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1 *Efficiency, Equity, and Legitimacy: The Global Trading System in the Twenty-First Century*

Scholars will undoubtedly judge the twentieth century as one of the most remarkable in history. It was a century filled with troubled times and with astonishing accomplishments. Among its most notable developments were the twin triumphs of democratic political institutions and market-oriented economic arrangements. The ascendancy of democracy and free enterprise were anything but assured as the century began. As the century closed, much of the globe enjoyed a time of both peace and prosperity.

The first fifty years of the twentieth century witnessed two world wars and a deep, prolonged depression. Unemployment in the United States never fell below 14.5 percent in any month for a full decade. Many factors contributed to this economic distress, including well-intentioned but misguided policies such as a dramatic increase in tariffs among the world's trading nations. This led to a sharp decline in global trade, which fell to approximately one-third its previous level.

The second half of the twentieth century represented a marked contrast. While there was a prolonged cold war, in military terms it was a time of relative peace. There were regional conflicts to be sure, but, as Richard Cooper has reminded us, Europe has experienced its longest period of peace since the Roman Empire.

Moreover, the second half of the century has witnessed unprecedented global prosperity. During the period from 1950 to 1990, world per capita income increased by 2.2 percent per year, a more rapid rate of growth than in any previous period. Per capita income was more than two and a half times larger at the end of the century than it was in 1950. This remarkable material improvement is especially evident in many of today's economically prosperous countries such as Japan, South Korea, Italy, and Spain, to name just four, nations that were much poorer only fifty years ago.

Not only has the production of goods and services greatly increased, but advances in health care reflected in the decline of infant mortality and progress in treating communicable diseases have led to substantial increases in longevity. Life expectancy for someone born in the United States in 1900 was forty-six years of age. One hundred years later, life expectancy had increased more than three decades. Partially as a result, the global population, which was approximately 1.9 billion in 1900, exceeded 6.0 billion as the century drew to a close.

Many factors influenced this remarkable rise in prosperity. Not least among them is the growth of trade in goods and services, which is widely acknowledged to have made a significant contribution. During the last fifty years, international trade outpaced the growth in economic output, growing more than 6 percent annually. This was partly a result of the decline in import protection during this period following eight rounds of multilateral tariff reductions.[1]

Developments in transportation and communications helped to fuel trade in goods and services. Between 1920 and 1990, average ocean freight and port charges for U.S. import and export cargo fell almost 70 percent. Between 1930 and 1990, average air-transport fares per passenger mile fell by 84 percent, and the cost of a three-minute telephone call between New York and London plummeted 98.6 percent.[2] By 1995 tariffs on manufactured goods into developed economies were only about 10 percent of the levels they were in 1947, the year of the first multilateral round.

Yet at the beginning of a new century the prospects for the global trading system are anything but settled. The disappointing ministerial in Seattle in December 1999 underscored the uncertainty and divisions that exist about what direction the multilateral trading system should take, what next steps are both feasible and desirable, and what processes should govern negotiations and the implementation of agreements in the future.

The enthusiasm for a bold new round of trade negotiations is surprisingly muted. A sense of urgency regarding the next steps in trade liberalization is strangely absent. Why, when increased trade appears to have benefited so many to such an extent, does there appear to be so little agreement on where to go from here?

In some respects the trading system is a victim of its own success. As societies become more affluent, the attraction of and interest in pursuing noneconomic objectives become stronger and the capacity to provide greater and greater amounts of security for citizens increases. Likewise, as societies prosper, distributional issues tend to loom larger. Most advanced industrial economies in the twentieth century adopted governmental programs designed to provide a floor, a safety net, for those with the fewest economic resources. At the same time the spread of democracy in the developing world, and the growth of organized groups, which understandably seek a greater voice in shaping public policies, have made reaching decisions and agreements more challenging.

Thus the discussion of the global trading system is not the province of a select number of officials and experts seeking to find mutually beneficial reductions in border barriers. In many respects trade has become the major game in town. The number of players eager to get on the field has grown. The range of considerations that various participants press has expanded. The process of fashioning agreements and getting them approved and implemented is increasingly complicated and difficult. In short, the discussions and debates about global trade today revolve around efficiency, equity, and legitimacy.

Efficiency

Having raised tariffs sharply in the early 1930s, policymakers concluded that such actions were counterproductive. In the United States, Cordell Hull championed passage of the Reciprocal Trade Agreements Act of 1934, but most of the significant tariff reductions came after 1947. Today tariff rates on manufactured goods are approximately one-tenth what they were in 1947. The average rate of duty on manufactured goods was over 40 percent in 1947 but less than 4 percent at the conclusion of the Uruguay Round in 1994.[3]

The success in reducing tariffs on manufactured goods has led many to question the size of the potential remaining gains. It is commonplace to assume that with average tariff levels one-tenth what they were a little more than fifty years ago, the remaining efficiency gains from further reductions are relatively modest. Moreover, many question whether more gains in efficiency can be achieved without forestalling a movement toward greater equity and without impeding progress on valued noneconomic objectives such as the environment and workplace standards.

Critics of globalization advance a host of subtexts, but their essential arguments fall generally into a three-pronged attack: the economic benefits from globalization are essentially complete; the complexity of deeper integration will entail a substantial transfer of nation-state sovereignty; and desirable noneconomic goals will suffer from a continued emphasis on the pursuit of economic efficiency. The low-hanging fruit has already been harvested. Retrieving the remaining crop is not worth the costs associated with capturing it.

Jeffrey Frankel's thoughtful assessment of what potential efficiency gains remain, however, posits a far different reality. Whether one measures against the standard of what trade flows would look like in a fully integrated global economy (assuming the absence of transportation costs or cultural differences) or one examines the real impediments that exist in many economic sectors, Frankel appropriately concludes that the global economy is still far from complete integration and that large gains are still available.[4]

One source of these gains comes from achieving greater allocative efficiency utilizing the conventional rationale for trade that has been advanced since Adam Smith and David Ricardo. Some have underestimated these allocative efficiencies because focusing on average tariff rates is deceptive: actual tariffs include many peaks as well as valleys. The peaks (with tariffs as high as 20 and 30 percent) still significantly restrain trade flows. More important, many of the constraints on trade now consist of nontariff barriers—quotas, orderly marketing agreements, regulatory standards, procurement requirements, and the like—which often exist to advantage domestic firms.

Many economists, including Robert Willig, have noted an increase in international cartel-type behavior during the past five years and that the increasing frequency with which antidumping provisions are sought and applied has also had the effect of reducing the rate of growth of trade in goods and services. Significant barriers remain in agriculture and textiles, in government procurement and transportation, particularly ocean transport. As Jeffrey Frankel reports, several computable general equilibrium (CGE) models have estimated that further gains from a new round of multilateral liberalization to achieve allocative efficiencies would improve world income by $350 billion, or roughly 1 percent of global GDP. In addition, as the new trade theory posits, pure gains in efficiency also result from the powerful effects that flow from constraining rents, from achieving greater economies of scale, from stimulating technological innovation, and from accelerating the diffusion of ideas and processes. A rough estimate of Frankel's suggests that, when these dynamic effects are included, the effect of a new round could be to raise world GDP by 2 percent over the subsequent twenty-five years.

It is a mark of modern market-based economies that they usually are highly efficiency conscious, implicitly recognizing the enormous economic gains that can come from appropriate investments and allocating those resources to their most efficient uses. With respect to international trade, the answer to the question of what remaining efficiency gains are possible is clearly that substantial potential gains still exist. Barriers remain and, if reduced or eliminated, can contribute to major gains.

How best to achieve them remains an open question. Alan Sykes adopts a realistic approach, accepting that nations for the foreseeable period will, for a variety of reasons, act to restrain trade in some ways. Accordingly, he calls for making those constraints as nondistorting as possible, all the while seeking to remove them as quickly as is politically feasible.

Advancing the efficiency agenda is also likely to be aided by encouraging greater transparency. Tariffication helps individuals and societies understand the price they are paying for trade barriers, and therefore it illuminates the choices they make. In doing so, societies come to understand the economic costs associated with restraints on trade. This makes those barriers seem less attractive. Another tool in dealing with many barriers that are regulatory in nature is to pursue performance-based regulation, a more efficient approach than traditional command and control regulatory schemes.

The evidence that a half-century of policy-driven increases in trade flows has yielded substantial aggregate economic benefits is overwhelming. The argument that restraints on trade remain and that further potential gains exist is equally powerful. Yet the debate over next steps engages competing values beyond the quest for efficiency.

Equity

A second powerful idea helped shape policy during the twentieth century, a concern about equity both within and across nations. During the past seventy years, and increasingly in the past fifty years, governments in Europe, the United States, Canada, Japan, and elsewhere have adopted programs designed to redistribute income as a means of providing citizens with greater security—job security, health security, retirement security.

In 1930 U.S. federal government spending was approximately 3 percent of gross domestic product. Today it is roughly seven times that level, with more than 60 percent of spending devoted to so-called entitlement programs. The figures are equally striking in other developed economies. The rise of mandated or entitlement spending is driven partly by the pursuit of greater security and stability but also by an interest in an equitable distribution.

Likewise, the past fifty years raised several questions: How should the unprecedented gains that efficiency has helped produce be allocated among and within nations? What share of the expanding pie should be devoted to public purposes and to the achievement of public goods such as a clean and inviting environment and a safe and healthful workplace? Policymakers debate not merely how best to increase the size of the pie, but how the pie should be divided up. The debates over equity tend to take three forms: equity between nations, equity within nations, and an equity concern that involves the tension between economic and noneconomic objectives.

Equity between Nations

There is a feeling on the part of many developing nations that they are being left behind, that they are receiving a disproportionately small share of the benefits of a more liberal global trading system. Jeffrey Sachs reminds us that trade is only a part of the process of economic development. Equally important, investment, technology, and the capacity to use that technology are essential. Addressing the gap between developed and developing economies will require not only much effort, but also receptivity and a willingness to engage on the part of developing countries—a readiness to accept foreign investment and to make what changes are needed to facilitate the transmission of new technologies throughout their economies.

Equity within Nations

A second equity concern involves the distribution of benefits within countries. The recognition that increased trade in goods and services occasions adjustments by individual workers and firms has prompted much deliberation over whether and how best to ease those adjustments. Affected groups, including organized labor, have resisted efforts to reduce trade barriers in an attempt to avoid such adjustments altogether.

Provisions that ease or cushion these adjustments have played a prominent role in securing approval to negotiate a reduction in trade barriers.

For more than four decades, provisions on trade adjustment assistance for workers, firms, and communities have been among the most fiercely fought provisions in U.S. trade legislation. Proponents of such measures have argued that while all citizens receive the benefits from trade in the form of favorable effects on price, quality, and selection, displaced workers bear a heavy burden and therefore merit special assistance.[5]

The negotiations over these provisions involve how much assistance, for how long, in what form, and with what conditions. The arguments revolve around what level of "compensation" is equitable and over whether the form the assistance takes will facilitate or prolong the period of adjustment. The persistence and growth of such provisions underscore the reality that equity considerations within national economies remain a prominent feature of the landscape for trade policymakers.

One striking aspect of this debate is the comparison between adjustments occasioned by technological innovations and adjustments driven by increased trade. The rapid diffusion of technological innovations has contributed to the increased dynamism that characterizes modern economies. Indeed, the amount of adjustment that is driven by technological change and innovations is much larger than the adjustments occasioned by changes in trade policies.

Those seeking to reduce barriers to trade must address how they propose to ease the adjustments that increased trade will produce in ways that those urging governmental spending on programs designed to expand research and development and increase the pace of technological innovation do not. Arguably, the connection with job losses is more distant and more difficult to establish in the case of technological innovations. Moreover, the changes driven by technological innovations are less easily attributable to specific governmental actions. Not least, foreigners do not vote. The difference between the treatment of workers displaced by trade and those displaced by technology reflects in part the strength of equity concerns in trade policy.[6]

Economic and Noneconomic Objectives

A third equity concern involves the tension between economic and noneconomic objectives. The growth of per capita incomes and increased affluence in many societies have produced an intensified debate about not simply the allocation of income between individuals, but also the allocation of national income between economic and noneconomic objectives.

This debate has increasingly revolved around the environment and around the conditions under which employees work. Attention to environmental quality and workplace standards has risen dramatically since the 1970s and now plays a significant role in trade policy discussions as well as in debates over appropriate social regulation.

Environmental policy is an interesting case in point. Environmental considerations played virtually no role in the deliberations leading to the Trade Expansion Act of 1962, and an extremely limited role in passage of the Trade Act of 1974 and the Omnibus Trade and Competitiveness Act of 1988. Likewise, when the phalanx of advisory committees was established to assist the Office of the U.S. Trade Representative, little, if any, thought was devoted to whether to establish a committee dealing with the environment.

The past decade, however, witnessed a marked change. The environmental effects of trade agreements, and whether trade agreements should be used to seek improvements in environmental quality, played a pivotal part in the debates over fast-track authority for a North American Free Trade Agreement (NAFTA), the negotiation and approval of NAFTA, and the intense debates over fast-track authority in 1995 and 1997.

Proponents of greater trade liberalization have sought to draw attention to the long-term effects of trade liberalization and to shift the focus from an emphasis on short-term considerations. While acknowledging that the increased economic activity resulting from trade liberalization may contribute in some instances to modest short-term increases in pollution, they point to a remarkably consistent pattern in economies that achieve higher levels of prosperity. Greater economic prosperity is almost uniformly associated with an increased interest in the environment and more willingness by nations to devote greater resources to improving it.

By the end of the twentieth century, the U.S. economy was producing more than twice as many manufactured goods as in 1970, and it was doing so with less absolute pollution. Indeed, the attention and resources devoted to environmental protection in developed economies during the last three decades of the century were remarkable.

Rather than a feared "race to the bottom" with respect to environmental standards, whether measured by resources devoted or results achieved, a healthier environment has accompanied the prosperity in developed economies associated with liberalized trade. Yet despite this pattern, trade and the environment are likely to remain linked in the future.

Likewise, workplace standards have received much attention in recent trade rounds with the oft-asserted fear that the demands associated with an integrated and competitive global economy will produce a race to the bottom. Many have claimed that the result of greater trade is a reduction in workplace standards for health and safety. Yet the evidence of a race to the bottom is difficult to find. More frequently, workplace standards in developing economies rise than workplace standards in developed countries fall. Indeed, in the United States there has been a steady, decade-by-decade rise in workplace standards in the last half century, a time when the share of the U.S. economy engaged in trade roughly trebled. One of the driving forces behind this phenomenon is the rise of multinational enterprises. They have tended to encourage the diffusion of best practices in manufacturing processes with safer equipment and fewer workplace injuries. Whether between nations, within countries, or with respect to such noneconomic objectives as labor standards and the environment, equity considerations now claim a much larger place in trade discussions than in past decades.

Legitimacy and Governance

The modern age accords much attention not only to the substantive outcomes of policy but also to the process by which decisions are reached. Internationally, policymakers vigorously debate the procedures by which disputes should be settled and what institutional arrangements should govern global economic activity.

Any discussion of legitimacy and governance should acknowledge the patterns of the past as well as the challenges for the future. The successful multilateral trade rounds during the second half of the twentieth century produced trade agreements that were highly technical in nature filled with specialized jargon and classifications. As in many other arenas, a cadre of officials expert in the substance and nuances of trade policy negotiated the agreements.

These agreements were built around the nation-state and were fueled by the opportunity to reach, in the aggregate for a country, Pareto optimal outcomes. Political leaders who provided direction to their trade negotiators justified the final agreements to their citizens by saying that the net benefit to the nation would exceed the costs or adjustments. Once agreements were adopted, the decisions reached by international bodies in resolving disputes have largely been self-enforcing. The entire system has relied heavily on trust between participating countries.

New Elements

Several developments have challenged the old regime in trade policy. First, the number of countries with membership in the World Trade Organization (WTO) has sharply increased, complicating the task of reaching consensus in future negotiations.[7] As was abundantly clear at the Seattle Ministerial, a broad consensus is necessary to make even modest progress, and the ability of the WTO to reach a consensus is complicated by the range of views and interests represented by member countries. Overlaid on the increased number of participants is the reality that participating countries vary widely in population, economic output, and trading interests.

Second, the task of reaching agreements has become more complex, and concluding multilateral agreements has taken longer. Negotiations that revolved around reducing tariff barriers, largely on manufactured goods, have been replaced by more contentious issues—agriculture, services, intellectual property, investment, competition policy, and restraints associated with regulatory regimes.

Third, perhaps the most striking new element wrought by the Uruguay Round was adoption of the single undertaking. It greatly expanded the reach of the new World Trade Organization by establishing binding disciplines on all members in those areas covered by WTO agreements. Given that all members are now bound by changes in the rules, one effect of the single undertaking is to entrench the principle of consensus.

Fourth, the other major structural change adopted during the Uruguay Round was the Disputes Settlement Understanding (DSU), which has the effect of establishing a more juridical system for resolving disputes. To the extent that rulings by panels and the appellate body are seen as balanced and unbiased, and to the extent that parties abide by the decisions, a body of WTO law will gradually be established. In the end, final sovereignty still rests with member nations who are able to determine, subject to WTO rules, whether they will modify their practices consistent with the ruling or suffer the trade consequences. But clearly, the new DSU represents a departure from the past.

Fifth, recent decades have seen a dramatic rise in the proliferation and sophistication of organized interests at all levels of government and across national boundaries. Many of these have sought to infuse the agenda with new issues, complicating the task of negotiation. Their insistent and persistent efforts have raised the question of what roles these organizations and their concerns should play in future negotiations.

Sixth, as reaching large multinational agreements has become more difficult, the number of regional agreements has grown, more than doubling during the past decade. Indeed, in the United States the trade policy advanced during the 1990s was specifically multipronged: a series of unilateral and plurilateral initiatives accompanied the commitment to seek a multilateral agreement.

In one sense the negotiation of regional agreements demonstrates an interest by countries in reaping the benefits of freer trade and helps maintain momentum toward reducing barriers to the movement of goods and services. A real question is whether regional agreements will complement, or serve as a substitute for, a more comprehensive multilateral agreement. The events in Seattle as the millennium drew to a close are a sobering reminder of the challenge posed by this series of recent developments. The lack of agreement, even on next steps, illuminates how difficult fashioning the next multilateral round will undoubtedly prove.

What Is Needed?

As discussion about the longer term occurs, four immediate tasks deserve attention. First, there is value in pursuing a realistic, if limited, short-term agenda. This agenda should include at a minimum the Uruguay Round mandated negotiations on agriculture, the commitment in the General Agreement on Trade in Services (GATS) for negotiations on liberalizing trade in services, and the negotiations mandated by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs).

Second, there is a need to develop credibility for the new disputes-settlement procedures. The WTO is a fledgling organization with a modest staff and greater responsibilities than resources; greater expectations than capacity. Strengthening the WTO machinery can assist in helping to produce fair, balanced, expert, and credible decisions.

Third, governments must attend to establishing improved relationships with the increasingly active phalanx of nongovernmental organizations (NGOs). The advisory committee structure in the United States is one avenue for constructive exchanges. Less formal but sustained interactions between government officials and NGO representatives is another. There is evidence, in fact, that officials are engaging NGOs more actively. In the United States the formal advisory committee structure within the executive branch has been expanded. As more and more congressional committees have successfully laid claim to elements of the trade policy agenda, a wider range of voices has been heard in legislative branch deliberations.

Officials, however, should carefully pursue more actively engaging NGOs given two sobering realities. The first concerns the issue of formal standing. The second concerns the scope of trade negotiations. Granting standing in legal or quasi-legal proceedings or a place at the negotiating table to insistent parties is a slippery slope. Democratically elected governments have a responsibility to consider the concerns and interests of all citizens. There is some evidence this is occurring. Many of the debates over trade policy have acquired greater visibility and received more press attention. In that sense more aggressive and pervasive media have helped illuminate and convey views and positions. Second, elected and appointed officials have engaged in greater outreach to organized groups through formal advisory bodies and greatly augmented informal consultations.

At issue is the extent to which certain groups are entitled to a more definitive role in the process of negotiating agreements and resolving disputes. What groups? Under what conditions? In what ways? With what rights? These are questions worth measuring carefully. Precedents once created are difficult to reverse. Sensitizing government officials to the need to genuinely engage organized interests has many advantages over granting nongovernmental entities a more formal role.

It is understandable why a wide variety of groups wants to use trade negotiations (and sanctions) to address issues these groups consider urgent, but such a path is fraught with risk. Trade negotiations have themselves become more complicated as the number of parties involved has grown and the range of trade issues under consideration has expanded. Expanding the agenda even further undermines the prospects for achieving the kind of consensus that is needed to reach agreements. Moreover, many developing countries view NGOs, which are largely based in and driven by individuals and groups in developed countries, as often hostile to their trade interests. Given adoption of the single undertaking, creating binding disciplines that apply to all WTO members, future trade negotiations will engage those from developing countries to an even greater degree than in the past.

Fourth, the Seattle Ministerial reminded us that careful preparation is essential. Some of that preparation is formal; much of it is informal. A central task of political leadership is to build support for an undertaking before beginning a journey. The muted reaction to the Seattle Ministerial in many quarters in the United States and elsewhere illuminated how disengaged those in the business community were and how little they felt was genuinely at stake. By contrast, the vote on a permanent normal trading relationship with China illustrated the willingness of business interests to become active when they saw real benefits and tangible markets.

The new world of trade policymaking now involves in a more intense way not merely the quest for efficiency but also the search for equity. More nations are more actively engaged. More organized interests are pressing their claims for a voice. The challenge for political leaders is not only to articulate the benefits of further trade liberalization but also to fashion a broader set of policies that will help ease the inevitable adjustments, policies that can generate the broad base of support that will be needed to make that agenda a reality.

Notes

1. Richard E. Caves, Jeffrey A. Frankel, and Ronald W. Jones, *World Trade and Payments: An Introduction,* 8th ed. (Addison-Wesley, 1999), p. 5.

2. Council of Economic Advisers, *Economic Report of the President, 1997,* p. 243.

3. Caves, Frankel, and Jones, *World Trade and Payments,* p. 165.

4. See Jeffrey Frankel's chapter in this volume.

5. See Roger B. Porter, "The President, Congress, and Trade Policy," *Congress and the Presidency,* vol. 15 (Autumn 1988), pp. 165–84.

6. André Sapir has written perceptively about many of the differences between how U.S. and European policymakers have struggled with the type of domestic adjustment assistance that is preferable. See his chapter in this volume.

7. The General Agreement on Tariffs and Trade numbered twenty-three members when it was formed in 1948. By the time the Uruguay Round concluded and the WTO replaced it, GATT had 110 members. As of March 2001, the WTO has 140 members and more than 30 applicants eager to join.