Trade challenges in a globalizing imbalanced world

Rubens Ricupero[*]

Summary: The article deals with the complex relationship between the current state of the world economy and recent patterns of international trade. More specifically, it analyses the symbiosis between China, Japan and Asia in general, on the one hand, and the USA, on the other, and how this association between reciprocally dependent economies has been providing for many years the major source of import demand growth in a world where Japan and the European Union have been suffering from sluggish domestic demand. The article argues that this state of affairs should be described as one of "stable disequilibrium", instead of "unstable equilibrium", as the emphasis rightly belongs to relative stability, albeit imbalanced. It equally describes the current deadlock in trade negotiations and the likely tendencies of the multilateral trade system.

Keywords: trade, stable, disequilibrium, exchange rate fluctuations.

Far from pretending to offer you a scholarly presentation, full of certainties and abstract arguments, my aim is to conduct in your company an exploration through the jungle of our daily insecurities and uncertainties. My subject is trade and economic life as they are, here and now, and not as they are supposed to be in the textbooks. That is why the narrative will at times resemble a collage of yesterday's newspaper clippings and not a dry economic report punctuated by characteristic curves, graphs and figures.

Our starting point will be an apparent paradox. Last year was one of the very best in 30 years in terms of the expansion of the world economy – above 5% – and of international trade – more than 9%. At the same time, 2004 was the year that the US current account, trade deficits and budget deficit all reached an unprecedented grave level – the signs of major disequilibria between that country and the rest of the world. We were taught that economic disequilibria, particularly of this gravity and affecting an economy that accounts for one quarter of the entire world output, are inherently a bad thing and will not last. Nonetheless, despite all dire predictions, year after year, the main features of the international economy have shown a remarkable and surprising stability amidst great uncertainty.

[*] **Rubens Ricupero** is currently the Dean of the Economics and International Relations Faculty at Foundation Armando Alvares Penteado (FAAP), São Paulo. Previously, he was the Secretary General of United Nations Conference on Trade and Development (Unctad) in Geneva, from 1995 to 2004, Chairman of the GATT Contracting Parties (1991), of the GATT Council of Representatives (1990), Minister of Finance of Brazil (1994), Minister of the Environment and the Amazonian Affairs of Brazil (1993). This text was written in early March 2005, as the Annual Commencement Day Lecture of the Export-Import Bank of India, Mumbai. The best proof of the correctness of its central thesis is that, ten months later, nothing practically has changed in the world economy, except the Chinese mostly symbolic gesture of allowing for an extremely limited fluctuation of the renmimbi.

Having been collecting, as a sort of hobby and for eventual use in the future, the end-of-year predictions of major economic newspapers and magazines, I am amazed by how they repeat themselves over and over again, waiting for something that never happens, for a train that is always delayed and never arrives. To give just one example: not long ago, John Plender wrote in his *Financial Times* column, "Herb Stein, the economist, once remarked that if something is too good to be true, it probably is". He then added, "That applies to the United States deficit, which is unsustainable. So the risks are mounting. The dollar could crash. Bond markets could blow the whistle on United States fiscal policy. Americans could start saving at normal levels again, which would put a big squeeze on the United States economy. Overheating spreading outward from China could lead to lower Asian savings surpluses on which the United States deficit depends. The world economy would muddle through, but markets would judder".

As you see, this is a long list of not-implausible developments. Well, the column was published on 29 December 2003, a year and two months ago, and except for the gradual descent (and not "crash") of the dollar, none of those predictions has proven right.

Until that point in time, one could cautiously have added: Let's wait a little bit more and we will start seeing the inevitable changes; and such was the tone of many comments at year-end. One expert who quoted the same source as John Plender was Professor Joseph Stiglitz, who wrote an article for *The Guardian* published 1 January 2005 entitled "This can't go on forever – so it won't", attributing the phase to the same Herb Stein. His list of uncertainties included the price of oil, rises in interest rates, their impact on housing prices and household consumption, the unavoidably huge fiscal and trade deficits in the US and a weaker dollar, with serious losses for Europe and Japan.

On a different subject, but expressing the same surprise at the implausible resilience of certain traits of the US economy, an editorial in the *Financial Times* weekend edition of 8-9 January this year was devoted – as its title indicates – to "The puzzle over United States interest rates". It opened with the phrase, "In Arthur Conan Doyle's *The Adventure of Silver Blaze,* Sherlock Holmes solves a mystery by analysing something that did not happen: the 'curious incident' of the dog that did not bark". And it continued: "Economists might do well to follow the same line of thought. Last year the dog that did not bark was the United States bond market. Against all expectations the yield on the benchmark 10-year bond ended the year lower than it began, in spite of strong growth and four rate hikes by the Federal Reserve. There are goods reasons to expect yields to rise this year. But it is puzzling that they have not done so already".

The last phrase captures well the reaction of most analysts to the surprising aspects of the recent behaviour of the world economy. It is in fact puzzling that despite oil prices hikes, fast growth and a booming budget deficit, core inflation in the US has been extremely moderate. It is equally puzzling that private savings in that country have dipped to a historical low, that indebtedness keeps growing at an accelerated pace, and that personal bankruptcy has been spreading at a frightening rate with no apparent downside in terms of consumer confidence.

It is as if the good old religion of our textbooks has been turned upside down. Thrift, austerity, frugality, hard work and investment in the future, the supposedly Protestant virtues at the root of the capitalist revolution, have gone out of fashion. Deep in debt, America – the government and private households together – are behaving more like the irresponsible, light-hearted and spendthrift Renaissance Popes: a combination of bellicose enterprises, extravagant projects – not, unfortunately, Michelangelo's Sistine Chapel, but Star War systems and a superfluous new generation of atom bombs – of borrowing not to invest but to consume.

Puzzlement is again the term that best describes another John Plender column in the *Financial Times*, this time dated 3 January 2005. With admirable self-assurance, he asserts: "We know" (do we really?) "that the United States cannot continue accumulating external liabilities and that Asian countries cannot go on piling up dollar reserves at the current rate indefinitely. Yet the present unstable equilibrium keeps both sides of this recycling equation happy, even if many countries with floating currencies are mercilessly squeezed as a consequence".

I have a problem with calling this situation an "unstable equilibrium", as it puts the accent on "unstable". This does not fit into the logic of the argument that follows, and I quote: "In fact, the Asians have little choice but to finance the United States deficit. They are running current account surpluses (...) The cost of not adding to the dollar stockpile is high. If any one country yields to the American mercantilist demand for currency appreciation and abandons the dollar peg, there will be an immediate loss of competitiveness vis-à-vis Asian neighbours together with a risk of deflation, something that China has come close to in the recent past and Japan has already experienced".

This does not strike me as a description of instability, at least not in the foreseeable future. If one turns to another much-respected *Financial Times* analyst, Martin Wolf, we will see that, in his opinion, the Chinese are not going to change. In his predictions for 2005, published in the weekend edition of 31 December 2004-1 January 2005, Wolf deals with the following question: "Will China revalue its currency?" He does not hesitate to remark that "much pressure will be put on China to revalue the renminbi in 2005. But the Chinese authorities will resist, since they believe that the costs of such a move greatly outweigh the benefits (...) It is unclear what the best alternative to the peg might be. Overall, China will cling on to nurse, for fear of something worse."

On the basis of such opinions – and they do not seem far off-target, as they reflect a sort of widespread consensus – it would perhaps be better to call the current state of affairs not one of "unstable equilibrium" but one of "stable disequilibrium" instead. This is not merely a play on words: it puts the accent where it rightly belongs, on "stable", because as everyone knows, and the abovementioned quotes confirm, this puzzling situation has been ongoing for years, at least for as long as that other anomalous phenomenon, "irrational exuberance". On the other hand, what we have now is in no way a condition of "equilibrium" – a term that, however qualified or limited, cannot apply to the huge differences between the two giant deficits in the United States and the situation prevailing in Europe, Japan or China.

I have quoted these excellent texts of economic journalism at such length in order to show how difficult it is to make sense of what has been happening in the world economy in the light of neoclassical theories of general equilibrium or of the currency stability assumptions underlying the original Bretton Woods agreements. Take, for instance, the case of trade. Although its levels of gravity have varied considerably, the trade imbalance in the United States has existed for over 10 years now. It has indifferently presided over periods when world trade contracted, as in 2001 (minus 1%) and over holy years, as in the 2000 boom, when trade volumes expanded by an exceptional 13%. Contrary to widely shared expectations that once the trade deficit went beyond a certain level, it would set off an automatic, self-correcting mechanism, the deficit has kept growing and resisted everything in its path, which so far has included a not-insignificant devaluation of the dollar against many floating currencies.

Perhaps one of the explanations lies in the exceptional nature of our time. During the Victorian Golden Age of economic liberalization – between, say, 1870 and 1914, marked by currency and exchange rate stability and the reign of the gold standard – capital flows were relatively free, trade was expanding but there were few important economic players aside from the US and Western Europe, which was far from a truly global arena. Urbanization, mass consumption, budget deficits were all in their infancy. Between the two world wars, the gold standard, currency stability, capital movements and trade all suffered a severe setback. In the first three decades after Bretton Woods, from 1944 to 1974 – the period the French call "the 30 glorious years" – there was a remarkable degree of currency and exchange rate stability; reconstruction and economic expansion in Japan and Western Europe proceeded swiftly, capital liberalization evolved progressively, world trade boomed but oil was cheap – sometimes even cheaper than mineral water – and most of the developing countries in Asia and Africa were still at a very low stage of integration into the world economy.

This is the first time in history we have had a combination of more or less free fluctuation among the major currencies (and episodes of sharp volatility); an unprecedented degree of capital account liberalization; an advanced stage of trade integration between Western countries, in particular the US and China and Asia; and the internationalization of the production and distribution chains of global corporations. At the same time, the urbanization occurring in the mega-cities of the third world, mass consumption, budget deficits and the constant threat of an oil price shock are further complicating the situation. No wonder we sometimes struggle to find relevant precedents for what we have been experiencing lately.

We probably don't know enough about the new heightened complexity of the interplay of these factors to predict the results with any accuracy. A few months ago, when faced by the sudden surges in oil prices, many feared that, just as in the spring of 2000, we would soon be engulfed by a wave of protests and unrest in Western Europe, followed by a sharp economic slowdown in the United States and elsewhere. In reality, nothing of the sort took place, or at least not to the extent feared, as the appreciation of the euro cushioned the impact of the oil price rises in Europe, and in the US they were seen as a non-inflationary tax on rapid growth.

It is reasonable to postulate that the increasing trade and financial integration between East Asia and the US, creating a kind of informal, non-institutionalized but highly effective economic bloc, is of all the recent developments enumerated above the one with the farthest-reaching consequences as far as trade is concerned. In effect, some of the other elements – capital account liberalization, or free currency fluctuation – are not common characteristics of East Asian countries. It is precisely their absence from economies like China's that explains much of the extraordinary symbiosis developed by China and many of its neighbours with the United States, in the literal sense given by the dictionary: as an association of heterogeneous organisms dependent on each other for existence.

Heterogeneous they are indeed, in the sense that they belong to different natures, as indicated by the persistent American refusal to consider China a "market economy". But who could doubt that they "depend on each other for existence", given how much China has been growing for the past 20 years and more, thanks in part to the US market for its manufactures, and given the increasing reliance of the US on China, Japan and other Asian countries to finance its current account and trade deficits?

Again, that symbiosis helps to explain some of the puzzling behaviour of the economy, such as the stubborn resilience of the trade deficit or the low inflationary pressures in the US. Both of them have something to do with a sort of permanent high import propensity developed by the US market as a consequence of the transfer abroad – mainly to China – of many production lines, on account of the lower costs involved; or to put it better, as a result of integration brought about by investment and trade.

To understand well the nature of the phenomenon is not a trivial matter, since it will enable us to determine whether the current stable disequilibrium is sustainable, and the extent to which this is desirable or unavoidable. This formulation is likely to cause some surprise, as there is a widespread assumption that the major global disequilibria are unsustainable and undesirable. That is undoubtedly the mainstream opinion, adopted as the official discourse of G-7 governments, the IMF and other multilateral organizations and also articulated by most economists and economic pundits.

Nevertheless, there is also a minority report of some substance that argues in favour of the sustainability of the current account deficit, seen almost as a condition of economic growth in a world sorely lacking in alternative and autonomous sources of import demand outside of the United States. A neat contrast between those two diverging views is evident in the discussions between the more representative advocates of the mainstream on this topic – people like Harvard Professor Kenneth Rogoff and Berkeley Professor Maurice Obstfeld – and a dissenter of equally impressive academic and practical experience credentials like Harvard Professor Richard Cooper.

In a recent article, the first two rhetorically asked: "Should [the US Administration] worry that the United States is singlehandedly eating up more than 70% of the combined current account surpluses of China, Japan, Germany and all the other surplus countries in the world? Should it worry that foreigners might start balking at the sub-par returns they have been averaging in the United States for more than a decade?" Their answer to these questions is, as they put it, a resounding "yes". More than four years ago, when they first began publishing papers on the risks of the US current account collapse, this was an important medium-term problem. "Today", they say, "it should be problem number-one on the [...] president's international financial agenda".

Not at all, contests Professor Richard Cooper, for whom the US current account deficit is not only sustainable but also perfectly logical, given the world's hunger for investment returns and dollar reserves. In his opinion, it is not in the slightest inconceivable, in today's increasingly globalized world, that savers would want to put 10% to 15% of their savings into the US economy (he estimates that the world is generating US$ 6 trillion a year in savings), a share that decreases with time. He believes that "US$ 500 billion a year in net private foreign investment may actually be on the low side. In periods when such investment in the US falls short of US$ 500 billion, official investment in the form of reserve accumulation will fill the gap [...]. Japan and China have led the accumulators of dollars reserves, but dozens more countries, including India, have added significantly to their reserves". Their motives, he concedes, "stem purely from their desire to inhibit export-damaging currency appreciation [...]". And he concludes: "This is not a foolish strategy, if not carried to extreme". Unlike Obstfeld and Rogoff, who fear foreigners' reactions to "the sub-par returns they have been averaging in the United States market for more than a decade", Cooper affirms unequivocally that that economy "provides higher returns on real investment than do Europe or Japan, and offers more reliability and security on these returns than do emerging markets".

It is difficult to imagine how the two positions could be more diametrically opposed. Alas, there is much more. Cooper claims, in effect, that it is the sheer size of the US current account deficit that "permits many countries to run surpluses that would not otherwise be possible". This is because the continuing deficit reflects not only a deficiency of savings in the United States relative to investment there but "also reflects an excess of savings relative to investment in the rest of the world". Therefore, "any attempt to reduce the United States deficit abruptly, other than through a spontaneous but unlikely surge in domestic investment in many other countries, would undoubtedly produce a world recession".

This is one of the few points where the two visions converge. Obstfeld and Rogoff admit that "if current accounts are forced towards balance in the context of a difficult global economy, the effects could include financial crises, higher interest rates and a big drop in global output". With this one exception, however, the two mainstream authors favour a therapy that is the complete opposite of that recommended by Cooper. While the latter does not say a word about the US budget deficit and looks to a "spontaneous surge in domestic investment" abroad for a cure, the former recognizes that "the federal government's own impecuniousness is a big part of the problem". Accordingly, they prescribe raising taxes to fight the budget deficit as a way of facilitating the adjustment to the dollar exchange rate. Raising interest rates would be another way of stimulating

US private savings and tempering the dollar's fall. The external contribution should come through productivity growth in the non-traded good sectors in such countries as Germany and Japan, as well as through a move to more flexible exchange rates in Asia.

The most striking divergence between the two approaches lies, of course, in the significance of the US budgetary deficit, absent from Cooper's macro-vision and central to the analysis of Obstfeld and Rogoff. Looking at that country's twin deficits (current account and fiscal) in the context of open-ended security costs, geopolitical tensions, rising old age pensions, high energy costs and extraordinarily stimulative macroeconomic policies, they see strong parallels with the difficult economic years of Richard Nixon's early 1970s. The crucial point where the two views frontally collide is exactly on the actual role of the current account deficit. For Cooper, the deficit's role has been to finance investment by foreigners in the US economy, whereas his colleagues argue that this may have been the case four to five years ago but that today the deficit is mainly financing government borrowing, a far riskier situation. They conclude that "with the government's fiscal deficit now accounting for most of the country's overall borrowing, events are likely to unfold within the [current] presidential term".

When I read the two articles side by side, on the eve of the recent US presidential election, I had the eerie sensation that they had been written by the Italian playwright Luigi Pirandello. In his play "Cosi è se vi pare" [Right you are (if you think you are)], he puts two characters on stage, a man and his mother-in-law, who give totally opposite but equally plausible versions of everything happening in the play.

One could in any case argue that in practice, the adjustment will mainly come, as Alan Greenspan suggested last year in Frankfurt, through the devaluation of the dollar and its impact on US trade. As a matter of fact, this process has been under way for some time already, with the predictable rise in tension with the Europeans, called on to pay the highest prices in terms of export losses, and with the increased US pressure on China to revalue its currency.

Call it competitive devaluation or something else, it will still have to be painful if it is to be effective. Rogoff and Obstfeld estimate that, beyond the depreciation that has already taken place, the dollar would have to fall by an additional 20% to 40% for the current account deficit to disappear. Early this January, the dollar had fallen by 38% against the euro from its peak in November 2000, but in terms of the Federal Reserve's broad trade-weighted index, the overall devaluation was only 16% since its peak in early 2002. The discrepancy stems from the resolve of many governments, primarily in Asia, to resist the decline of their currencies through the accumulation of reserves. From December 2001 to September 2004, there was an increase in foreign currency reserves of US$ 1,396 trillion, of which Asia alone accounted for US$ 1,068 trillion.

Thus, the question is, as Martin Wolf puts it, not only how smooth the adjustment will be but how widely it is shared. Even if China and others are not inclined to give in, a dollar devaluation of the magnitude estimated by Rogoff – 40% – would represent a US$ 200 billion loss for the Chinese government as a consequence of the fall in the value of the reserves. Despite those staggering figures, the United States and many Asian surplus countries are still clinging to the continuation of the status quo, which former US Treasury Secretary Lawrence Summers called a "balance of financial terror" – in other words, stable disequilibrium.

Since President Nixon unilaterally abandoned in the early 1970s the pillars of the Bretton Woods system of fixed exchange rates, the external monetary environment within which trade operates has been like the climate: unpredictable, full of swings, subject to sudden blasts of winds and quite stormy at times. It is ironic to read today what the economic pundits were saying in 1973-1974: that there would be a few years of turmoil, three to four at most, and then everything would get back to normal and the system would find a new and lasting equilibrium. That was more than 30 years ago....

It is important to recall this well-known piece of history in order to draw attention to a central fact: what we have in our days is not at all what the Bretton Woods architects had in mind for an external monetary context that would ensure a truly competitive, level playing field for the trade game, without the distortions provoked by competitive devaluations. Neither does it correspond to the ideal conditions of monetary neutrality postulated by the free trade theorists as a *sine qua non conditio*, a prerequisite for extracting the maximum welfare benefits from an international trade system free of barriers and unfair distortions. That description, we have to admit, does not in the least resemble a system where changes of 20% or more, whether upwards or downwards, can occur in the value of the major currencies within the space of just a few weeks or months.

Those are unpleasant truths that were bitterly learned during the interwar period of the 20th century but which seem to have been largely forgotten since then. Unctad, the United Nations Conference on Trade and Development, has been almost alone in calling attention to the need for better international arrangements in the monetary and financial areas. Unfortunately, most of the other international organizations chose to concentrate their exclusive attention on the adoption by developing countries of domestic reforms, overlooking the fact that such reforms can be easily undermined or nullified by the absence of a supportive external economic environment. The problems suffered by Hong Kong and Singapore during the 1997-1998 crisis clearly demonstrate that even the very best governance in terms of institutions and policies is no guarantee against the damage wrought by a structurally flawed international monetary and financial system.

Unctad's *Trade and Development Report* last year focused in particular on an analysis of the links between trade and exchange rates. It underlined the importance of avoiding overvaluation as a means of preserving trade competitiveness and as a form of insurance against the risks of financial crisis. At the same time, it recognized the difficulty of implementing such a strategy with an open capital account that leaves countries vulnerable to short-term speculative capital seeking so-called "arbitrage gains", or earnings based on the differential between international and local interest rates.

A better international system should be able to reduce excessive volatility in exchange rates among the major currencies and provide a measure of stability to international financial flows. In the absence of universally agreed mechanisms for those goals, countries should be allowed to protect themselves through appropriate capital controls, as the IMF itself reluctantly admitted in April 2003. The true reason why some developing countries have found it difficult to re-impose short-term capital controls, as Chile did in the past, is not the weight of the intellectual arguments against any type of capital controls. The explanation lies elsewhere, in their precarious dependence on the international financial markets for the continuous inflows of foreign exchange to service their debts, and the fear that the re-imposition of controls, however prudent, necessary and temporary, would frighten away the lenders. An inescapable trap is thus created by premature and exaggerated financial liberalization, a trap that is self-perpetuating and that feeds upon itself. This is why Columbia Professor Jagdish Bhagwati, one of the most respected trade economists but a caustic critic of the premature opening of the capital account by developing countries, compares the difficulty of escaping the financial liberalization trap to the predicament of someone who tries to resign from the Mafia. As is well known, the "Onorata Socièta", as Sicilians call it, does not like letters of resignation….

Countries that have painted themselves into a financial corner – that are highly indebted, with an open capital account, and that use high interest rates to fight inflation – will see their currencies appreciate against the dollar and their export competitiveness implacably eaten away, bit by bit. The bitter result is not hard to predict: the return of growing trade and current account deficits that at some point will scare off investors and produce a sudden reverse in financial flows and a new crisis. This is not a script for a disaster film in the future; we can already see it in action in some Latin American theatres.

The truth of the matter is that, once again in our lifetime, we are beginning to witness a major reorientation of trade currents, exports and imports alike – not because of any acquisition of new competitiveness on the part of some and competitive losses on the part of others as a result of innovation, hard work, trade talents, but purely on account of dramatic realignments among currencies. It is quite clear that the US is determined to seek adjustment not through the painful process of cutting the budget deficit and putting its house in order but through shifting the burden of adjustment to economies with a floating currency: Europe, Latin America and others. We will see yet again how, in the space of a few days, weeks or months, a realignment of exchange rates can completely subvert or erase trade concessions that took years and years of patient negotiations to achieve. And once again we will have to conclude that coherence between the trade system on the one hand, and the monetary and financial system on the other, is but a fig leaf, a rhetorical figure in the vocabulary of the hegemonic Powers.

I have spent a great deal of time dealing with the link between trade and currency volatility because this is the most immediate and acute challenge faced by the trade system today. Behind the problem lurks the macroeconomic disequilibrium between the US and the rest of the world, which I have already examined here at some length in order to fulfil my promise to speak about the reality of an imbalanced global world as it is here today. It is time now to turn our attention to a different aspect of reality, the world of negotiations and of the functioning of the multilateral trading system, its institutions and their performance.

In doing so, we must start from the current state of the Doha Round which, after the false start ended so ignominiously at Cancun, now finds itself in a curious stage that resembles the "Phony War" at the beginning of World War II. Waiting for a new WTO Director-General to be selected in the next few weeks, no true negotiations are taking place to prepare for the Hong Kong Ministerial Conference at the end of this year. There is therefore no concrete basis for an informed conjecture about whether that Conference will succeed in paving the way towards a successful conclusion of the Round someday in 2006, before the US Trade Promotion Authority expires the following year or a new American farm bill further complicates the negotiations.

We are thus reduced to trying to figure out the shape of the future trading system without any assurance that the present one will survive the current test. About 15 years ago, in 1990, the year that the Uruguay Round talks were supposed to conclude but instead collapsed in Brussels, the situation closely resembled in some respects what we are experiencing today. I remember the era well, because I was then the Chairman of the GATT Council, waiting to become the Chairman of the Contracting Parties the following year. A long and tedious crossing of the desert lay before us until a breakthrough was achieved in 1993. During that period, much effort was spent in trying to visualize what would likely be "The world trading system after the Uruguay Round", the title of the best essay on the subject, written by Robert Z. Lawrence and Robert E. Litan and published by the Boston University International Law Journal, 8 (Fall 1990).

Four main scenarios were outlined by the authors as the most probable outcome of that Round, but they apply equally to the current stalemate if we replace the word GATT with WTO: the continuation of a GATT-based regime; the development of a world of trade blocs; the transition towards a managed trading system and, finally, the emergence of a GATT-plus system. The pre-condition for the existence of the first scenario was the successful conclusion of the Round. In that case, the GATT/WTO would continue to play an important but declining role because it was confined to the traditional "border measures" -— that is, tariffs, antidumping, countervailing duties, etc. The spirit of the times allegedly required "deeper integration" in the form of harmonization of domestic legislation and national standards in sensitive areas hitherto reserved to countries' sovereignty. For that reason, according to the article, an organization like the Gatt/WTO, with a membership of over 100 countries (they now number 150), at very different stages of economic development, would not be adequate to reach consensus on a significant number of questions within a reasonable time limit.

The study asserted that it would be more efficient to advance towards global integration through a process that would first establish regional "building blocks" to be connected subsequently to form a more open global integrated unity. It admitted that if the Round failed, the blocs might become closed to third parties and, instead of "building blocks", they might evolve into "stumbling blocks". In that event, the blocs could not only frustrate the goal of "deep integration" but might lead to the fragmentation of the 1930s, a remote hypothesis for the authors.

The worst danger would be the prevalence of managed trade where the goal of negotiations would be to fix quantifiable objectives, not to agree on general rules. This undesirable outcome might be the result either of the proliferation of "grey area measures" – of the so-called Voluntary Export Restraint Agreements in such sensitive areas as steel, automobiles, semiconductors, textiles – or the imposition of artificial goals in order to achieve an arbitrary balance in bilateral trade.

Lastly, Lawrence and Litan did not hide their preference for a Gatt/WTO-plus system to harmonize policies in competition, technology, product standards, regulatory practices, etc. That modality of "deep integration" should be sought in a sort of super-Gatt/WTO or preferable in several organizations of a more restrictive composition than the Gatt/WTO, something of the same nature as the OECD Free Trade and Investment Area postulated by Gary C. Hufbauer in 1980 to create a unified market for goods, services and capital by the year 2000.

A couple of years after the publication of the article, I wrote a commentary in which I said that, in effect, the four scenarios should not be seen as a basis for organizing the trade system according to a single pure model, with the exclusion of all the others. They were, in reality, elements that already existed and co-existed inside the then-current system. That system did not mirror the first scenario. It was, on the contrary, the total sum or the combination of the four described scenarios, each of them in a different dose; a co-existence, within the trade system, of heterogeneous and frequently contradictory tendencies.

Let us take what the panel of eminent personalities appointed by the WTO Director-General and chaired by former Director-General Peter Sutherland considers the greatest threat to trade multilateralism: the active promotion of bilateral and regional agreements (RTAs). They are indeed a threat, as they have quadrupled since 1990 to about 230, covering almost 40% of world trade. Nevertheless, those figures have to be qualified by the knowledge that many of those blocs either exist solely on paper or are performing quite badly. At the time of the Uruguay Round, it was fashionable to pretend that in the future, the world would be divided into three continental blocs with the United States, Japan and Europe as their leaders, each with its own currency. Well, time went by and the only bloc that now exists is the European Union, which has been around in one form or another since the late 1950s.

I have no doubt that RTAs will continue to flourish in the years ahead, for the reason pointed out by Lawrence and Litan: they are effective tools for the US, Europe or Japan to extract from developing countries WTO-plus concessions that would be out of reach in a multilateral arena. As the World Bank rightly asserted in *Global Economic Prospects 2005*, RTAs with more advanced partners risked burdening poorer countries with complex rules that did not help their economic development. The Bank, in a welcome change, warned developing countries that they would suffer diminishing returns and even economic losses by rushing into deals with leading industrialized countries. The report added that US pressure on poorer countries to sign bilateral investment protection agreements, embrace strict intellectual property rules and abolish capital controls did not meet their economic needs.

Notwithstanding this courageous and wise admonition, the lure of acceding to the US or European market will probably lead some countries to accept those unequal and imbalanced deals. Yet they do constitute a threat to the integrity of the trade system because they subvert and undermine the basic principles of multilateralism, non-discrimination and the MFN clause. Contrary to the pious intentions of those who believe that RTAs are the building blocks of a better system, in fact they create new obstacles to trade under the guise of complicated rules of origin or special safeguards. Their advocates like to call them "preferential agreements", forgetting that to prefer is to choose some to the detriment of others — in other words, to prefer is to discriminate in violation of the first two articles of the General Agreement.

Despite the growing trend towards RTAs, I do not believe that they will replace the multilateral trade system, for two basic reasons. The first is that developed countries badly need a multilateral system for their own needs, to negotiate new rules and to solve their numerous trade conflicts. It is a fallacy to claim that industrial countries would agree more easily among themselves if they were not hindered by developing nations. The truth is that they did not succeed in negotiating a Multilateral Investment Agreement in OECD because they could not agree. Even today, five years after Hufbauer's deadline for the OECD Free Trade Area, none exists and none is being negotiated, just as there are no negotiations whatsoever between the US, Europe and/or Japan to form a bilateral or trilateral free trade area. As the subsidies conflict between Airbus and Boeing or the panel against the US corporate tax rebate proves, most of the important disputes brought to the WTO involve developed economies and do not oppose the latter to developing countries. The second reason is that only in a multilateral trade organization such as the WTO can developed countries achieve systemic breakthroughs like the General Agreement on Trade in Services (Gats), the Trade-Related Intellectual Property Agreement (Trips) and many others. RTAs may help reduce the resistance to such proposals but they do not lead to truly universal deals.

I could go on for hours about the numerous other challenges faced by world trade. A fascinating one, for instance, is how the system will ultimately be able to absorb the emergence of China in manufactures and of India in services. There are obviously positive precedents, such as the absorption of Japan and Italy after World War II. At the time, however, the world economy in general and Europe in particular were growing at extraordinarily accelerated rates that would never be seen again. Full employment was widespread, and no one had nightmares over oil shocks. In the absence of those ideal conditions, I very much fear that protectionism of a new variety, a sort of post-modern protectionism, will gather strength, which is what we are starting to witness in Europe with the development of the insidious modality of "community preferences". If not resisted in time, they will certainly reinforce the good old instruments of managed trade that are already being threatened against the surge of Chinese textile exports and against the outsourcing of services to India.

Yet the greatest of all trade challenges, in my opinion, is not new but is, on the contrary, a quite traditional and old one, not related to "deep integration" but arising from the unwillingness of developed countries, the self-appointed champions of free trade, to renounce their rich and efficient arsenal of "border measures". I refer to the well-known problem, ever postponed, of dealing with the "unfinished business" of the Tokyo and Uruguay Rounds, doing away once and for all with the backlog of barriers and obstacles to developing countries' exports: tariff peaks on sensitive products, tariff escalation to prevent import of value-added goods, a form of managed trade, the abuse of antidumping and countervailing measures and, above all else, the scandalous procrastination of agricultural trade liberalization, which was to be the key to the success of the Doha Round. In a comment on Lawrence and Litan's article by Brandeis Professor Rachel McCulloch, she rightly remarked: "Between the two Gatt-plus scenarios of Lawrence and Litan, there is room for a third option that would also qualify as Gatt-plus … [and which] would go back to the first principles and would equally implement and apply the old rules before adding new ones. The current Gatt (we should read WTO) is full of exceptions and is undermined by national actions in violation of the spirit and often of the letter of past agreements. This kind of Gatt-plus would deal with many questions of shallow integration that are still with us before proceeding towards the formidable challenges of deep integration".

I could not say it better or more eloquently. It is high time to do justice to developing countries and finally face the challenge of an unfair legacy of the past. In addition, it is indispensable to improve the coherence between trade, money and finance, putting an end to the prevailing stable disequilibrium, which may not be eternal but, as the memorable verse of a Brazilian poet has it, seems to be infinite as long as it lasts.