

Lamy, Pascal

**Article**

## Europe and the new devision of labour: Introduction

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Keynote Address by

**PASCAL LAMY,**

Director-General

of the World Trade Organization (WTO), Geneva

Ladies and gentlemen,

There is a popular story among economists that when a critic asked Paul Samuelson, a Nobel-prize laureate, to provide a meaningful and non-trivial result from his discipline, Samuelson responded: “comparative advantage.” The theory by David Ricardo, who uses the example of England producing cloth and Portugal producing wine, and both of them growing their output of these products through specialization, is the basis for the idea of the benefits of open trade.

By producing goods and services in which it has a comparative advantage – and importing others – a country manages to create more value than it would otherwise do. In ideal conditions, trade allows countries to specialize in products that they produce best – and import others, and everyone stands to gain. As a consequence, the economies of all countries grow.

For the man in the street, trade is often associated with exports and imports of consumer goods. According to this common view, a country like Germany, for instance, would export cars and import tropical fruits. That was certainly true in the past. But new forms of the international division of labour appeared, like offshoring or outsourcing, whereby certain production stages are allocated abroad, thus leading to an increased trade of inputs, rather than finished consumer goods only.

Offshoring and outsourcing have contributed to a complex system of inter-linkages between countries that produce and export different final and intermediate goods. Thus, a country like Germany ends up importing not only bananas but also car parts, while it continues to export cars. This increasing division of production stages – and the division of labour it entails – is driven by companies’ desire to increase

productivity and to create more value than they would do otherwise.

The evidence of this growing specialization lies in the numbers: in the 1950’s, world GDP grew by 5 percent, and world merchandise exports grew by 7 percent. In 2004, the proportion is much higher: World GDP grew by 4 percent and world merchandise trade grew by almost 10 percent. International trade is now growing at a multiple of the growth of our economies. This multiple, which is increasing, is the best measurement of this trend.

The challenge for countries – big or small, rich or poor – is to be able to capture the positive growth effects of trade for themselves. To do so, economies need to change. What does this mean? It means that production factors need to be reallocated to different activities. Change can be painful, and often requires investment in a broad range of factors, both of a social and economic nature. While trade opening can be beneficial for the economy as a whole, some individuals may be negatively affected by it. Trade opening thus represents a challenge to countries, because it requires governments to find ways to deal with the pains and difficulties arising from change, and also with distributive consequences of change.

In this regard, international trade works like technological progress: it creates efficiency gains, which economists love; it reshuffles the economic and social fabric, which politicians tend to resist. In between, entrepreneurs know that the ability to lead, the courage to change and the capacity to address transition costs are preconditions for reaping the benefits of these changes.

Trade and technological progress not only pose similar challenges to economies – they are two inter-linked phenomena. Trade fosters technological change, as new technologies incorporated in imported products become accessible. In its turn, technological change facilitates trade – for example, through modern means of communication and transport technologies. All this explains that it is some-



times difficult to distinguish which of the two forces is driving the other.

What is true is that changes – and pains – caused by this combination of trade opening and technological advance are often attributed only to trade opening. Either consciously or unconsciously, societies and governments know that they cannot turn back the clock on new technologies. But history has shown that they can go backwards in terms of trade opening.

Hence the importance of the WTO that has adopted a set of rules and procedures to lock in trade opening. This was already true in the GATT that contained three basic rules: (1) non-discrimination between trading partners (the Most-Favoured-Nation rule); (2) non-discrimination between domestic and imported products once goods have gone through customs; and (3) binding of import tariffs, or the “security of concessions” – i.e. the obligation to respect the maximum import tariff for goods, usually agreed with other countries during a multilateral round of trade negotiations.

The WTO agreements expanded these three basic principles to a 500-page set of rules that has become the cornerstone of world trade in goods, services and intellectual property rights. The WTO also developed a powerful mechanism of the settlement of trade disputes – a remarkable achievement in international law, for its ability to solve disputes in a peaceful manner. The WTO’s dispute settlement mechanism is the arbitrator of those rules – and a credible arbitrator, because it has the power to authorize sanctions in case of lack of compliance with those rules. Over 300 trade disputes have been brought to the WTO in the ten years of its existence, and the system has ensured that the rule of law is applied and respected by the whole Membership, no matter their size or economic power. Since 1995, thanks to the dispute settlement mechanism, a consistent body of decisions has been developed, interpreting and clarifying many of those rules.

As we all know – and it suffices to read the economic press to check some worrying current trends – there will always be pressures on governments to find quick-fix protectionist solutions to certain trade problems, particularly those that attract (or are given) a high level of popular attention. WTO rules help governments to defuse those pressures by pro-

viding the domestic political process with an external point of reference to bolster its position in favor of a more measured response.

The WTO, in this respect, functions like an anchor, helping governments to resist the waves of protectionism. That, of course, does not make the WTO a popular institution with the public or with politicians – I myself have been witness to (and the object of) occasional but forceful expressions of dislike of the WTO on the part of NGOs or students. But the WTO does help to dispel the illusion that protectionism is a relatively low cost way of dealing with trade problems. Imposing trade restrictions is quickly done – removing them can take decades.

Are the WTO rules perfect, are the critics of the WTO totally wrong? The rules, of course, are not perfect, and some of the criticism is more than justified. The multilateral trading system needs to be improved, and that is mainly achieved through negotiations.

The current negotiations – the Doha Development Agenda – cover more than 25 different issues, being negotiated by 150 Members, decided by consensus. Any rational observer would say this is an impossible task, will point to a series of missed deadlines in the negotiations, will say that this Round is doomed. On my part, I am convinced it can be done, with the good will of all Members. It is extremely difficult, but it can be done.

At this moment, the key to the end game in the current negotiations lies, to a large extent, in the hands of the EU, the United States and the group of emerging developing countries, which we call the G-20. The main issues are tariffs on agriculture and industrial products, and agricultural subsidies.

This does not mean, of course, that other Members or groups, like those which group most of the poorest developing countries, do not play an important role in the negotiations, but somehow their main interests are being covered as far as these issues are concerned. Nor does it mean that issues such as opening trade in services or updating antidumping procedures are not important for the system.

But the reality is that the movement has to start now in this triangle of parties and issues: the G-20 and the United States want the EU to slash import tariffs on agricultural goods; the EU and G-20 want the

United States to reduce its agricultural subsidies; and finally the EU and the United States want emerging economies like Brazil, India and South Africa (which are included in the G-20) to lower tariffs on industrial goods.

This Round, as you all know, did not start yesterday. There has been a lot of work since 2001 – and notably during the Hong Kong Ministerial Conference in December 2005, and we have already made significant progress. What is already on the table ensures that this will not be a trivial round of negotiations, a “cheap round” as some commentators say.

Let me quickly summarize what is already on offer. On agriculture, it has been decided that 2013 is the end date for the elimination of export subsidies. There is agreement that the EU, the United States and Japan will undertake the biggest reductions on agricultural subsidies that distort trade, and that these will be effective cuts, which is a vast improvement as compared with the previous round. On industrial products, there is a broad understanding on a so-called Swiss formula to cut import tariffs, with high tariffs subject to bigger cuts. There has been a step forward towards completely duty-free and quota-free access for the world poorest country Members of the WTO. On Services, negotiations are focusing on certain sectors such as computer services, engineering and logistics and financial services, among others. Finally, an Aid for Trade package is being designed, to help developing countries address their supply-side constraints. The hope is that this will help those that now constitute around two thirds of our membership to translate the market access gains they make from the Doha Round, from theoretical into real commercial possibilities. As a whole, the round will provide a more level playing field in international trade, something which surely tallies with the theory of comparative advantages.

And where is Germany in this picture?

First of all, Germany has been, in recent years, the world's leading merchandise exporter – a true “Exportweltmeister”. If services are also taken into account, Germany's exports rank second only to the United States. Exports therefore make a significant contribution to Germany's economy. The ratio of exports to GDP increased from 30 percent to nearly 40 percent over the last two decades.

It is difficult to quantify in exact terms Germany's gains from increased integration in European and world markets, as pointed out by some observers. What we know is that Germany, with its impressive export performance, has benefited from such increased integration. Again, there might be a debate on “how much”, but surely not on “whether or not” Germany has gained from a more open international trading system.

Also, we have a fairly good idea on how countries can maximize the benefits they get out of integration into the world economy. We know, for example, that education and research and development (R&D) play an increasingly important role in the relationship between trade and the gains that a country derives from exports and imports. Labor market rules also affect the extent to which a country can take advantage of opportunities offered in global markets and how the gains resulting from trade are distributed.

It is true that Germany's main trading partner is the European Union. In 2005, 63 percent of German exports went to the other 24 EU Member States and 64 percent of Germany's imports were sourced from these countries. But German industry, according to its own statements, considers that it is trade with third countries that has the largest growth perspectives. According to a recent paper by the German Federation of Industries (BDI), China, Brazil and India are key export markets for Germany, with a significant growth potential.

The automotive industry continues to be key for Germany and is directly or indirectly responsible for one in seven jobs in this country. Already today, this industry generates more than a quarter of its sales outside the EU. The newly industrializing countries in Asia are expected to exhibit significant increases in demand for German cars over the coming years. The engineering industry is likewise one of Germany's most important export industries and generates 50 percent of its overall sales revenue outside the EU. Also important are the chemical and the electrical industries. Germany is also an important exporter of certain services, in particular insurance and reinsurance services.

Clearly, Germany has a lot to gain from a successful outcome of the Doha round. It is an extremely competitive country, with comparative advantages in manufacturing and services. The challenges for

Germany, as for all other countries, are to keep on with the hard work, to have the courage to adapt to ever changing circumstances, and in not getting discouraged. As you see, these challenges are not very different from the ones facing any national football team coming to the World Cup here in Germany next month – keep on with the hard work, adapt to changing circumstances, do not get discouraged. I am sure that, if it follows this advice, the “Mannschaft” will have great chances of success in the World Cup, as Germany will have in international trade. Like all good teams, Germany and Europe know that what they need are clear and transparent rules, a level playing-field and a trusted referee. This is why the WTO negotiations are so important to all of you.