THE URUGUAY ROUND: WILL IT REVITALIZE THE TRADING SYSTEM?

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The world trading system has received some good news for a change. The 92 nations that are Contracting Parties to the General Agreement on Tariffs and Trade (GATT) agreed at Punta del Este, Uruguay in September 1986 to launch a new round of multilateral trade negotiations. The new talks — known as the Uruguay Round — will be the eighth since GATT was founded in 1947. But how long will the good news last? New negotiations could increase worldwide economic growth and restore confidence in the trading system, or they could contribute further to the disintegration of the system. Which will it be? That will depend critically upon the strength of the U.S. commitment to trade liberalization and upon the willingness of the other major countries to join in efforts to achieve major breakthroughs.

The setting in Uruguay was symbolic — the first ministerial meeting of GATT to be held in a developing country since the early years when GATT was founded — because many of the agenda issues are of great importance to the developing countries. They include textiles, emergency protection in import-sensitive industries, tropical products, and agriculture. One major aim of the new round will be to integrate the developing countries more fully into the trading system.

The agenda is also crowded with several new issues that were championed by the United States and that have never been negotiated before at an international level. These are trade in services, intellectual property, and trade-distorting investment practices. Another priority item is the institutional strengthening of the GATT. Compared with the other two international economic agencies — the IMF and the World Bank — GATT has less than one-tenth the personnel and relies upon the cooperation of member countries to uphold its rules.

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The most contentious issues at the ministerial meeting were over agriculture and over whether services ought to be included on the agenda. The European Community and the United States disagreed over the timetable for addressing agriculture and over the types of agricultural policies to be included in the negotiation. A group of other agricultural producers (the "Cairns group"), led by Australia and including Canada and Argentina, pushed for faster resolution of all outstanding agricultural issues. In the end a compromise was struck to put all agricultural policies on the table but with no specific timetable. On services, a group of 10 developing countries led by Brazil and India adamantly opposed inclusion of services on the agenda. A compromise was fashioned that allowed services to be negotiated on a separate but equal track under the overall framework of a single negotiating committee. Such an arrangement would allow for tradeoffs between goods and services, but the contracting parties reserve judgement on whether services will be included in the GATT system until the completion of the negotiation. These disputes presaged what will certainly be protracted disagreements over these issues during the course of the actual talks.

From the perspective of someone interested in more open trade, the Punta del Este meeting resulted in a remarkably clean launch. The U.S. negotiators deserve a lot of credit; it is not often that you go into a negotiation with your bottom line on the table (as represented in the draft consensus declaration) and come out with your bottom line. But the U.S. negotiators should not let their success at Punta del Este impair their judgement. After all, this was a negotiation to set the agenda for the negotiations and it took four years to get this far. The major work lies ahead.

In order to assess what these talks could accomplish and whether they can be successful, it is best to set the context.

Setting the Context: Challenges and Opportunities

As the Uruguay Round begins, pessimists question whether the time is auspicious for bold initiatives. The United States does not have its own house in order: the trade deficit is at record levels, the budget deficit looms large, and an economic downturn is likely. Support for new negotiations among traditional U.S. business proponents of freer trade is lukewarm at best. The halls of Congress, where enabling legislation must pass, echo with protectionist speeches. The administration is still vague about what it hopes will emerge from the negotiations.

These problems bedevil the United States, the staunchest supporter of new negotiations. Other governments have even more doubts. Europe, with its enduring record unemployment, supports negotiations with an air of resignation, but with no visible enthusiasm. Japan favors multilateral negotiations because they will be long and complex and might divert attention from its bilateral trade tensions. Many developing countries (LDCs), especially those working their way out of their debt problems, believe that they will get little from a new multilateral exercise.

But most countries agree that the trading system is in disarray. International cooperation is at its lowest point since World War II. With discipline lacking, a full-scale trade war is a distinct possibility. Pressures for trade restrictions abound because of current unemployment problems and will increase because of the labor adjustment problems inherent in heightened international competition and in the transition from old to new technologies. The record trade deficit also increases the pressure for protection in the United States.

Yet, even as the trading system faces great dangers, opportunities are evident as well. The developing countries, the fastest growing markets for industrial country exports, still have vast pools of unemployed or underutilized resources. Integrating the LDCs more fully into the trading system will be the greatest challenge of the coming decade. If this were to be accomplished, the world economy would get a sorely needed stimulus to growth comparable to the one the world enjoyed after World War II when the United States used its dominant economic power to promote trade liberalization in a series of trade negotiating rounds. For over a generation from 1950 to 1973, the world economy experienced unprecedented growth averaging 3.3 percent per annum. Trade liberalization was a major factor creating that growth and helped spread it around the world.

But those real income gains gave way to stagnation and unemployment in the mid-1970s. Now the trading system, from which all countries have benefited, is under severe pressure. Countries are pursuing more nationalistic trade policies and some are on the verge of adopting the beggar-thy-neighbor policies which characterized the depression of the 1930s. In the words of the GATT "Wisemen's" group assembled to study the trading system, "Today, however, the world market is not opening up; instead it is being choked by a growing accumulation of restrictive measures. Demands for protection are heard in every country, and from one industry after another."[1]

1. See Introduction and Summary, *Trade Policies for a Better Future: Proposals for Action*, GATT, March 1985, Geneva, p.5.

But trade is a complex policy issue, standing as it does at the intersection of foreign policy and domestic economic policy. Although nations as a whole gain from freer trade, the gains are net gains. Trade creates domestic conflicts of interest, even though freer trade increases overall income and welfare. Domestic adjustment is painful. Mobility is not perfect. Firms and their workers do not move effortlessly to sectors favored by comparative advantage. Together with community representatives, firms and workers adversely affected by import competition lobby their elected representatives to protect their interests. Politicians are easily tempted to buy political support from vocal minorities even if the overall good of the silent majority suffers. Because trade policy is at its heart an internal distribution issue, maintenance of a free trade regime requires an effective countervailing force comprised of the stakeholders in open trade: the exporters, retailers, and consumers.

The GATT system provides the rules and discipline under which trade is conducted. When that discipline is followed, uncertainty is reduced, which allows international investment, trade, and growth to expand. However, GATT was designed in the 1940s to deal with trade in goods because the exchange of goods dominated the world economy. Certain sectors such as services were never covered by the GATT, and over time other sectors, prominently agriculture and textiles, became exceptions in the system. Although the GATT system changed somewhat in response to new realities, the system has not kept pace with the rate of change in the world economy. New trade talks could update the GATT.

Without a doubt the upcoming talks will be different, more complicated and probably last longer than any that preceded them. At least 10 significant developments will challenge the ingenuity and determination of the negotiators.[2]

First, the *world has become more interdependent*. Individual economies are much more sensitive to foreign interventions and their integration into a unified global economy has rendered the distinction between domestic and foreign economic policies obsolete. Internal economic conditions are quickly transmitted across national boundaries through trade, technology, and financial flows. Ostensibly domestic policies directed at taxes, agriculture, regional development, or investment have as much impact on trade flows as tariffs or quotas. Attempts to deal with the trade effects of domestic policies are viewed

2. *Trade Talks: America Better Listen!* by C. Michael Aho and Jonathan D. Aronson (New York: Council on Foreign Relations, 1985).

as infringements of sovereignty and quickly become politicized. If the domestic policies of one country injure firms and workers in another country, unfairness is claimed and redress is sought. Multilateral agreement on which practices are fair and which are not is absent.

Furthermore, many transactions today do not cross borders in the traditional way, but instead are carried over telephone lines and beamed by satellites. Distinction and data are not as clear as they once were, which makes regulation and negotiation much more difficult.

Second, relative *U.S. dominance has declined* sharply, even though the U.S. economy is still the strongest in the world. It can no longer defend the trading system alone. Joint leadership will be necessary to move ahead. The European Community (EC) has a combined GNP and volume of trade comparable to the United States. Japan is closing the gap and ranks as the third pillar. While the EC and Japan have an abiding interest and commitment to the principle of free trade, they have not taken the lead in defending it.

Even if it still could dictate terms to the rest of the world, the United States is no longer willing to lead alone. International economic integration has provoked a strong domestic reaction. Domestic political forces have mobilized to resist internationally induced change as never before. When trade played a relatively small role in the American economy, there was little domestic opposition to trade liberalization. Now, achieving a consensus in support of liberalization is extremely difficult.

Third, a related development which complicates decisionmaking is the *increased pluralism in the trading system.* More countries will play a critical role in the negotiations. GATT had 22 original signatories. Today, 92 countries are full signatories and 30 more apply its rules, de facto. Although the role of new actors such as the newly industrializing countries (NICs), the members of OPEC, and China is growing in international trade, they have no deep-rooted commitment to free markets.

Bargaining diplomacy has replaced power diplomacy as the mode of operation. But the trading system's rules and procedures are public goods. In a bargaining context, it pays for each country to understate the benefits it receives from the system. This greatly complicates the negotiations unless new means are found to put pressure on free riders and foot draggers.

Fourth, the world has entered an era of *slower economic growth and higher unemployment.* Adjustments to changes in trade or trade liberalization are easier when economies are expanding and unemployment is low. In the OECD area, growth rates have decreased and unemployment rates have increased over time.

The OECD unemployment rate when the Kennedy Round was completed in 1967 was about 3 percent. Growth at that time was proceeding at an annual rate of over 5 percent. When the Tokyo Round ended in 1979, the unemployment rate was 5 percent and growth was 4 percent. Today unemployment is 8½ percent (over 11 percent in Europe) and growth is under 3 percent.

The future does not look much better. The economic outlook is for continued slow growth, under 3 percent through 1987 with unemployment rising slightly. The pace of structural change will not slacken and could accelerate during the rest of the 1980s. When significant worker displacements are occurring, workers and their elected representatives are more reluctant to support policy changes, like trade liberalization, which could lead to more displacements. The conflict between the need for economic adjustment to increase growth and the political pressure to erect obstacles to adjustment will continue and probably intensify in the future.

Fifth, *the easy things have all been done.* Except for politically sensitive industries like textiles, tariffs have been reduced significantly during the previous seven negotiations. Those negotiations were relatively straightforward because tariffs are transparent and easy for policymakers to follow and understand. But as tariffs were lowered, many countries switched to subsidies and nontariff barriers (NTBs) to keep products out.

These new obstacles hampering international trade are just as effective at preventing imports, less transparent, and more difficult to remove. GATT rules on subsidies and other NTBs are not as explicit or as fully accepted as the rules on tariffs. The Tokyo Round did address NTBs in a series of codes, but they have been found wanting, particularly the subsidies code. When a country feels damaged by another country's subsidies, it claims unfair trade, retaliates, and resists further reduction of its own trade barriers. To proceed in this fashion undermines the GATT system

Sixth, *excess capacity is a growing problem.* In sector after sector, the world can grow, build, and produce more than it can sell, deliver, and consume. The challenge is to allocate production and to assure distribution. Markets could do both, if only governments would let them. LDCs, eager to industrialize, insist that they must have textile, steel, and chemical industries. Any country with a capacity to buy and run automobile, airplane, or electronics industries wants them. Meanwhile, industrial countries are intervening to protect basic industries. GATT has not been able to address problems of excess capacity on a multilateral basis as countries have resorted increasingly to bilateral circumventions, the logical conclusion of which is a cartelization of the industry.

Seventh, today *many countries are using industrial policies to create comparative advantage for their industries*. In this rapidly changing world economy in which technological advance can alter the conditions of competition almost overnight, new theories of trade based upon learning curves and dynamic economies of scale have been put forward. These theories stress government intervention and commitment, and have little in common with traditional trade theory. Japan, France, and several LDCs have instituted policies to foster technologically advanced industries. The United States officially deplores such industrial policies, but its heavy spending in the security area is an indirect form of industrial policy.

There is no agreement on what constitutes legitimate support for the development of an industry. Explicit subsidies can be countervailed against, but government procurement policies and subsidies for R&D at the outset of industrial development can bestow advantages which last for years. In the absence of a multilateral agreement on which policies are acceptable, internationally inconsistent policies will heighten trade conflict.

Eighth, *sectoral distinctions are breaking down*. Financial supermarkets are replacing separate banking, insurance, brokerage, and securities industries. Similarly, the merging telecommunications, computer, and broadcasting technologies are creating a world information economy. The service input into manufactured products is increasing. A growing percentage of the revenues and profits of manufacturing firms come from services they sell in association with their products or independent of them. As a result, interests are more difficult to identify.

A ninth development is the *changing shape of global competition*. Firms from different countries are forging complex alliances across sectors. Joint venture strategies and cooperative arrangements have divided the world market among coalitions of competing internationally-based alliances. Multinational corporations are planning and operating on a global basis as negotiators continue to view the world in terms of competing economies. The discontinuity between the way corporations see the world and the way governments are structured to deal with trade problems is widening.

Will multinational corporations continue to support efforts to liberalize trade? Firms planning on a global basis may want strictly enforced international rules because that would reduce the uncertainty and the cost of doing business. However, corporations grandfathered in countries behind trade barriers or investment distortions have learned to live with them. In some cases, existing restrictions serve as barriers to entry to potential competitors and allow the firms to make oligopoly profits.

A tenth complicating factor is *time*. In many areas, the time between the introduction of new generations of products and services has shortened. As a result, the shape of competition in the world economy is changing at a faster pace. Negotiators will need to make sure that the results of negotiations that could continue until the mid-1990s are relevant to the world economy that is coming, not just the one that exists today.

With all these complicating factors, how can the trading system move forward? One way is if countries contemplate the alternative — the disintegration of the trading system. Consider a few questions. If the open trading system were to disintegrate, will the indebted developing countries and the United States be able to generate current account surpluses to service their mounting debts? Unlikely. Will Japan and the newly industrialized countries be able to sustain their impressive economic performance? I doubt it. Before the trading system self-destructs, efforts to strike a multilateral bargain should be redoubled.

A multilateral bargain would touch deep-seated domestic interests in all countries. Each country has contributions to make. For its part, the United States would have to accept more import competition in textiles and steel, phase out its farm price support programs, admit that its defense policy is an industrial development policy, and be willing to accept multilateral discipline when it goes against U.S. interests as well as when it supports them.

The European Community, with its record unemployment, would have to accept more import competition, liberalize its national regulations in telecommunications and data processing, reform the Common Agricultural Policy, and accept stronger international discipline.

Japan, with the highest growth and lowest unemployment, is in the best position to liberalize its markets. It will have to open its borders, eliminate agriculture restrictions, and agree to curb its ability to protect and target the development of new industries. Unless it does, other countries may gang up on Japan for the first time in a multilateral negotiation.

The developing countries will also have to pay their fair share. The strongest among them, the newly industrialized countries, will have to accept more responsibilities for maintaining the trading system. Preferential treatment would no longer be available. They will also have to liberalize their markets in technologically advanced industries and services and in labor-intensive sectors to give their less well off colleagues a chance to grow.

However, such a far-reaching global bargain lies far in the future. For now, the major players must act responsibly to ensure that these talks get off on the right foot.

NEXT STEPS AND MAJOR POLICY QUESTIONS

Launching of the Uruguay Round is good news for the world trading system. But a critical question is how long the process can remain credible — credible as an international negotiation and credible to national legislative bodies. To remain credible as an international negotiation, countries are going to have to abide by the standstill agreements in the Ministerial declaration and over time they will have to begin the process of rolling back restrictions taken outside of GATT. If countries start to take new unilateral restrictive measures, the confidence and trust built up in Punta del Este will dissolve quickly. To remain credible to national legislative bodies, the negotiations will have to produce concrete results in a short period of time or, at least, to suggest the possibility of progress. One way to get concrete results would be to get agreements in a more limited fora.

The United States and Canada are engaged in a historic bilateral negotiation to establish a comprehensive trade agreement between the world's largest trading partners. How will the bilateral negotiations between the United States and Canada blend in with the multilateral negotiation? The bilateral is like a mini-multilateral because most of the issues are the same. On the positive side, a valuable learning experience is sure to result because one learns to negotiate by negotiating. Pathbreaking agreements are also possible in the new areas of services, intellectual property, and investment. On the other hand, if it is not open-ended and contains unique discriminatory provisions that cannot be generalized, then it would reinforce the trend toward bilateralism and fragmentation. Either way, these bilateral talks over the next two years will do much to set the tone for the Uruguay Round.

Besides the historic negotiation with Canada, the U.S. administration also needs to conduct a significant negotiation with Congress and the private sector. Trade negotiations are as much domestic negotiations among interest groups as they are international negotiations among countries. As the Uruguay Round begins, ominous signs are coming from the U.S. Congress and the private sector. What is the responsibility of the major players domestically?

The administration, in consultation with Congress and the private sector, must decide what and how to negotiate, in light of what other countries want as concessions. Then it will have to develop and sustain the domestic consensus necessary to complete a successful negotiation.

Thus far, the administration has made little headway in establishing the domestic consensus needed for a successful negotiation. Support in the business community is lukewarm. Congress has lost confidence in the President's ability to conduct trade policy and is threatening to embark on a policy of its own. The administration is groping to find its way on trade policy, and the world is waiting nervously. The United States had better get its act together, because it is still looked to for leadership on international economic issues. Its actions are emulated. If the United States were to rush mindlessly into an aggressive tit-for-tat posture on trade, the trading system could end up fragmented.

Two votes from Congress will be needed to complete negotiations — one delegating authority to negotiate and another ratifying the agreement. The U.S. administration needs a trade bill in 1987 extending its authority to negotiate both bilaterally and multilaterally. The U.S. Constitution grants the authority to the U.S. Congress to "regulate foreign commerce" and historically the Congress has delegated the authority to negotiate to the Executive Branch. The current delegation expires on January 3, 1988. The law as it is written today gives the president a broad mandate to negotiate trade agreements and requires "fast track" consideration of those agreements by Congress within 90 days with no amendments in order. Without an extension of "fast-track" negotiating authority, the Executive Branch would lack credibility in negotiating with other countries, because any agreements reached would be subject to amendments and delay.

But passage of a trade bill extending the authority to negotiate always comes at a price. As the price in 1962 and 1974, Congress rewrote U.S. trade remedy laws, included provisions for worker adjustment assistance, and gave more authority to the U.S. trade representative's office. The 1979 trade bill implementing the results of the Tokyo Round multilateral trade negotiations further expanded the reach of U.S. trade remedy laws and limited presidential discretion in unfair trade practices cases. Any trade bill next year will likely continue this trend in U.S. trade remedy laws. In order to get an extension of negotiating authority, the president will end up accepting something he found unpalatable in the past. That is, any changes will make it easier to obtain import relief. I expect that the definition of unfair trade practices will be broadened, presidential discretion over whether to impose restrictions will be reduced, and retaliation will be mandated under certain circumstances. But if Congress goes too far, the trade talks could be derailed. An extremely difficult domestic negotiation lies ahead and unfortunately this U.S. administration has proven itself extremely inept in getting its way with Congress on trade matters. The administration had better work diligently to draft a compromise bill because passage of restrictive legislation would start the negotiations off on the wrong foot.

As an alternative I would propose that Congress should not tie the president's hands but instead should give him free reign to negotiate but with intermediate deadlines for agreements, say every 2-3 years, with final agreement set at 10 years. This would maximize U.S. leverage. The biggest threat the United States has in negotiating with other countries is the fear that Congress might pass something protectionist. Why only use that leverage before negotiations begin and again at their conclusion?

Another advantage is to compel the administration to take action on trade policy issues. This country does not focus upon trade or competitiveness issues unless it is forced to by Congress or by an international negotiation. Only in the context of a major multilateral round of negotiations does the United States come close to articulating a coherent trade policy. As deadlines approach, trade will receive higher-level political attention and decisions will be forced.

Some may object because Congress would play a more important role but that is happening anyway. This approach would be preferable to mandatory procedures that require retaliation or impose restrictions. Mandatory procedures actually reduce U.S. leverage in negotiations. Under this approach the Executive Branch would have flexibility to negotiate and yet Congress would still have substantial oversight authority. In drafting the negotiating authority, Congress should structure the negotiations so that the round becomes a way for resolving issues, not postponing them.

Besides forceful U.S. leadership at home and abroad, an extraordinary effort will be required internationally in order to make the talks a success. Several factors are necessary to conclude the negotiations successfully. They include the following.

— More high-level political involvement is needed, not less. A far-reaching global bargain can only be struck at the higher levels.

— More cooperative action is needed, not less. Joint leadership is necessary to move ahead. If the other pillars of the trading system, the European Community and Japan, fail to exercise leadership, no progress is likely. Coalition formation will play a critical role as it did at Punta del Este.

— The GATT Secretariat needs more authority and responsibility for resolving trade problems, not less. The complexity of today's trade problems requires ongoing mechanisms for identifying and resolving problems before they get out of hand.

— More involvement by the stakeholders in an open trading system is needed, not less. Each nation should prepare "wish lists" of foreign restrictions it wants removed in order to mobilize private sector interests behind the negotiations.

Without continuing high-level political involvement and active support from the private sector in all countries, sustaining these negotiations over the course of what could be a decade will be impossible.

CONCLUSION

Trade talks can succeed. If countries cooperate, higher growth and greater discipline are possible. But, needless to say, a great deal needs to be done to reform the international trading system. It will not be easy and it will not happen overnight, but the stakes are too high not to try.

Institutions, like human beings, seldom mark time. The GATT will observe its 40th birthday in 1987. Much has changed since its inception. But now, as then, the world is sorely in need of more international cooperation on trade matters. In the absence of efforts to make progress on the important international trade issues, the system will regress further. If nations of the world do not begin to focus on these pressing trade problems, the world faces the possibility of a repeat of the 1930s, when the collapse of the trading system contributed to the length and severity of the depression.

Although the problems confronting the trading system are grave, failure to deal with them is a prescription for disaster. If all countries would put aside their long-standing differences and be bold and forthcoming, a better future is possible. Let us begin that long and arduous process.