

The Future of the Global Trading System

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Introduction

Good morning. Thank you very much for inviting me to speak to you today. The program, like the Farm Foundation's 30-Year Challenge issue report, covers a number of interesting and timely topics. It is natural that one of the topics for the meeting should be the future of the global trading system. The Doha Round of WTO talks has become hopelessly mired in complicated technical detail and recent events cause many of us to wonder about the motives of some of the players. The trade liberalization we planned in 2001 is now at least six years late. In most countries, you cannot get business people interested in WTO talks that seem to have no end in sight. Nobody in Geneva seems to have a "PlanB".

State of Play in the Doha Round

Like many others² I think it is unlikely that the Doha Round of negotiations will conclude with a substantial result and may have no result. The latter outcome would be new and disturbing, but the former would be a familiar disappointment.

The result of the Uruguay Round suggests that both in industrial and agricultural products many developing countries bound their tariff commitments, on average, above the average rates that applied before the start of the Round.³ This time around, with the emergence of developing countries as centres of global trade, including in agriculture, we should have expected greater developing country participation in duty reductions, especially reductions of 'ceiling' bindings on tariffs adopted in the Uruguay Round.

But the reality—demonstrated again by the ultimate causes of the collapse of WTO Ministerial talks in July 2008 and the failure to organize a high-level meeting in Geneva last month—is that the Doha enterprise is shackled by GATT/WTO's provisions for 'special and differential' treatment, infant industry protection and non-reciprocity by developing countries.

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² Distinguished commentators have expressed doubt that the processes or even the objectives of the WTO negotiations reflect the political or economic reality of the global economy in 2008 and have speculated that the Doha Round is doomed to at best a 'puny' outcome, or to continuing failure. They range from long-standing critics of the of 'intrusive' comprehensive trade liberalism (Dani Rodrick) to commentators unimpressed by the pretensions of the GATT/WTO given its record (Razeen Sally) to trade economists (Joseph Francois, Patrick Messerlin, Simon Evenett) who consider that the Doha enterprise, at a minimum, and possibly the constitution of the Organization needs to be reconsidered. This essay draws freely on their more detailed analysis cited in the references.

³ See Tables 10 and 11 of the WTO World Trade Report, 2007

Thanks to what is called the 'single undertaking' of the WTO these limits are now more binding on negotiations than they were under the GATT. The single undertaking – where nothing is agreed until everything is agreed and all 151 WTO Members are supposed to be part of every negotiation - provides countries with the highest trade barriers or the smallest trade interest an opportunity to dictate the degree of liberalization.

Another reason to be disappointed by the state of play is that this Round was supposed to benefit from the technical reforms made to the structure of tariff and subsidy commitments by the Uruguay Round agreements; especially tariffed barriers and 100% bindings in agriculture. Thanks to these simpler and more transparent structures of protection, we should have seen much more substantial progress in opening agricultural markets by both developed and developing countries.

Instead, we have witnessed Members bidding to prolong and further elaborate the 'interim' devices developed in the 1980s to manage the transition to tariffed markets. In full retreat from the Uruguay Round's historic attempt to place all merchandise trade obligations on a similar footing, both developed and developing countries:

- have designated, perhaps perpetually, the tariff quotas designed to ensure minimum levels of market access as 'sensitive' product protection;
- have demanded the extension of a 'special safeguard' whose rationale was to deal with the unforeseen impacts of the 1994 tariffication; and
- they have proposed creating new 'special product' exceptions that have no trade-related justification.

The Cato Institute's Sallie James, a collaborator of ours in a new research project, sums up the behaviour of developing countries in the current Round by noting that for many of them the appearance of flexing one's negotiating muscle, no matter how misguided or ultimately self-destructive, may in fact bring political kudos to obstructionists in their home market.

She observes that a mercantilist atmosphere, selectively understood development focus, and ability (indeed, political incentives) to obstruct a deal – facilitated by the single undertaking - is not an auspicious combination for negotiated trade liberalisation.

The Director General of WTO, who as EC Trade Commissioner favoured a more deliberative approach to the problem as it emerged from the Cancún debacle, is pressing hard for a conclusion of Doha. He hopes apparently to rescue the 'package' that was on the table in Geneva in July. A number of the 'Group of seven' governments that contributed to that package seem ready to go along with this idea.

But I think Mr Lamy's earlier idea was a better one. There has to be a more productive way to reach agreement on commitments to open markets than continuing with the wrangling and compromised ambitions of the Doha Round. It may finally be time to recognize that the GATT/WTO needs a different approach to the negotiation of mutually beneficial trade reforms that reflects the political and economic realities of this century.

What if Doha Fails?

I am not in favour of concluding the Doha Round on the basis of the texts that are on the table because I believe that the result would produce only minor economic gains and create major structural damage to the multilateral system.

The creation through the current draft agricultural negotiating modalities of multilaterally-sanctioned protectionism in the form of sensitive and special products would create a future negotiating framework that would throw us back beyond the Uruguay Round. And, it is not just an issue for the Doha Round. The vast majority of those surveyed in a recent Institute opinion poll believe that these categories of protected agricultural products will likely be with us for decades.

But the fact that I oppose concluding the Round on the basis of the texts on the table does not mean that I oppose a multilateral liberalization of trade through WTO negotiations. We all need this system and we need it to succeed. Moving forward in the WTO – even if only slightly – is better than failure. One reason for this is that the counterfactual to a Doha result may well not be the status quo in terms of protectionism. Even without breaching WTO obligations, individual countries have the capacity to become much more closed to trade than they are today.

A recent study by two economists⁴ at the International Food Policy Research Institute, examined the impact on world trade and welfare of governments' decisions to raise tariff levels to the levels bound in the WTO – or alternatively (and more realistically) to the highest levels of tariff protection maintained at some point in the past thirteen years. They modelled the impact of these potential actions on world trade and welfare and obtained some very worrying outcomes. After first developing a baseline economic scenario for the world economy in the year 2025 (assuming status quo in trade barriers), they look at what would be the situation in that year if likely Doha Round reductions were implemented over the period 2009 – 2014 and, in the case of a Doha failure, if higher rates of duty – up to bound levels or up to the highest level of the past 13 years – were phased in over the 2009 – 2014 period.

With a modest Doha Round outcome, world exports in 2025 would be about 1.5 percent higher than the baseline, with Agra-food exports up about 4 percent. But in what they labelled the “up to bound” scenario, world exports in 2025 would fall by nearly 8 percent, with agra-food exports down by 15 percent, representing a decrease in the value of agra-food exports of \$ 250 billion in 2004 constant dollars. In a more likely scenario, with duties raised to the highest levels actually applied in the past 13 years (which they call “up to max”), world exports would be 3.2 percent lower in 2025, with agra-food exports down by 6.9 percent representing a decrease in value of agra-food exports of \$ 116 billion.

Alternative Frameworks

So we need some kind of forward movement in multilateral liberalization of trade in agriculture if for no other reason to provide an insurance policy against slipping backwards. But we would do ourselves a big disservice by pretending that a result employing the modalities now on the table in Geneva would be a good outcome.

At the Institute for International Trade, a colleague, Peter Gallagher, and I are currently working on a research project funded by the Australian Rural Industries Research and Development Corporation. The hypothesis we are testing is that non-single undertaking agreements—possibly 'critical mass' agreements like the Information Technology Agreement—offer a faster and more robust framework for agreements on the expansion of agricultural trade than the complex, difficult-to-negotiate, comprehensive, single-undertaking approach embodied in the Doha Round modalities.

When I refer to “critical mass” agreements, I am referring to trade agreements where obligations apply only to a sub-set of those WTO Members most concerned with trade in the covered products or services, but where benefits accrue to all WTO Members.

The attraction of 'critical mass' agreements is that they offer a simple method for discovering mutual interest in opening markets on a reciprocal basis. If there exists such an interest, it is likely to be most obvious when the reciprocal partners account for a high proportion of each other's trade.

In order to better define approaches we believe that we will need agreements that are structured to require an 'opt-in' rather than an 'opt-out' decision so that trade liberalization takes place by agreement only among parties for whom liberalization offers either the prospect of substantial gains or at least a politically feasible choice.

There are, broadly, two kinds of non-single-undertaking trade agreements that we can imagine:

⁴ Antoine Bouet and David Laborde

First, agreements whose benefits would be extended to all WTO Members on an MFN basis, and where the obligations undertaken by participants would be registered in Members' schedules. This could be in the form of a critical mass agreement where countries accounting for – say 90 percent – of global trade in covered products agreed to a liberalization package.

A second form of agreement would be those whose benefits would be restricted to participating countries. These could include regional agreements consistent with GATT Article XXIV including 'grand regions' such as a trans-Atlantic FTA or an APEC FTAAP.

The difficulty is to define the "realistic" opportunities for critical mass agreements that meet these criteria. Such opportunities depend on a calculus of the commercial and possibly the 'strategic' interests of importers and exporters in different markets in commodities that, on the surface seem homogenous but are certain to be diverse in practice.

The Institute for International Trade has compiled a survey of countries accounting for a 'critical mass'—defined as economies accounting for 90% of world imports or exports—in thirty highly traded agricultural products (6-digit level of the Harmonized System).

The survey overall reveals two characteristics of current trade patterns that suggests critical mass agreements might be feasible

1. The number of economies needed to account for 90 percent of world exports and imports is relatively small; the largest group (refined sugar) comprises 74 economies. In nearly all other cases, the numbers are much smaller. For wheat, just seven countries account for 91 percent of exports and 36 countries account for 90 percent of imports. For the two most highly traded categories of bovine meat, only nine exporters and twenty importers account for 90 percent of global trade.
2. There are a number of product groups in which there seems to be a potential for the same countries to be on both sides of the trade; that is, as importers and exporters (refined sugar, cheeses, barley, durum wheat, pork meat, poultry)

Questions that need further study include:

What product coverage would be needed to make a Critical Mass agreement 'mutually advantageous' for a large number of participants? An agriculture Critical Mass agreement might have to cover a large group of products in order to ensure that every member of the agreement could expect to find export opportunities in return for access obligations. In that sense it would be like the Information Technology Agreement that covers a broadly defined—possibly 'open-ended'—group of information technology products.

How big will the gains be in the context of the trades they affect? If the gains from full goods liberalization are small compared to recent macroeconomic growth in the emerging developing economies, the gains from sectoral liberalization can be expected to be very small. But they may nonetheless be large in relation to the size of the sector.

What 'critical level' of participation is needed to attract membership initially? On the table shown on the screen we used 90 percent. Would 80% of trade be sufficient? Does it depend on which economies participate as much as on the aggregate share of world trade? For example an 80% share might be 'critical' in agreements that included all of the major traders but might be insufficient if the remaining 20% were in the hands of just one 'hold-out'.

This morning, you've asked me to talk about the future of the global trading system. So what's the point of exploring the potential for critical mass agreements? The point is that we think it is not either useful or necessary to involve 151 countries in a trade negotiation where so many account for a very small

share of trade but demand damaging special treatment. And some of the countries that would not necessarily be involved in a critical mass agreement are geographically large countries that trade very little while causing big problems for others. India is an example.

Another of our international collaborators, Dr. Surabhi Mittal of the Indian Council for Research on International Economic Relations wrote a paper for us in which she suggests that India currently has little interest in pursuing trade liberalization in agriculture because self-inflicted impediments to price transmission in Indian agriculture would prevent any trade-related benefits from reaching small farmers. In other words, India has to get its own act together before it will cooperate in trade liberalization. Globally speaking, India accounts for only 1.25 percent of world agricultural exports and 0.5 percent of imports. Why do we need India in an agriculture trade agreement – particularly if India is prepared to play the spoiler role?

In the Short Term – Back to the Future

Whether or not critical mass agreements offer a viable alternative to the current negotiating frameworks may not be a question that we will be able to answer in time to save the Doha Round. I would like to think it may at the very least be a solution for the next round of global trade negotiations. In the meantime, we have a near-term problem.

Under any realistic scenario, it is very unlikely that the WTO negotiations can be concluded before the end of 2009, well into the projected global economic downturn. Elections in India and the cycling of the EC Commission also suggest agreement on Doha is at least a year away.

Considering that the world economy now faces a serious recession, G-20 governments should move to open markets quickly in a co-ordinated, multilateral action to encourage the recovery of trade flows.

Here’s where a different approach—but an old methodology—could bring about an early trade agreement as an effective response to the economic crisis. G-20 governments should agree to immediately implement an across-the-board tariff cut in agricultural and non-agricultural products using the same approach as the Uruguay Round:

What would the application of this Uruguay Round approach mean?

Uruguay Round: cuts to bound rates of duty

	Agriculture tariff cut (average across all lines)	Ag. Minimum tariff cut per tariff line	Ag. Tariff quotas	Non-Agriculture* cut (average across all lines)
Developed countries	36	15	Expand in-quota volumes by 4% of domestic consumption	(33.3)
Developing Countries	24	15		(25.0)

Agriculture

For agriculture, a review of the latest WTO data on average bound rates of duty suggests that this “Uruguay Round” level of cut could be agreed by most of the G-20 governments without significant disruption to current trade policies. In these economies, bound rates of duty in the agriculture sector are more than 33% above than the trade-weighted (applied) rate of duty.

Those economies where the bound rate is less than 133% of the applied rate would see a cut in the overall applied average duty. The biggest impacts would be in Korea (a 52-point cut in the trade-

weighted average rate) and Mexico (an 11-point cut). China would see its trade-weighted average cut by 6 percentage points.

All agricultural tariff quotas should be expanded by the same amount as in the Uruguay Round (or some substantial fraction; e.g. by 2%).

If we could get G-20 agreement to do this as an early down payment on multilateral liberalization in agriculture,

- (a) There would be no modalities that differentiate among products on the basis of their 'sensitivity' or 'special' character; tariff cuts will be 'across the board'.
- (b) Developing countries will have fewer obligations as a consequence of the Uruguay Round targets but no other 'categorical' exceptions would be made
- (c) There will be no new safeguard
- (d) The EC and USA could be asked unilaterally to cut their domestic supports in line with the offers that they made during Doha Round negotiations in July 2008.
- (e) The Hong Kong Ministerial Conference decision on export subsidies should be made final.

Non-agriculture:

In the case of industrial goods, the latest WTO data on bound rates of duty shows that all G-20 countries could meet the Uruguay Round target for non-agricultural trade without cutting their trade-weighted applied rates of duty.

The apparently 'non-disruptive' character of this tariff cut may seem to be an argument against it. There are, however, three factors that stand in its favour in addition to its simplicity:

It would cut the bound rates on which any resumed Doha Round tariff cut will be based, increasing the 'leverage' of whatever modalities are finally agreed in Doha.

It would reduce the scope for governments in the most important countries to move in the negative directions modelled by our economist friends at IFPRI.

And, it could be implemented by G-20 members and its benefits extended multilaterally without any explicit provision for 'sensitive' or 'special' products. This is politically possible because the Uruguay Round tariff cut is an average across all tariff lines.

This means that participants can reduce the incidence of the tariff cut on 'sensitive' tariff lines—but not below the minimum rate of cut—while raising the incidence on other lines to meet the overall average. In other words, the Uruguay Round modality has built in 'flexibility'.

This approach to liberalization could be agreed by all G-20 Members for 'immediate' application. It would be an MFN agreement to which other WTO Members outside the G-20 (and Russia) would be encouraged to adhere. But its implementation by G-20 Members would not be conditional on any other WTO Member taking the identical action. In other words, the G-20 would consider that implementation by all G-20 Members comprised a 'critical mass' that allowed them to extend the benefits of the agreement on an MFN basis.

This agreement would not be a substitute for eventual completion of the Doha Round, where we would hope that a period of reflection that could be facilitated by this G-20 action might lead to reconsideration of the flawed modalities now on the table, with a better longer-term result.

In addition to the tariff cuts in agriculture and non-agricultural products, G-20 Members could agree to provisionally implement the new trade facilitation agreement that promises to put more money in traders' pockets by slashing red tape and cutting clearance times at customs posts.

In the Long Term – There's Got to be a Better Way

In the longer term, if the global trading system is to survive, there has got to be a better way. It just does not make sense to have over a hundred pages of draft modalities for an agriculture negotiation. Here's where the critical mass idea could come into play.

Another of our collaborators on the project, Alan Winters, suggests that the WTO might experiment with critical mass. If purely sectoral deals emerged with a critical mass, that would be fine, but overall he suspects that we will have to combine several of them into a single package to reach closure.

Once several plurilaterals were packaged into a mini-round, Winters thinks it is likely that there would be pressure to move back to universality. The fact that there was an option to continue without universality may bring a sense of realism to negotiations. I agree.

With the help of people like Alan Winters and collaborator institutions we are working with in India, China, Indonesia and Brazil, we will continue to test the possibilities for alternative negotiating approaches for agriculture over the coming year. Critical mass agreements might be the answer. The relatively small number of WTO Members seriously involved in agricultural trade makes such agreements look promising for the future.

It is also possible that very large scale FTA-type agreements might be more capable of helping us to liberalize trade in agriculture than the smaller FTAs have proven to be. With Australia, Vietnam and the United States all beginning to show an active interest in the so-called P-4 trade agreement, it may well be that an APEC-wide FTAAP may not be so far fetched an idea. Whether such a large FTA would work for agriculture is hard to predict.

I think it would be best if the future global trading system remains a multilaterally applied exercise founded on the GATT and WTO, but it should not be one based on the current draft Doha modalities that promise to deliver such a flawed result. And, as far as I can tell, the people in Geneva don't have a "Plan B". There has to be a better way.

Thank you for your attention.