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JUMPSTARTING GATT

by Jagdish Bhagwati

On December 7, 1990, the Uruguay Round talks on the multilateral trading system broke down. These talks are aimed at redesigning and revitalizing the General Agreement on Tariffs and Trade (GATT), which oversees world trade. In essence, the United States walked out as the European Community (EC) dug in its heels over the issue of agricultural export subsidies.

Washington's negotiating strategy had been to use EC concessions on agriculture, partly to benefit the United States directly, but more to win the support of key developing countries for its position on other trade issues. In return for agricultural liberalization, it had hoped developing countries would consent to new disciplines on trade in services, to stricter intellectual property rights, and to limits on their regulation of foreign investment—matters of interest and profit principally to the United States and other developed nations. The EC agriculture offer was simply not substantial enough to strike this grand deal.

Temporarily suspended, the talks have now resumed at the technical level. But their successful conclusion requires that the fast-track authority granted by Congress to the Bush administration, making possible a straight vote on the entire package of GATT reforms in lieu of votes on each item, be extended beyond the end of May. Barring a highly improbable resolution of disapproval by either house of Congress, fast-track authority will be extended two more years, during which a final deal must be struck.

Having brilliantly maneuvered the EC into a difficult position, the Bush administration is nonetheless unlikely to push the Uruguay Round to a successful conclusion unless it now

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recognizes that its bargaining leverage is not as strong as earlier believed. The EC may be over a barrel, but the barrel can roll right out of the negotiating arena. The United States has three strategy options: inaction, threats, and incentives. Of these, the last may be the most promising and also the least explored. The strategy of inaction presumes that the EC cannot afford to derail GATT because the stakes are too high and the guilt would be too great. This presumption is not compelling.

The stakes are indeed high. The Uruguay Round, launched in Punta del Este, Uruguay, in 1986, is the single most important trade negotiation since GATT's creation in October 1947. Its agenda is complex, its promise considerable. GATT's rewards rest critically on what economists call a "fix-rule" trading regime: Member nations compete according to rules and generally the chips fall where they may. This conception contrasts with "fix-quantity" trading systems, or what is known popularly as "results-oriented" or "managed" trade. There, bureaucrats and politicians negotiate quantities, not rules, and the former determine who will trade what. GATT matters to many who believe that significant efficiency gains come through a world trading system that lets markets work unimpeded by tariffs, quotas, and other interventions.

A prime example of the Uruguay Round's relevance and importance is the exclusion to date of services from the provenance of GATT, and the intention now to redress that omission. If successful, the Uruguay Round will extend the discipline of a fix-rule trading regime to this new set of sectors, including accounting, airlines, banking, construction, insurance, legal services, medical services, and telecommunications. Such services generate nearly a quarter of world trade today.

At the same time, the Uruguay Round will begin to bring discipline to such older economic sectors as agriculture and textiles. Ironically, it was the United States that in 1955 exempted agriculture from GATT controls with a widely followed waiver. Now the sector is riddled worldwide with myriad market-distorting interventions. Textiles, too, have been heavily protected since 1961 when the United States, under pressure from domestic interests, helped negotiate the Short-term Arrangement on International Trade in Cotton Textiles that survived long term as the Multifiber Agreement (MFA).

Yet the failure to extend GATT's mandate to new sectors and to restore discipline to old ones would entail not only the costs of missed opportunities, great as they are. The probable ensuing consequences also carry costs, which could be very large. The breakdown of negotiations critical to strengthening the common institutions of an increasingly interdependent global economy could undermine confidence in the capacity of key nations to provide necessary leadership. One failure may engender many others.

Further, there are more immediate costs, in particular a resurgence of protectionism. Economists distinguish between the demand for protection (from firms, unions, and communities) and the supply of protection (by the administration and Congress). The supply of protection would probably increase because an irate Congress would more readily accept demands for protection from its constituents if it believed that the EC and others had failed to accept American demands for more open markets. Then again, if the United States were to give in to protectionist demands, which are likely to increase thanks to the recent recession, as all previous experience suggests, so would its trading partners. Competitive "beggar-thy-neighbor" trade restraints could accentuate the recession much the way the global proliferation of tariffs is generally believed to have followed the U.S. Smoot-Hawley Tariff Act of 1930.

Trade restraints and tariff wars are not the only likely outcomes. In agriculture, the failure to reach agreement could mean export-subsidy wars, as the United States starts to match subsidies the EC refuses to surrender. Similarly, reductions in agricultural income-support payments in the 1990 U.S. budget that are contingent on EC concessions on agriculture at the Uruguay Round could be lost. The lost chance to reduce income supports coupled with higher export subsidies would doubly strain the U.S. budget at a time when the United States can least afford it.

Congress is also likely to become less committed to GATT's multilateralism and more enamored with quick-fixes like regionalism and unilateralism—the former leading to the formation of free-trade areas south of the Rio Grande, the latter rooted in American use of economic power to extract unilateral concessions from weaker trading partners. Congress has recently flirted with both alternatives, as panic and petulance break out over the continuing trade deficit and the rise of Japan. Regionalism threatens to fragment the world economy; unilateralism undermines GATT's central tenet that the strong and the weak should play by similar rules. Exacerbating these destructive trends in the United States would undermine the world trading system when the pressing task of the day is to reinforce it.

The Blame Game

Could the United States successfully blame the EC for all this mayhem? Not really. Much of the disarray would stem from American actions. Protestations by the Bush administration that a frustrated Congress was the culprit may carry conviction among the experts, but foreign governments will only experience déjà vu.

There is an exaggerated but nonetheless real feeling in the EC bureaucracy that the United States unwisely backed the EC into a corner on an issue of utmost political difficulty. The "blame game" can be played equally well by the EC, and thus seriously undercuts the possibility of unilateral accommodation by the EC to break the Uruguay Round logjam.

If guilt will not work, can shame suffice? Unfortunately, politicians in pluralistic democracies typically suffer from cognitive dissonance on trade policy. Some commentators have criticized French President François Mitterrand for the incongruity between the high ground of his rhetoric on Third World needs and the low ground of his support for protection of 10 million relatively well-off EC farmers against hundreds of millions of farmers in less-developed countries. In the same vein, the MFA has protected the senescent textile industries of most industrial countries in the Organization for Economic Cooperation and Development

(OECD) at the expense of developing countries, even as these same OECD countries spend large sums on aid programs. Altrusim has been easier in aid than in trade, because constituency politics makes trade policy treacherous ground for the national interest. It is not likely, therefore, that Mitterrand will feel particularly embarrassed by his unwillingness, which reflects his political inability, to yield more on agriculture.

A strategy of threats to coerce the EC offers no better prospects. The twin components of a threat strategy would be American regionalism and unilateralism. Neither would wound the EC into submission. Instead, both promise to wound GATT.

American regionalism is an empty threat to the EC. Arguably, the "regional card" in the shape of the 1988 U.S.-Canada Free Trade Agreement played a small role in prompting a reluctant EC to join multilateral negotiations it had rejected four years earlier. But when the question is not one of joining negotiations but instead of yielding in them, the threat approach is much less compelling.

Besides, the prospective U.S. regional partners are the troubled countries of Latin America. It is not credible that the United States would divert its energies and trade to a region whose slow growth rates, fragile democracies, inflation, and debts offer a far less attractive market than the burgeoning Far East and EC. If the United States foolishly turns away from the world to its own backyard, the likely EC reaction would be: Go ahead.

Nor can the United States expect the EC to bend because the threat of American regionalism would weaken the multilateral trading system and reduce the benefits accruing to the EC. A staunch believer in the simultaneous practice of regionalism and multilateralism, the EC itself is, of course, a regional arrangement. It is unlikely to view the growth of similar regional arrangements elsewhere as necessarily harmful to the multilateral trading system. A warmer American embrace of regionalism is therefore unlikely to alarm the EC into renewed efforts at the Uruguay Round, no matter how much it frightens those who see greater virtue in multilateralism.

It is tempting to believe, however, that aggressive unilateralism may pay off where regional initiatives do not. Since the passage of the 1988 Omnibus Trade and Competitiveness Act, the United States possesses weapons under sections 301-310, popularly known as Section, Super, and Special 301, designed not merely to enforce American trade rights, but also to extract new concessions through tactics such as the threat of GATT-illegal tariff retaliations. The Super 301 sword, under which unacceptable "priority practices" and "priority countries" can be targeted for retaliation, is now sheathed because of the lapse of its two-year legislative mandate but was used on May 25, 1989, by U.S. Trade Representative Carla Hills against Brazil, India, and Japan. The "priority practices" objected to in these countries included many that were in fact compatible with these nations' trading rights as defined by GATT or other treaties.

Resorting to the law of the jungle rather than the rule of law works only against the weak, making its successful application to the EC highly dubious. The EC is a sufficiently sizable economic power to preclude intimidation. Further, unlike the case of Japan, the imbalance of trade between the United States and the EC is not significant, suggesting a broadly equal stake in trade by both sides and lack of decisive power by either. For example, the EC was left out of the Super 301 hit list despite many American objections to EC policies. By promising tit-for-tat response, and even adding 301-type legislation into its own arsenal, the EC has inured itself to undue pressure, though not to occasional trade battles like the U.S. invocation of 301 against the EC ban on hormone-fed beef in January 1989.

The EC will only sit back and enjoy the action if the United States lashes out with 301 actions against other weaker states to force one-on-one concessions it cannot procure through multilateral negotiations at the Uruguay Round. Nothing has drawn the wrath and condemnation of the world's trading nations more than America's 301 policy.

Japan, too, is a great economic power capable of resisting 301-style intimidation. But Japan feels seriously exposed and thus far is unwilling to indulge in a tit-for-tat strategy toward either the EC or the United States. It is an interesting question whether, and when, Japan will find the American fixation with Japan, and consequent attempts at imposing solutions on Japan for every imagined perfidy, intolerable and deserving of a tougher response.

The Bush administration is unlikely to push the Uruguay Round to a successful conclusion unless it now recognizes that its bargaining leverage is not as strong as earlier believed.

Still, all is not lost in the Uruguay Round. An incentive strategy might bring the EC around. Such a strategy can be based on two wholly different but complementary ideas: one addressing fairness in balancing political costs in negotiated concessions between the EC and the United States, and the other relating to easing the political cost to the EC.

Economists think of mutual gain from trade transactions; negotiators think of mutual pain from trade concessions. It is improbable that a trade negotiation among equals could reach fruition unless each party felt the political cost of market-opening concessions was matched by costs to the other side. Reciprocity of benefits in terms of increased exports must be broadly matched by reciprocity of costs in terms of the political difficulty of accepting increased imports.

In the current GATT standoff, the agreement that the EC rejected in December appears heavily unbalanced in favor of the United States in terms of political costs, relative to those of the EC, and especially France. The proposed deal essentially involves four elements: services, trade-related intellectual property rights (TRIPs), trade-related investment measures (TRIMs), and agriculture. Only a decade ago this agenda would have seemed strange. After all, why are intellectual property and foreign investment issues included in a trade negotiation, even if they are prefixed by the magic words "trade-related?" TR is, in fact, more aptly read as "tangentially related" than as "trade-related."

The agenda reflects the changed politics of trade policy in the United States, and this in turn explains the imbalance of political costs plaguing the current stalemate. Of late, U.S. trade politics has been marked by increased influence of producer interests in the design and execution of trade policy. Changes in the world economy in the 1980s have strengthened producer interests. The most compelling factor has been the "Diminished Giant Syndrome."[1] There is a national fear of being overtaken by East Asian nations, which will then create a new "Pacific century." Safeguarding U.S. producers against other competitors has gained such enormous importance that it now tends to dominate the definition of national interest.

Interestingly, Japan's role as feared rival has contributed to this ideological shift. Popular attribution of Japan's economic success to a benign, symbiotic partnership between its government and producers has led many to advocate following Japan's example. This belief has undermined the traditional American belief that the national interest is not simply an aggregation of producer interests. Older Democrats who once argued that what was good for General Motors was not necessarily good for the United States have been replaced by younger Democrats whose gut instinct is that what is good for Eastman Kodak cannot help but be good for America.

The institutions defining trade policy have increasingly been reshaped to reflect this ideological shift. Traditionally more responsive to producer interests, Congress has progressively recaptured trade policy from the administration, reversing its surrender to the administration following the Smoot-Hawley Tariff disaster. Particularly evident in the 1988 Omnibus Trade and Competitiveness Act were new limits on the scope of the administration's discretion, with mandatory requirements being imposed in some areas.

Producer influence on trade policy has also arisen from necessity imposed by pluralistic

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[1]*See Jagdish Bhagwati and Douglas Irwin, "The Return of the Reciprocitarians: U.S. Trade Policy Today,"* The World Economy, *June 1987, vol. 10.*

politics during the 1980s. Faced by powerful protectionist pressures, the Reagan administration yielded partially by negotiating export restraints in autos, footwear, and steel. It allowed the dollar to fall. But it also encouraged a coalition of interests to counter protectionist lobbies. Service sector lobbies were a natural candidate as were industries such as pharmaceuticals and communications that had long felt intellectual property protection abroad was inadequate. Other potential allies were multinational companies that were unhappy with developing-country restrictions and requirements on their operations, chiefly in the form of export-performance targets and local-content rules.

Lobbies for TRIPs and TRIMs were thus eagerly embraced by the administration and dispatched to Brussels and Geneva as part of the elite corps attending the multilateral trade talks. In turn, these lobbies saw in these negotiations a chance to gain concessions denied to them in other forums. The tangential relationship of TRIPs and TRIMs to actual trade issues was ignored, though some developing countries did object. Neither the absence of empirical evidence establishing that lack of intellectual property protection in fact adversely affects technical progress, nor the findings of theoretical research that intellectual property protection can harm developing countries even as it augments world efficiency, were allowed to stand in the way of putting TRIPs on the trade agenda. American spokespersons, such as the current and former U.S. trade representatives, Carla Hills and Clayton Yeutter, shifted from the utilitarian, efficiency-based, and mutual-gain reasoning underlying GATT to a "rights"-based assertion that inadequate intellectual property protection amounts to piracy or theft.

From the perspective of political costs, then, an agreement that yields *any* concessions on services, TRIPS, TRIMS, and agriculture (where U.S. grain exports are expected to profit from liberalization) represents a nearly all-win situation for the United States. The only political pain would be from the modest promise of market access on dairy products, peanuts, and sugar, and from concessions on textiles. The American agenda would have triumphed, its lobbies duly rewarded, and the pain principally one of inadequate gain.

For the EC, the role of producer interests in the Uruguay Round is very different. EC producers would profit equally from agreements on services, TRIPs, and TRIMs, but they are relatively ineffective lobbies; therefore, the political payoff is negligible. By contrast, liberalization of agriculture poses tremendous political difficulty in both France and Germany. So from the EC perspective, the agreement currently on the table looks alarmingly like an all-lose proposition in terms of political costs.

The result is a massive imbalance of political costs from the proposed agreement that must be corrected if the Uruguay Round is to be successful. The United States must agree to accept more pain, for example by allowing a substantially greater reduction of protection for dairy products, sugar, and peanuts—that is, by going the extra mile where it is politically tough. The United States could also undertake a faster and more comprehensive dismantling of its MFA restrictions than the EC. Now that President George Bush has emerged from the Persian Gulf war with great political clout, he can afford to shed the embarrassing MFA in a show of burden-sharing solidarity. It would also be a trade concession to developing nations that have suffered over the years from the MFA.

At this point the spurned accord gives the benefit of concessions in the new areas to OECD countries without comparable concessions to developing countries. By extending benefits to developing countries that can increase textile and clothing exports, the overall settlement at the Uruguay Round could reduce the massive unfairness implicit in the accord currently promoted by the Cairns Group (a coalition of 14 countries exporting farm products) and the United States. In addition, because the EC has an export advantage over the United States in textiles, an accord that substantially opens up textiles trade would afford the EC comparatively greater benefits than the United States, and the United States comparatively greater pain. This would further narrow the gap in political costs that divides the EC from the United States.

The acceptance of more pain would also imply a role reversal, enabling the United

States to appreciate that political costs make a difference and to consider acceptable only a modest revision upwards in the final EC offer on agriculture. In turn, the administration must persuade the lobbies and the Congress that the modest gains in regard to services, TRIPS, and TRIMS are significant when put into perspective. After all, these areas have escaped effective discipline over the last four decades because of their economic and political complexity. To expect more rapid and substantial progress in them within one negotiation when it took seven to reduce tariffs to their current low levels is to be not utopian but self-destructive.

The Perestroika Solution

While redressing the imbalance in political costs may well suffice, an added inducement on agriculture for the EC would surely help. Such an inducement could be provided by exploiting the necessity of food imports for the success of *perestroika*. The Soviet Union could offer a significant, if temporary, market for excess European farm production, cushioning the shock to EC farmers of a more substantial cut in agricultural export subsidies.[2]

An agreement could be reached in which the EC would annually sell up to 20 million tons of grain and meat to the Soviet Union, close to half of the Soviet Union's 1989 imports, over a period of perhaps five years. The USSR would be granted long-term credits so that repayment in convertible currency would begin only in the sixth year. This arrangement would ensure that the Soviet Union, strapped for foreign exchange, would be able to import this quantity above and beyond its normal imports, thus guaranteeing that the sale would represent a genuine new market.

The sales would naturally gravitate to the furnishers of the credits, ensuring the EC (and the United States insofar as it extends credits) a share of the extra market. While the EC would lose some subsidy-financed markets by accepting further cuts in export subsidies at the Uru-

[2] *See Jagdish Bhagwati and Padma Desai, "Making a Virtue of Moscow's Necessity,"* The New York Times, *November 12, 1990.*

guay Round, it would gain the new Soviet market. The EC's political cost from agricultural liberalization would be greatly eased until the expiration of the Soviet pact in five years, whereas the more competitive Cairns Group countries could immediately pick up markets abandoned by the EC as its current subsidies dwindled. At the end of five years the EC would be forced to adjust, and the world would retain the gains in agricultural liberalization agreed to at the Uruguay Round, thanks to the cushion provided by the Soviet pact.

The Soviet Union could profitably use credit-financed supplements to its grain and meat supplies. Unfortunately, the Soviet problem was not limited to getting through this past winter with "emergency" food aid—a program that united the EC, the United States, and others. Over a longer period, the USSR will require sustained and sizable supplements to food supplies in order to make the transition to a market economy politically appealing. Supplemental imports need to be integrated systematically into a coherent economic reform plan if they are to have the maximum benefit.

The Soviet problem is not one of falling food production. On the contrary, agricultural production is one of *perestroika*'s success stories. Adjusted for weather variations, Soviet grain yields have increased at an accelerated pace during the Gorbachev years. Farms, by and large, have managed to bypass the state's procurement drive at controlled prices, instead selling food at higher prices in the marketplace. Food shortages in major cities reflect the declining procurement powers of the state: In 1989 the procurement of 59 million tons of foodgrains fell well short of the 86 million ton target. Procurement shortfalls mean that the Soviet government has correspondingly less processed bread and meat to distribute at fixed, low prices in the state shops. As the main problem intensifies, further shortfalls are anticipated and people will begin to drain stores of whatever they can find, leading to unseemly scrambles for vanishing sausages and bread that will fuel still further the frenzied emptying of shelves.

Under the pact with the EC proposed here, imports would largely fill the gap left by lagging procurement. *Perestroika* would be helped in several ways. For example, food would be immediately available in state stores in restive cities. This would help contain the revolution of falling expectations about what Soviet leaders can deliver. Expectations about future shortages and price hikes would be dampened by a large influx of food. Further, a deal with the EC would soak up excess Soviet expenditures, reducing the huge budget deficit—now 10 to 11 per cent of gross national product—that is fueling an inflationary spiral. Moscow's need to slash investment expenditures (and not just defense spending) in order to reduce the budget deficit would be mitigated. One of the principal lessons of developmental planning is that cutting investment for short-run, anti-inflationary objectives is unwise since it saps growth and creates serious problems later.

Simultaneously buttressing *perestroika* and concluding the Uruguay Round by exploiting the complementarity of these tasks is attractive. Tragic events in Lithuania and the increasing likelihood that *perestroika* may succumb to disintegrative tendencies that Gorbachev can no longer control require that the proposed grain and meat agreement be contingent on three factors: the continuation of *glasnost*, the grounding of *perestroika* in a coherent economic plan, and a reasonable prospect for the resolution of the political crisis between the center and the republics, without which no economic reform plan is credible.

The recent resumption of EC credits worth $1 billion, which were suspended over the January 1991 Lithuanian repression, and renewed EC confidence in Gorbachev's democratic credentials and good intentions, if not in his ability to manage the increased domestic turbulence, suggest that marrying the Uruguay Round and *perestroika* remains an attractive way of advancing both causes.

But all will be lost at the Uruguay Round unless U.S. officials reassess their fundamental strategy and develop an approach that takes into account the political realities faced by its key negotiating partners.