. So it is mainly accountable to the people through their governments. But we are accountable in other ways as well. Through the media, for instance. Through our contacts with civil society, trade unions, business, lobbies, churches and NGOs. And through parliamentarians like yourselves.

Let me say a little more about our current efforts concerning parliaments and parliamentarians. The WTO's External Relations Division deals with enquiries from Members of Parliament most days. I hold regular meetings with parliamentarians. I make a point of testifying before parliamentary committees as often as possible. I have made contact with global parliamentary associations like the International Parliamentary Union and regional assemblies in an attempt to inform and involve. Early in my term, I approached the IPU and suggested we should hold seminars to explain to legislators our role, to point out that we don't own governments, they own us. I have also made contact with the global international organizations such as Socialist International, Liberal International and the Democratic Union, addressing their conferences and offering our services.

Of course, we can do more. We always can. But consider the alternatives. One option is to do away with the WTO. Some extremists suggest that if there were no WTO there would be no globalization. If each country set its trade laws in isolation, we would not need to worry about the imperfections of international democracy. But we have been down that road before. Before too long, protectionist lobbies would get the upper hand. And as we learned from the 1930s, beggar-thy-neighbour policies soon end up making beggars of us all.

Another option is to treat the world as if it were a nation state writ-large. There could be world elections to a world parliament and even a world government.

But that is not realistic, in fact it would be dangerous. It would achieve the opposite of what the proponents suggest. There is no such thing as a world electorate. Europe's 350 million people would not accept being continually outvoted by China's 1,300 million. Nor is it desirable: most decisions that affect New Zealanders are still best taken in New Zealand rather than at a global or regional level.

Our global institutions are 50 years old. We are middle-aged, and at 50 it is prudent to undergo regular check ups. We were established out of the horror and lessons of the First World War and Great Depression, made deeper and more lethal by protectionism policies and higher tariffs. The twin tyrannies of our age, fascism and marxism, were given momentum from this economic collapse. Then came the Second World War. From this came the noble Marshall Plan, where the victors funded former enemies into future competitors. The mirror opposite of the Versailles Treaty, they gave us the United Nations and its many agencies, the World Bank, the International Monetary Fund and the GATT.

It is time for a check-up, an audit of our global institutions. I believe in the post-war structure. With all its imperfections, the world would be less stable, less predictable and more dangerous without these institutions. We are fortunate that great public servants like Kofi Annan and Jim Wolfensohn are there to guide us with their wisdom and vision. Perhaps we can assist their efforts, and my own, by updating our various management structures.

The best option is to improve on what we have already. For, me, that means doing more to reconnect the WTO with ordinary people. Some of this is up to the WTO Secretariat (and we have important initiatives underway). But most of it is a job for governments. So, what can WTO Members do?

First, I believe the WTO could be more open, so people can judge whether their government is carrying out its mandate in Geneva. (I also believe that the debates on transparency currently underway in Geneva show this

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