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The Pros and Cons of Free Trade

By

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Introduction

Ladies and Gentlemen:

I am honored to be here with you today to share some thoughts with you regarding the pros and cons of free trade. I will do so with reference to the current status and prospects for continuing multilateral trade liberalization and integration, and to what many actors and observers are beginning to call a “crisis of Globalization”.

Before I begin, I would like to preface this discussion with a little history and disclosure of my own involvement in these subjects. Back in the early 90’s the GATT (General Agreement on Trade in Tariffs), which was first begun in 1947, was being updated into GATT 1994, which was the parent entity for the World Trade Organization (WTO). As I followed the progression of those events, I was seized by the vision of what a truly fair and open global trading system could mean to all of us, and similarly by the value that multilateral discipline could have in overcoming the inertia of entrenched interests that blocked progress. The chance to revitalize Arab creative and inventive capacities through intellectual property protection, and the strengthening and development of our service sectors through liberalization had offered the potential of huge gains for our societies. There was also the opportunity through the multilateral process to achieve greater intra-Arab economic integration, which could only strengthen our region as a whole. That was also the time when the Internet was first beginning its vertical ascent into the public eye and imagination, and beginning the process, that in combination with trade liberalization has led to the phenomenon of globalization.

Where many, perhaps most people in the Arab world initially were apprehensive, defensive, resigned or hostile to the inevitability of the WTO, I was an early and prominent supporter, I pointed out that WTO membership was not forced on any nation: no one was forced to join. Some Arab countries, like Egypt and Jordan joined early, while others Like Lebanon and Saudi Arabia took their time. But the choice was theirs. Nations joined, because ultimately it was in their interest to do so. Certainly there are bound to be some winners and some losers at the micro-level, but as a whole it was just too beneficial to be part of the WTO for most nations to pass on it.

That is not to minimize the real challenges that WTO membership brought. For example, Arab countries, and developing countries in general, were at a disadvantage in negotiating due to a relative lack of institutional capacity for trade

negotiation vis-à-vis industrialized nations, and there was also somewhat of a language barrier as well that contributed to this. I worked closely with the International Trade Centre at that time, which is a Joint Secretariat of the WTO and UNCTAD that assists developing countries to take advantage of the benefits of trade and deal with the challenges of WTO-led liberalization. Together we jointly published in Arabic, The Business Guide to the Uruguay Round and later the Arabic version of its sequel, The Business Guide to the World Trading System. We also held numerous conferences, seminars and roundtables to educate the Arab world about trade, promote liberalization and build capacity for proactive negotiation and coalition building. We teamed up with ITC and the Centre for Applied Studies In International Negotiations (CASIN) to actively develop trade negotiation capacity in the Arab world; needless to say, this is a long-term process, but there are short-term gains to be had, particularly with laying out a basic framework for building a clear negotiating strategy, with input from key governmental, private sector and non-governmental constituencies.

In the 1990's, when others were fretting how the WTO would allow the industrialized countries to dominate the developing world, I prognosticated that the day would soon come when information and communication technologies would foment the formation of a global knowledge economy, free from the limitations of terrestrial geography; the developed countries, I said, would begin to fear globalization and the strongest protectionist tendencies would emanate from the developed world. Rather than cater to false modesty I will admit to a significant pride in the prescience of my vision at that time. Sure enough, today there are forces of protectionism and nationalism rising with uncomfortable resonance in the developed countries.

The Arab world has come a long way in the last 13 years; most Arab countries are WTO members, and public acceptance has been achieved as time has shown that trade liberalization, at least in measured doses, is no menace, but in fact a boon to society. Yet at no time since before its creation has a greater cloud hung over the future of the WTO. The collapse of the Doha Development Round, in combination with broadly shared anxieties over current geopolitical and economic tensions have begun to raise alarms celebrations in some circles –that globalization is like the Titanic, a big and sinking ship.

The question is, if that is true how should we think and feel about that? And what should we do about it, if anything? Where does our interest lie? What are the pros and cons of free trade, which after all is what the WTO is all about?

The principal of comparative advantage

There is probably no more widely accepted and esteemed economic concept than the principal of comparative advantage. In fact it is one of the only economic theories that is largely held to be true in an absolute sense. The entire modern trading system is fundamentally based on the principal of comparative advantage, or in other words, the concept that if trade is fully free, all countries will benefit; trade is not a zero-sum game, but in its most pure formation is a win-win formulation for all players.

Of course the reality of the world is far from the theoretical and beginning from the starting point of an absence of free trade, or at least imperfectly free trade, it is more challenging to get to move to the ideal state. That journey is complicated, as are all things in life, by numerous details and obstacles, most notably the fact that “free trade” in the real world must be modified by innumerable rules, regulations and stipulations. The devil is in the details, so to speak. But with the basic premise established and agreed: the ideal of comparative advantage as the foundation of the modern world trading system, we can progress beyond the theoretical to our actual situation.

Real World: Challenges

The developing world has more than its share of problems, which run the gamut of human experience and misery from the ecological to the political, a veritable devil’s banquet of filth, abuse and degradation. While there may be numerous causes that originally contributed to the dire situation in which so many of the world’s people find themselves, there is one clear culprit contributing to the maintenance of the status quo: Poverty. More than half of the world’s population lives on less than \$ 2.00 a day and that number is rising fast. The current population of the world is estimated to be slightly over 6.5 billion souls. It is estimated to surge to over 9 billion souls by 2050. Over 2.5 billion new people, most of them doomed to live Hobbesian lives (as famously described by Thomas Hobbes, lives that are “solitary, poor, nasty, brutish, and short.”)

By comparison to less fortunate areas of the globe, the Arab region has been relatively fortunate. However tens of millions of Arabs still live lives mired in poverty and hopelessness, and those numbers aren’t changing fast. Over 40% of Egypt’s population of 70 million lives on less than \$ 2.00 a day, and 3%, or 2.1 million Egyptians live on less than \$ 1.00 a day. Over 45% of Yemen’s population live on less than \$ 2.00 a day, and over 15% on less than \$ 1.00, 7.4% of Jordan’s population and slightly more than 15% for Algeria, and slightly less than 15% for Morocco, live on less than \$ 2.00 a day.

If we expand our focus beyond Arabs to include other fellow Moslems the situation appears even bleaker. 65% of Pakistan's 169 million people live on less than \$2.00 a day and 13% of them on less than \$ 1.00; meanwhile over 82% of Bangladesh's 146 million people live on less than \$ 2.00 while fully 36% live on less than \$1.00 a day.

The abject poverty of these untold millions of individuals results in a loss of human potential that is not even quantifiable. It means that people do not get educated, that they do not have access to clean water, food, shelter and most of all, to hope. It results in the degradation of life itself. The horrible thing is that this is not the exception, but rather the rule; this is the real condition of mankind. Those of us with pleasant homes, and hope and clean and plentiful food, water and health care, we are the exception.

I think this description presents fairly sufficient justification for viewing The Millennium Development Goals (MDGs) as important not just to the poor, but to all of us. I will not speak for you, but as for me, I cannot accept to live in a world of such injustice, without doing all in my power to change it. The MDGs signed into being with the UN Millennium Declaration of 2000, commit member states to "making the right to development a reality for everyone and to freeing the entire human race from want." Unfortunately, the MDGs, which include reducing infant/maternal mortality, reducing the percentage of people without access to safe water, and others, are not being met, and in all likelihood will not be met by 2015. In some areas, it is likely that rather than progress we will see increased suffering.

Poverty often means no clean water, limited shelter, hunger, poor sanitation and health. It also means circumscribed capabilities for dealing with other emergent crises such as war, plague, famine and environmental disasters. In other words, poverty has a negative multiplier effect that compounds other problems.

The next two decades are likely to see enormous environmental pressures. For example, the Nile River Basin is under severe pressure, and is expected to reach critically low levels by 2025, due to both high demands from growing populations in the riparian states, and from the effects of global warming: in the worst scenario the ancient country of Egypt may slowly die of thirst. Meanwhile, scientists, and others including former US Vice President Al Gore, in his Academy Award-winning documentary, 'An Inconvenient Truth' state that global warming may lead to a rise in sea level that could submerge most of Bangladesh and leave over 40 million of the world's poorest people with nowhere to go!

These environmental problems are real and growing under our noses. I'm not here today to raise an environmental alarm. But my point is that these problems are bad enough if you have money: but poverty compounds such disasters ten-fold or more.

The Real World – meeting goals through growth

The Millennium Development Goals are both noble and necessary. We need targets to

aim for, even if we don't reach them on schedule. But there is no hope for meeting the MDGs through UN programs, or charity or the best of intentions. The one force powerful enough with the ability to create the hundreds of millions of jobs necessary to raise the world's poor out of poverty is the engine of economic growth. Trade liberalization is an essential requirement in getting that engine started.

Seen in this light we can see that the current crisis of confidence in the global trading system, and the potential breakdown of the multilateral trade liberalization process, is a direct threat to the socioeconomic stability of the Arab region. Aside from poverty and misery, the other side effect of high rates of unemployment is social and political destabilization.

Creating sufficient jobs to eliminate poverty and maintain stability requires a range of simultaneous steps, ideally completed in close temporal proximity to each other and on a multilateral basis, including reduction in red tape, development of human resources, removal of bureaucratic bottlenecks, and uniform application of the rule of law. The key driver of job creation is the entrepreneurial and innovative small and medium sized enterprises (SMEs). Free trade is critically important for this economic segment. With their limited capital and resources, they are hindered far more than big businesses by inefficiencies, red tape, and complex trading rules and regulations. The breakdown of the multilateral system will have the most severe repercussions on this critical sector of the economy. Actually in many countries that are suffering from high rates of poverty and unemployment, a dynamic, innovative, entrepreneurial SME sector does not currently exist. But that is the goal! Failure to set the stage for this activity means failure for the economy and that may as well mean failure for the state.

Information and Communication Technologies (ICTS) and the Global Knowledge Economy

I mentioned previously that I had correctly prognosticated the rise of the global knowledge economy, particularly in relation to the empowerment of the developing countries. This indeed has been a remarkable development during the last decade. Modern ICTs reduce transaction costs and eliminate geographic barriers opening huge new service markets to developing countries. India, which has the lowest cost ICT services in the world has, not coincidentally become the leading provider of outsourcing services to the developed countries. The growth of this industry during the last decade has been so great that it has transformed parts of India, and led to some political issues in Europe and the North America. Unfortunately the Arab countries, which have also been among the slowest in the

world to adopt ICTs, and where numerous barriers and restrictions were put in place, has largely been passed by in this industry.

To the extent that there has been positive change in the Arab countries, both in regard to IT tariffs, intellectual property protection that is, for example, necessary for software development, and reduction in other impediment to business and trade, much of the progress can be attributed to the discipline of being part of the multilateral System. We haven't benefited as much as we should have, but much potential still exists.

Equality and fairness

The World Trade Organization is not perfect: it would be surprising if it were, considering the world we live in. But it is a reflection of our desire for a world with greater equality and fairness than exists in the past or present. As I mentioned in my previous remarks, the developed countries have an advantage in negotiations based on their resources and experience. However I also described efforts being made to balance the equation, efforts being made with the full support of the WTO leadership.

A common comparison is that between the WTO and the United Nations. But there is a huge difference between the two. The UN, for all the great work it does, and I have worked closely with it for four decades, is still at its core undemocratic. I say at its core, because of course the periphery, the General Assembly, is decidedly democratic. But the Security Council, which reflects the world order as it is, and not as we wish it, is dearly not subject to the vagaries of democracy. Probably that is sometimes for the best, but other times, clearly not.

The WTO on the other hand is a democratic institution, with the opportunity for the weakest member to enforce its rights against the greatest and strongest, and there is an actual mechanism to do so. If everyone negotiates in good faith and achieves a balanced compromise that we can all live with, we all – and by all I mean the nations of the world – we all profit. In the past, the biggest weakness in this democratic institution was the lack of negotiating capacity of the developing countries vis-à-vis the industrialized nations. The bloc represented by Europe, the US and Japan, seemed to have a knack for bullying the other nations into line with what they wanted.

Considering this fact, we can look at the breakdown of the Doha Development Round as a sign, at least in once sense, of health. The G20 group of developing countries finally got together and presented a unified front that the Europeans and Americans could not breakdown. I'm not saying that it isn't also a very serious situation, but only that it does have at least this good implication. It is a game of economic brinkmanship with the years of delays and failed expectations the necessary price of a transition to a more fair and equal balance of negotiating strength.

The existence of the multilateral system is crucially important to us in the Arab world and

the developing world. This is true even for GCC countries whose economic health is related primarily to the petroleum industry and auxiliary services. This is true because we all have a stake in the political and economic health of our neighbors and our security is connected to that of those around us.

The Doha Development Round can still be concluded successfully but needs a strong push from all sides to overcome apathy, resistance and gathering despair. The Arab countries need to take a strong and proactive role in seeking a fair and balanced compromise that will reduce global agricultural subsidies that adversely impact the poorest of the poor. We need to lobby our friends in both the North and the South to make the necessary compromises, and let them know that this is something important to us.

As we push toward a new horizon in the world trading system with an empowered block of developing countries, I want to highlight the risks of negotiating failure. I explained the benefits of the WTO and the fact that it offers a fair, legally enforceable mechanism to provide equal protection to all members in a democratic fashion. If this system breaks down, and some observers believe it is in the process of doing so, it will again put the small and the weak at the mercy of the large and the strong.

So as we prepare to revive those negotiations we must keep in mind our unique responsibilities based on our own place in society. The key players in establishing the national trade negotiating position are the government politicians and administrative officials, the business sector, and the non-governmental organizations, which means groups like the Arab Society of Certified Accountants (ASCA) or the Arab Society of Intellectual Property (ASIP). It is important that the national trade policy officials consult broadly and attentively and set up a negotiating strategy that focuses carefully on what we wish to accomplish, and secondarily on what we wish to defend against. My own belief is that at this time the crucial issue is for the developing countries to maintain a united front and to have a balanced plan, based on real compromises that can deliver results to the world's poor. The small countries and poor countries have far more to gain than the rich and industrialized countries. Those developing countries that have chosen the path of free trade, i.e. open markets and trade liberalization have risen sharply up the league tables of national and per capita income.

The Downside of Free Trade

The failure of free trade

As we move forward toward the goal of freer, fairer trade, and global economic integration and mutual respect and security, we would be remiss if we did not at

least consider the downside of free trade. Global trade has been growing steadily freer for over 50 years, and that trend has accelerated since the creation of the WTO in 1994.

As previously noted, there are few concepts in economics that are more universally agreed upon among economists than that free trade enhances the economic well being of the participants. The concept of free trade is based on the principle of comparative advantage and the premise of competitive global markets.

As long as the principle of competitive markets work things go smoothly, but if countries act in a manner that undermine competitive markets; for example if they manipulate exchange rates so that they gain an advantage in every industry as is the case of China, and was at one time the case in Japan, problems arise.

From a standpoint of the end welfare of global consumers the system of free trade based upon the principles of comparative advantage and competitive markets clearly is the maximum economic benefit to all of the participants.

One of the greatest limitations of free trade is that it is clear that very few if any countries are willing to pursue the application of free trade to its ultimate end. This in fact, places a nation's economic, political or military security beyond the control of the nation's leaders. For example, virtually all nations have pursued agricultural policies to ensure a modicum of domestically sourced food supplies for basic necessities. Secondly no nation is likely to place the production of items vital to its military security in the hands of an actual or potential rival. Relatively few countries have been willing to place their energy security at risk or in the hands of actual or potential rivals.

Because countries subject the free trade model to constraints, it doesn't work in practice the way it should in theory. Consequently major dislocations, such as the anticipated economic crisis expected by many to be coming soon to the United States from its unsustainable trade imbalance with China will likely be interpreted within both the US domestic political spheres and perhaps internationally as well, as a failure of free trade, although it is actually a result of impediments to free trade.

The Success of Free Trade

Finally the most surprising downside of free trade is the gradual usurpation of US power and influence; ultimately military power is based on economic and particularly industrial power. There are clearly some current distortions in global trade patterns as they apply to China, but even if these were corrected for, the ultimate direction in which trade and investment patterns are moving is in a direction that will weaken the United States and Europe militarily vis-à-vis China

and Asia. Currently this reality is not widely recognized in the West, but as becomes better understood there is likely to be pressure from what is rapidly becoming the post-industrial West to apply the brakes to trade liberalization and limits to free trade, particularly in manufacturing.

As I have noted, the greatest beneficiaries of free and fair trade are the marginalized, the poor and the small nations. So we can only hope that the West will not reach the point where it seeks to negate the message it has been preaching for so long. Particularly in the US, the conflict between free trade and national security creates an essentially existential conflict, so deep is the identification of free trade with American values.

Assuming that trade liberalization continues rapidly, we may ultimately find that the greatest downside of free trade is the diminution of US power and influence, and the rise of competing superpowers: in other words the real downside is that free and fair trade in a framework of open and competitive markets results in dynamic changes in the economic composition of a nation. While this will be to the benefit of all consumers, it does not mean -within the framework of international security concerns- that fully free trade will result in what is best for a given nation state. That warning aside, there is little to fear, and much to gain from an accelerated pace of global trade liberalization.