



William A. Kerr

Conflict, Chaos and Confusion

The Crisis in the International
Trading System



ESTEY CENTRE FOR LAW AND ECONOMICS IN
INTERNATIONAL TRADE



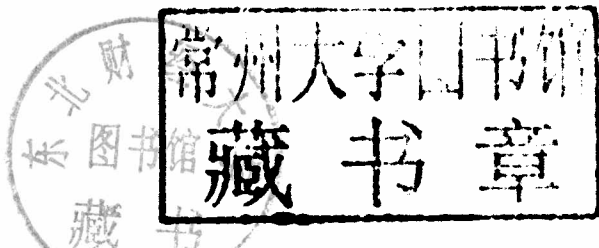
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The Crisis in the International Trading System

William A. Kerr

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IN ASSOCIATION WITH THE ESTEY CENTRE FOR LAW AND
ECONOMICS IN INTERNATIONAL TRADE

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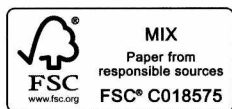
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Preface

In the autumn of 1999 I was given a unique opportunity. The newly established Estey Centre for Law and Economics in International Trade was looking for a means to raise its profile in the trade policy community and to gain a measure of academic credibility. I suggested that the centre sponsor an academic journal for which I would agree to be the founding editor. I firmly believed that a market niche existed for a multidisciplinary trade policy journal. This was just at the beginning of the era of electronic publishing and I was convinced that a credible online academic journal could be produced at a low cost relative to traditional print journals. I had also recently finished a term as editor for a print journal and had a number of ideas about how to shorten the publication process. It was agreed that the *Estey Centre Journal of International Law and Trade Policy* would be launched in January 2000. To kick off the inaugural issue of the journal, I decided to write a short piece that I hoped would provide some background to the international trading system, yet be somewhat controversial so as to pique the interest of potential readers of the new journal. It was published under the heading of 'Editor's Pages'. I received considerable positive feedback from both colleagues and readers I was unacquainted with regarding my effort and decided that I would continue the practice of 'Editor's Pages' for each subsequent issue.

The *Estey Centre Journal of International Law and Trade Policy* succeeded and by the end of 2009 the 20th issue (in ten volumes) had been published – and 20 'Editor's Pages' essays had been completed. Over the years I had continued to receive positive comments from reviewers, colleagues and the general readership regarding my essays. I had also used some of the essays as readings for graduate classes in my department of Bioresource Policy, Business and Economics, in the graduate class I provide as part of the Masters of International Trade (MIT) degree offered by the University of Saskatchewan and in various WTO capacity building courses offered around the world by the Estey Centre for Law and Economics in International Trade. Over time, students in all of these courses have suggested that it would be useful to have the essays collected and published in one convenient place. This volume represents such a collection.

In writing these essays I had three main objectives: (1) to ensure the material was accessible to a wide audience; (2) to illustrate why institutional history is important for how current trade policy is made and; (3) to shed light

on how complex and difficult current issues in international trade policy can be – and thus why they are difficult to resolve. The second objective stems directly from my experience with students both in the university and among trade policy practitioners in capacity building training around the globe. Trade policy specialists may know the institutional history and how it may affect an issue in trade policy but they seldom write it down. Thus students have considerable difficulty in filling in the blanks when they begin to study trade policy issues.

When the *Estey Centre Journal of International Law and Trade Policy* was launched in 2000 it was still a time of great optimism regarding the international trading system. The World Trade Organization (WTO) was still new and expectations for its potential to foster greater liberalisation were high. The Doha Round was yet to be launched and while there had been troubling demonstrations at the WTO's Ministerial Meeting in Seattle in 1999, these were seen as a one off – no one expected them to become a permanent feature at international trade meetings. The Doha Round was subsequently launched in 2001 with its explicit recognition of the role of trade policy in global development.

By the end of 2009 any optimism regarding the efficacy of the international trade institutions was long gone. The Doha Round lies in tatters and there appears to be neither the political will to complete it nor to let it die. Conflicts abound among WTO Members, particularly between developing and developed countries as well as between governments and some members of civil society – environmentalists, consumers, animal rights activists, labour standards advocates, etc. In the wake of the terrorist attacks of 9/11/2001 security concerns have often taken precedence over open trade. Climate change has become a major international policy issue and a sanctioning role for trade is being contemplated in a number of quarters. With no discernable progress in the WTO multilateral negotiations, interest in regional and preferential trade agreements has expanded – but so has the realisation that these are forums where unequal bargaining power is largely unchecked and where any advantage in market access may be transitory – eroded in the trading partner's next regional agreement.

It is in light of these developments that the title for this book was chosen – *Conflict, Chaos and Confusion*. The current conflicts are obvious for all to see. There is no apparent way forward out of the current antagonistic climate – in the absence of any constructive initiatives the system appears chaotic. Everyone, from seasoned trade policy veterans to domestic politicians, to business people engaging in international transactions, to voters, seem confused and apprehensive given the complexity of the problems brought by globalisation. Over a decade the international trading system has gone from one that was imbued with considerable optimism to one in deep crisis. This book

attempts to shed light on both the major issues confronting the international trading system and their complexity. It offers few suggestions for solving the crisis but hopefully provides insights that can inform the debate and discount some of the simplistic solutions that are all too often proffered. Hopefully, it also assists in developing a healthy respect for the persistence and resourcefulness of protectionists among those venturing into the trade policy arena for the first time. Many of those who wish to harness international trade institutions to broader social objectives fail to comprehend that much can be at risk from an alliance with those having vested interests.

Of course, bringing a book to fruition takes many hands. I would like to thank James Leach, Executive Director of the Estey Centre for Law and Economics in International Trade for his initial enthusiasm and long-term support of the *Estey Centre Journal of International Law and Trade Policy*. I have had a number of excellent technical assistants over the years in the journal's office – Shari Boyd, Laura Loppacher, Desaree Larsen and David Hutchinson. I have also benefitted from the wisdom and skill of Leona Theis who has been the technical editor since the journal's inception. David Hutchinson's assistance with the preparation of this book is greatly appreciated. I would also like to thank Jo Betteridge and the rest of the excellent team at Edward Elgar for their hard work in moving the process from proposal to manuscript to published book.

William A. Kerr, Saskatoon, Canada,
March 2010

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PART I

The institutions of international trade

1. A new world chaos? International institutions in the information age

1. INTRODUCTION¹

The title of this chapter was chosen for effect. Chaos is a word that brings forth strong emotions – fear, disgust, apprehension and, hopefully for a very few, elation. The history of international relations in the latter half of the twentieth century can be characterised as a search for order. It is interesting how often the term New World Order cropped up in the 50-odd years that followed the end of the Second World War. It was applied to the United Nations and the Bretton Woods system that was set up by the victors after the war. It was adopted by those hopeful of more equitable relations between developed and developing countries in the 1970s. It was a buzzword for the re-emergence of US hegemony at the end of the Cold War. Order is the opposite of, and the antidote to, chaos; it soothes the strong emotions created by the threat of chaos.

2. ORDER

The search for order in the last century is not hard to understand. Politically, the First World War rent asunder the last vestiges of the system of diplomacy, based loosely on alliances among monarchies cemented by family ties and strategic marriages, that had developed with the nation-state in the eighteenth and nineteenth centuries. There were rules, or more correctly, conventions of diplomatic behaviour understood by gentlemen that even republics such as the United States and France were willing to abide by, but no international organisations. The failure of that system to prevent a world war and the sheer scale and bloodiness of the conflict that followed totally discredited the system. At the end of the First World War there was a half-hearted attempt to establish a system of international organisations to provide order through the League of Nations. It would take the failure represented by the Second World War (sometimes seen as simply a continuation of the first war after a respite) to fully convince the remaining powers that order required multilateral organisations grounded in international law.

For international commerce, the breakdown of the Old Order had to await the chaos of the Great Depression of the 1930s. The underpinning of the Old Order was the gold standard – a non-institutionalised mechanism for moving the international economy towards equilibrium. In normal economic times, its equilibrating mechanisms were sufficiently long-run that short-run economic shocks could be accommodated without the need for political action in terms of strategic devaluations or trade restrictions – or at least these interventions were sufficiently rare that the order the gold standard provided was not threatened. The depression of the 1930s, however, did not represent normal economic times, and while the root of its economic turmoil lay in domestic economies, governments turned to strategic devaluations and trade barriers as part of their desperate attempts to stem the chaos that gripped their economies. The gold standard was abandoned once and for all as countries in the throes of economic malaise could no longer live with even the limited international discipline it imposed.

Given the failure of the system of governing international relations without the use of formal structures, it is probably not surprising that those charged with reinstating order in international relations at the end of the Second World War chose formal international organisations as their preferred mechanisms. The move to international organisations was assisted by the change in economic thinking towards proactive government intervention that arose out of the widespread adoption (and adaptation) of economist John Maynard Keynes's theories. Technology also helped – international organisations made little sense when it took weeks or months to communicate with home governments.

The institutional pillars of the New World Order put in place at the end of the Second World War were the United Nations – to handle political disputes; the International Monetary Fund (IMF) – to regulate international financial matters and in particular to limit the use of strategic devaluations; and the World Bank – to transfer resources, initially from relatively undamaged economies such as the United States and Canada to those devastated by the war, and subsequently from developed to developing countries. The fourth pillar of the New World Order was to have been the International Trade Organization (ITO) but the forces of protectionism, particularly in the US Congress, could not accept even the limited amount of relinquished sovereignty it would have entailed. One of the ITO's sub-components – the General Agreement on Tariffs and Trade (GATT) – filled the institutional gap on a perpetual temporary basis until it was rolled into the new World Trade Organization (WTO) that came into existence in the mid-1990s.

The preference for creating order through international organisations continued, and the post-war institutions, particularly the United Nations, spawned or incorporated sub-organisations to bring order to a host of problems

– food (Food and Agricultural Organization, FAO), culture (United Nations Educational, Scientific and Cultural Organization, UNESCO), labour (International Labour Organization, ILO), health (World Health Organization, WHO), etc. Other organisations arose to seek order in more specialised forums: the Organisation for Economic Co-operation and Development (OECD); The Commonwealth; the Organization of American States (OAS). Following in the footsteps of the European Union, a host of regional trade organisations were formed: the Association of South East Asian Nations (ASEAN); the North American Free Trade Agreement (NAFTA); the Southern Cone Common Market (MERCOSUR); Asia-Pacific Economic Co-operation (APEC). More recently, international environment problems have led to multi-national environmental agreements (MEAs): the Biosafety Protocol, the Convention on International Trade of Endangered Species (CITES); the International Whaling Commission (IWC). Even command economies, with their professed belief in the deterministic order prophesied by Marx, sought solutions in an international organisation, the Council for Mutual Economic Assistance (CMEA). Currently, the list of organisations with official international standing – each with its information-cost acronym (cost increasing for the uninitiated, cost decreasing for those in the know) – runs into the hundreds. Sometimes it may seem that this plethora of organisations is a contributor to international chaos but the reality is that the growth in their popularity reflects the success of their predecessors.

While international organisations have been allowed to proliferate, national governments have been careful to guard their sovereignty. The absolute sovereignty of nation-states has almost never been relinquished to international organisations, although limited conditional sovereignty over some aspects of international relations is commonly agreed under the rubric of international obligations. This is an important distinction because it is often lost on those who perceive international organisations as having usurped national sovereignty. It is also important because national politicians often attempt to pass off unpopular international obligations as an absence of sovereignty – for example, the WTO is forcing us to give up our cultural heritage. What has been voluntarily agreed to can always be unilaterally withdrawn – but of course not without cost. The entire history of the development of international organisations in the latter half of the twentieth century can be interpreted as attempts to raise the cost for countries choosing to ignore their international obligations, without also requiring the surrender of absolute sovereignty. The granting of limited conditional sovereignty to international organisations has progressed the furthest in international commercial relations – through the WTO and some regional trade organisations such as the European Union and NAFTA. Political relations and MEAs hold the middle ground, while little progress has been made in international law. As a result, international law

largely remains in the pre-war, non-institutionalised stage of understood conventions rather than international adjudication organisations. The one major notable exception is the limited conditional sovereignty granted to the European Court by the member states of the European Union. Order is provided through due process in international organisations. The voluntarily agreed rules of international organisations represent avenues for co-operation among countries.

While the non co-operative assertions of absolute sovereignty by rogue states such as Iraq, or the snatching back of conditionally given sovereignty over intra-EU trade in beef in the wake of the mad cow disease outbreak in the United Kingdom, receive well-publicised attention, for the most part international organisations function as intended – and as agreed. These organisations were instrumental in providing order in the second half of the twentieth century and it is a tribute to their success that when they have failed, as was the case with the UN in Rwanda, it is so surprising. This does not mean that international organisations have been totally successful in achieving their goals – trade barriers remain, countries are poor and underdeveloped, wars break out – but the situation is a far cry from the chaos that characterised international relations in the first half of the twentieth century.

3. CHANGE

Change is often confused with chaos. Change often brings forth the same emotions as chaos. The more rapid the rate of change, the more likely it is to look like chaos. The pace of change that characterises the convergence of new technologies underlying the process that has been dubbed globalisation is very rapid. The spread of computing power to every corner of the developed world, including its enthusiastic uptake by children, has taken place in little more than a decade and a half. The electronic revolution in information technology embodied in the internet has become a mass technology in half that time. The potential for these technologies to change the way we live and work has only just scratched the surface. Add the fundamental change to human society's ability to manipulate nature represented by the information revolution of gene mapping – another technology whose application is only in its infancy – and the next half-century looks to be one of monumental changes.

Globalisation sometimes looks like chaos. Computer programs and electronic communication mean that vast quantities of the world's savings move around the globe on the basis of pre-programmed trigger mechanisms. Governments seem incapable of controlling the movements – the Mexican and the Southeast Asian economies are testimony to the devastating effects that the unfettered movement of financial capital can have. The internet is full of

pornography, quackery, racism, misinformation and fraud that no one apparently is capable of regulating. Publishers in the United Kingdom produce books that are written in Canada, copy edited in Jamaica, printed in Hong Kong, and sold worldwide by an internet company located in the United States. Everything but the actual delivery of the book is done electronically (of course that can also be done electronically) in ways which severely challenge the ingenuity of tax authorities in all those countries. Sheep are cloned before society has decided whether animal cloning is ethical. We are informed that the tomato we have just eaten was actually part fish and we weren't even asked if we liked fish – we're not even sure what genetically modified means and the Net is no help because the 75 000 hits the search engine comes up with all tell you something different. Children hack into the computers of major corporations and crash their e-commerce systems just for a lark. Head offices migrate to warm places with good golfing to run things by remote control in some twenty-first-century reincarnation of absentee landlordism. Chaos?

All of these recent developments represent change. For the most part they do not represent chaos. The electronic movement of financial resources in response to economic signals is systematic rough justice for poor economic management. The governments of Mexico and Southeast Asia will not soon forget the lessons of their respective economic crashes. They will be better governments for it and this will lead to more international order. The globalisation of book publishing is the most current representation of the order that comes from Adam Smith's invisible hand. Make no mistake, this is no rant about the superiority of the market – it is only making the point that the market is not chaos. The order imposed by the market has never been accepted *carte blanche* by any society. The degree to which society will be subject to the order of the market has been one of the great debates in economics – particularly in the twentieth century with its command economy experiments and Keynesian interventions. Markets are constrained by law. Markets fail. Markets produce inequities which society may find unacceptable. Markets do not function smoothly and costlessly but themselves require resources that might, at times, be better used elsewhere. Non-market means of bringing order are sometimes required. The internet and biotechnology currently represent new technologies with very high transaction costs for consumers – whether monitoring what their children are consuming while surfing the Net or determining what actions they need to take to ensure they are consuming wholesome food.

Detection of hackers is costly and the legal constraints are outstripped by the technology. Countries fret over the long-run effect of technological and head office brain drains. These are serious concerns that require international institutions to ensure that the degree of order achieved in the late twentieth century continues and improves in the twenty-first.

Change will cause some individuals to be worse off than they were. Change means that people have to alter the ways that they do things. While some individuals, commonly denoted as entrepreneurs, perceive change in terms of opportunities, others find aspects of it unsettling. No matter how much governments would like us to be the former, most people fit into the latter category. One major facet of the search for order is to make change palatable for those who tend to see it in terms of costs rather than opportunities. The trick is to provide a sufficient degree of order without stifling the ability of entrepreneurs to advance society's well-being.

The models of international trade taught by economists often assume that resources move costlessly between sectors as the terms of trade change – the steel worker let go in Hamilton because his/her industry is no longer competitive with Korea is magically transformed into a computer scientist in Calgary's internationally competitive telecommunications sector. While there are powerful insights which can be gained when such assumptions are made, this approach is not particularly useful in the making of trade policy, except that it shows what will be lost if change cannot be accommodated over the long run.

The WTO and regional trade organisations attempt to provide an orderly balance between the need of governments to respond to those who perceive they are threatened by change and those entrepreneurs who recognise and wish to act upon an international commercial opportunity arising from change. Protectionists fundamentally ask governments to prevent individuals from having to absorb the costs of adjustment associated with a loss in relative international competitiveness. Examples of protection being proactively sought in the absence of an external threat are rare. Of course, the granting of protection imposes an opportunity cost on society in terms of the benefits of trade forgone.

The limits international trade agreements place on the use of trade barriers provide those who wish to invest in international commercial opportunities with a degree of security against having those investments threatened by the imposition of trade barriers by governments wishing to extend protection to others who might face costs in adjusting to the changes that created those investment opportunities. The general movement towards trade liberalisation that characterised the latter half of the twentieth century can be interpreted as encouraging governments to find means other than protectionism for dealing with the adjustment costs brought by changes in the international commercial environment.

Alternatives include better educated workforces to increase labour market flexibility, direct retraining and improved social welfare systems. Still, some adjustment costs will be borne by those adversely affected by change and they will, naturally, continue to seek protection. The increased rate of change which characterises globalisation will lead to additional demands for protection.

The changes arising from the technologies underlying the information economy have expanded the set of individuals who feel threatened by change. The GATT and, subsequently, the WTO only recognise one source of protectionism – domestic producers of a product (and owners of the inputs they use). Consumers were always seen as beneficiaries of liberalisation because of the lower prices they have received. Consumers seldom asked for protection. When they did ask for protection – from drugs, from pornography, from dangerous goods – the issues were not particularly contentious and were easily accommodated in international organisations.

The information and electronic media technologies currently available represent significant sources of change for consumers. Consumers worry about the erosion of local cultural norms arising from widespread satellite/fibre optics/internet-disseminated culture – a concern not to be confused with the traditional protectionism engaged in by those involved in the production of local cultural products and services. Consumers have become interested in issues linked to how the foreign goods sold in their markets are produced – animal welfare on farms, the use of leg-hold traps, tuna harvesting methods, child labour, genetic modification, multinationals with practices some consumers consider questionable, etc. Those who have strong preferences in these areas lobby politicians hard for protection from goods with characteristics they consider unacceptable.

Environmentalists have also become vocal advocates of using the threat of trade sanctions to induce countries with poor environmental records to improve. They ask for protection from nuclear waste, from products arising from harvesting tropical timber, from goods that are produced without accounting for the costs of pollution, from excessive packaging, from polluted air or water that crosses international boundaries.

The international organisations that have been put in place to bring order to international trade do not recognise these alternative seekers of protection from change. The debate over how these interests are to be accommodated in international trade organisations came dramatically to the fore at the WTO Ministerial meeting in Seattle in November 1999. While the chaos in the streets of Seattle had little to do with the failure of the meeting, it served to illustrate the degree of unease that exists, among segments of society, regarding a wide range of changes (imagined or actual) associated with globalisation. In the wake of Seattle, there has been considerable discussion of how these new protectionists can be accommodated in international organisations – including direct public mention of the issue by (then) President Clinton, Prime Minister Tony Blair, and Mike Moore, the head of the WTO. While producer-based protectionists have been content to have their governments represent their interests at international organisations, the NGOs that represent the new interests have been asking for a direct seat at the negotiating table. This issue