

Are Preferential Trade Agreements Threatening the WTO Doha Round?

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Introduction

Good evening ladies and gentlemen. Thank you very much for inviting me to speak at your annual general meeting this year. Last week, the Australian Financial Review carried a story on the state of play in the WTO's Doha Round with the title "Not Waving...Drowning". The story was about the very serious situation we now have in those very important international trade negotiations. Tonight, we'll be talking about the WTO talks and whether Doha is foundering in its own right or whether – as some commentators have suggested - an increased emphasis on preferential trade agreements is partly responsible for the lack of progress in Geneva.

I don't think there is any disagreement that the Doha Round effort is the most significant undertaking affecting the future prospects for growth – both globally and here in the Asia-Pacific region. Study after study has shown that the potential gains from a successful WTO negotiation are far greater than the gains developed and developing countries could hope to achieve through bilateral or regional trading arrangements.

On top of that, this is supposed to be the development round where a conscious effort is to be made across the board to produce trade results in areas of priority interest to the developing world. But Doha is running about three years behind the initial schedule set for the talks. Results that were to have been achieved in March 2003 are now being put forth as objectives for the Hong Kong Ministerial Conference in December 2005.

Two weeks ago, business leaders from 23 countries joined forces to signal a "wake-up call" about the real risk of failure in the WTO talks and warned that failure in Hong Kong could have serious consequences for worldwide economic growth. The business warning followed months of little or no progress on agriculture and other issues at the core of the WTO negotiations.

At the same time as the WTO talks seem to be teetering on collapse, we have been witnessing a historically unparalleled level of activity in the negotiation of bilateral and regional preferential trade agreements (PTAs). And this activity is everywhere: in Latin America, in Africa and especially here in the Asia-Pacific. Both the Australian and New Zealand governments are actively negotiating

several PTAs today after having completed and implemented a series of agreements in the past couple of years.

Are the WTO Round's problems linked to this high level of PTA activity? At our Institute, we periodically survey experts around the world on issues such as this. We found there has been a marked change of view over the past two years. In February 2003, we asked whether PTAs were seen as a problem for the WTO. A minority of thirty-three percent responded that they were worried about the impact of PTAs on the Doha Round. When we asked the same question this past May, a majority of 53 percent of respondents saw PTA negotiations undermining the prospects for progress in the Round.

If the experts are worried, we need to ask "why?" We need to look at the characteristics of these agreements and how they differ from WTO in order to assess whether – from a policy angle – they help or hurt the WTO.

Modern trade agreements, both in the WTO context and bilaterally or regionally, tend to be very complex agreements. The agreements are not really – for the most part – about border trade measures. We cannot understand how preferential trade arrangements affect the multilateral trading system solely by looking through the prism of preferential tariff margins. More important than classical trade diversion are the systemic implications of excluding particular sectors (like agriculture) from coverage under certain of these agreements and what kind of impact that has on market access negotiations in the WTO.

We also need to understand whether so-called "third wave" PTAs that focus primarily on inside the border policies impart additional discriminatory problems for other countries.

There is the issue of whether institutional arrangements negotiated in bilateral agreements might complicate multilateral rule-making.

All of these considerations – not to mention the interplay of political forces that tend to be much more significant at the regional level – makes for a complex analysis. With the Doha Round and WTO in trouble and less than three months to go before a crucial Hong Kong Ministerial Conference, it's an appropriate time to consider the WTO- PTA relationship. Questions we should be thinking about include:

- whether the "competitive liberalisation" approach that some argued helped to conclude the Uruguay Round in 1993 and launch the Doha Round in 2001 is still productive in 2005;
- whether the different scope of the WTO and PTAs has a bearing on the relationship;
- and, whether we might be seeing a degree of policy confusion on the part of certain WTO member governments.

State of Play in the WTO Round

Let's go back for a couple of minutes for a brief review of where we are in the multilateral negotiations. When he reported to WTO Members at the end of July, the outgoing WTO Chief, Dr. Supachai summed up the negotiations by saying that the negative side of the ledger outweighed the positive. In his frank assessment, he said progress over the past year had been insufficient. Where we have seen some forward movement in 2005, it has often come at a high cost in terms of time and negotiating resources. Generally recent advances have been uneven across negotiating areas and progress within specific areas sporadic.

Agriculture is of course central to any successful outcome in the WTO talks. What the last four months has shown us is that – notwithstanding all of the grandstanding on export subsidies -

market access barriers are far more difficult to address successfully than are the issues of domestic support and export competition. WTO Members' inability to reach convergence on core issues like the structure of the formula to be applied to cutting tariffs is very worrying because the formula is a precondition for sorting out other issues in market access.

Working out an acceptable formula is also the core problem for the industrial tariff negotiations. Some of the approaches that have been put forward are very dangerous as they would severely limit the tariff cutting we can expect in this round from developing countries. This is a problem for at least two reasons: (1) everyone knows that opening markets to imports has a beneficial impact on an economy's growth and development and (2) because it is often in South-South trade where the greatest potential benefits lie in market access for the developing world.

In the services trade negotiations, now under way for more than five years, just 68 initial and 24 revised offers are on the table. The WTO's 148 members were all to have had their offers on the table prior to the Cancun meeting. More than two years later, less than half of the governments are participating in the negotiations. As with agriculture and industrial tariffs, this is essentially a market access problem.

What is particularly distressing about the unhappy state of play in the Doha Round is that this is not a highly complex rule-making negotiation like the Uruguay Round.

Ten years ago, we negotiated for the first time rules for trade in services, complex approaches to measuring agricultural support and the TRIPS agreement. The Doha Round implies no new architecture in the WTO system. This time we are on well-known territory. It is a market access round – the most traditional of all GATT-WTO exercises and if we are having trouble gaining WTO Members' agreement to increased market access in 2005 we should be asking why that is the case and whether part of the problem might be due to the PTA phenomenon.

Success or failure in the WTO, has important implications for global growth prospects. According to a recent paper by Kym Anderson and Will Martin at the World Bank, global welfare could be boosted by as much as \$300 billion per year if we can realise significant liberalisation of merchandise and agricultural trade through the Doha Round and eliminate the worst forms of subsidies to agriculture.

But Anderson and Martin warn that much of this gain could be lost if the Doha result permits numerous exceptions for designated "special" and "sensitive" product categories.

Here's one statistic that illustrates why we don't want to see "sensitive products" excluded from meaningful results in the Round. Global protectionism in sugar and extremely high prices for sugar in protected developed country markets has created a situation where 10 million tons of sugar consumption annually have been displaced by sugar substitutes.

Industrial tariff reductions are also a very important component of the "development" aspect of this negotiation. Improved access to developing country markets for industrial products is important for exporters in other developing countries. Between 1990 and 1999, the share of intra-developing country trade in manufactures increased from 29 to 34 percent.

It is frequently on products of greatest interest to other developing countries where developing countries maintain their highest tariff protection. The World Bank has calculated that a hypothetical agreement to reduce tariffs to an average level of one percent in industrial countries and five percent in developing countries would raise developing country income by US\$108 billion - more than twice as much as the gain estimated for developed countries.

The WTO negotiations are not addressed to investment, but they are very much concerned with trade in services and there is today a very strong connection between the two. This is due in part to the fact that most services are still not easily traded cross-border and require a local presence in the economy in which they will be provided. Today, more than 2/3 of all foreign direct investment flows are services-related, with services industries accounting for more than 60 percent of world FDI stock – compared to about 25% in the 1970s.

Countries need investment for development. If today most of this investment is services-related, then it is clear that open services trade regimes will attract more investment. It doesn't take rocket science to see that the current failure to enhance market access through the WTO services negotiations can only impact negatively on countries' ability to attract investment and stimulate growth.

There are also important gains to be realised from a significant outcome in the trade facilitation negotiations. One study has estimated that a one percent reduction in transport and logistics costs could represent an increase in Asian GDP of \$3.3 billion. A World Bank study suggested that if we could bring APEC's under-achievers in trade facilitation to just one-half the level of APEC's top performers, we could see an annual increase in APEC trade of as much as \$280 billion.

The business community is right to warn WTO Members of the dangers of failure in this negotiation. Right now there are dozens of unresolved issues on the table in Geneva and experience has shown that you cannot present Ministers from 148 countries with more than a handful of political issues to resolve in their four-day meeting. It is going to be a very difficult job to boil down the issues in just a couple of months between now and the end of November.

Recent History of PTAs

Meanwhile, in the time since the launch of the Doha Round, Australia and New Zealand – long seen as two of the most ardent backers of the GATT-WTO – have negotiated and agreed PTAs with Singapore and Thailand. Both are negotiating PTAs with China, Malaysia and ASEAN as a group. New Zealand has concluded the Trans-Pacific SEP with Brunei, Chile and Singapore and is also negotiating with Hong Kong. Australia is implementing an agreement with the United States and negotiating with the UAE.

The US Administration had a close call with the recent vote on its FTA with Central America, but has nevertheless not abandoned plans for a deal with the Andean countries and has signalled potential FTAs with Malaysia, South Korea, Egypt and even Switzerland. Japan and Mexico have a PTA, as have Korea and Chile. China is reportedly engaged in the second phase of its negotiations with ASEAN in an effort to add services coverage to that existing agreement. Singapore and Panama are exploring a deal. The European Union is in active negotiations on a PTA with Mercosur.

Little wonder why, in the face of this activity, a number of commentators have speculated that at least some of the blame for the WTO Round's current sorry state should be ascribed to the enthusiasm key WTO Members are showing for PTA negotiations.

How did we get here? The successful conclusion of the Uruguay Round in 1993 and the entry into force of the new WTO system in 1995 were widely seen as a triumph of multilateralism and a vindication of the international trading system. 1996 saw agreement on the Informational Technology Agreement and the launch at Singapore of an impressive WTO work program on some cutting edge issues. The following year, WTO Members concluded two new high visibility

multilateral services agreements dealing with basic telecommunications services and financial services. Notwithstanding all of this successful multilateral activity, the number of PTA's recorded in the 1995-1999 period grew by an additional 64 agreements, although 28 of these new PTAs were between the transition economies.

More recently, South-South agreements have accounted for a much larger percentage of the new PTA's notified to the WTO, particularly in the period after 2000. In just three years (2000 through 2002), the world witnessed a 55 percent growth in the number of PTAs between developing countries. The reasons behind this growth differ according to the region, but in many cases, PTAs have grown out of a perceived necessity to overcome the small size of purely national markets and economies. South-South agreements today seem to be a bit better thought out than were earlier initiatives.

The current wave of PTA activity in Africa tends to embody a minimalist approach where deeper international integration takes place only as infrastructural constraints are eliminated. In Latin America, PTAs seem to be driven more by a cost-benefit logic of small countries linking up with larger economies both as a way of building larger markets but also as a means of increasing bargaining power vis-à-vis third countries, including in a multilateral context. In Asia, PTAs are often motivated today by international production-sharing arrangements and deepening relations with China.

As of January, 312 PTAs had been notified to the WTO – 196 of these notified since the WTO entered into force ten years ago. By some estimates, there are an additional sixty or so PTAs in operation but not notified to WTO. New PTAs are being notified at the rate of 11 agreements per year, compared with an annual average of three or less during the almost five decades of the GATT. The WTO estimates that by the end of 2005, slightly more than fifty-one percent of all world merchandise trade will occur among countries linked by preferential agreements.

If you are a WTO multilateralist, these are some pretty scary numbers.

Gains from Doha / Gains through PTAs

Governments have a range of strategic reasons for negotiating preferential trade agreements. Often there is a strong political element to the negotiations. PTAs might be more attractive than the WTO because issues like investment and competition policy can be negotiated bilaterally where the topics have been ruled out for WTO negotiations.

I have cited some numbers on the forecast conclusion of a WTO negotiation. What can we say about PTAs? For many reasons, it is inherently more complicated to try to demonstrate positive benefits of PTAs than for a WTO outcome. In a 2003 Staff Working Paper, the Australian Productivity Commission concluded that of 18 recent PTAs that it examined in detail, 12 diverted more trade from non-members than they created among members. Interestingly, the Commission study also uncovered evidence that where non-trade (regulatory) provisions of PTAs have affected foreign direct investment, the result has been net investment creation rather than diversion. Relative size of the partners also matters. The United States International Trade Commission, for example, finds that it is almost never possible to show a gain to the United States economy from PTAs because in nearly all cases the size of the American economy is so much larger than that of the negotiating partner that the impact of liberalisation is statistically insignificant.

I think we have to admit that for both the WTO negotiations and for PTAs, traditional economic modelling does not serve us very well because trade agreements at both levels these days contain

so many behind the border measures that do not yet lend themselves to quantitative measurement. Comparing the impact of WTO versus PTA results at this level is not very meaningful.

On a more qualitative level, we do know that regional agreements cannot be a substitute for the WTO negotiations. There are a number of reasons for this, but perhaps the most important is that they are nearly always deficient in their coverage of sensitive sectors like agriculture and they are almost by definition incapable of capturing distortions like agricultural production subsidies. Measured against WTO compliance criteria for goods and services trade coverage, it seems fairly clear that many of these agreements would almost certainly be found to be inconsistent with the legal requirements for consistency with the WTO's rules on preferential trading arrangements.

Are PTAs Undermining Doha?

We still haven't really faced the issue of whether PTA negotiations are actually undermining the WTO and the Doha Round of negotiations.

To do this, I think we have to ask the question "what are the ways in which PTAs could operate to the detriment of the global system?" In the answer we might include:

- Inconsistency with WTO rules in Article XXIV of the GATT And Article V of the GATS. Unless the PTA is comprehensive, covering substantially all trade and eliminating substantially all forms of discrimination, the agreement won't satisfy the WTO conditions for legal departure from the MFN rule. This is, I think, a serious potential problem with PTAs, not because of non-compliance with a legal rule but because the systemic exclusion of large sectors from trade liberalisation in bilateral deals is – I am convinced – contributing materially to the Doha Round's problems with market access liberalisation;
- "Liberalisation" that effectively excludes third countries from markets that would otherwise have been open to them under the multilateral system – in effect, classical trade diversion. In agreements between developed countries, like the Australia-USA FTA, I don't think trade diversion is a real-world problem because of the generally low levels of MFN duties and the likely product mix. Trade diversion is much more of a threat in South-South PTAs and in agreements between developed and developing countries;
- Encouragement of preference maintenance and sectoral protectionism. There are arguments that can be made that one of the big stumbling blocks in the Doha Round's core market access negotiations results from countries, especially developing countries, seeking to maintain in the WTO margins of preference resulting either from a PTA or a one-way preference scheme;
- Institutional conflict possibilities. Most PTAs have their own internal dispute settlement provisions and procedures. We cannot rule out the possibility that in disputes between the PTA members, these bilateral procedures might produce a "legal" result at odds with a result that would be produced on a like case in the WTO system. Such an outcome could be dangerous for the future of the WTO's rules-based system; and,
- Resource diversion. The intensive level of PTA activity in some regions is bound to strain the resources even of large countries like the United States. Most governments have only so many people who are available to work on trade negotiations and there is always a risk that people and financial resources will be diverted away from work on the Doha Round. Personally, I have no reason to believe that this is today a problem for Australia, New Zealand or the USA – but it might be for Thailand, Malaysia and even China.

On the other hand, we know that many important elements of modern PTAs are not possible to negotiate in the WTO.

PTAs can be valuable test beds for what the Productivity Commission has dubbed “third wave” trade agreement provisions in areas like investment, government procurement, competition policy, electronic commerce and more liberal approaches to the opening up of trade in services. Earlier I talked about the very important connection between services trade and foreign direct investment. This should be a WTO subject. The more we succeed in negotiating PTAs involving developing countries where rules are included for FDI, the more we are likely to see FDI as a subject agreed for negotiation in the WTO.

This enumeration of possible problems and benefits leads me to conclude that it would be wrong to draw general conclusions about the inter-relationships between PTAs and the WTO. Rather, there is a real need to examine PTAs on a case-by-case basis. Depending upon the governments involved, their motivations for negotiating the PTA and the content of the PTA, we may or may not find reason for concern in terms of the impact on the multilateral system.

New Zealand and Australia don't seem to be worried that their PTA agreements might hurt the WTO.

In this country the Ministry of Foreign Affairs and Trade website proclaims that New Zealand's agreements can make a useful contribution to generating momentum for the WTO process by highlighting the benefits of liberalisation and also contribute to the achievement of the APEC Bogor goals. New Zealand's agreements are also described as comprehensive, consistent with WTO provisions and open to other economies to join. Australia would take a similar position. It is also true that both countries take the position that the multilateral WTO process remains their top trade priority. Others, like Chile and Singapore, would likely take a similar stance.

But even those governments that are not worried about the impact of their own PTAs on the WTO system seem to have some level of concern about the nature of PTAs under negotiation by other parties.

To guard against the potentially negative impact of PTAs on the WTO system, a number of initiatives have been undertaken in recent years. An important effort in our region are the APEC Best Practice guidelines for negotiation of FTAs and RTAs. If APEC members' PTAs can be negotiated to the high standards reflected in the 12 headings of the best practice guidelines, the risk they will undermine the WTO can be substantially reduced. Some of the more important principles deal with comprehensiveness, consistency with WTO and APEC rules and principles, transparency, trade facilitation and possibilities for third party accession. These principles are designed to emphasize the liberal and non-exclusive nature of the trade agreements.

We also know we need to fix the broken WTO surveillance system for assessing PTA consistency. Since 1995, not a single report on consistency of a PTA with WTO rules has been adopted in Geneva. The recent Sutherland report on the future of the WTO advocated clarification of the WTO rules and strengthened administration of their provisions in respect of PTAs. WTO Members are pursuing this through the Doha Round Rules negotiations and there are some encouraging signs that a new approach – involving in part an objective assessment of a PTAs provisions by the WTO Secretariat – could help to break the long-standing stalemate in PTA reviews.

The fact that the WTO surveillance process in the Committee on Regional Trade Arrangements has broken down so completely is a major systemic loophole that needs to be closed –or at a minimum

significantly narrowed. We know that PTA's can have negative economic effects, both nationally and globally. We also know that PTA's motivated by the wrong political reasons have the potential for undermining support for the WTO. At a minimum, governments should not add to the problem by continuing to be in the position that they are in today of not being able to say conclusively whether or not a given PTA complies with the rules of the multilateral system.

Overall, it seems the world is unlikely to come to a consensus anytime soon on the question of whether or not PTAs – generically - assist, complement or undermine the multilateral system of the WTO. But as I said earlier, I don't think this is important. We need to take a case-by-case approach.

PTAs have been flavour of the month for a number of years, but I don't think we can make a generic connection between the enthusiasm for PTAs generally and the Doha Round's troubles. I can see many reasons why competitive liberalisation can be an attractive trade policy to governments, and I can see where the right kind of PTAs can contribute to progress in the WTO.

I believe there are advantages to using PTAs as test beds for negotiating commitments in areas like investment that cannot today be negotiated in the WTO framework.

But some PTAs can harm the WTO process and I believe that those PTAs that have excluded coverage of substantial sectors of international trade or have operated to create artificial preference margins are undermining efforts in the Doha Round to liberalize market access barriers on a multilateral basis. This is serious because this is the market access round and those countries that will suffer the most from the Round's failure will be the developing countries. Many of these WTO Members are operating in a state of policy confusion. Proposals on the table in Geneva show some countries believe that preference maintenance and exclusion of products from WTO liberalisation will serve their interests.

Motivation and outlook are important. Two ground rules of policy behaviour suggested by the WTO Secretariat in its 2003 World Trade Report are helpful in ascertaining whether a particular PTA is likely to complement or undermine the multilateral system. It's a question of evaluating the responses to two simple questions.

The first question we might ask is whether the participants in a particular PTA negotiation have engaged in preferential commitments on certain topics that they would be unwilling, sooner or later to negotiate in a WTO negotiation. The second question turns on whether the PTA participants would be willing – eventually – to extend the commitments made in the PTA to non-discriminatory multilateral application, provided third parties agreed to reciprocate.

If – in relation to a particular trade agreement - one gets the right answers to these two questions, then it is a pretty good bet that the PTA at issue could be seen as complementary to the WTO and multilateral trade liberalization. Taking Australia's FTA with Singapore as an example, I think it's clear that both Singapore and Australia would be willing to negotiate in WTO on all of the subjects covered in SAFTA. We can also conclude that Singapore and Australian participation in APEC and acceptance of the Bogor Goals ensure that SAFTA's liberalisation will eventually be extended to third parties.

So motivation and outlook are important. It's also important that we bear in mind that PTAs are no substitute for the WTO system and that the longer term gains from multilaterally negotiated liberalisation are far more significant than what we can hope to achieve through the bilateral route.

Thank you very much for your attention.