Bretton Woods, GATT & WTO
Trade in a Politicised World

Dani Rodrik

Theme

- Trade policy is politically contentious since it has important domestic distributional consequences and it generates clashes between values and institutions in different nations.
- None of this would matter much if trade policy could be insulated from national politics
- Historical experience showed that when domestic needs clash with the requirements of the global economy, domestic needs ultimately emerge victorious.
- Economists realized that it was better to accept this and build the safety valves into the system than to ignore it and risk total collapse.

Systems put in place

- Bretton Woods
- International economic policy would have to be subservient to domestic policy objectives—full employment, economic growth, equity, social insurance, and the welfare state—and not the other way around.
- The goal would be moderate globalization, not hyperglobalization.
- The most notable contribution to the postwar international economic system was *multilateralism*—rule-setting through international organizations, based on the cornerstone principle of non-discrimination.
- Multilateralism meant that rule enforcement and belief systems would work henceforth through international institutions—the International Monetary Fund, the World Bank, and the General on Tariffs and Trade (GATT)—rather than through naked power politics or imperial rule.
- This was a very important innovation. Even though the influence of the United States was undeniable, multilateralism endowed these institutions with a certain degree of legitimacy independent of the powers that backed them up.

- They never became truly autonomous from the major economic powers, but neither were they purely an extension of these powers.
- They played important rulemaking, rule-enforcing, and legitimating roles.
- Multilateralism gave smaller and poorer nations a voice and protected their interests in an unprecedented way.

- GATT

GATT

- Followed Bretton Woods
- Even though the GATT was not constituted formally as a full-fledged organization like the IMF or the World Bank, it became de facto the multilateral forum overseeing global trade liberalization
- Was a roaring success
- The volume of world trade grew at an average annual rate of almost 7 percent considerably faster than anything experienced to date.
- Output also expanded at a higher rate than ever before in rich and poor nations alike—both a cause and effect of the rapid rise in trade.
- Except for one odd thing: GATT policies did not directly take aim at globalization
- Globalization requires a significant reduction in transaction costs in cross border trade and finance.
- This did occur in certain areas.
- Trade in most manufactured products among industrial countries was progressively and substantially liberalized, within certain important limits.

- Transport costs continued to decline.
- Yet, policy makers displayed a decided lack of ambition in pushing for liberalization under Bretton Woods.
- Large parts of world trade remained either completely outside multilateral agreements or protected by generous exceptions to the existing agreements.
- The goal was freer trade in some areas, not free trade in all.
- What pushed globalization along instead was the background of economic growth, equity, security, and stability that the Bretton Woods compromise helped prop up.
- National policies promoted globalization mostly as a byproduct of widely shared economic growth along with some modest opening up.
- The success of the Bretton Woods era suggests that healthy national economies make for a bustling world economy, even in the presence of trade controls.
- Liberalization barely touched the following areas.
- Agriculture was kept out of GATT negotiations and remained riddled with tariff and non-tariff barriers—import quotas aimed at stabilizing domestic prices at levels much higher than in exporting countries.
- Most services (insurance, banking, construction, utilities, and the like)

- Manufacturing sectors that were liberalized but began to face significant competitive threat from lower-cost/higher-productivity exporters soon received protection
- The 1980s witnessed the spread of voluntary export restrictions (VERs), arrangements whereby (typically) Japanese exporters of autos, steel, and some other industrial products undertook to keep their exports within specific quotas.
- Developing nations themselves were pretty much free to do as they pleased with their trade policies.
- They typically were not required to offer tariff “concessions” during GATT negotiations, even while they benefited from others’ tariff reductions
- They had recourse to various GATT clauses that allowed them to resort to limitations on imports virtually on a permanent basis.
- Even for the industrial countries, the rules contained loopholes wide enough for an elephant to pass through GATT’s Anti-Dumping (AD) or Safeguard clauses.
- The AD arrangement in particular was an abomination from the standpoint of free trade.
- The importing country could impose duties as long as it determined that an exporter had sold its products at “less than normal value” and caused “injury” to the competing industry at home.

- Domestic authorities could easily manipulate the notion of “less than normal value.” And punitive tariffs could be imposed even if the behavior in question constituted normal commercial practice
- These rules were widely—and predictably—exploited by domestic firms to obtain custom-made protection.
- Finally, the enforcement powers of the GATT were a joke
- If a government thought another one had violated the rules, it could ask a GATT panel to adjudicate.
- If the panel ruled for the plaintiff and the panel’s report was approved by GATT’s membership, the guilty party had to change the offending policy or else the plaintiff was entitled to compensation.
- The only catch was that approval of the panel report required a unanimous decision.
- Every single member of GATT, including the government that had been found in violation of the rules, had to sign off on it.
- If a jury includes the defendant, it is a safe bet that it will not often rule against him.
- So the GATT rules left whole segments of world trade uncovered; they were weak where they existed; and they were unenforceable.
- These features made the institution obviously deficient—and made the ensuing World Trade Organization, which took over in 1995, much more attractive from the perspective of free trade.

- But to find fault with the GATT regime because it fell considerably short of free trade would be to judge GATT
- from an inappropriate perspective.
- The GATT may not have been aimed at "minimizing economic entanglements among nations," but it certainly was designed to leave each trading nation room to pursue its social and economic objectives relatively unencumbered by external constraints, albeit within a loose framework of international cooperation.
- When trade threatened domestic distributional bargains, trade would give way
- The considerable maneuvering room afforded by these trade rules allowed advanced nations to build customized versions of capitalism/ "varieties of capitalism"
- The United States, Britain, France, Germany, or Sweden were each market-based economies, but the institutions that underpinned their markets differed substantially and bore unmistakably national characteristics.
- GATT's purpose was never to maximize free trade.
- It was to achieve the maximum amount of trade compatible with different nations doing their own thing.
- In that respect the institution proved spectacularly successful.

- In reality, trade became (and remained) free only where it posed little challenge to domestic institutions, distributional preferences, or values.
- Much of manufacturing trade carried out among advanced countries at similar levels of income raised few of the questions of distributional justice
- Other kinds of trade—in agriculture, say, or with developing countries—were different because they pitted domestic groups starkly against each other.
- They threatened farming groups, garment, or low-skilled workers with sharp income losses.
- So these types of trade were heavily circumscribed.
- “endless departures from logic of free trade”

WTO

Regime of deep integration

- Era of hyper-globalization.
- Domestic economic management was to become subservient to international trade and finance
- Economic globalization, the international integration of markets for goods and capital (but not labor), became an end in itself, overshadowing domestic agendas.
- Reason behind this transition;
- Shortcomings of GATT which were done away with
- Multinational companies demanded more extensive global rules that would facilitate their international operations.
- Developing nations sought to become export platforms and became increasingly willing to submit themselves to such rules in their drive to attract foreign investment.
- Accompanied by an important ideological transformation
- The emergence of belief system that combined excessive optimism about what markets could achieve on their own with a very bleak view of the capacity of governments to act in socially desirable ways.
- Governments stood in the way of markets instead of being indispensable to their functioning, and accordingly had to be cut down to size.

- The regime under WTO involved a significant ramping up of economic globalization and a dramatic rebalancing of nation states' domestic and international responsibilities.
- Resulted in an impressive agreement with much broader coverage than anything else accomplished under the GATT.
- Agriculture and certain services, two areas which had eluded trade negotiators in the past, were now firmly brought into the liberalizing fold.
- In services, countries were required to specify areas they were willing to open up, and the extent of liberalization varied across countries.
- In agriculture, import quotas were to be phased out and converted into tariffs and subsidies.
- In addition, there were new rules on patents and copyrights, requiring developing countries to bring their laws into conformity with those in the rich countries.
- Domestic health and safety regulations became subject to WTO scrutiny
- Tighter restrictions were put in place on the use of government subsidies; prohibitions on government rules requiring firms to use local content or limit their imports in relation to their exports.
- For the first time, developing nations, except for the poorest among them which remained exempt, had to comply with rules that tightly circumscribed certain important areas of industrial policy.

- A new appellate court was a defining feature of the WTO; a new procedure for settling disputes.
- WTO dispute settlement was both compulsory and binding.
- Member states had no choice but to submit to it and accept the consequences of the WTO's ruling.
- Is the trade regime under WTO subverting democracy by allowing it to override domestic legislation?
- Or is it helping nations achieve better outcomes by preventing protectionist groups from hijacking the domestic political process for their narrow interests?
- The reality is a bit of both.
- We need to make a distinction between "shallow" and "deep" versions of global integration.
- Under shallow integration, as in Bretton Woods, the trade regime requires relatively little of domestic policy.
- Under deep integration, by contrast, the distinction between domestic policy and trade policy disappears
- any discretionary use of domestic regulations can be construed as posing an impediment to—a transaction cost on—international trade.
- Global rules in effect become the domestic rules.
- Trade officials and technocrats become tone-deaf to other economic and social objectives when the pursuit of globalization develops a life of its own.

- Issues:
- Where do the rules of the WTO come from?
- How can we ensure that they are designed to benefit all rather than the few?
- What happens when different nations desire or need different rules?
- Can *any* model of deep integration prove sustainable when democratic politics remains organized along national lines?
- Failure of rounds post Doha- evidence
- There exists a growing recognition by workers that what is good for the global economy and its business champions [is] not necessarily good for them."
- Greater global integration "places more competitive pressure on an individual economy [and] workers are likely disproportionately to bear the brunt of this pressure."
- The MNCs are like stateless elites whose allegiance is to global economic success and their own prosperity rather than the interests of the nation where they are headquartered."
- These companies have little stake in the "quality of the workforce and infrastructure in their home country" and "can use the threat of relocating as a lever to extract concessions."

- Broad-based economic growth could help diminish the tensions, but that objective would require locally tailored strategies and the requisite domestic maneuvering room
- We cannot take it for granted that the potential economic benefits of this new wave of globalization will accrue to the many rather than the few.
- If trade makes some people worse off and exacerbates inequality, one response is to enhance social safety nets and adjustment assistance.
- The problems that trade creates should be solved not by protectionism but through domestic policies that compensate the losers.
- Fine, in principle.
- But what happens when promises of adjustment assistance and compensation fall short, as they have repeatedly done in recent decades?
- The reality is that we lack the domestic and global strategies needed to manage globalization’s disruptions.
- As a result, we run the risk that the social costs of trade will outweigh the narrow economic gains

Globalisation and all that

Abhijit Vinayak Banerjee

Theme

- Most theories of international trade are not wrong but the context or world in which they were created no longer exists
- Hence, while look at the distributional consequences of IT and trying to come up with solutions to help the poor/losers, we must keep this in mind
- Most empirical studies find that being open to trade either increases inequality or has no effect at all.
- Factor price convergence? Fall in inequality?
- Explanation for increasing inequality?

- FDI-rise in the skill premium: Only a part of the explanation
- If trade helps countries specialize in what they are good at, it is expected that removal of trade barriers would result in reallocation of labour in the same direction
- But, labour reallocation and changes in the occupational structure/ employment patterns are largely absent
- Rigid labour laws?
- Conventional trade theory cannot explain these puzzles
- Key missing ingredient
- Reputation
- Brand names- quality and Trust- doing business with each other
- Quality is important and price is not as important as it used to be
- It is worth paying a little extra

Several consequences follow from recognising the centrality of reputation

- Reputation is like a fixed cost
- The advantage it gives producers is independent of how much they sell
- Must: quality maintained
- Amazon, Gucci
- When firms with brand value shift production to the third world, they are RELUCTANT TO CHANGE THE PROCESS OF PRODUCTION even when local cost structure might favour reorganisation
- They are worried about whether they will be able to maintain control over the quality if they shift to an unfamiliar new process
- Given that there is so much riding on delivering quality, experimentation with process is not something they would opt for lightly

- This means that when they relocate to third world countries, they demand the same kind of labour as they were using in their home country
- Most MNCs that set shop in the third world tend to head for the services sector again raising the skill premium.
- Since brand value is important, a great deal of inertia in decisions of from whom to buy is expected.
- Combined with the fact that those with reputations would tend to expand, it implies that it would take a LONG TIME before COST ADVANTAGES SHOW UP in the trade pattern
- All this suggests that there will be some time lag between re-employment for those who lose their jobs due to liberalisation
- In the LR, countries will specialise in industries where its factor endowments have a natural advantage but its success depends crucially on building reputations.

How to build reputations? What steps should be taken?

- Effective institutions
- Courts- easier to sue for damages in case of supplier misbehaviour
- Creating a friendly environment towards MNCs
- Can intermediate between domestic sellers and foreign buyers
- China: exports produced by nameless firms but marketed under global brand names
- Improving capital markets

The Global Economy and the Poor

Pranab Bardhan

Theme

- Difficulties that poverty alleviation policies in poor countries face in an environment of international economic integration
- Globalisation can affect the poor adversely but, it also opens up opportunities that some countries can utilise and others cannot depending on their domestic political and economic institutions.
- When we look at poor, we refer to poor as workers and as recipients of public services and users of CPRs
- We will be ignoring poor as consumers

Poor as workers

- Can either be self employed or wage earners
- As self employed, major constraints faced: credit, storage, marketing, infrastructure, government regulations etc.
- Relieving these constraints requires substantive domestic policy changes
- Largely unaffected by globalisation
- Exception: heavily involved in exports
- For e.g. small farmers in developing countries can be shut out by rich countries by use of safety and sanitary regulations
- Solution: involving rich country global companies in marketing poor country products
- It must be kept in mind however that, trade liberalisation even when increasing the mean incomes of poor produces may heighten their vulnerability.

Poor as wage workers

- Traditional IT theories suggests that workers in poor countries having a CA in products intensive in unskilled L should benefit from trade liberalisation
- But, many developing countries may import L intensive products from poorer countries leading to lower wages in the developing countries
- If poorer countries have large endowments of other FOPs such as land or mineral resources, trade liberalisation may not benefit the labour intensive sectors.
- There are three important reasons as to why opening up worsens the conditions of workers
- Worker mobility: ability to retool and relocate as mkt condns change
- Depends on state of available credit, info, infra and social networks
- Absent- workers hurt

- Nature of technical change
- Since much of the tech change in the rich countries is biased against services of unskilled L, transplantation of those new techniques by MNCs to poor countries will cause emp & w of unskilled L to go down
- Collective bargaining
- Globalisation leads to weakening of unions
- Foreign comp lowers profit margins & old rent sharing arrangements bet employers & unionised workers come under pressure
- L takes a larger cut since it is less mobile than K
- Can policies be made to compensate the losers?
- Depends on credibility of commitment by ruling politicians
- Much depends on society's institutions of conflict mgmt. and coordination

- Weakening of nation state
- Weathered the storm: robust institutions
- Doing away with multilateral agencies like WTO? No!
- Greater transparency and accountability
- Absence- poor countries worse off

Poor as users of CPR and Pub Services

- Fiscal options- ltd (K flight)
- Cuts in budgets- macro stabalisation
- Easier to cut pub exp on voiceless poor
- Overexploitation of fragile environmental resources
- Pollution havens

Conclusion

- There are policies which may attempt to help the poor without necessarily undermining the forces of globalisation
- In the medium to LR, glob need not make the poor worse off if appropriate domestic policies & institutions are in place and appropriate coordination among the parties involved is achieved.
- International agencies also have a role to play