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Research Report

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Last Chance in Hong Kong?

Obstacles on the Road to the Conclusion of the Doha Round

Heribert Dieter

The World Trade Organization, the WTO, was established more than 10 years ago and at first glance the utility of this multilateral organization is beyond question. Since 1996 it has added 35 new member states and an additional 30 countries are preparing for membership. At the same time, however, the WTO is facing enormous challenges. A descent into meaninglessness can in no way be ruled out. The WTO Ministerial Conference, which takes place from December 13–18, 2005 in Hong Kong, will send an important signal in this context. The policies of the two most significant actors in the WTO, the EU and the U.S., will be decisive. Because of the inability of these two actors to cooperatively solve their serious bilateral disputes, such as the Airbus/Boeing subsidy dispute, the WTO is navigating through rough seas. The situation is made even more critical by the fact that the Fast Track Authority of the American government expires in 2007. If this is not extended, which as of today seems likely, the American Congress would have the right to discuss trade agreements in detail and demand changes. This could result in a deadlock on trade issues within the American government, which would in turn paralyze the entire WTO.

The WTO provides central functions, not supplied by any other international organization, for the regulation of international trade of goods and services. It is an important cornerstone of what is known as “global governance.” In the WTO, each member state is represented with a seat and a vote. In no other relevant organization do developing and emerging countries have such wide-reaching power of creation and obstruction. In contrast to the IMF or the World Bank, all 148 members of the WTO have a veto. This clearly makes the negotiation process more difficult, but at the same

time, it gives the organization’s decisions a high level of legitimacy. The extremely important dispute resolution mechanism is a significant step forward in comparison to the regulations of the GATT (out of which the WTO was born in 1995): whereas in the GATT the introduction of a claim could be blocked by the affected party, this cannot be done in the WTO. In increasing numbers, developing and emerging countries, led by Brazil, have made sure, through complaints in Geneva, that the international trade rules, which were agreed to by all of the WTO members, are in fact enforced.

The establishment of the WTO was the most important step on the way to a global regulatory and structural adjustment policy since the late 1940s. After the end of the Cold War, for a certain time period, multilateral cooperation was made a priority in the most important capitals of the world. Since the late 1990s, rather than since the more recent Iraq War, the willingness to create new multilateral regimes has given way to other goals. Neither in the field of climate change nor in the field of international financial markets—to name but two of many policy fields—has there been an ability to respond to growing problems with sensible regulations.

Widespread Criticism of the WTO

In addition, the public debates in many developing and industrialized nations have contributed to the weakening of the WTO. Paradoxically, the organization is regularly portrayed in both poor and rich countries as a threat: free trade is made responsible for the increase of poverty in the Southern Hemisphere as well as for declining standards of living in the Northern Hemisphere. This is obviously not logical, but in the public debates, the positive effects of free trade are rarely presented to compare them to the negative ones. Simply stated: liberalized trade is correlating with poverty in Africa and wealth in East Asia. Development is a complex process and free trade as such cannot be identified as the prime cause of economic problems.

In many southern countries, the WTO is still considered to be an organization which represents the interests of the OECD countries. This is a fatal misjudgment of the importance of the WTO for the countries of the South. A symptom thereof is the assessment of Dipak Patel, Zambia's trade minister and the coordinator of the least developed countries (LDC) in the Doha Round. According to Patel, a failure in Hong Kong would lead the industrialized nations to concentrate more on the WTO. That is a gross miscalculation. The coun-

tries of the North have, in the form of regional and bilateral preferential trade agreements, begun to create an alternative to the WTO. A further failure would hardly lead to the strengthening of the WTO.

The structural economic problems in the Western European economies—especially the continued high unemployment—have little to do with free trade. However, in the public debates, such a connection is made again and again. The assumption that free trade is responsible for the high unemployment in Germany is not correct. In fact, the opposite is much more accurate for Germany: an economy, which continuously achieves high export surpluses, is actually in the business of exporting unemployment: more is sold abroad than bought from there. If the balance of trade were even, the unemployment in Germany would presumably be even higher. But those misperceptions have damaged the reputation of the WTO, both in Germany and elsewhere.

New Challenges for the WTO

Today, the WTO is facing several challenges that could lead to a structural weakening of the organization. The biggest problem is presented by bilateral and regional trade agreements, which are increasingly becoming a systemic competition for the WTO. As a result, trade will no longer be regulated in Geneva, but by bilateral or regional agreements. The wave of bilateral treaties, which has been growing for several years, does not serve the goal of strengthening multilateralism, but undermines it.

In 2005, for the first time, more than half of the world trade will be governed by the more than 300 preferential trade agreements. The most-favored nation clause—accurately characterized as the core of the liberal world trade order, which has continuously developed for almost six decades—has atrophied into a rather irrelevant affair. The European Union is intimately involved with this trend. It is a party to a large number of a wide range of preferen-

Canada, the U.S. and the Lumber Dispute

The problem of regulating international trade outside of the WTO is illustrated by the continued tension between Canada and the U.S. Since 2001, the U.S. has levied a high duty on Canadian lumber. The American lumber industry has argued for years that the fees charged by the Canadian government for the harvesting of wood are too low and represent a trade-distorting subsidy. Upon closer inspection, this argument has little merit. Canada has extensive forests, whose economic exploitation does not require any major public investment. In fact, these forests are a natural resource. All of the NAFTA committees that have been involved in the dispute have confirmed the Canadian position and stated that the low stumpage fees are not subsidies.

Nevertheless, since 2001, the U.S. has levied 4.2 billion euros of punitive duties on imports of Canadian wood. In addition, it is also a problem that the money from these duties does not go to the government but rather to those American wood producers who had complained about the import of Canadian lumber. This procedure—whereby the affected industries receive the duties collected—is part of the Byrd Amendment (Continued Dumping and Subsidy Offset Act), which was passed in 2000. In fact, this regulation was the subject of a complaint by the EU and other countries and was found to be illegal by the WTO. However, the U.S. has still not corrected the law.

On October 6, 2005, Prime Minister Paul Martin characterized the American position as “nonsense” and a “breach of faith.” On the other hand, 21 American Senators signed an October 20, 2005 letter to Commerce Secretary Carlos Gutierrez urging that “NAFTA panel decisions cannot and should not force the Department to deny legitimate relief under U.S. law to the domestic lumber industry and its workers.”

How is this dispute related to the WTO Ministerial Conference in Hong Kong? The conflict between Canada and the U.S. highlights the importance of multilateral dispute resolution, which only the WTO can provide. The growth in the number of bilateral trade agreements is creating competition for the WTO and weakens the willingness of actors to work for success within the World Trade Organization.

tial agreements—from Free Trade Zones and General Preference Systems to “Everything-But-Arms” initiatives—and today is carrying out trade on a most-favored nation basis with less than 10 of the 148 WTO member states. Naturally, this small group of countries includes the largest economies outside of Europe such as the U.S., Japan, Canada and South Korea.

The multitude of preferential agreements not only makes it more difficult to further advance the liberalization of world trade, but also undermines the dispute resolution mechanism of the WTO. In numerous trade agreements, such as NAFTA, a party has the option to choose between a bilateral and a multilateral dispute settlement. This eliminates the critical role of multilateral dispute settlement for the regulation of trade, and trading relationships become more hierarchical: the existence of a choice between multilateral and bilateral dispute resolution can lead to the more powerful actor pushing for the use of the bilateral alternative—a step backwards (see box). This is especially true for bilateral free trade agreements to which the U.S. or the EU is a party.

The systemic competition created by bilateral agreements is, however, by no means the only challenge for the WTO and the Doha Round. In 2005 and 2006, a troublesome situation in American domestic politics is added to the mix: the upcoming expiration of Fast Track Authority for the current administration is putting the WTO under immense time pressure. Fast Track Authority expires in 2007. So

long as the Bush administration has Fast Track Authority, the American Congress cannot discuss a trade agreement in detail, but only vote for or against it. After Fast Track Authority expires, the House of Representatives and the Senate will have the right to reject individual parts of an agreement. With the run-up to the 2008 presidential election, and a growing protectionist trend in the U.S. in the background (which will be further fueled by the continuing, extremely high trade deficits), a renewal of Fast Track Authority is highly unlikely. Therefore, after 2007, there is a good chance that trade policy will become a key issue in American domestic politics and protectionist reflexes will play a major role in the related policy debates.

For these reasons, the WTO Ministerial Conference in Hong Kong in December 2005 is critical. If member countries do not manage to overcome the major obstacles in Hong Kong, a conclusion of the Doha Round before the expiration of Fast Track Authority is unlikely. As a result, the success of the entire negotiating round would be significantly delayed.

For the WTO, this would be a disturbing set back. The players reproaching the multilateral trade regime for lack of vitality and favoring bilateral free trade zones will have won a substantial argument. If the Doha Round should fail, it is—based on the experiences in Seattle, Cancun and possibly Hong Kong—more than unlikely that in the next ten years a new round would be initiated. In the interim, international trade would become even more regulated by bilateral agreements. That would clearly pave the way for the slide of the WTO into meaninglessness.

The notion that the failure of the Doha Round would only slow the development of the WTO but not weaken it is not convincing. If there were no systematic competition between bilateralism and multilateralism, the WTO could cope with such a stagnant phase. However, in light of the present competition, a failure of the Doha Round would structurally weaken the WTO—one of

the most important cornerstones of global governance would be washed away.

Overstated Agricultural Problems

Recent discussions about the Doha Round could give the impression that the restrictions on trade in agricultural products are the only stumbling block for a successful conclusion. In particular, the EU's agricultural subsidies have been the object of criticism in the media. It seemed as if France and ultimately the entire EU were obstacles to the conclusion of the Doha Round. Brazil and the U.S. have repeatedly and rather brusquely turned down all European proposals and in the past few weeks have written them off as insufficient. While doing so half-truths were mixed with imprecise definitions. On closer inspection it becomes clear that agricultural problems are not an insurmountable obstacle.

Time and again, the media references the high level of subsidies that OECD countries' agricultural sectors enjoy. The World Bank, as well as the non-governmental organization OXFAM, claims that farmers in wealthier countries receive about 300 billion dollars of subsidies. Thus, approximately one billion dollars worth of subsidies are spent on agriculture each day. Based on these figures, many have concluded that a reduction of these subsidies would provide more equality between North and South and an outright cancellation would stimulate considerable growth in prosperity in many developing countries. Both expectations are unfounded.

To start, one must distinguish between the very different types of agricultural subsidies: there are subsidies for exports, payments to farmers that influence production and payments that do not have any influence on production. The oft-cited data relate to production subsidies, known as Producer Support Estimates (PSE). These encompass all payments that are made to farmers including the trade-distorting duties and quantity quotas. The labeling of all payments to farmers as subsidies, as

always happens, originates from a very broad, useless definition of the term subsidy. For international trade, only export subsidies and production-influencing aid are significant. For instance, whether a country grants farmers free health care—to make up an example—is not relevant to international trade.

Of course, export subsidies, whose amount has decreased significantly in the past few years and surprisingly arrived at a low level today, are problematic. In recent years, the level of export subsidies offered by all the industrialized countries combined fluctuated between three and five billion dollars per annum. It is true that these subsidies will have to be eliminated, a step that should be comparatively easy for industrialized countries.

It is a more difficult state of affairs regarding payments to farmers that have effects on the production of agricultural products. In the past few years there have been considerable efforts, especially on the part of the EU, to decouple production and subsidy payments. These efforts by industrialized countries have led to the fall of agricultural subsidies to well under 100 billion dollars per year. Even though this is still a considerable amount, it is well below the frequently cited numbers of the total subsidy payments to farmers. It should be possible in the Doha Round to agree upon the complete elimination of export subsidies and a further reduction of production-distorting subsidy payments to farmers.

Liberalization and Development

It is completely naive to expect the liberalization of agricultural trade to spur the development of the poorest countries. This link is continuously suggested but does not withstand close scrutiny. What would happen if the competition in agricultural markets increased considerably? Eliminating subsidies in OECD countries would first lead to an increase of world market prices. This would result in countries, which import food, having higher import bills. Ac-

cordingly, one should not forget that 45 of the 49 world's poorest countries are net importers of food. Today these countries benefit from food subsidies paid for by the taxpayers of the OECD members and in the future would either import less food or have to increase their exports.

This is certainly a legitimate consideration but these countries could, if subsidies were canceled, increase their own production as well as extend their food exports. Whereas the former proposition still seems plausible, the expansion of exports is unrealistic. Modern agriculture is comparatively capital intensive and there is a shortage of capital in the poorest countries. Moreover, successful export of food requires the creation of complex supply chains, the compliance with strict hygiene standards and the marketing of products. It is quite possible that a liberalization of agricultural trade would strengthen those producers who, in these respects, are already considered to be efficient; above all Brazil, Argentina, Canada, but also the U.S. Brazil, in particular, would undoubtedly be a beneficiary of agricultural liberalization.

For the removal of all obstacles to agricultural trade to be agreed on, not only industrial but also developing and emerging countries, including Brazil, would have to undertake considerable efforts. In 2001 duties imposed on agricultural imports, assessed on the volume of foreign trade, amounted to 36% in Japan, 12% in the EU, 3% in the U.S., but 94% in South Korea, 44% in India and 13% in Argentina and Brazil. A further reduction of the duties levied by emerging countries should be possible in Hong Kong.

Beyond that, however, there are procedures that so far cannot be understood either through the analysis of payments to farmers or through the examination of the amounts of duties. The increase in bilateral free trade areas led to participating countries falling back on protectionist rules of origin in order to protect their domestic agriculture. This is particularly true for the U.S., which offers its cotton producers a

little known, but very effective form of protection from foreign competition. The direct subsidy of American cotton farmers—in total, four billion dollars per annum or about 150,000 dollars per grower—has been debated again and again over the years. African countries' criticism of these subsidies contributed to the failure of the WTO Ministerial Conference in Cancun. But today the U.S. uses bilateral agreements to exclude other cotton producers. So-called rules of origin are applied here: with respect to textiles the “fiber-forward-rule” is in several U.S. agreements: a piece of clothing only qualifies as a product of the free trade area if all production steps, including the extraction of the fiber, occurred within the free trade area. To provide an example: a shirt sewed in Singapore can only be imported duty-free if the cotton used comes from either Singapore, which does not grow cotton, or the U.S. The use of African cotton is not prohibited but leads to paying relatively high duties on textiles upon importation into the U.S.

Progress with the liberalization of agricultural trade is hoped for in Hong Kong. It is possible to eliminate agricultural subsidies and protective duties if all WTO parties approach the meeting constructively. But in light of the effects of such measures on development policy, expectations should not be set too high. Today Africa's poorest countries, for instance, already have unrestricted access to EU markets within the scope of the “Everything-But-Arms” initiative. This created modest sales prospects for these countries. But if all customs barriers in the EU were pulled down the ACP countries (African, Caribbean, and Pacific developing countries) would presumably lose between 50 and 75 percent of their exports to the EU. Access to markets is required for successful development, but this access alone does not at all guarantee development. The development policy dimension of the Doha Round would not be substantially strengthened by agricultural trade liberalization.

WTO Reform

In the past three decades the U.S. and the EU have dominated the international trade system and disputes were frequently limited to these two actors. This has changed: in contrast to the Uruguay Round of the GATT, today developing countries are self-confident and do not shy away from conflicts. This basically positive development is on the other hand dangerous because developing and emerging countries have shown a growing readiness to make use of their blocking power. In the past, conflicts were sorted out by only few actors who were able to produce a consensus within a short amount of time towards the end of the negotiating rounds. Today, in contrast, there are more complex disputes to be managed involving a greater number of relevant actors. The failure of the WTO Ministerial Conference in Cancun two years ago can essentially be attributed to such management problems.

Against this backdrop, an institutional reform of the WTO is distinctly important. It stands to reason that the organization would benefit from the creation of management groups within the organization in order to reduce the complexity of the negotiation processes. But the introduction of majority decisions is neither advisable nor realistic because this would elevate the WTO to a supranational regime. In developing countries as well as in the OECD, such proposals have no prospects.

Beyond the running of Doha Round, it is urgently necessary to clarify the procedures concerning the relationship of preferential agreements to the WTO. Presently, there is no serious examination of bilateral and regional free trade agreements, and their compatibility with Article 24 of the GATT agreement. This agreement provides, among other things, that preferential agreements are only valid when they conform to the GATT contract and when “approximately the entire trade” is liberalized. But with a multitude of agreements this is out of question. Parts of agriculture, in particular, but also, for instance, finan-

cial services, are left out over and over again. A specification of the procedures, including the commitment to consequences concerning the violation of GATT regulations, would be a contribution to the WTO.

Which Strategy for European Foreign Trade Policy?

The successful conclusion of the Doha Round and the strengthening of multilateral trade rules must be a priority for Europe. At the same time, the elimination of agricultural subsidies should not put at risk the essence of the common agricultural policy. It is certainly true that the common agricultural policy can be held responsible for undesirable trends and overproduction. On the other hand it should not be overlooked that a complete reduction of all subsidy payments to European farmers would not only significantly change the rural spaces in Europe and lead to the destruction of centuries-old cultural landscapes, but also raise the question of food security and the availability of high-quality food. The readiness of European citizens to make themselves dependent on food from abroad should not be overestimated.

In case of a failure of the Doha Round, new trade policy strategies will be required. Here, transatlantic trade will play an influential role. Despite considerable reservations about bilateral trade agreements in general and a transatlantic free trade area in particular, in the event of a recognizable standstill within the WTO, a transatlantic forum for the discussion of disputes over the trade in goods and services should be created. This forum should include not only the executives, e.g. the two foreign trade representatives or commissioners, but also the American Congress and the European Parliament. In any event, the range of transatlantic trade disputes, e.g. the 1976 argument about the taxation of the "Foreign Sales Corporations" or the current controversy about Airbus/Boeing subsidies, is an

argument for the creation of such a forum. The objection, that such a forum would, like free trade areas, compete with the WTO, is legitimate. However, the goal of such a transatlantic body would not be the lawful, binding regulation of trade, but, above all, the reduction of conflicts at a level below WTO dispute resolution.

In addition, institutional reform of the WTO and its procedures will have to be discussed. Within the organization, that is with all 148 member states, this would be extremely difficult to achieve. Therefore the creation of an efficient institution to discuss the pressing problems of global regulatory and structural adjustment policy—certainly not only trade policy-related questions—would clearly be sensible. The creation of a group that includes the most important OECD countries as well as emerging and developing countries is obvious. The efficiency gains that can be expected from reducing the number of participating countries are the most persuasive argument in favor of a new international regime to regulate the world economy.

There is much at stake in Hong Kong. Presumably it is clear to all negotiating partners that the failure of the Doha Round cannot be ruled out anymore. The WTO would, in this case, be stuck in the position it reached before the Doha Round. This would be tragic to the extent that the supporters of bilateral preferential agreements would be provided with a good argument. Even considering all the shortcomings of the multilateral regime, it should not be overlooked that international trade of goods and services should preferably be regulated by a global regime that is the same for all regions of the world. Too many levels of regulation – national, bilateral, regional, global – make it more difficult for less efficient actors, in particular, to participate in possible welfare gains achieved through the international division of labor.

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