

# In Defense of the WTO

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## I Introduction

Since its inception, the WTO has come a long way, at least as far as the strength of opposition it attracts is concerned. Every ministerial sees a successively larger and more aggressive group of protesters congregated in the vicinity of the negotiators. While the anti-WTO group has used the internet effectively to disseminate information (and more often, opinions) on the myriad ways in which the WTO is yet another tool of exploitation of the Third world, there is little that is available <sup>1</sup>, even to those looking

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<sup>1</sup>Papers by Rose (2004) and (2005) and Subramanian and Wei (2003) are econometric studies on impact of trade of GATT/WTO using the gravity model. Rose does not find that GATT/WTO accession had a significant impact on trade once other factors are taken into account. However, they constrain the impact of WTO accession to be the same as that for GATT. This may bias the results downwards, because GATT was a much weaker agreement than WTO and had narrower coverage. Subramanian and Wei (2003) is a critique of Rose's initial studies and find a stronger, but more uneven impact of GATT/WTO membership on trade.

for it, on how far the WTO has achieved its professed objective, notably, enhancing trade amongst its members, how it has influenced the direction of trade, whether or not the developing countries as a whole can be said to have benefited from being members of the WTO, and how the gains are being shared among individual members. To argue that developing countries have benefited from being members of the WTO is not to argue that there is reason to be complacent - that there aren't ways in which the gains from trade can be shared more equitably between members; or that the total gains cannot be larger. It is only to recognize that potential gains are larger for everyone within the system than without. Only when one accepts the existence of the system, and knows what it is worth (in terms of realized gains), can one credibly suggest improvements.

WTO has completed 10 years of its existence and I think time is ripe for evaluating its worth - the impact that member countries commitments had on their trade and economic performance. Such an assessment is necessary not only to satisfy theoretical curiosity, but also to form the basis for future negotiating positions. This paper is a step in that direction, albeit a small one. Here we look only at the the actual numbers on trade flows and direction and some important macroeconomic variables for WTO members for 10 years before and after the inception of WTO. While the numbers do tell a story, they do not comprise a proof of causality. A more convincing way of evaluating the WTO would be to establish whether the WTO membership *caused* higher trade and growth, *ceteris paribus*, through regressions. Time constraints, however did not permit such an analysis which must remain the subject of a future endeavor.

The paper begins with a look at the magnitude and direction of trade

flows of the WTO members. Since the WTO exists primarily to enhance trade, it must be judged in the main, in its performance in that area. However, since trade is valued because it allows trading parties to exploit opportunities for economic gains and therefore to enjoy higher welfare, it is for its perceived failure in this regard that the WTO has come most under the fire. In Section III, we try to understand the main criticisms leveled against the WTO and also to answer some of them through a look at the numbers. Section IV concludes.

## **II WTO's impact on Trade and Investment Flows**

This section assesses the realized gains in trade and investment flows that WTO has induced since its inception.<sup>2</sup> These numbers are important not only because they tell a story about the realized gains, but because they indicate how much more could be gained by further liberalization, given that there still exist significant barriers to trade even among WTO members.

### **II.1 Magnitude of Trade Flows**

In order to assess the impact of WTO on member countries' trade, we look at how developing and developed countries have fared since after their accession, compared to their pre-accession performance. A number of countries

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<sup>2</sup>Throughout the paper, the direct link between trade and welfare is not disputed - even though the anti-WTO lobby does so. One needs look no further than the fact that trade has existed as long as civilization itself, that history has absolutely no example of a developed and completely closed economy or civilization to prove our assertion.

that are now members of the WTO were not founding members. We therefore look at trade and openness indicators for developing and developed members of the WTO <sup>3</sup>, averaged for pre- and post-WTO accession years, beginning in 1985. These are shown in Table 1 below. For members who joined in 1995, the pre-WTO years correspond to the 10 years, 1985-1994 and for members who joined later, the pre-WTO averages use data up to the year before accession. The pre- and post - accession averages were tested for statistically significant differences using robust standard errors from the regression of the relevant average (separately for developing and developed country members) on a constant and a dummy variable that took the value 1 for years equal to or after the year of accession to the WTO.<sup>4</sup>

What stands out in Table 1 is that both developed and developing country members on average are more open post - WTO than before, the latter more significantly so. Even so, the developing countries remain less open than the developed countries on average, on the basis of Trade - GDP ratios and ratios of exports and imports to GDP. Both developed and developing country groups saw higher average growth rates of exports and imports post-accession, but the only increases that were statistically significant were the export growth of all members and import growth of Developed countries. This lack of statistical significance may be attributed to the higher

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<sup>3</sup>WTO do not have a classification system to designate members as developed or developing countries. Such designation is based on self-selection and can be disputed by other WTO members. Here we use the World Bank's classification to group countries as developed or developing. The developing countries include all low or middle income countries.

<sup>4</sup>For each variable X in the first column of the Table 1, the regression equation was:

$$X_{it} = c + d_{it} + \mu_{it}$$

where  $d_{it} = 1$  if  $t \geq$  the year that country  $i$  joined WTO

variances of growth rates post - WTO. Higher growth rates of exports but not of imports of all WTO members taken together would also come about if there is trade diversion due to WTO. One thing that this does establish is that developing countries haven't seen the deluge of imports from the developed countries that many doomsday prophecies promised they would.

## **II.2 Direction of Trade: Merchandise Trade Flows between WTO's North and South**

Tables 2 and 3 below look at merchandise exports of industrialized and developing country members of the WTO, at 5 year intervals beginning 1985 and their annual average growth rates in the pre and post- WTO periods, respectively. All figures in Table 2 are in billions of constant, 2000 US dollars. They were derived by summing the data on bilateral exports, as reported by exporting country from IMF's Direction of Trade Statistics and converted from current US dollars by using the GDP deflator for the US. A more accurate picture could be obtained by using export unit value or export price indices for each exporter to deflate the series, however, such indices were available for only about half the countries in the sample. One hopes (not unreasonably) that the use of US GDP deflator does not change the qualitative results. The total value of merchandise exports of WTO members grew from 2.2 trillion dollars in 1985 to 4.2 trillion dollars in 1994, an average annual growth rate of 7.4 per cent. From 1995 to 2004, these grew at an average annual growth rate of 6 per cent, from 4.9 trillion dollars to 7.2 trillion dollars. However, the developing country WTO members saw a faster-than-average increase in their exports post-WTO, and faster than

their pre-WTO growth. Their average annual growth rate of their exports was 10.4 percent from 1995 to 2004 and 8 percent in the 10 years prior to the birth of WTO. It is the developed country members who saw a reduction in their export growth post-WTO, from 7.3 percent between 1985 and 1994 to 4.9 percent between 1995 and 2004, suggesting that perhaps the loudest demonstrations should be in and by the industrialized countries, not in the developing countries.

In terms of direction of flows, the industrialized country members continued to export more to each other than to developing country members; however, the surplus that the industrialized country members had vis--vis the developing country members in 1995 has since turned into a deficit, with the year 1999 being the turning point. The developing country exports to the industrialized countries almost doubled between 1985 and 1994, from 277 billion US dollars to 551 billion US dollars and then more than doubled in the next 10 years, from 645 billion to 1.4 trillion US dollars. The industrialized country members of WTO exported merchandise worth US dollars 1.2 trillion to the developing country members in 2004, up from 766 billion in 1995. Another interesting trend that the tables bring out is that the developing country trade to each other grew 1.6 times as fast post-WTO than before. The fears that the WTO agreements are designed to open up developing country markets for industrialized country products while keeping the industrial country markets closed seem not to have been borne out by experience. What the WTO does seem to have accomplished is the expansion of South-South trade through an opening up of developing country markets for each other, a dream of many a socialist around the world. This is not surprising, given the fact that developing countries often had the highest barriers to trade and agreed to the greatest reductions - and that these

reductions were extended to all WTO members in keeping with the MFN clause.

### **II.3 Composition of (Merchandise) Trade**

The share of manufactured products in total trade of both developing and developed countries increased significantly on average post-accession, as is clear from Table 4 below. Agricultural exports are significantly lower as a share of total exports for developed countries post-accession.<sup>5</sup> For developing countries, agricultural exports as a share of total exports are higher post-accession, but not significantly so. For the Least Developed countries (LDCs), the picture is somewhat different. Their average share of manufactured in total exports fell significantly and share of agricultural exports rose, but not significantly, implying that share of primary commodity exports rose significantly. Although this change in the pattern of trade does not preclude gains from trade, in a dynamic sense, this is a worrying trend.

### **II.4 WTO and FDI Inflows**

Although WTO as yet does not include promotion of FDI as one of its goals, its agreements do have implications for FDI flows. WTO's Trade Related Investment Measures (TRIMs) Agreement forbids member countries to make FDI approvals conditional on certain trade-related criteria, including local

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<sup>5</sup>This need not imply that absolute level of agricultural exports is lower, only that non-agricultural exports have grown faster.

content, trade balancing requirements<sup>6</sup> . FDI in services is part of the General Agreement on Trade in Services (GATS). Moreover, a reduction in tariff levels would reduce tariff-jumping FDI and promote FDI with the purpose of exploiting differences in factor proportions. In practice, the net impact seems to be on the positive side (See Table 5). There is a large, significant increase in average annual FDI inflows for each group of countries, developed, developing and LDCs, and this holds even when we exclude China from the group of developing countries.

### III WTO Under Fire: What the Demonstrators Say (and Where They are Mistaken)

WTO has been blamed for every ailment, real or imagined, that afflicts any of its members - especially developing country members. Opposition to the WTO encompasses people in the rich as well as developing countries. Here we present a smorgasbord of allegations against the WTO, and try to answer some of them:

1. *WTO undermines global environment protection, public health and safety.*

The pamphlet “The WTO: Five Years of Reasons to Resist Corporate Globalization” gives several examples of disputes about protectionist measures based on environmental/public health excuses and argues that the fact that the defendants either lost or gave in before the dispute was taken to the WTO court proves that governments have lost their right

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<sup>6</sup>And a more comprehensive agreement on Investment under the aegis of the WTO is a distinct possibility in the future

to protect their environment by punishing corporations that don't comply with environmental/health standards.

Lets consider the (only) three environmental cases brought to the WTO since 1995, and settled.

- (a) 2001 <sup>7</sup> Case brought by Canada against the French ban on asbestos and asbestos containing products. Canada lost the case.
- (b) 1998 Case brought by India, Malaysia, Pakistan and Thailand against US law prohibiting certain shrimp and shrimp products imports - the famous Shrimp-turtle case. US lost.
- (c) 1996 Case brought by Venezuela and Brazil against US rules on gasoline standards. US lost

The anti-WTO lobby would look at this list and argue (as they do) <sup>8</sup> that in 2 out of 3 cases, the WTO ruled against sovereign's rights to protect the environment and against environmental protection itself. But the reason why the US lost its two cases was not because the WTO ruled against its right to protect the environment or endangered species, but because of the discriminatory way in which this right was exercised. As the WTO website's information section on environmental disputes emphasizes, in the ruling on the Shrimp turtle case, "the Appellate Body made clear that under WTO rules, countries have the right to take trade action to protect the environment (in particular, human, animal or plant life and health) and endangered species and exhaustible resources). The WTO does not have to allow them this right." In the said case, the US allowed (mostly) Caribbean

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<sup>7</sup>Years mentioned are those in which the WTO ruling was adopted

<sup>8</sup>See, for example Wallach and Sforza (1999)

exporters longer adjustment periods and technical and financial assistance to adopt the turtle excluder devices, a measure that was not extended to the complainant countries. Moreover, the US rules prohibited imports of shrimp caught using nets that had turtle excluder devices, if the exporter belonged to a country did not have certification from the US. The case could not have been brought or won to the WTO if the US government had extended either the same standards to all countries that exported shrimp to it or the same standards to all producers of shrimp, whatever country they resided in. Moreover, the measures taken by the US to comply with the ruling did not consist of it abandoning its protection of turtles around the world. In the case on gasoline standards, the US domestic producers could de-facto have lower standards than foreign producers. Why would a government caring about environment quality not set the same higher standards on its own producers? What is striking is that the US was defending its right to protect environment in one case and defending its lower environmental standards in another. One then has to ask why a benevolent, democratically elected, environment loving government that cares so much about turtles does not care about the quality of air humans breathe? Do we really believe that any of these governments actions had nothing to do with domestic producers lobbying? Or the complainant government would have just raised its own standards, in the absence of WTO?

2. *WTO is undemocratic and opaque.*

WTO undermines the authority of local, democratically elected governments to erect barriers to trade (actually that's not

how the anti-WTO groups put it - they call them rewarding local companies to hire or purchase locally, or punishing companies that do business with dictatorships like Burma).

Since when did trade sanctions become the best way (or even a slightly effective way) to topple dictatorships? How many countries that have faced US trade sanctions had their dictators thrown over or pushed below the poverty line *because of the sanctions*? As far as hiring/purchasing locally is concerned, government policy of rewarding such practices do constitute barriers to trade would be welfare enhancing only in a partial equilibrium framework. The world achieves a general equilibrium, and whether or not one recognizes this, trade barriers are general welfare reducing.

### 3. *WTO hurts workers' rights.*

WTO promotes a race to the bottom as far as workers rights are concerned. It encourages and makes it easier for businesses to relocate to areas with the lowest wages and working conditions. So workers in the rich countries lose . And so do workers in the poor countries...

...notwithstanding the fact that they would be earning even worse wages in even poorer working conditions before the multinationals came and set up their 'sweatshops'<sup>9</sup> Or that a lot of these 'sweatshops', especially in China, were thriving long before it joined the WTO.

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<sup>9</sup>Brown, Deardorff and Stern (2003) give empirical evidence that multinationals in developing pay better wages than local firms and are not on average attracted by weak labor laws. See also Krugman(1997)

The above line of argument takes it as given that WTO has a significant, positive impact on world trade and investment, especially North-South flows <sup>10</sup>. The question is then essentially one of whether trade and foreign investment hurts or helps workers in developed and developing countries, and has been studied in numerous economic studies. The literature on trade's impact of <sup>11</sup> wages of unskilled workers in developed countries is inconclusive, although the one thing that does emerge is that trade has not had quite as big an impact on wages of unskilled workers in rich countries as technological change. Yet, no large demonstrations can be seen anywhere in the world clamoring for a shut down of R&D centers.

4. *WTO has double standards over producer subsidies.*

It allows rich countries to subsidize their farmers while denying producer subsidies to developing countries.

It does. But net food importing countries cannot be said to lose from food subsidies in the rich countries.

5. *Tariff escalation by developed countries denies the developing countries a chance to export higher value added commodities.*

One cannot deny that tariff peaks and tariff escalation exist nor that they should not exist. However, tariff peaks and tariff escalations exist in both developed and developing countries, and while we oppose one, let's not leave out the other. Moreover, as discussed in the section on composition of merchandise trade, manufactured exports as

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<sup>10</sup>And as discussed above, WTO has had a rather significant impact on South - South trade

<sup>11</sup>See, for example, Krugman (1997), Feenstra and Hanson (2001), Feenstra(2000)

a percentage of total merchandise exports are significantly higher for developing countries post - WTO entry. Although the same cannot be said for the LDCs, the argument for gains from trade does not rely on composition of trade to be valid.

6. *Promised gains to developing countries haven't materialized.*

Economic growth in the developing world has slowed, unemployment has risen, income inequality is rising, the world has seen unprecedented financial instability, living standards in developing countries are falling.

Lets look at Table 6 below. Both developing countries as a whole and least developed countries have had higher average growth rates - of GDP and of GDP per capita - post accession. Their average inflation rates are lower, for developing countries, significantly so. Current account balance and unemployment rates are not significantly different than before.

## IV Conclusions

In sum, WTO accession is seen to be associated with greater openness - to trade as well as to FDI, faster export growth for developing countries as a whole and LDCs in particular, greater South-South trade and faster growth of trade in manufactured goods than total trade. the benefits get manifested in higher growth rates and lower inflation rates, especially in developing countries. The magnitudes are large and point to significant potential gains from further liberalization.

Finally, a note to the anti-WTO lobby: There do exist deficiencies in the existing framework - the agricultural subsidies allowed to developed countries, the trade barriers allowed to developing countries, tariff escalation and tariff peaks that both developed and developing countries get away with, to name a few. Focusing on these can go a longer way toward rectifying these, rather than spreading thin your resources to oppose phenomena that are neither of WTOs making nor necessarily welfare reducing.

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