

# General Remarks on Trade Zones and the Uruguay Round

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I very much regret that I cannot be with you to discuss matters personally with so many distinguished economists and officials. I am sure that I would have left the symposium with a number of fresh ideas and insights.

I do want to make some observations about trade zones, but before doing that, perhaps I should say something about the Uruguay Round trade negotiations.

## **The Uruguay Round**

You know, of course, 'about the very serious setback we suffered at Brussels last December and that since then we have managed to revive the Uruguay Round and keep it going, mainly on the basis of technical discussions plus a small amount of serious negotiation.

A consensus has emerged that we should complete our negotiations around the end of this year, and I strongly hope that governments will resolutely stick to that "target period." I refrain from using the word, "deadline."

To let the Uruguay Round drift on into 1992 would give too many hostages to fortune. The Presidential elections in the United States are not the only political developments that could affect the Round. And as each month passes it will become more difficult to maintain

a strong sense of purpose and to prevent the unraveling of matters already agreed.

This autumn is the time to make the deals that will put the Uruguay Round over the top, the time when if we cannot end it, we must put the end clearly in sight. And although a vast amount of work remains to be done, the elements are at hand to carry the Uruguay Round to a successful conclusion.

In short, what we need are political decisions—the right political decisions. With the right political decisions we will finish the Uruguay Round in a very credible way. Without them, technical work and endless meetings of negotiators will be to no avail.

Clearly, there is a political consensus that the Uruguay Round must be concluded successfully. And clearly, one government after another in the developing world, in Central and Eastern Europe, and in Australia and New Zealand has been moving autonomously to liberalize its economy and its trade regime. This autonomous liberalization creates a propitious atmosphere for the Uruguay Round; indeed, failure of the Round would be doubly bitter if it were to occur in such an atmosphere.

So, the elements are in place; there is a consensus that the Round must be finished successfully, and soon; and many governments are acting independently to meet key objectives of the Round. But we all know that some major problems remain, and if they are to be resolved, great and politically powerful lobbies—especially in the European Community (EC), the United States, and Japan—must be told that things have to **change**, **gradually** to be sure, but change must occur.

Only the people at the very pinnacles of government—presidents and prime ministers—have the authority and, let us hope, the political courage and vision to make the very difficult decisions on these matters. If they do, we shall have a successful Uruguay Round.

## **Financial services negotiations**

The organizers of this symposium have asked me to comment on the financial services negotiations. Before I do, I wish to say just a few words about the overall services negotiations, which embrace, of course, much more than just financial services.

On the basis of all that I know at this time, I can give you a relatively optimistic report. We are actually negotiating in services, and we are making progress. Progress is not as fast as many of us would like, but in our July meetings we were able to move forward.

There are some very difficult problems to be worked out, especially in the areas of maritime transport, telecommunications, and television programming and films, areas where governments may seek to apply trade restrictions in a discriminatory manner; that means not fully in accordance with the General Agreement on Tariffs and Trade's (GATT) cornerstone, the most-favored-nation principle which requires that trade restrictions be applied equally to all nations. But I see no insuperable obstacles to a successful negotiation.

The "north-south" gap that bedeviled earlier efforts to launch a successful services negotiation has largely disappeared. Developing countries are negotiating constructively, partly because they realize that there must be a successful outcome in services if there are to be successful outcomes in areas of prime interest to them, such as textiles and agriculture. But I think that is only part of the reason. They also have begun to see clearly that a modern economy requires, for example, efficient banking and telecommunications services, best provided perhaps by foreign companies. Moreover, and possibly most important, they are beginning to identify service sectors where they can be quite competitive—construction, other labor-intensive services, software, and all sorts of back-office financial work, for instance.

Just as I believe that a successful negotiation in services is within grasp, I also believe that we can resolve the problems in financial services. First, there is now a consensus that financial services must be a part of a general agreement on trade in services, not apart from

a "GATS" as was earlier suggested. Institutional questions do remain, however: the relationship of **GATS** itself to **GATT** and whether there should be an independent, or relatively independent, financial services body, staffed by experts, to handle **problems** in this area.

Two major substantive problems concern a proposed "dual track" approach to financial services and what the negotiators call a "prudential carve out." The dual track proposed by Canada, Japan, Sweden, and Switzerland envisages a first track setting out an ambitious level of liberalization to which governments would commit themselves, although reservations from this level could be negotiated.

These developed countries also envisage a second track that will allow participants to negotiate and inscribe commitments through the provisions **contained** in the agreement. Although a similar level of commitments could be obtained under either approach, a number of countries, especially developing countries, are concerned about the dual-track approach.

The "prudential carve out" issue simply is about the degree of discretion which regulatory authorities should have under the GATS in regulating banks, insurance companies, and other financial institutions. All governments agree on the need for a carve out and that regulators must continue to regulate. The question, again, is about how much discretion they should have. **The** Asian nations and Korea argue that they should have complete discretion. Others fear that complete discretion could be used to frustrate liberalization.

These are difficult questions, of course. Moreover, there is the further issue of initial liberalization commitments, not just in financial services but in other service sectors too. At this time we have initial commitments from more than 35 countries but many of these commitments would simply maintain the status quo. Some **governments**—for example, the United States—want significant initial liberalization, so this is another issue to be pursued this autumn.

You can see from this brief, nontechnical discussion that we have

much work to do and that "nothing is in the bag" either in general services negotiations or in those on financial services. Assuming, however, that we can move forward in other major areas of the Round, we are likely to reach a successful outcome on services.

### **Trade zones**

We are keenly aware in Geneva that the world is not standing still, patiently waiting for us to finish our job. The international press has articles almost every day—some of them a trifle apocalyptic—about the emergence of trade and currency zones, or as they are frequently called, "blocs."

There is such a great array of high-powered banking and financial talent at this symposium that I am diffident about commenting on **currency zones**. I will venture a few observations, however, about trade zones.

First, contrary to popular opinion, GATT's statistics do not support the view that trade is becoming more regionalized. The following table shows the importance of intraregional trade for North America, Western Europe, and Asia for the years 1979 and 1989. It excludes their trade with the Middle East and Africa in order to prevent skewing of the statistics by declining petroleum prices. (As world oil prices dropped, the dollar value of the three regions' petroleum imports from Africa and the Middle East also declined, automatically increasing the relative size of their intraregional trade.)

**Table 1**  
**Share of Intraregional Trade in Exports and Imports Excluding the Middle East and Africa**

	<b>1979</b>	<b>1989</b>
North America	<b>34</b>	32
Western Europe	76	76
Asia	<b>48</b>	<b>48</b>

*Second, political considerations make it unlikely that the world will be divided any time soon into three or four great trading zones or free trade areas.* How many new members will the EC or the North American free trade area have in the next few years? A few in each case, perhaps, but one has only to witness the struggle in the U.S. Congress over entering into negotiations with Mexico, and the European Community's hesitancy, particularly about Central and Eastern Europe, to realize that the process is unlikely to be swift.

The former U.S. deputy secretary of state, Kenneth Dam, argued in a recent article that "the political basis has not been laid for *major* new free trade areas" (my emphasis). Mr. Dam was speaking about the United States, but his argument can be applied to other parts of the world as well.

How likely is a Pacific free trade zone with Japan, either with or without the United States? Again, the political obstacles seem formidable.

None of this is intended to argue that there will not be any expansion of existing zones or that no new zones will be created. Indeed, I believe that the march will continue but both trade statistics and political considerations suggest that it is likely to be slow and undramatic.

*Third, regional zones are not necessarily incompatible with multilateral trade liberalization.* The GATT itself explicitly recognizes the right to form free trade areas and customs unions provided (1) that all the trade barriers (there are some exceptions) among members are eliminated and (2) that trade barriers to nonmembers are not increased.

As my colleague, Richard Blackhurst, director of GATT's economic research unit, has written:

"Certain types of agreements were expressly foreseen by the inclusion of GATT's Article XXIV, permitting the formation of free trade areas and customs unions as exceptions to **most-favored-nation** treatment under Article I. As a result, regional

arrangements have coexisted with multilateralism throughout most of GATT's history. Nor was it simply a matter of tolerating such regional trading arrangements.

"Generally speaking, the motivation behind integration has not been the negative one of wanting to discriminate against third countries, but rather the positive one of wanting to increase efficiency by creating larger markets and stimulating competition (the resulting faster economic growth, in turn, expanding the demand for imports). They were seen as an optional route to the broader goal of an increasingly open and liberal world trade system.

"The role which the newly formed European Communities played in the 1960s is often cited as an example for the positive interaction which is possible between the two approaches to lowering trade barriers. Multilateral trade liberalization contributed to the regional integration process by helping to keep it on a liberal track, and the regional integration helped the multilateral trade negotiations in the 1960s by boosting the optimism and confidence in the future of the participating countries. Another way in which regional trade agreements have complemented the multilateral process is by extending trade liberalization and rule making to areas not covered by the GATT at the time.

"Current efforts to achieve closer integration in Western Europe are a logical continuation of a process of integration that began more than 30 years ago. Plans to dissolve customs frontiers between most Western European nations are no more protectionist than the constitutional ban on trade barriers between states in the United States. In other words, if France and Germany want to make their mutual trade more like trade between New York and New Jersey, that is **hardly** a threat or challenge to the multilateral trading system. In Canada, there are internal barriers to trade between the provinces and the same is true of trade between states in Australia. If either of these countries began removing their internal trade barriers, would we accuse them of creating a trade bloc?

"The principal risk to third countries is trade diversion (that is, that efficient third country suppliers will lose markets to inefficient insiders). The likelihood of trade diversion will be minimized, however, if the process of regional integration is embedded in a parallel process of multilateral trade liberalization. As was noted above, this was the case in the 1950s and 1960s when the process of European integration was accompanied by the Dillon and Kennedy Rounds under the auspices of the GATT. Indeed, empirical analyses of European integration show that trade diversion was negligible, except for those areas in which the multilateral liberalization process stalled, notably agriculture, textiles and clothing."

I agree with Mr. Blackhurst's analysis, and I think that much of the press commentary has missed the real question. This takes me to my fourth observation.

*The real question is whether regional trade zones will be an adjunct to, or a substitute for, a vigorously liberalizing multilateral trading system.* Whatever happens in the Uruguay Round we will have trade zones. But a truly successful Uruguay Round will minimize trade diversion and, it follows logically, maximize the opportunities for the global connections that modern business requires.

Further, by bringing sectors, such as textiles, clothing, and agriculture that are scarcely covered by the GATT's rules effectively under the GATT and by agreeing on rules for the new subjects, such as services, intellectual property, and investment, a successful Round will diminish serious trade disputes. And I need hardly point out that success would have beneficial political, as well as economic, consequences.

Finally, if multilateral liberalization stalls and we must rely on trade zones, who gets hurt? The short answer is, "everyone." A system of trade zones, with many outsiders, cannot be as efficient as a truly liberal multilateral system.

The long-term trend in world merchandise trade growth is *down* from an average of 8.1 percent in the 1950s and 1960s, to 4.7 percent

a year from 1970 to 1990, and a further drop to 4.1 percent in the 1980s.

Trade growth, along with investment, is one of the great engines of economic growth. Empirical evidence shows that for every 1 percent drop in trade growth, world economic growth drops by 0.7 percent. In other words, if world trade were to grow just 1 percent a year faster over the next decade as the result of a successful Uruguay Round, we might reasonably expect world economic growth to average 0.7 percent higher.

That is not an inconsequential number when applied to a \$25 trillion (\$25,000 billion) a year world economy. A quick calculation shows that if the world economy were to grow 0.7 percent a year faster over the next ten years, then total world output—the increments cumulated over the entire ten-year period—would be about \$10 trillion (\$10,000 billion) greater. (And do not forget the political consequences.)

Well, if everyone would be hurt, who would be hurt the most? The answer, I fear, is ages old: the weak, the small, the poor. Let us ask, which small, *developed* countries are fairly certain by, say, the year 2000, of being members of a free trade zone that includes either the United States, the European Community, or Japan? Perhaps two or three members of the European free trade area, but who else?

Now ask the same question about *developing* countries. Mexico, yes, perhaps several more in Latin America, but what about the others? No one can be certain, of course, but many developing countries are likely to be on the outside looking in, as are, perhaps, some developed nations. It is, however, the developing nations that could be especially hurt, perhaps rather badly. Table 2 helps make this point.

**Table 2**  
**Export Dependence of Developing Countries on**  
**Developed Country Markets, 1980-1988 (percentage)**

	<b>1980</b>	<b>1988</b>
Food	62	66
Fuels	77	65
Machinery and Transport Equipment	55	69
Textiles and Clothing	68	70
Total Manufacturing	60.5	68.5
Total Exports	71.5	67

It is doubtful that any developing country would be left completely out in the cold. Some regional integration, not involving the great industrial countries, already is taking place and more could occur. Moreover, the developed nations probably would "do something" for the exports of developing nations, but recent developments demonstrate again that "import sensitive" products are likely to be dropped from a liberalizing process.

It would surely be one of the great paradoxes of this century if the Uruguay Round could not be completed successfully precisely at the time when many governments are showing real political courage and adopting—because it is in their interest to do so—the trade and economic policies so long urged on them by the World Bank, the International Monetary Fund, and the major industrial nations.

But neither fine rhetoric nor clinging to the belief that "the Round is too **important** to fail" will, by themselves, pull us through. It will take lots of work—and we shall be hard at it in Geneva this **autumn**—and a strong push or two right from the very top.

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Editor's Note: Charles R. **Carlisle** prepared this paper for delivery at the Federal **Reserve** Bank of Kansas City's Symposium on "Policy Implications of Trade and Currency Zones," Jackson Hole, Wyoming, August 1991. Though Mr. **Carlisle** was unable to be present, his paper is being published with the proceedings.