Cordell Hull Institute

Trade Policy Analyses

Vol. 1, No. 8 December 1999

On December 2, 1999, during the WTO Ministerial Conference in Seattle, the Cordell Hull Institute and the Centre for International Economics, Canberra, held a one-day seminar for the Cairns Group Farm Leaders on the issues for a first WTO round of multilateral trade negotiations.

The seven papers for the meeting were published in advance as Reason versus Emotion: Requirements for a Successful WTO Round (Canberra: RIRDC, 1999).

Reproduced here is the text of the paper presented by **Andrew Stoeckel** (above).

About the Author

Andrew Stoeckel is the Executive Director of the Centre for International Economics, Canberra, Australia.

SEMINAR IN SEATTLE...

Removing the Hidden Taxes of Exports

Andrew Stoeckel

THE BASIS for trade and trade policy has been analysed extensively over the past three hundred years by some of the "greats" in the economics profession — Hume, Ricardo and Smith, for example. The extraordinary thing is that many of the basic concepts worked out all those years ago remain poorly understood today. In fact it is worse than that. Paul Krugman, a leading US trade economist, argued several years ago that "what a student is likely to read or learn about international economics [today] is nonsense".[1] He went on to claim that the "level of public discussion [of international trade] is extremely primitive".[2]

The point Krugman makes is a potent one — the lack of understanding of the basics behind international trade is a primary cause of the lack of trade reform in problem areas such as agriculture. It is the primary cause for three reasons. First, policy makers and the public are ill-informed about what is at stake. For example, before the start of the Uruguay Round negotiations it was forbidden to discuss estimates of the costs of agricultural protection at the OECD.

Second, the process or "game" of multilateral negotiations to reduce trade barriers is sending out the wrong messages to the public about trade policy. This is making it harder to reduce trade barriers, a point I come back to later.

Third, the lack of understanding of the basics behind trade is leading to faulty diagnoses of the political economy behind the "trade problem", so that often the wrong research and incomplete measurement of the consequences of trade distortions have been undertaken.

I begin by expanding on these issues since understanding them is critical to appreciating the size of the gains from freeing up trade, which is the main subject of this paper. An understanding of the

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Dr Stoeckel is a specialist in policy analysis and the international economy. He has initiated and directed major research programs that have attracted world-wide attention.

Dr Stoeckel, after graduating from the University of Adelaide, received his PhD from Duke University, in the United States, and has over thirty publications to his credit.

About the Meeting

The meeting was attended by about 450 from NGOs, labor unions, the media and so on who were in Seattle to observe the WTO ministerial conference.

Besides **Mr Stoeckel**, the following presented papers at the meeting: **Guido Di Tella**, Argentina's Minister of Foreign Affairs; **Clayton Yeutter**, former U.S. Secretary of Agriculture; **Robert Litan**, Vice President and Director of Economic Studies at the Brookings Institution; and **Robert L. Thompson**, Director of Rural Development at the World Bank.

Others who spoke were **Brian Chamberlin**, New Zealand farm leader; **Hugh Corbet**, president of the Cordell Hull Institute; **Victoria Curzon Price**, of the University of Geneva.

basics behind trade is also important to appreciate what needs to be done to change the political economy of trade policy if we are to see a more prosperous, secure and environmentally friendly world with lower trade barriers.

Some Lessons about the Basics

For all the chest beating about "globalization" — meaning the growing trade, specialisation and economic integration of the world economy — it is a process that has been going on since the start of trade. People seem to have lost sight of that fact. Because globalisation is not a new phenomenon some perspective needs to be placed on this trend. By some measures, the United Kingdom was more "globalized" in Queen Victoria's reign than the United States is today.[3]

Trade has sprung up in every corner of the planet, even in the places where restrictive regimes have tried to stamp it out, because it is mutually beneficial. Lesson one — which has been forgotten or not even learnt in the first place by many people — is that trade is a win–win undertaking.

But "pop" internationalists write in best selling books that "head-to-head competition is win–lose".[4] People treat trade as a competition and feel the need to be "more competitive". Mind you, there is a serious competition going on but it is a competition between firms within a country to make the best use of the nation's resources — more on that later.

The misconception that trade is a win–lose competition is serious because it spills over into the negotiating game played out during a round of trade talks. Negotiators want to get as much access to other markets as they can but make as few concessions as they can. That is, they treat imports as a bad thing and access to the local market as to be only reluctantly given away. In-deed, so misconceived is this notion that my colleagues have en-countered cases of officials at the highest levels of the former GATT advising developing countries contemplating joining the WTO to raise tariffs prior to accession to improve their "negotiating coin"! There is a fundamental error here appreciated by trade economists but not by most policy makers, politicians or the public at large.

That brings me to lesson two: imports are good and are the whole purpose of trade. Exports are good too, but only because they are the means to get imports. We know that there is a major misunderstanding here because we hardly ever see imports being subsidized or government-sponsored promotion campaigns for imports like we do for exports. Governments and negotiators around the world tend to treat exports as good and imports as bad. As a rule, we see exports promoted and encouraged, and imports restricted and taxed through tariffs and other less transparent devices.

Why have so many people got this basic principle so wrong? Mostly, it is a legacy of the days of mercantilism, when to sell something overseas was seen to lead to an inflow of gold or foreign exchange to your country. But "while it might be nice to save some foreign exchange for future use, to deny its use forever would simply make the foreign exchange worthless; it would be like being marooned on a desert island with a bucket of gold".[5] Foreign exchange from exports cannot be used up domestically; ultimately it has to be spent on imports. It is these imports — the things that cannot be produced at home for the same low cost — that add to welfare.

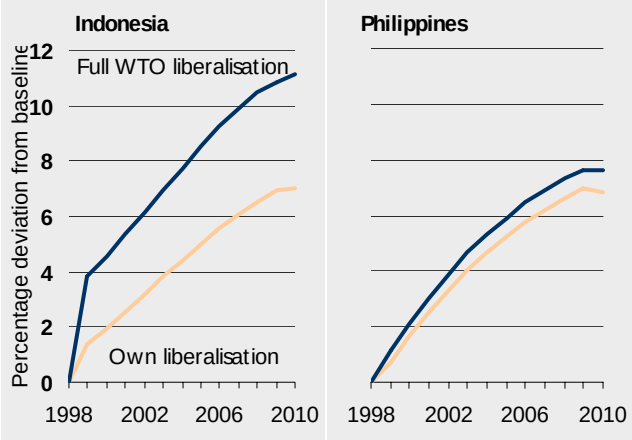
To drive this point home, consider the following thought experiment. Suppose a country stopped all of its imports by imposing a prohibitive tariff (that is, an import tax). For a while exports would continue, but eventually accumulating foreign exchange without supplying any foreign exchange in return (that is, importing) would see the exchange rate appreciate, pricing exports out of foreign markets. Through the workings of the economy, the import tax ends up being in effect an export tax. So when a country puts up barriers to its imports it also puts a constraint on its exports and hurts itself.

The economic nonsense is that removing these import barriers, which hurt the country imposing them, is treated by trade negotiators as a concession! This mercantile game played through the WTO process is poisoning the public perception about the gains from freer trade. Let me be clear about this. Exports from most countries are penalized twice — first by the country imposing taxes on its own exports and then by destination countries imposing barriers. Which of these penalties matters the most? For nearly all countries the self-imposed penalties matter the most.

Typical of many countries are Indonesia and the Philippines, whose potential gains in real consumption from full liberalisation of trade over five years starting in 2000 are shown in chart 1. Two cases are shown for each country: one where the world liberalizes under a WTO round and one where each country liberalizes its own trade. Most of the gains (expressed as the percentage deviation from what would have otherwise occurred) would come from each country removing its own trade barriers. This is the case for most countries — except those at or close to free trade. The countries that have realized it is in their own interests to liberalize, such as Australia, New Zealand, Chile and Thailand, have dramatically reduced their protection that has had nothing to do with the WTO. Some economies — Taiwan, for example — have liberalized trade and they are not even members of the WTO!

Related to the misconception that trade is a win–lose process is the misconception that a trade surplus must be the result of a country restricting its imports and promoting its exports. But such surpluses (or deficits) are the result of differences in the country's

1. Potential gains in consumption from trade liberalization in Indonesia and the Philippines



Data source: W McKibbin and A Stoeckel, East Asia's response to the crisis, Paper presented at the ASEM Regional Economist's Workshop, Denpasar, Bali, 15–17 September 1999

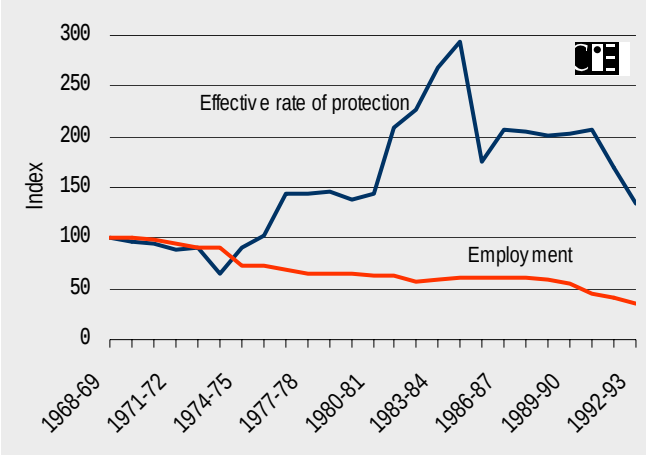
level of savings and investment. If a country is investing more than it is saving, the gap must be filled by capital inflow and borrowing overseas. In national accounts a capital inflow must be matched by a deficit on the current account of the balance of payments. The United States will run a current account deficit (and hence a trade deficit) for as long as it saves less than it is investing. Japan will run a surplus for as long as its savings exceed its domestic investment. Hectoring Japan to buy more imports will not change its surplus for as long as savings and investment do not change. Attempts by the United States to bully Japan to open trade on the basis of its surplus are unhelpful.[6]

A third misconception is that trade reform costs jobs. Robert Litan makes this point clearly in his paper in this publication. Unemployment is due to the level of aggregate demand and the workings of the labor market and has little to do with trade policy. And experience supports this. In a major World Bank study of the experiences from trade liberalisation by 19 different countries, aggregate unemployment was found not to be an issue.[7] The study found that the costs of adjustment were very small and that liberalisation was associated with job growth.

But what about the employment effects in specific industries that are faced with removal of protection from imports? Surely trade protection preserves jobs in targeted industries? Not so. That experiment has been tried — most notably in Australia for textiles and motor vehicles. In the mid-1980s, effective protection (the measure of protection that really matters) for the already highly protected textile industry went up three times! But employment in textiles continued to fall at its long-term rate of 2–3 per cent a year (chart 2). The pattern for motor vehicles — a very different

industry from textiles — is the same. So lesson three is that trade reform does not cost jobs.

2. Changing protection and employment for textiles in Australia



Textiles, clothing and footwear.
Data source: Industry Commission, *Australian Manufacturing Industry and International Trade Data 1968-69 to 1992-93*, Information paper, AGPS, Canberra, 1995.

Lesson four, well appreciated by virtually all good economists but not the public or politicians, is that relativities are what matter. It is the relative efficiency of producing different goods between countries or comparative advantage that drives trade. A farmer decides to plant sugar beet and not cereals on the basis of the return from one crop relative to the other. That relativity is determined by the efficiency of one country in producing sugar relative to cereals compared with the relative efficiencies of other countries. These relative returns can be distorted by protection.

The cost from imposing trade barriers depends on the relative distortions in the various markets. It is the relativities induced by protection that change the incentive to use resources in one industry rather than another and it is the use of resources in the "wrong" industries that leads to waste and inefficiency. The cost of trade protection is a measure of this waste. So it is the disparities in protection given to different products that matters. But show me the measures of how the disparities in protection of all goods and services by country have changed over time. They are not to be found. We are lucky in most cases if we can get measurements of the levels of protection.

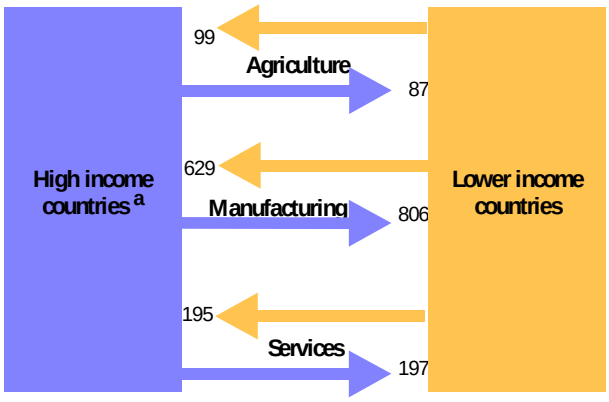
If disparities matter, it follows that to reduce the cost of protection the worst distortions have to be reduced first and by a greater proportion. That means we have to tackle the hard cases — sugar, dairy products and textiles as well as services, among others. But what has been happening? Compelled by the need to be seen to be

doing something, bureaucrats and politicians tackle the "easy marks" first where the politics are not so difficult. But tackling the easy marks first or even reforming just one difficult sector such as agriculture can actually widen the disparities between industries and sectors and end up making the cost of trade protection worse! Using our powers of reason, two conclusions must follow: to reap the gains from trade reform there has to be a comprehensive round of talks and there will have to be significant cuts in the protection of the most highly protected sectors and industries.

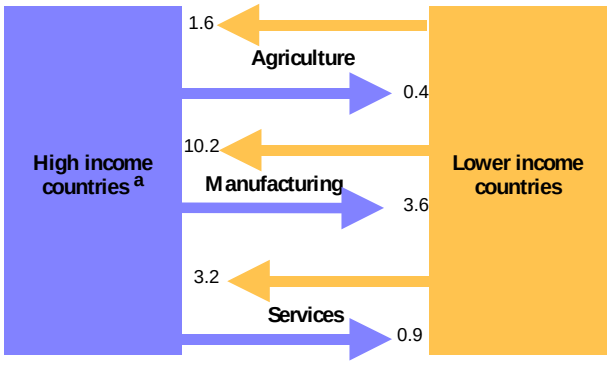
Putting Agricultural Trade and Protection into Perspective

Bearing in mind the above trade principles it is worth putting agricultural trade and protection into perspective to highlight the factors that will lead to a successful outcome from the next round of trade talks.

3a. Trade flows between high and lower income groups, 1995



3b. Net Trade as a Percentage of GDP



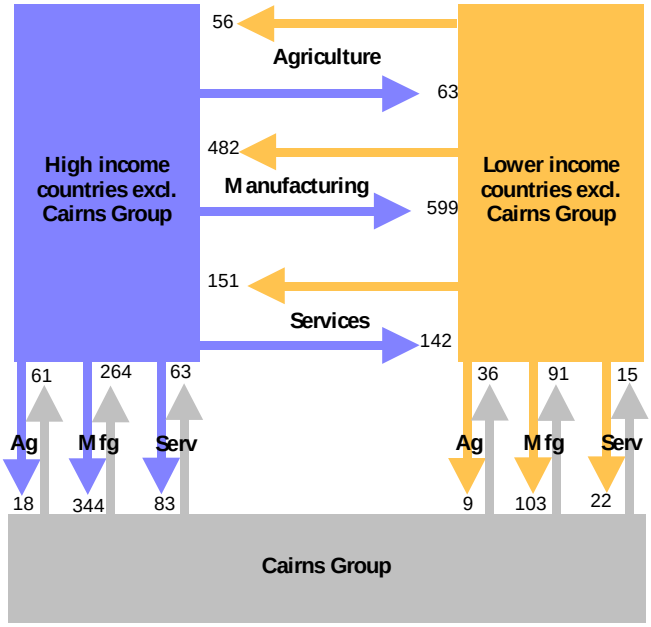
a As defined by Hertel, Anderson, Francois, Hoekman, and Martin, Agriculture and non-agricultural liberalization in the millennium round, Paper presented at the Conference on Agriculture and The New trade Agenda in the WTO 2000 Negotiations, 1–2 October 1999.
Note: Energy and mining trade flows have been omitted.
Source: GATP Version 4 database

Agricultural trade is more important to lower income countries than it is to high income countries (chart 3). As a percentage of GDP, it is four times more important.

Although manufacturing looks to be far more important than agriculture in trade, agriculture is very important to developing countries. Sixty per cent of the population of low and middle income countries live outside urban areas[8] and many countries, such as Thailand, Indonesia, the Philippines and China, have at least half of their workforces engaged in agriculture.[9]

Agricultural trade is also more important to the countries in the Cairns Group than it is to the high income countries (chart 4)

4. Trade flows between the Cairns Group and high and lower income countries, 1995 Value of net trade (US$ billion)



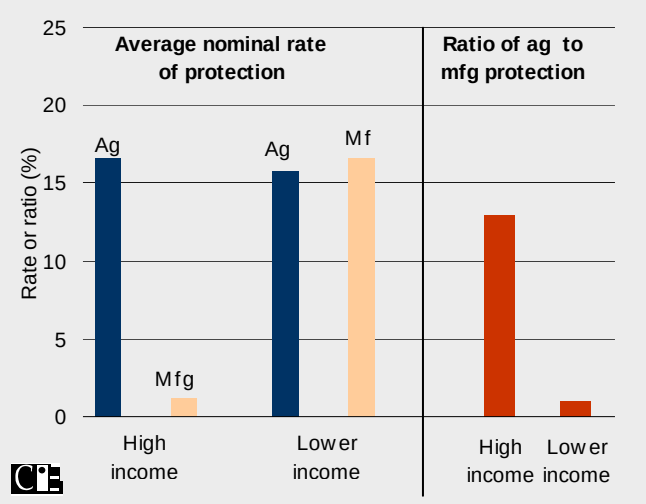
Note: As for chart 3.
Data source: GATP Version 4 database

Both high and lower income countries assist their agricultural sectors. But agriculture's protection compared with manufacturing's protection is thirteen times higher in high income countries than in lower income countries (chart 5). In lower income countries the ratio is less than one. Strictly, it is the dispersion of effective rates of protection across all industries within each country that matters for the distorting effect on resource use but the simple ratio of the nominal rate of protection for agriculture to that for manufacturing makes the point.

There are few "hard" estimates of the size of the barriers in services. To the extent that they have been measured, the finding

is that the protection for services is at least as great as it is for agriculture.[10] The conclusion is that protection for agriculture in high income

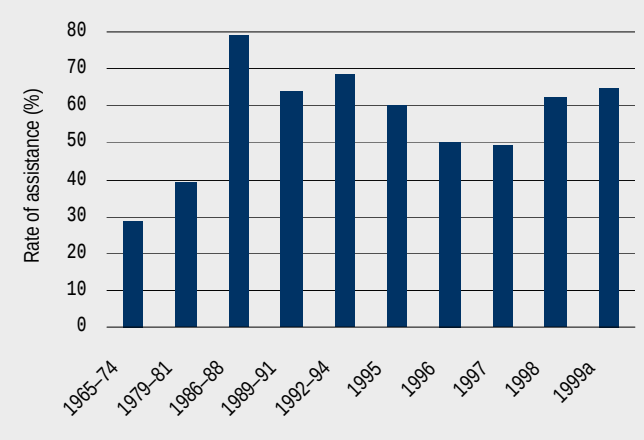
5. Protection relativities in high and lower income countries, 1995



Note: Averages are weighted by output.
Data source: GATP Version 4 database

countries will have to fall significantly if lower income countries are to gain anything from the next round of trade negotiations. And lower income countries will have to reduce their protection of manufacturing and services. This will remove the hidden taxes they impose on their agricultural exports and "offer" something to high income countries to give them a political reason for reducing their protection.

6. Nominal rates of assistance for agriculture in OECD countries



[a] CIE estimate.
Source: Roberts et al., *Reforming World Agricultural Trade Policies*, ABARE Research Report 99.12, Canberra, 1999.

We can also learn something else from looking at the aggregate assistance given to agriculture by OECD countries (chart 6). Nominal assistance has not really fallen since the conclusion of the Uruguay Round of talks. In fact, assistance for agriculture in OECD countries has risen over the past couple of years as world farm prices have fallen. When firm estimates come in for 1999, it will be seen just how little was gained from the Uruguay Round as far as reductions in agricultural protection are concerned.

The reasons for this poor outcome are now reasonably well known.[11] Dirty tariffication, backsliding and the choice of base from which to cut protection are the main reasons. We are in the predicament of trying to "sell" meaningful progress in agricultural reform as part of the "built-in agenda" of the next round of trade talks to countries who rejoinder that "We didn't get anything out of the last round". And they are right; there has not been any pay-off because there has not been any liberalisation to speak of.

Examining the structure of protection reveals another fact. There is a huge difference between applied rates of protection (the rates that exist in practice) and the bound rates (the rates that are legally binding under the WTO agreements). In many cases, bound rates exceed applied rates, especially in developing countries. Since it is bound rates that are negotiated, some countries could offer up large reductions without making any real difference to market access. The Agenda 2000 reforms by the European Union make it easier for them to offer some reductions without really doing anything.

The case of sugar shows how seemingly large cuts to protection can lead to small gains. Some detailed work reported by Brent Borrell shows that a 50 per cent expansion in quotas for sugar leads to just 2.5 per cent of the potential gain from full liberalisation — or about $125 million.[12] To put that in perspective, compare that level of annual gain with a rough estimate of the cost of the WTO Seattle Ministerial Conference of $175 million and whatever follow-up meetings are required to secure the 50 per cent expansion of quota.[13]

The Gains from Trade Reform

If the potential gains from full sugar reform amount to around $5 billion, what are the total gains from agricultural and other sectoral reforms?

The principles spelt out earlier — that trade gives a win–win outcome, that import taxes are export taxes, that relativities matter and that trade balances are determined by savings and investment balances — mean that the tool needed to measure the effects of trade reform requires some special features. What is needed is a multi-country, multiproduct, economywide framework that captures all the linkages between sectors and resources. Also,

the framework must capture exchange rates, savings, investment and capital flows. Once savings and investment have to be considered, a full intertemporal model is required to capture the effects of trade reform. One of the best frameworks with these desirable features in-built in a theoretically consistent way is the model developed by Warwick McKibbin and Peter Wilcoxen.[14]

There are four sources of gains from trade reform:

- the better use of an economy's resources and the terms of trade effect;
- the dynamic gains of higher capital accumulation;
- the endogenous gains to productivity that arise from opening to trade; and
- the reduction in risk that stems from a country being more open to the world market.

The first of these — static resource gains and the associated terms of trade effects — has a long history of measurement. But it is only since the conclusion of the Uruguay Round that serious regular measurement in a multicountry, economywide setting has occurred.

The second source of gains is important but has started to be captured only with the use of dynamic intertemporal models. To assess the impact of trade reform on capital accumulation, savings and investment must be considered. That, in turn, means formally accounting for time.

The third source of gains has been intuitively obvious for years to many researchers that have studied episodes of liberalisation around the world. Whenever there has been significant trade liberalisation by countries there has been a surprising boost to productivity and growth well in excess of the static resource gains suggested by traditional analysis. The problem has always been how to estimate the size of this effect — that is, until Frankel and Romer estimated the effect of trade opening on endogenous productivity.[15] They found that, by increasing the trade to GDP ratio by 1 percentage point, productivity (labor augmenting) will rise by 2.04 per cent. The results of the analysis reported here include the productivity effect estimated by Frankel and Romer.

The fourth source of gains is also self-evident to financial markets and analysts of episodes of trade reform. Countries with open trade and investment regimes run their economies with better policy settings overall. When economies are open there is a discipline over introducing "silly" policies that politicians are tempted to use for short-term political gain — like winning the next election. "Silly" policies show up extremely quickly in open economies. Either inflation takes off, exports start haemorrhaging, the exchange rate collapses or some other imbalance shows up. There is a discipline on policy makers.

Openness is therefore one of the criteria that agencies such as Standard & Poor's and Moody's use to rate a country's sovereign risk. The more open an economy, the better its risk rating and the lower the interest premium a country has to pay to borrow funds on the international market. Borrowing on better terms also lowers the domestic interest rate structure and stimulates domestic investment and growth. Lower interest rates and higher growth have a powerful effect on asset prices. A technical paper presents some new estimates of the gains from trade reform when lower risk premiums are also considered to result from that trade reform.[16]

The results of the analysis undertaken for this paper show just what a lack of reform puts at stake. Full liberalisation throughout the world phased in from 2000 to 2010 was simulated even though that outcome is unlikely. But such an analysis shows the opportunity cost or what the countries of the world are forgoing by not reducing barriers to trade. These results include the effects of reducing barriers to services that often involve, for example, no right to establish in another country rather than a formal barrier to trade.

If the world removed all barriers to trade, real consumption for most of the world would rise by $630 billion in the year 2010 (table 7). The annual gains of Asian developing countries would be among the biggest in proportion to their GDPs because they experience some of the greatest barriers to trade and so the reductions in their risk premiums are also the greatest.

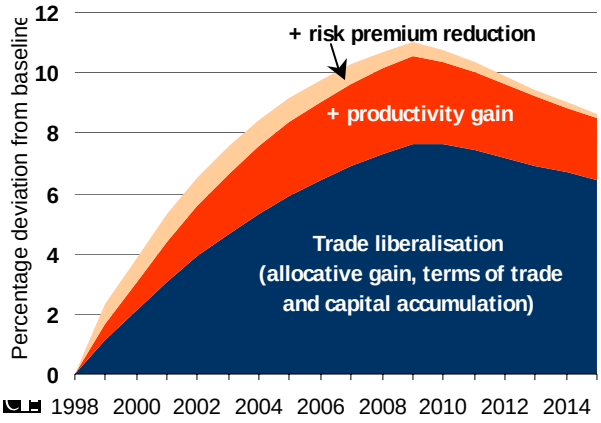
7. Potential gains in real consumption in 2010 from full liberalization

	Value US$ billion	*As a proportion of GDP* %
United States	44.0	0.6
Japan	149.1	4.3
Australia	14.4	4.2
Indonesia	24.9	14.3
Malaysia	16.0	20.9
Philippines	9.2	10.8
Thailand	26.6	19.1
China	65.2	9.1
India	18.1	6.4
Taiwan	33.2	10.5
Korea	22.5	5.5
Rest of OECD	205.2	2.6
Total	**628.6**	

[a] Total does not include other countries such as Singapore, New Zealand and Hong Kong.
Source: Simulations with APG-Cubed model.

The results for the Philippines (chart 8) are used as an example of the time profile and composition of the potential gain. They show that just the resource allocative gains, terms of trade effects and dynamic gains from capital accumulation would lead to real consumption being nearly 8 per cent above what it might otherwise be in 2010. When the endogenous productivity gains are also included, real consumption could be over 10 per cent higher than otherwise. Adding the effect of lower risk as a country opens to trade could cause real consumption to be 10.8 per cent higher than it might otherwise be.

8. Composition of the gain in real consumption from full liberalization in the Philippines



9. Estimated changes in stock market values in 2000 as a result of full liberalization

Country	Indexes	10 November 1999	Net Change	Percentage Change
United States	Dow Jones Industrial	10 617	-245	-2.3
Japan	Nikei 225	18 229	152	0.8
Australia	Australian All Ordianries	2 919	22	0.7
Indonesia	JSX Composite Index	639	33	5.2
Malaysia	KLSE Composite	716	47	6.6
Philippines	Philippines Composite	1 988	69	3.5
Thailand	Thailand	426	27	6.4
India	Bombay SE Sensex	4 622	26	0.6
Taiwan	Taiwan Weighted	7 363	218	3.0
Korea	Korean Kospi	947	1	0.1

Source: Simulations with APG-Cubed model.

Perhaps a better way to report the annual gains over time is to show what would happen to asset prices around the world. Asset prices represent a future view of an economy's prospects discounted by an appropriate interest rate for each country. The best indicator of asset prices is the index of the overall stockmarket in each country. The potential changes in key stockmarket indicators are shown in table 9.

The most striking observation is that there are some potentially large gains to be made in the stockmarkets areound the world. Malaysia's stockmarket shows one of the biggest gains; it could reise by 47 points or 6.6per cent. Indonesia could also gain considerably; the JSX Composite Index could reise by 33 points or 5.2 per cent. Thailand, the Phillippines and Taiwan would also gain considerably. By constrast, wven thought the United States is expected to gain from trade reform in welfare and GDP terms by 2010, there would be a short-term drop in its stockmarket. The Dow Jones could fall b 245 points or 2.3 per cent.

The reason for the Dow Jones fall is that investment returns in Asia would become relatively more attractive than the returns in the Unitd States. Asian economies would gain most form liberzation and consequently would have greater productivity gains and reductions in risk. Investors in the US would therefore sell US investments and invest in Asia. US citizens would be better off over time from their investments in higher returning assets but in the short term there would be a decline in the Dow Jones index. The shift in invest-ments form the US would lead to large capital flows to Asian economies and a large reduction in the US current account deficit.

Measurement and the Political Economy of Trade Reform

The most powerful force for change is self-interest. Logically to bring about change we have to measure what is in the self-interest of each country. It has already been shown that for developing countries the potential gains are especially large relative to the sizes of their economies. But typical measurements of the benefits of trade reform understate the potential gains. They do not include estimates of the boost to productivity and the fall in risk premiums realized as countries open their economies. So to encourage change measurements must reflect all potential gains.

However, even with measurements of large gains from trade reform, we still encounter sectors or industries such as agriculture and textiles that fervently resist reform. Clearly aggregate measures of the gains are not enough to convince some people of the need for reform. Either:

- they do not believe that free trade is good;
- they do not understand the message;
- they understand the message but do not care; or

- there are powerful political forces overriding forces for free trade.

The first reason can be rejected on several counts, the most important being the consensus among the economics profession and a plethora of studies that free trade offers considerable gains. Besides, vast volumes of trade between and within countries occur now because it is free.

There is something in the second possible reason. The fact that there are so many misconceptions about the basics of trade means that substantial work remains to be done to "get the message out". And there is the problem mentioned earlier — the way the WTO game is played is sending out the wrong implicit message that imports are bad.

I find the third reason — that people do not care — hard to reconcile with the numbers. An awful lot of people around the crisis-hit Asian countries, for example, seem to care about economic welfare and asset prices. They seem very willing to accept bail-out money from the IMF and World Bank to keep things going. They obviously care. But the day is looming when the taxpayers of the world are going to ask these countries: "Why should we fund you when it is within your control to improve your economies?". Besides, trade policy reform is the closet thing there is to a "free lunch" in economics. As pointed out earlier, the adjustment costs are overstated — especially those for employment. (The estimates of the gains given earlier are net of adjustment costs.)

The fourth reason for little action — that there are powerful forces resisting change — has something to it at first pass. After all, why are the industries producing sugar, dairy products, textiles and steel so highly protected compared with other industries? What is so special about sugar production in the United States or Europe that farmers have to receive a tariff equivalent of 300 per cent and more (at today's prices) to stay in production? And sugar has been highly protected in the United States for a long time. Clearly there are some powerful political forces at work.

But what makes many people suspicious about the reasons given for providing protection is that they keep changing. Europe first justified the common agricultural policy on the need for self-sufficiency. That gave way to "protecting farm incomes" once Europe became 140 per cent self-sufficient in some food items. The farm income justification had to go once it was shown that 80 per cent of the support went to the wealthiest 20 per cent of farmers. Then the argument became "protecting jobs", but that too had to go once it was realized that agriculture had lost one job a minute for twenty years.[17] Now it is argued that the social, cultural and aesthetic values of the countryside — the so-called "multifunctionality" of agriculture — needs to be protected.

The rate at which the protectionists can spread bogus justifications throughout the media and capture such groups as the Green lobby has to be admired. We know the arguments are bogus, not only because they have to keep changing, but also because the policies protectionists use to achieve their stated ends are not the least costly. There is no justification for wasting resources — everyone is made worse off when there is waste.

If the people in Switzerland want their country to look like a giant theme park with cows eating grass on the hillsides, that is their choice. But it would cost far less to subsidize "cows eating grass" rather than milk production. It would be less costly to the Swiss people and less costly to large milk-exporting countries such as New Zealand. Farmers would not need to suffer a drop in income and might even prefer to run dry cows on the hillsides and not have to milk each day.

The EU banana regime is another classic example of unnecessarily wasteful policies. The stated aim of the regime is to provide aid to poor African, Caribbean and Pacific (ACP) countries. Bananas have become big business; they are the most valuable horticultural product traded on the world market. The problem is not just that the WTO has ruled that the regime is illegal seven times! The real problem is that it costs $13 to transfer $1 of aid to the ACP countries.[18] But far more aid could be granted to ACP countries at less cost to EU consumers and less cost to other banana producers such as Columbia by reforming the banana regime and transferring aid directly.

Yet another example of the reluctance to use more obvious measures to assist industry is in Australia. The motor vehicle industry is one of Australia's most highly protected manufacturing industries. During the last review, some proponents of trade liberalisation suggested that the industry be supported by an annual subsidy paid out of the budget rather than the combination of a hidden production subsidy and a hidden consumption tax effected through the import tariff. This option was rejected by the car industry because it knew its support would be more visible and come under annual budget scrutiny. The industry relies on the costs of protection being less obvious to the public even though a tariff is involved. Imagine the lack of transparency if a quota or other non-tariff measure were used as the protective device. Why is it then that least wasteful policies are not used? The answer is always the same — the real basis for the protection programs has not been exposed; if it were, the public would not put up with the programs. Implicitly that says protection owes its existence to deceit and deception. So the solution is clear — more measurement to explain what is at stake.

This measurement has been translated into something people can understand. When the CEO of Boeing Corporation complains to President Clinton that Brazil cannot afford another 747 because the

United States will not buy its raw sugar, or when the sugar refiners in the United States complain that their margins are squeezed unnecessarily, we might see some action. And the bigger the coalition, the more action there is likely to be.

But where are the contemporary studies showing the impact of the sugar regimes on, say, Japanese sugar refiners? They are not there. Yet it was pressure from sugar refiners in Japan that was instrumental in the last significant reduction in protection for raw sugar production in that country. By measuring in detail the impacts of protection programs it will be possible to identify the coalitions needed to change the politics of protection.

Unless equally powerful political forces are mounted on the side of reform the protectionists will win the day. Debating the modalities of reducing protection such as across-the-board cuts or using the "Swiss formula" will not change the political economy of reform. Sugar farmers in the United States or the European Union are not going to give up their protection willingly and debates about "modalities" and whether "blue box" measures could be counted as "green box" measures simply play into their hands. It deflects the debate from the real questions: why should a particular industry be protected and what does that protection really cost?

Conclusions

To capture the $630 billion potential gain in 2010 from removing the hidden taxes on exports we have to take concerted action to change the political economy of reform. That change stands the best chance of happening if supports are made more transparent so that people can make more honest choices about what they want to achieve domestically and at what real cost. Putting the full cost of programs "on budget" is a good start. Then, if there are legitimate reasons for assisting industries or individuals, policy makers will be encouraged to find the least wasteful ways of providing this assistance — without having to hide behind the deception that border protection is not really costing much.

Negotiations on agricultural trade reform will need to focus on expanding market access rather than reducing domestic supports. Doing so will change the long-run political economy of reform. Focusing on domestic supports and arguing whether payments are "decoupled" will lead only to a vortex that will suck in vast resources for little gain.

The arguments for not freeing trade are ludicrous; so trade reform is a debate that can be won. Because the most potent force for change is self-interest, countries need to do the hard analysis and convince themselves that it is in their own interest to reform. That hard analysis implies measurement at two levels. One is at the aggregate level, undertaken in a way that captures all of the gains that countries get from reform. Countries need to convince

The **mockingbird** is the state bird of Tennessee. Cordell Hull represented a district of Tennessee in the Congress of the United States, and was elected a senator from there, before becoming U.S. Secretary of State (1933-44).

Trade Policy Analyses

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The Institute's purpose is to promote independent analysis and public discussion of issues in international economic relations.

The interpretations and

themselves that there are large gains to be had from removing the hidden taxes they impose on their own exports. The effects of these taxes are large enough to be a major concern for macroeconomic policy makers.

The second level of analysis required is of the details of specific programs to show who gains from reducing barriers to trade, thereby helping to identify and build coalitions for reform. Without these coalitions there will not be the political force needed to override the narrow vested interests.

Measurement will make it clear to countries that it is their own interests to reform — that removing barriers to their own imports boosts their own exports. It makes it more obvious that unilateral action is sensible. Concentrating on multilateral reform through the WTO inadvertently sends out the wrong message that "exports are good; imports are bad" — making the going tougher. Emphasising unilateral reform is consistent with, and makes the politics of, multilateral reform easier.

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[13] Based on 4500 officials from delegations, 2500 media (two-thirds of whom are assumed to be based in the United States) and 3000 delegates from the registered non-government organisations. Costs include travel and accommodation and a very rough approximation of the opportunity cost of the time to prepare for and attend the meetings.

[14] W McKibbin, and P Wilcoxen, 'The theoretical and empirical structure of the G-Cubed model', *Economic Modelling*, vol. 16, no. 1, 1998, pp. 123–48.

[15] JA Frankel and D Romer, 'Does trade cause growth', *American Economic Review*, col. 89, no. 3, 1999, pp. 379–99.

[16] Details of the simulations and calculations behind the endogenous effect of trade opening on risk premiums are given in the paper by A Stoeckel, K Tang and W McKibbin, The gains from trade liberalisation with endogenous productivity and risk premium effects, CIE paper presented at the seminar 'Reason versus Emotion: Requirements for a Successful WTO Round', Seattle, 2 December 1999. The authors believe that the risk premium effect would be an underestimate of the effects involved.

[17] This is the average job loss up to the 1980s (Commission of the European Communities, *The Agriculture Situation in the Community, 1983 Report*, Brussels, 1984, p. 43).

[18] B Borrell, Bananas: straightening out bent ideas on trade as aid, CIE paper presented at the 1999 Global Conference on Agriculture and the New Trade Agenda from a Development Perspective: Interest and Options in the WTO 2000 Negotiations, Geneva, 1–2 October 19999. There is some hope that the banana regime may change for the better prior to t he Seattle WTO Ministerial Conference.