THE CASE FOR TRADE

Why the Multilateral Trading System is More Important than Ever for the United States of America

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Thank you John. Distinguished guests, faculty and especially students. It is a great pleasure to be here at one of the world's greatest centres of learning -- a place where so many brilliant minds come together to confront some of the world's most pressing problems. No fewer than 20 members of Berkeley's faculty have won the Nobel Prize, seven of them still impart their knowledge to this generation of students – a generation on which much will depend. Discoveries by these brilliant men – and I regret to say that for the moment, all of Berkeley's Nobel laureates have been men -- have advanced human understanding in medicine, chemistry, the origins of our universe and the sources of man's inhumanity to man.

I am profoundly aware of the aura of genius that swirls around Berkeley's hallowed halls, so it is with some trepidation that I begin my lecture with a statement that is glaringly obvious – we live in perilous times.

We are all know familiar with the commentators' cry that we are in the midst of the greatest financial crisis since the 1930s. World Bank economists tell us 400 million more people live in poverty in the developing world that was previously thought. Roughly 1.4 billion people in the developing world now live on less than $1.25 per day. The glaciers recede, the polar ice caps melt and our oceans rise as the planet's temperature increases at a rate the National Academy of Sciences says has not been seen for at least 2,000 years.

The policy challenges facing the world's leaders today are as great as they have been at any time since the Second World War. As policymakers ponder the way forward, they would be well served to let history be their guide. History tells us it was the political mistakes – or inaction -- of the 1930s that transformed a financial crisis into a full blown economic catastrophe. Banks were allowed to fail. Panic was allowed to grow. When assessing the disastrous consequences which flowed from these policy mistakes, politicians predictably shifted the blame to foreigners. It's always easy route because foreigners can't seek revenge at the polling booth.

Among the most disastrous political decisions taken in the wake of the Crash of 1929 was the passage of the Smoot-Hawley Act, signed into law on June 17, 1930. The idea of this ill-conceived legislation was to protect US farmers – a notion popular in many WTO member governments to this day. As farmers pressed to have greater protection from imports, many other industries joined the queue of lobbyists and as they often do, these lobbyists succeeded in gaining protection for their industries. Duties of more than 60% were slapped on 3,200 imported products, lifting overall average tariffs by about 20%. If the idea was to curb imports, Smoot-Hawley was a fantastic success – by 1933 imports had fallen from $4.4 billion to $1.3 billion while exports fell 69% over that same period to $1.6 billion. But there was an unintended consequence to Smoot-Hawley -- its contribution to an economic depression. Smoot Hawley touched off a domino effect of retaliation and counter-retaliation among trading partners which provoked a severe contraction of international trade, depressed growth and rising unemployment around the industrial world. From 1930 to 1932 the unemployment rate soared from 8.7% to 23.6% and remained at more 14% for the remainder of the decade.

How did the collapse of trade contribute to this? One reason is that contrary to the conventional wisdom, imports are good for you. A great many Americans were then and are today employed in sectors linked to imports. Parts needed for manufacturing became dearer if they could be found at all. The soaring jobless rate was also a product of the response from other countries which were anything but pleased to be the target of trade sanctions. Predictably, these countries retaliated. US exports to Europe, for instance, declined from $2.3 billion in 1929 to $784 million in 1932. Globally trade contracted by 60% between 1929 and 1932.

The economic affects of this contraction are well documented, but the geopolitical impact should not be underestimated either. The application of trade sanctions is regarded as a hostile act by those being sanctioned. No one should have been surprised that Canada or Germany retaliated against US exports. What followed were policies in which each nation was out for itself. The global depression and economic nationalism that ensued were surely among the factors contributing to the geo-political instability that in turn lead to the Second World War.

As World War II was winding down, governments made the decision that the ruinous beggar-thy-neighbour trade policies imposed in the 1930s could never be repeated. An international system of co-operation in security, finance and development was created. The establishment of the United Nations, the World Bank and the International Monetary Fund provided the international framework for addressing international tensions -- be they border disputes, balance of payments crises or the rebuilding of ruined states. Trade was more complicated. For a variety of reasons, a great many of them to do with the United States Congress, the International Trade Organization which was proposed at the 1947 Havana Conference, never got off the ground. Instead, 23 countries signed the General Agreement of Tariffs and Trade, a compact which was largely about regulating global trade in goods. Over 60 years, and eight rounds of international trade negotiations, the GATT and now the WTO, have established a framework of regulations in which nations interact commercially. Since the conclusion of the Uruguay Round in 1994, these rules have been extended to trade in services and have expanded into areas of interest to developing countries – particularly agriculture and textiles – that had previously been addressed only marginally.

Economically speaking, few would doubt that multilateral trading system has been a resounding success. Global trade has grown 30 fold in real terms since 1948. For the United States, merchandise exports have risen from $13 billion in 1948 to $1.16 trillion in 2007. The growth in services exports have been equally impressive, expanding from $38 billion in 1980 to $456 billion last year.

Today, as the United States faces looming spectre of recession, export growth has assumed even greater importance. The Federal Reserve indicates the country may already be in a recession. Corporate profits have fallen in every quarter this year. Last month, retail sales fell 1.2%, the first drop in three years. Durable goods purchases are down the last two quarters and private domestic investment has fallen the last three. Against this backdrop, one segment of the economy has been roaring ahead – exports. In the second quarter this year, export growth and slowing imports were responsible for GDP growth of 2.9% on an annualised basis. The growing reliance on trade is the continuation of a trend toward a more trade-oriented economy. In 1970, exports and imports combined were the equivalent of just over 11% of GDP. Last year, exports alone were 12% of GDP and combined with imports, international trade was the equivalent of nearly 29.1% of domestic output -- a record.

Trade flows are a function of three phenomena, economic activity, technological innovation and the removal of trade barriers.

The sharp rise in the growth of global output in recent years has been mirrored by significant gains in trade volume, with trade growth actually outstripping output gains by two to three times. In bad times, trade has had a stabilizing impact on the global economy. In times of slow economic growth or recession, trade has often continued to grow.

Technology too has played an important role in increasing trade flows. Productivity improvements in production have boosted overall output and lead to more trade. Improvements in transportation and communications technology have opened new avenues for trade growth as well. Containerization, first put into widespread commercial use in 1956 by Malcolm MacLean of Sea-Land Service, had the immediate effect of reducing rates of pilferage and cargo damage. As the boxes became standardized, loading and unloading operations also became much more efficient. Port officials estimate that container cargo moves more than 20 times faster than break-bulk cargoes.

Lastly, there is the question of removing trade barriers and this is where the WTO fits into this equation. In 1947, before the GATT began operations, average tariffs in the industrial world were between 20%-30% and trade was constrained by a myriad of quantitative and exchange restrictions. Eight trade rounds succeeded in reducing average tariffs on manufactures to 4%, and quantitative restrictions were phased out, at least for manufactured goods.

We know that trade opening creates greater efficiencies, encourages innovation and generates wealth. But this does not mean that trade opening is good for every person, every country, every time. There is little question that greater competition puts companies and indeed entire sectors of the economy under pressure. There can be no doubt that trade is responsible for *some* job losses in the United States and around the world. It is true that over the last 60 years, the share of people employed in the United States manufacturing has fallen from 33% of civilian non-agricultural employment to less than 10% today. It's also true that the number of manufacturing jobs has fallen sharply, with 4 million such jobs having been shed in the past decade.

Economists agree some of those jobs were lost due to international trade. Likewise, they agree that some of the wage stagnation that has beset American workers is due to competition from lower wage country exporters.

But Bob Lawrence at Harvard estimates that only about 11% of job manufacturing job losses this decade are due to international trade. Other studies put the figure somewhere between 4%-15% . The great bulk of the decline in manufactured jobs can be attributed to surges in productivity growth – brought about by technological innovation. This would explain why US despite the loss of 4 million industrial job, manufacturing output rose to an all-time record last year. According to the Federal Reserve, real manufacturing output has risen 124% between 1978 and 2007. Output of durable goods – cars, machinery and aircraft – more than tripled over the same period.

Other statistics tell the same story. The US Bureau of Labor Statistics states that productivity growth in US manufacturing is at an all time high. Between 1950-73, non-farm business sector productivity rose at an annual rate of 2.8%. Manufacturing productivity rose at 4% on average each year from 1995-2000. Since 2000 it has risen at the rate of 3.7%. Higher productivity through more advanced technology means fewer workers are needed to produce greater output.

Stagnant wages in the manufacturing sector are likewise due only in small part to trade, says Lawrence. Instead, he attributes this wage stagnation to the sharp rise in the share of income going to the superrich (the top one percent of taxpayers) and the share of corporate income going to profits – which were at near record levels until this year. Other economists say the meagre growth in manufacturing paychecks is due principally to the phenomenal rise in health care costs. Labour costs for US corporations have risen 25% since 2000 but little of that has found its way into the pockets of workers since virtually the entire increase went to pay the higher bill for health insurance, which is twice as expensive today as it was at the beginning of this decade.

This is compelling evidence that the blame for job loss and stagnant wages lies outside the field of trade. Moreover, since America's engagement with the outside world has added at least 10% to US GDP, according to Lawrence, to adopt an isolationist or protectionist response would be counterproductive in the extreme. To address the problems facing American workers US policymakers must find other means. Trade, especially inside the system of WTO rules, generates wealth -- this we know. But the WTO cannot address income inequality inside the borders of any individual country. Nor can it fix creaky health or pension systems. Such disparity can only be addressed through domestic tax and spend policies. With the election now less than a week away, I do not intend to enter too much into this highly charged political debate in the United States. I would only say that restoring citizens confidence in trade requires governments to ensure that sound domestic policies are in place. It is reassuring, however, to see that both Presidential candidates have indicated that concluding the Doha round is an important economic priority and that both reject protectionist solutions to US economic difficulties.

A bit about this Doha round. As many of you know, Ministers came to Geneva in July to conclude framework agreements in agriculture and industrial goods trade which would have provided the springboard for agreement across the Doha agenda. As you will all be aware, we didn't get there. We made a great deal of progress, reaching tentative accord on something like 17 of the 20 topics on our agenda. But we hit the wall on a technical matter – how to provide safeguards to poor country farmers when agriculture imports rise -- which turned out to be of great political importance. The issue of the acceptable threshold for import surges and the magnitude of tariff protection to be applied were technical issues that masked underlying political concerns. Some countries, including India, Indonesia, the Philippines and China, believe existing agreements do not yield sufficient safeguard protection. Others, including the United States, Uruguay, Thailand and Paraguay find it difficult to accept that a negotiation designed to bring trade barriers down, could result in some existing tariffs going up.

Many journalists and commentators suggested the inability to resolve this safeguard issue meant that the July meeting ended in failure. That's not the way I see it – it was certainly a serious disappointment, but not a failure. During those meetings we found ways to unlock seemingly intractable issues like the erosion of preferential tariff treatment, trade in tropical products, and special treatment for agricultural products produced in the developing world. We now have a formula for cutting farm tariffs and for reducing trade distorting domestic farm subsidies. We already know that direct export subsidies will be eliminated. We also know that rich country duties will be eliminated on at least 97% of the exports from the poorest countries. We have narrowed gaps in the opening markets to trade industrial goods. The July meeting also featured, for the first time in the Doha round, productive discussions on opening services markets.

All of this has been negotiated in such a way as to ensure that developing countries receive, what is known as special and differential treatment. There is no "one size fits all" system at the WTO. Rather the negotiations are structured to produce tailored accords which will result in an outcome where the contributions countries make are based on their ability to pay. The world's poorest countries, for example, will not be required to make any reductions in their level of subsidies or tariffs. Nor would they be required to further open their services markets. All developing countries will pay less than their developed partners and small and vulnerable economies and recently acceded members will also receive special treatment. There are provisions for other categories of developing countries and for individual nations as well. Such a myriad of exceptions and derogations makes the negotiations extremely complicated. But it makes the result more credible and sustainable.

The bottom line is that the package on the table is truly significant. Governments now know precisely how much that stand to lose if the round falters. This explains the reaction of governments when confronted with the fact that the meeting would not achieve its objective. Previous setbacks have been marked by acrimonious exchanges and extended versions of the blame game. This time members departed Geneva far more in sorrow than in anger. While there were a few testy comments from some, the entire membership expressed the overwhelming view that we must continue. We must consolidate the progress made in July, build on it where we can and when the time is right prepare for another political push aimed at reaching agreement in agriculture and industrial goods trade.

So, as we wait for the right political signals, in Geneva we continue to work towards resolution of the Special Safeguard Mechanism issue and others, including the question of high levels of trade distorting subsidies extended to cotton farmers. We continue our work as well in areas like services, reducing fisheries subsidies, anti-dumping and specific development measures.

Elsewhere, the issue of the Doha round remains, surprisingly to some, firmly on the radar screens of world leaders. It will not have escaped your notice that in the midst of the financial turmoil that has shaken the world, the leaders of the G-8 group of industrial countries have called for a conclusion to the round.

Why have all these governments come to the same conclusion on the urgency of reaching agreement? One reason is the perilous condition of the global economy. Jittery markets and a nervous public are looking for signals that governments are prepared to work together to solve the world's problems. With many major economies seemingly on the cusp of a recession, the additional growth generated from removing trade barriers would be also be a welcome shot in the arm.

But there is another reason as well. It is clear to many of us that current trade rules are inadequate for the world of today. Many see it as inequitable that rules on our books permit rich countries to pour billions of dollars into agriculture programmes which have impoverished developing country farmers over the last three decades. Many see it as unjust that we preside over a tariff system in which rich countries hit exports from poor countries with duties three or four times higher than those applied to exports from rich countries. Rules on the movement of goods through customs which date back to a time before bar coding and laptops, seem antiquated. Failing to help Africa reform customs policies which require 40 documents and 30 days to clear shipments, is difficult to explain. But failing to address fisheries subsidies which contribute to serious depletion of fish stocks, seems downright irresponsible.

Governments know all of this. In Doha in 2001, all WTO governments committed to the creation of a more equitable, ambitious, relevant and development-oriented trading system. All of them remain committed. I am convinced of this. But reaching a consensus of 153 members, on 20 topics each with many subtopics is no easy chore. Bit by bit, we have reduced the scope of the work needed to conclude the Doha round and indeed for the great majority of issues the outlines of an agreement are clear. A final package is certainly achievable provided key governments exhibit the necessary political will.

We know the benefits that will accrue from a successful Doha round. We understand as well the opportunity costs of no deal. Failure to conclude the round will not mean the demise of the WTO. We will still administer rules agreed over 60 years of negotiations. We will still adjudicate commercial disputes among members. We will still engage in monitoring and surveillance of government trade policies to ensure the most transparent trading system possible. But be in no doubt that such an outcome would hurt the credibility of our organization and the multilateral negotiating process that we oversee. Governments have said they will seek recourse to their trade problems through the dispute settlement system if they cannot negotiate rule changes. In my view, rule making through the judiciary rather than the legislature, as it were, is something which would not be sustainable.

Governments will also turn to regional or bilateral agreements rather than continue along the admittedly more difficult multilateral path. Such agreements have their place. I, myself, have negotiated a few of them in a previous life. But they are no substitute for a Doha deal. There are 430 regional and bilateral agreements in place today, 300 of these have been struck in the last eight years, and I can assure you that not one of them addresses the problem of excessive, trade distorting farm subsidies. Not one of them will reduce the fisheries subsidies that threaten to empty our oceans. None will lead to the creation of global rules to facilitate trade or open globally trade in services.

Too often, these regional or bilateral pacts are agreements in which partners of unequal strength enter into negotiations in which the weaker party is very much at a disadvantage. For all its cumbersome qualities, the WTO's system of negotiating through groups of like-minded countries and deciding by consensus ensures protection for the interests of our poorer members.

It is a system in which the interests of all members are aired, discussed and negotiated. And for 60 years, this system of global regulations for trade has done what it was intended to do – save governments from employing the sort of policies that brought about economic ruin in the last century. The system has on many occasions been put to the test. During the Asian crisis in the late 1990s, the developing countries of the Pacific Rim increased their exports to rich countries by tens of billions of dollars. Those increased exports helped the Asian countries stabilize their economies and regain prosperity. To be able to trade their way out of the crisis, was as vital to the Pacific as the Marshall Plan was to Europe after World War II. But the export surge did not play well in all quarters of Europe and North America and there were intense pressures on governments to erect barriers which would have disrupted trade flows and hampered Asia's recovery efforts.

North American and European governments resisted that pressure and the result was that countries of the Pacific Rim were back on their feet in a very short period of time. Governments resisted protectionist pressures then because they knew they had made international commitments to which they had to abide. As the West weathers a financial crisis and likely serious economic downturn, it can draw comfort from the fact that governments elsewhere which may be tempted to curb European or American exports will face the same constraints. Next year the IMF and others forecast that developed countries, which compromise two-thirds of global output, will hardly grow at all. The emerging economies, by contrast, are expected to grow by 6.1% next year, according to the Fund, with developing Asia growing 7.7% and African output expanding by 6%. If the pending recession is to be of limited duration it will be important for the West that emerging country markets remain open to their exports.

As policymakers ponder the necessity of negotiating new rules in other areas like international finance and climate change, they would do well to consider the merits of a system or international regulations like those we have in trade. Moreover, they can learn from the lessons we have learned in the Doha negotiations about making the concerns of developing countries central to any reforms. What we have learned is that there is no way developing countries will undertake commitments – and they will have to undertake commitments if we are to find global solutions – if they do not have a significant say in how these commitments are designed. No international agreement on finance or climate change is possible today without China, India, Brazil and Indonesia on board. And a failure to conclude what is after all the Doha *Development* Round is unlikely to inspire these countries to make concessions in negotiations where the industrial world is largely the demandeur. This is why the importance of reaching the Doha agreement extends beyond the confines of trade.

The causes of the financial crisis are complex and multi-faceted. What is clear though is that the systems suffers from a lack of regulation, transparency and accountability. Trade in goods and services represents only about 2% of international transactions and takes place in one of the most internationally regulated environments ever created. No such regulations exist for international finance and drawing them up will be considerably more complicated than concluding the Doha round – itself a highly complex series of negotiations. There are a plethora of regulatory bodies which oversee banking and securities at national level. Central banks, which have a significant portion of the oversight responsibilities are, in many cases, independent of governments. There is much merit in this independence, but it will create complications in negotiating an international agreement.

Negotiations to combat climate change will be no easier. Decisions on capping and trading emissions, on permissible border measures and on enforcement will have profound consequences on the way people live, not just in 20 years but today and tomorrow.

Compared to negotiations regulating international finance and climate change measures, the Doha round is low hanging fruit and a failure to pluck this fruit will send reverberations through other geopolitical forums.

I am often asked whether I am an optimist or a pessimist and I normally respond that for the Director General of the WTO it is imprudent to be either. Instead, I am an activist. But on the subject of multilateralism I remain hopeful. I remain hopeful because there is no other way forward. We face today a set of global challenges as troubling as any we have faced before. I do not know if we can summon the courage and the wisdom to meet these challenges. But I do know this, if we do not tackle these problems together we will not tackle them at all.

As I said, I remain hopeful that we will come to our collective senses and see a new dawn for multilateralism. On receiving his Nobel Prize for literature in 1980, one of Berkeley's many great minds, Czeslaw Milosz, offered words which seem particularly relevant today. "Transformation has been going on," he said, "defying short term predictions, and it is probable that in spite of all horrors and perils, our time will be remembered as a necessary phase of travail before mankind ascends to a new awareness."

Thank you.