

**Threats to the World Trading System:
Income Distribution and the Selfish Hegemon**

by

Jagdish Bhagwati
Arthur Lehman Professor of Economics
and Professor of Political Science
Columbia University

Discussion Paper No. 696

4/27/66
Bip

To appear in: Journal of International Affairs, Spring 1994
Revised: June 15, 1994

**Threats to the World Trading System:
Income Distribution and the Selfish Hegemon**

Remarks by:
Jagdish N. Bhagwati
Arthur Lehman Professor of Economics
and Professor of Political Science
Columbia University

at a Panel Discussion on Problems Facing The World Economy, with
Professor Richard Cooper and Dean Burton Malkiel, at Columbia
University.

The Uruguay Round is closing this week after a marathon of negotiations stretching well over seven years; so the timing of this Panel is exquisite from my viewpoint. The ceremony, besides, is in Marrakesh, an exotic place that sets our minds racing with thoughts of Casablanca, Humphrey Bogart and Ingrid Bergman. Indeed, one can imagine a movie being made of this historic occasion with Peter Ustinov cast as Peter Sutherland, the brilliant and portly new Director General of the GATT who finally brought the Round to successful conclusion, Dustin Hoffman playing our own inimitable Mickey Kantor, and perhaps Al Pacino as the elegant and suave Sir Leon Brittan of the European Union: the three principal players in the closing days of the Round.

In any event, the closure of the Round puts the GATT, or its new version the WTO, right at the center of the world trading system. This is a triumph that should not be underestimated. It was only a few years ago that my good friend Lester Thurow, reading the mood around him, had pronounced at Davos that the GATT was dead. His colleague at MIT, Rudiger Dornbusch, had urged that the GATT be killed. And their brilliant MIT colleague and my justly renowned pupil, Paul Krugman, before his celebrated recent return to the fold of free trade and multilateralism, had flirted with both thoughts: evidently, the company you keep affects you. Fortunately, this anti-GATT MIT School, (christened by me as the Memorial Drive School since MIT's famous Economics department is located at Memorial

Drive in Cambridge, while the phrase also evokes aptly the funereal view of the GATT that the School epitomized) seems today to be more obviously silly than when some of us pronounced on its demerits some years ago.¹ That School's demise and GATT's success are a cause for celebration. So is President Clinton's belated but strong support for the Round, though we must still see him take the agreement skillfully through Congress in the coming year.

All this is on the positive side of the ledger. But there are also problems that lie ahead, which threaten the world trading system in varying degrees, where careful examination is warranted. I will touch on just two of the central problems confronting us today.

(1) Income-Distribution Concerns and Reverse S & D for Developing Countries:

Among the danger points currently is the increasing preoccupation in the European Union and in the United States with the distributional effects of freer trade with the developing countries. A new North-South divide is opening up, in consequence. Traditionally, economists have had to fight the "pauper labour" argument against free trade by the North with the South. This argument asserts that trading with cheaper-labour countries will harm a country's overall economic welfare; in reality, the case for free trade is proof against this charge. But the new fear is not that trading with countries with paupers will harm oneself; rather it is that such trade will produce more paupers in one's own midst. In

¹Cf. Jagdish Bhagwati, The World Trading System at Risk, Princeton University Press: Princeton, 1991, Chapter 1 and Appendix I.

other words, the fear is that our proletariat, the unskilled, will be immiserized by freer trade with the poor countries of the South.

This fear comes from the experience of the 1980s when, in EU, unemployment increased and, in the US, the real wages of the unskilled fell. While nearly all careful studies show that the cause was overwhelmingly the outbreak of technical change that was unskilled-labour-saving, and that North-South trade had very little to do with this distressing reality, the fear that trade was the culprit has become widespread.¹

In fact, you will recall that the debate over NAFTA was particularly acrimonious precisely because the unions were petrified that it would lead to job losses and decline in the real wages of the US workers. One could plausibly argue that, just because many Americans had this stark image of Mexico as a source of pauper labour that was illegally coming across in large numbers and depressing the wages of our unskilled workers, and because they intuitively felt that free trade with Mexico would simply be an indirect way in which this would happen via imports of goods made with cheap labour, a most unfortunate effect of NAFTA was to exacerbate these fears and to undermine the political case for free trade. This would not have happened with the Uruguay Round because freer trade with the developing countries would have been alongside the many other issues negotiated at the Round.² Indeed,

¹For a detailed analytical and empirical analysis of this question, see Jagdish Bhagwati and Vivek Dehejia "Freer Trade and Real Wages of the Unskilled: Is Marx Striking Again?" in Jagdish Bhagwati and Marvin Kosters (ed.), Trade and Wages, American Enterprise Institute, Washington D.C., 1994.

²The British debate at the time of the enactment of the 1905 Immigration quota legislation, the first national legislation of its kind, happened to divide the

this debate has not surfaced in the same way, and with the same passion, in that context to date.

I suspect that this fear of freer trade with the South, no matter how exaggerated, will dominate trade policy through the rest of this millennium. The effect will be precisely what we observed in the case of NAFTA: attempts at linking cost-raising issues somehow with trade liberalization with the developing countries. Thus, attempts were made then, and conceded in spirit though without serious teeth, to raise Mexico's minimum wages, to raise her labour standards, and to improve her industry's environmental standards as well.

The GATT is similarly under pressure to adopt measures to harmonize up the environmental and labor standards in developing countries; and attempts have begun in earnest, with the United States teaming up with France (that great ally of ours on trade, as you will recall from the disputes we had over EU agriculture and audio-visual services at the Round) to push a Social Clause onto the GATT. The case for such upward harmonization, and linkage thereof to trade as well, is exceptionally weak; and developing countries have raised objections to it.

But the capture of these issues by "green" and "blue" protectionists gives them great salience in the developed countries,

politicians and policy advocates into two camps: the free traders and free immigrationists on one side and protectionists and anti-immigrationists on the other, precisely because, as I argue in the text, free trade with the countries containing paupers was considered to be similar in effect to free immigration of the paupers themselves. In fact, free immigration was described as "free trade in paupers" in that debate! See the discussion in Jagdish Bhagwati, "Free Traders and Free Immigrationists: Strangers or Friends?", Russell sage Foundation: New York, mimeographed, 1991.

while the ability to hide behind the umbrella of "social causes" in advancing these issues gives them the cachet of high moral ground. In short, one almost sees the white man's burden being used to advance the white man's interest; and one also sees, in the selection of issues and the precise shape being given to them, the other cynical reality: that stones are being (properly) thrown at other people's glass houses by people who (improperly) construct fortresses around their own.¹

To put it yet another way, what one is beginning to see is demands from developed countries now to introduce special restrictions on trade of the developing countries. Ironically, just as Special & Differential (S&D) Treatment in favour of the developing countries has finally been greatly circumscribed as a GATT principle after years of intellectual battle, we are now getting into Reverse S&D, designed to work against the developing countries.

It will be a major task for economists, and free-trade-oriented politicians, to confront these new problems. The main task will be to keep arguing (what I believe is true)² that the fears of immiserization of the proletariat from freer trade with the South are grossly exaggerated and therefore misplaced, that the real problem has to do with technical change, that the policy which can help address the issue is not protectionism but rather encouragement of

¹Thus, the US itself has serious problems with its children: recent studies show that over 4 million children live in great hazard and black children's infant mortality rates and life expectancy are a matter of embarrassment for a country of such relative affluence. Yet, the focus of our unions is on children in developing countries, since that is where they think their competition comes from.

²See Bhagwati and Kusters, ibid.

widespread skill formation to diffuse the benefits of the technological revolution that favours skills, and that such encouragement of environmental and labour policies as we seek on other grounds should be done, not by linking them to trade rights and access (which will inevitably be captured by protectionists and those seeking to rip off the developing countries instead of really wanting to improve and help them), but by suasion as through subsidizing NGO activity and by concerted, multilateral efforts at securing consensus on core values and policies as desirable objectives to be aspired to..

(2) The Selfish Hegemon and Impact on Multilateralism:

The other question of some importance today is our attitude to multilateralism, since we have recently come to embrace both regionalism (FTA's more strictly) and aggressive unilateralism (via 301 actions).

Historically, our embrace of NAFTA was largely inspired by the fact that the process of getting a multilateral negotiation at the GATT started had stalled in 1982 when the EC refused to go along.¹ In essence, we then served notice that we would try alternative ways of getting to worldwide freer trade, the chief one being the use of Free Trade Areas (FTAs). The Canada-US FTA did work in the end to jumpstart the GATT as the EC did turn around and agreed in 1986 to the Uruguay Round, and to inclusion in the agenda of several of the new issues such as Agriculture and Services. But the dynamic of FTAs and their eventual packaging into regionalism has been such

¹See Jagdish Bhagwati, "Jumpstarting the GATT". Foreign Policy, Summer 1991, vol. 83.

that we have now pushed FTAs beyond Canada, and despite the success of the Round and the GATT, to NAFTA and now seek to push them beyond, to other countries.¹

Similarly, we have become familiar with the use of Section 301 of the 1974 and 1988 trade Acts to issue trade threats to extract concessions from other countries concerning all sorts of issues where we unilaterally define and determine these other countries to be indulging in "unreasonable", "unfair" trading practices, quite regardless of whether any treaty-defined obligations exists on their part to do so. This is what economists have now come to call Aggressive Unilateralism.²

One might expect therefore, with the Uruguay Round almost concluded, and the GATT triumphantly turning into the WTO, and therefore there being no excuse to multiply inherently preferential FTAs as a necessary way to liberalize free trade further, that the US would cease and desist from further FTAs, especially of the regional variety (with their potential for retaliatory Asian response and hence for fragmentation of the world economy into blocs). Similarly, since the strengthened Uruguay Round Dispute Settlement procedures make the use of 301 actions to extract unilaterally-specified trade concessions by other Contracting Parties more risky and almost certainly GATT-illegal, especially in case of the actual use of tariff retaliation, the use of aggressive unilateralism by the US would also

¹See Jagdish Bhagwati, "Beyond NAFTA: Clinton's Trading Choices", Foreign Policy, Summer 1993, vol. 91.

²See, for instance, the essays in Jagdish Bhagwati and Hugh Patrick (ed.), Aggressive Unilateralism, Michigan University Press: Michigan, 1991, and Jagdish Bhagwati, The World Trading System at Risk, *ibid.*

seem to be destined to become a relic of the past.

Yet, it would be a mistake to think that WTO-centered multilateralism, uncluttered by FTAs (and regionalism) and 301 actions for unilateral extractions of trade concessions, will now emerge triumphant. Instead, I fear that these new instrumentalities will continue somehow in place. Why?

The reason is that, no matter why these policy options were arrived at earlier, the United States cannot but see them now as useful instruments for advancing her self-interest. I think that we now confront a model of the Selfish Hegemon, just as my great teacher Charles P. Kindleberger advanced the influential thesis of the Altruistic Hegemon. Let me explain.

Kindleberger thought of the United States after the Second World War as backing the GATT and the liberal international trading regime as a "public good". Now, the United States has been for some time in what Douglas Irwin and I have called the "diminished giant syndrome", where it wants "finally" to "look after its own interest".¹ The architectural approach to building a socially-productive, good-for-all world trading system is at a discount as the United States finds itself pursuing agendas defined more pointedly by domestic interests.

Thus, we have witnessed the United States seeking excessive intellectual property protection, and exploiting environmental and labour issues to reduce competitive pressures. FTAs are then used as

¹Cf. Jagdish Bhagwati and Douglas Irwin, "The Return of the Reciprocitarians: U.S. Trade Policy Today", The World Economy, 1987; and also Jagdish Bhagwati, Protectionism, MIT Press: Cambridge, 1988.

an incentive strategy¹ and 301 is used as a punishment strategy to bargain to advantage with individual, especially developing and smaller, countries,² to extract the best terms from the targetted countries on these matters which are strategically characterized by the interested lobbies as "linked" to trade.

While these favorable bargains are struck with specific countries with the aid of the incentive and the punishment strategies that I have identified, these are codified and enshrined eventually at the GATT in a multilateral agreement (like the Uruguay Round) with a divided, partially coopted and weakened opposition. If the US were to go directly to the GATT and bargain directly with all, on the other hand, she would extract a much inferior bargain. Thus, there exists a symbiotic (and, for the hegemon, diminished as it is, a productive) relationship between the new policies of FTAs and 301, and multilateralism at the GATT or WTO, which favours a continuation of United States embrace of these new policies.³

¹I draw this idea from John Whalley who has recently asked why a hegemonic power like the United States has created FTAs and found small countries like Canada and Mexico to go along with it. He talks of the United States using market access to itself as a way of extracting what he calls "side payments" that presumably would not be possible to extract in multilateral negotiations right out.

²Thus, facing the US in a one-on-one bargain, President Salinas had to accept the worst possible terms on intellectual property protection, something which the US could not extract at the GATT earlier. Then, the Mexican acceptance of these outrageous terms was touted by the US as the "model" which others should follow, with Special 301 threats and actions leveled at particularly recalcitrant countries. In the end, the concessions so gained by the US at the GATT on intellectual property protection were dramatically one-sided and certainly excessive from a worldwide efficiency viewpoint, thanks to the strategy that I have identified in the text.

³Thus, the proponents in Washington of the "GATT-plus" concept and phrase, when they imply that regionalism, aggressive unilateralism and multilateralism are simply different routes to freeing trade, each simply separable from and additive to the others, forget this symbiotic relationship among them. They are as naive as the proponents of the "marriage-plus" view

I suspect, in fact, that most lobbies, with their own agendas, are now aware of these advantages of the FTA-cum-301 Selfish Hegemon Strategy. Indeed, each domestic lobby now cites the previous one that prevailed as a sound reason for the United States government to extract concessions also for itself by use of the incentive and punishment strategies that I have identified. Thus, the environmentalists cite success in securing (for business) intellectual property protection; the labour unions cite the progress by environmentalists when seeking to impose labour standards on others; and other lobbies will doubtless cite the labour union's efforts and prospective success, in turn.

I believe therefore that we are now likely to continue being saddled with these instrumentalities (FTAs and unilateralism) even though they violate the spirit of genuine multilateral negotiations, fair and square, and indeed constitute violations in themselves of the spirit (and, in case of unilateralism, also of the letter) of the multilateralism enshrined in the GATT. It will be interesting to see how the world trading system will evolve, as these new perceptions and political realities shape US trade policy and intrude on the working of the multilateral trading regime at the WTO.

turned out to be in Robert Redford and Demi Moore's film, An Indecent Proposal.

1993-94 Discussion Paper Series
Department of Economics
Columbia University
420 W. 118 St., Room 1022
New York, N.Y., 10027
Librarian: Angie Ng

The following papers are published in the 1993-94 Columbia University Discussion Paper series which runs from November 1 to October 31. Domestic orders for discussion papers are available for purchase at \$5.00 (U.S.) each and \$140.00 (U.S.) for the series. Foreign orders cost \$8.00 (U.S.) for individual paper and \$185.00 for the series. To order discussion papers, please send your check or money order payable to Department of Economics, Columbia University to the above address. Please be sure to include the series number for the paper when you place an order.

- 671. Investment in U.S. Education and Training
Jacob Mincer (Nov. 1993)
- 672. Freer Trade and the Wages of the Unskilled: Is Marx Striking Again?
Jagdish Bhagwati and Vivek Dehejia
- 673. Employer Size and Labor Turnover
Todd Idson
- 674. Less Crime May Be Worse
Brendan O'Flaherty
- 675. Team Production Effects on Earnings
Todd Idson
- 676. Language, Employment, and Earnings in the United States:
Spanish-English Differentials from 1970 to 1990
David Bloom and Gilles Grenier
- 677. The Impact of Performance Incentives on Providing Job Training
to the Poor: The Job Training to the Poor: The Job Training Partnership
Act (JTPA)
Michael Cragg
- 678. The Demands to Reduce Domestic Diversity among Trading Nations
Jagdish Bhagwati
- 679. Mass Layoffs and Unemployment
Andrew Caplin and John Leahy

680. The Economics of Adjustment
Andrew Caplin and John Leahy
681. Miracle on Sixth Avenue: Information Externalities and Search
Andrew Caplin and John Leahy
682. Arbitrage, Gains from Trade and Social Diversity: A Unified Perspective on Resource Allocation
Graciela Chichilnisky
683. Who should abate carbon emissions?
Graciela Chichilnisky, Geoffrey Heal
684. Believing in Multiple Equilibria
Graciela Chichilnisky
685. Limited Arbitrage, Gains from Trade and Arrow's Theorem
Graciela Chichilnisky
686. International Emission Permits: Equity and Efficiency
Graciela Chichilnisky, Geoffrey Heal and David Starrett
687. Do Vehicle Emissions Testing Program Improve Air Quality?
Matthew Kahn
688. Sources of Real Exchange Rate Fluctuations: How Important Are Nominal Shocks?
Richard Clarida and Jordi Gali
689. Modeling Soviet Agriculture for Assessing Command Economy Policies
Padma Desai and Balbir Sihag
690. The Changing Labor Market Position of Canadian Immigrants
David Bloom, Gilles Grenier and Morley Gunderson
691. Herd Behavior, the "Penguin Effect", and the Suppression of Informational Diffusion: An Analysis of Informational Externalities and Payoff Interdependency
Jay Pil Choi
692. Shock Therapy and Russia: Was it tried? Why did it fail? What did it do? What now?
Padma Desai

693. Changes in the Structure of Family Income Inequality in the United States and Other Industrial Nations during the 1980s
McKinley L. Blackburn and David E. Bloom
694. Necessarily Welfare-enhancing Customs Unions with Industrialization
Constraints: a Proof of the Cooper-Massell-Johnson-Bhagwati Conjecture
Pravin Krishna and Jagdish Bhagwati
695. The Effect of Household Characteristics on Household-Specific Inflation Rates: An Application to Trends in Child Poverty and Educational Real Wage Differentials
Todd Idson and Cynthia Miller
696. Threats to the World Trading System: Income Distribution and the Selfish Hegemon