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The Future of the WTO after the Nairobi Ministerial Conference

Evita Schmieg and Bettina Rudloff

The WTO's 10th ministerial conference took place shortly before Christmas 2015, the first to be held in Africa. Verdicts on its outcomes range from "the death of the Doha Round" to WTO Director-General Roberto Azevêdo's praise for a "historic" package. A more measured assessment reveals a mixed picture. While a number of important decisions were reached in Nairobi, most of the controversial questions were not even on the agenda. And it is less clear than ever where the talks should go from here. A consistent and ongoing shared interest in the global public good of a strong world trade system should persuade the member-states to find constructive new approaches.

On 19 December 2015, the 164 members of the WTO – including the latest new additions Liberia and Afghanistan – agreed on the text of a ministerial declaration. Advance expectations were rather low, given the substantial differences on important points between the industrialised countries (especially the United States) and the developing countries. The WTO's Doha Round began in 2001, seeking a further liberalisation of world trade. Under the impression of the events of 11 September 2001, the initial meeting explicitly acknowledged that world trade needed to function to the benefit of all, and consequently placed the needs and interests of the developing countries at the heart of the talks. Over the subsequent years, however, the talks dragged on without producing results. The first significant success did not come until

Bali in 2013, with the conclusion of the Trade Facilitation Agreement. From the different positions, the course of the negotiations and the results achieved to date, conclusions can be drawn about the future of the WTO and whether this institution will continue to be in a position to provide the global public good of an international world trade system.

Overdue Decisions on Agriculture

In the agricultural sector Nairobi succeeded in agreeing a handful of changes in line with the three pillars of the existing agricultural agreement. Although the sector is economically marginal in the global context, it is very important for a number of developing countries. Moreover, agricultural trade is affected by considerable differences of in-

terests between developed and developing countries. Agricultural negotiations are often of great political and strategic importance for talks on other issues.

(1) *Internal subsidies*. The Nairobi decisions provide for exceptions for subsidies used to build food reserves. At India's initiative, the 2013 ministerial conference in Bali adopted an interim solution for the subsidisation of such reserves. This relativised the strict principle that permits agricultural subsidies only under specific conditions. Because most developed countries make such payments and were able to notify them formally to the WTO during the 1986–94 Uruguay Round, only they were in a position to fulfil these conditions. India protested increasingly vigorously against this historic injustice and sought a rule change to reduce its exploding budget for food reserves. But many others, in particular developing countries, also feared that allowing India subsidies would increase Indian exports at the expense of their own, or wipe out their own markets.

Nairobi failed to replace the temporary solution with a permanent arrangement. Observers assume that the differences may be so large as to preclude such a solution, with the temporary arrangement instead being extended at intervals.

Unfortunately a general subsidy reduction and comprehensive reform of the rules was not on the agenda, even though subsidies continue to be granted on a grand scale by actors such as the United States and the European Union, and increasingly also by countries like China and India. To date the strength of the agricultural lobbies has prevented any further reduction in agricultural subsidies. Yet such a move would ensure greater fairness and especially benefit poorer countries, which would then no longer have to compete with subsidised products.

(2) Deadlines were set for the final expiry of *export subsidies*, with an asymmetrical arrangement for industrialised and developing countries. While the developed countries must cease export subsidies with

immediate effect, the developing countries have until 2018, and the least developed countries and food importers until 2030. This step, which was long overdue, was made possible by the comparatively high recent global market prices, which meant that these subsidies are currently rarely applied. The timeframe for repaying state-backed *export credits*, which are granted on a large scale by the United States, was shortened, although less strongly for developing countries. This at least places a limit on the duration of public support. The third type of distorting export subsidy, *state export companies*, is found above all in India and China. This type was not negotiated in Nairobi, but is a topic in working parties.

Some observers regard the decisions on export subsidies as very important and system-transforming, because they finally abolish this strongly market-distorting instrument. If agreement had not been reached, this instrument could have reappeared on a larger scale when market prices fell again – a scenario that currently appears perfectly realistic in light of present market developments. The decision can also generate political pressure for further progress on other agricultural issues.

Once again, no significant decisions were taken on *food aid*, such as the abolition of monetisation of aid to fund development projects. The United States in particular makes intense use of this possibility and wishes to retain it. The better alternative of cash aid to support the purchase of local products (instead of in-kind aid) was again only vaguely recommended. Until these reforms occur, counterproductive food aid will continue to destroy markets.

(3) In the area of agricultural *tariffs* a general safeguard mechanism was adopted, permitting developing countries to increase tariffs in the event of import surges, as they have long been demanding. However, concretisation of the decision (scope, timeframe, products) was left to the regular WTO Agriculture Committee. Although there is already a possibility to impose protective tariffs, this can be used only by developed coun-

tries to trigger automatic tariff increases for strategic products when a particular price level is reached (Special Safeguard Mechanism). Nairobi's acknowledgement of an asymmetry to the detriment of the developing countries must be regarded as a great step forward. Whether the decisions will actually level the playing field will depend on details that remain to be fixed.

(4) The *cotton sector* saw substantial progress only in the rules on export subsidies, in line with the general rule changes for such subsidies. It was agreed that developed countries that felt "in a position to do so" could grant duty-free access to cotton exports from least developed countries (LDCs). Differences within the group of developing countries prevented a more far-reaching agreement specifically for market access for the LDCs: major cotton producers like India fear the competition created by a significant market opening.

From the perspective of the developing countries the achievements were modest. Although the 2005 meeting in Hong Kong decided to prioritise problems in the cotton sector, there were no decisions on resolving the pressing problem of trade-distorting production subsidies. In 2014 the United States alone granted subsidies totalling more than \$500 billion in the cotton sector. That represents about one quarter of the \$1.8 billion that the "Cotton Four" countries (Benin, Burkina Faso, Mali, Chad), as the biggest LDC exporters, together earned from their exports in the same year. China and India also contribute to distortions in the world cotton market, even if they process almost all the cotton they produce themselves. The Cotton Four countries are strongly dependent on cotton exports and suffer especially from the distortions of the world market.

Measures Benefiting the Poorest Countries

The Nairobi declaration repeats the promise of Doha, to secure for the developing countries, and especially the LDCs, a share of

world trade corresponding to their development needs. According to the WTO (Briefing Note LDC) the LDCs contain 12 percent of the world's population, produce less than 2 percent of global GDP and are responsible for only about 1 percent of world trade in goods. Options for improving the trade position of the LDCs have been under discussion since the beginning of the Doha Round. Two outcomes were achieved in Nairobi:

(1) *Improvements to rules of origin*. WTO rules permit lower tariffs to be applied to imports from LDCs, in order to promote their integration into the world economy. More developed countries grant these preferences unilaterally in the scope of their Generalised Systems of Trade Preferences (GSP). The standardisation and simplification of rules of origin agreed in Nairobi is intended to help LDCs to make better use of their trade preferences. The most important element of the decision is the call for member-states to permit a cumulation of 75 percent. In other words, exports from LDCs should still be granted preferences even where up to 75 percent of the total value of the inputs are imported from countries that are not LDCs.

Given that value chains in LDCs are generally short, this rule is important in order to allow a broader range of their products to enjoy preferential treatment. However, the rule will not come into effect until the preference-granting countries implement the Nairobi decision in their existing national preference schemes.

(2) The second decision affects *services*, for which LDCs can potentially also enjoy preferences. The "waiver" that permits these preferences was extended for fifteen years, until the end of 2020. One reason for this was that few such preferences have actually been granted to date, and it is hoped that greater use will be made of this instrument in future.

Measured against the low expectations, the Nairobi outcomes are certainly positive. But they do not represent any great progress towards the Doha Round's development goal

of improving the integration of the developing countries in world trade.

Duty- and quota-free market access for LDCs was not discussed in Nairobi. This measure was agreed in 2005 at the Hong Kong ministerial conference, but has only been implemented in full by the European Union, even though it only proposes abolishing tariffs on 97 percent of tariff lines. It is the other 3 percent that are decisive, because they affect exports of finished manufactured goods. The lion's share of LDC exports – primary products – is tariff-free anyway, because the importing industrialised countries require the inputs for their own industry.

The LDCs had also introduced far-reaching proposals for the service sector, for example for simplifying administrative processes for visa applications and work and residence permits relating to the export of services supplied by natural persons ("mode 4"). Because they can offer lower wage costs, LDCs possess a particular interest in these services. But tied as they are to questions of migration (such as residence permits), they are also particularly politically and economically sensitive for the industrialised countries and emerging economies. It therefore comes as no surprise that no consensus could be achieved on this issue.

Tariff Elimination for Defined IT-Products

Fifty-three members of the WTO agreed in Nairobi to expand the Information Technology Agreement (ITA), which affects trade flows worth \$1.3 trillion. Concretely, it was agreed to abolish tariffs on 201 IT products. 65 percent will be tariff-free from 1 July 2016, with the other tariff lines reduced incrementally to zero by 2019. As a plurilateral agreement under the auspices of the WTO, the ITA was not signed by (and therefore not valid for) all WTO members.

Ways Forward for the WTO

The Nairobi ministerial declaration explicitly lists the mutually contradictory ideas of the member-states about how the WTO should proceed, breaking for the first time with the tradition of adopting only unanimously agreed statements. Consensus was impossible because the developing countries would like to complete the Doha Round on account of its stated development goal, while the industrialised countries regard that as hopeless. They believe that a new start is required instead, to address the pressing issues of the twenty-first century. The gap between the two positions is currently unbridgeable.

One underlying problem in the talks is the UN's classification of developing countries, which has an especially strong effect on the negotiations on the elimination of industrial tariffs. The industrialised countries expect more advanced emerging economies like China, Brazil and India to open their markets more strongly, in line with their growing share of world trade. But in many respects these countries would prefer to continue to benefit from the privileges granted to developing countries. In return for reducing industrial tariffs they demand a further-reaching opening of the agricultural sector. The positions are so far apart that the question of industrial tariffs was not even on the agenda in Nairobi.

It is completely unclear how the talks will proceed after Nairobi, leading certain observers to speak of the death of the WTO. In fact, there are numerous starting points for the WTO to continue working constructively. The central elements are discussed in the following sections.

► A Stronger Legal and Administrative Framework

The members of the WTO possess a fundamental interest in continuing to develop the international system of rules, which can be regarded as a public good. 98 percent of world trade is conducted under WTO rules. If the negotiations fail to pro-

duce results, there is a danger that the successful dispute settlement system will increasingly be used to clarify disputed points, shaping the rules through its verdicts.

The dispute settlement system itself is a success story. It has dealt with more than five hundred cases in twenty years, and is frequently held up as a model in other fields of international politics, because as well as resolving trade disputes it also has the power to impose sanctions to enforce its rulings. It is therefore an important element of the “public good” of the WTO.

The WTO’s everyday routine work, which often involves defining and interpreting rules and standards outside the glare of public attention, offers a reliable frame of reference. For example, the WTO organs decided in October 2015 to benefit the LDCs by extending until the end of 2032 the transitional period for applying the agreement on Trade-Related Intellectual Property Rights (TRIPs) in the field of pharmaceutical products. That decision was then merely formalised in Nairobi. It permits the LDCs to continue cheap production of generics without having to pay patent licensing fees. For the meantime it also spares them the administrative costs of introducing and applying the protections laid out in TRIPs. So significant decisions can certainly be taken in the WTO’s regular working processes.

In view of the continuing success of the WTO’s routine work, one group of proposals for reforming the multilateral trade system would therefore seek to strengthen its committee work and the role of the secretariat. For example the E15 initiative put forward by the Geneva-based think-tank ICTSD proposes turning the WTO committees into active platforms for deeper analysis and informal dialogue.

The frequently discussed idea of abandoning the necessity to achieve consensus over decisions in the WTO, on the other hand, appears to be nothing more than a fancy. Decisions about trade policy have direct economic repercussions on all member-states, often enough problematic ones,

for example when their own production is displaced. At the same time, the level of political integration within international bodies is much too small to allow for majority decisions. It is therefore hard to imagine states entertaining such a far-reaching relinquishment of sovereignty. For comprehensible reasons, the member-states have no confidence that majority decisions would be to their overall benefit.

► Without Single Undertaking

The principle of all GATT negotiating rounds, that “nothing is agreed until everything is agreed” (“single undertaking”) has been quietly dropped since 2013. Although earlier rounds also featured an “early harvest”, these outcomes were regarded as provisional until the negotiations as a whole had been completed. That no longer applies to the Trade Facilitation Agreement concluded in Bali, nor to the Nairobi decisions. The “single undertaking” principle is too restrictive for today’s complex negotiations. It originates from a time when talks were exclusively about reducing tariffs in the GATT framework. It is easy to calculate the consequences of tariff reductions for individual member-states, the future export opportunities and import increases: in short, what each country gains or loses. The principle also corresponded to the economic theory that all countries would benefit from trade liberalisation. To that extent it made sense to search for the ideal solution until everybody was happy.

Today the classic tariff negotiation plays an increasingly small economic role, if for no other reason than the drop in globally weighted mean applied tariffs from 34 percent to 3 percent between 1996 and 2012. Instead, non-tariff trade barriers and regulatory policy gain in importance. And trade negotiations are consequently a great deal more complicated than they used to be. The dropping of the “single undertaking” reflects the pragmatic approach pursued since the accession of WTO Director-General Azevêdo in 2013, which consists in concentrating on

the possible and working towards smaller packages of results.

► **With Plurilateral/“Club” Solutions**

The success of the ITA expansion demonstrates that a smaller group of member-states with a shared agenda can achieve a further-reaching liberalisation in areas where the membership in its entirety would be unable to agree.

There are two forms of plurilateral agreement: (1) In one the outcomes apply to all WTO members under the most-favoured-nation principle. For example, theoretically all WTO members should benefit from the tariff reductions on IT products agreed in Nairobi. But only in theory, as in this case the countries that abstained from the talks have nothing to offer in the affected sectors. Plurilateral agreements are therefore a double-edged sword. Progress on trade liberalisation is welcome, the creation of a framework that other countries can join is positive, and in some cases arrangements become part of comprehensive WTO agreements (this applies, for example, to provisions from the plurilateral bovine meat agreement). But in practice there is a danger of the gap between participating and non-participating countries growing (in the case of the ITA also a technological gap). (2) In the second form of plurilateral agreement (example: public procurement) the agreed market access arrangements apply only to the participating states. While this may make agreement easier to reach during the talks, here too there is a longer-term danger of exacerbating differences between economically stronger and weaker countries. The fundamental problem with plurilateral agreements is that the weaker countries are least likely to participate in international rule-making. And because the rules do not take into account their interests and capacity restrictions, there are also difficulties associated with joining later.

► **Taking Level of Development into Account in Trade Rules**

The WTO has already developed approaches for avoiding these problems. In mid-January 2016, Director-General Azevêdo described “flexibility” in talks on new trade rules as an important precondition for achieving results. The Trade Facilitation Agreement for the first time coordinates the fundamental scope and pace of implementation with the administrative and financial capacities of the developing countries, not through exceptions but within the fundamental structure of the agreement. At the same time it permits poorer countries to make implementation conditional on support in the form of development cooperation.

Given the great challenges associated with implementing regulatory measures, this could also become a model for future agreements. Implementation not only costs money, but also depends on the existence of adequate administrative capacities for passing laws and regulations, reforming institutions and processes, and dialogue with the private sector. Although this form of agreement involves a danger of reform-resistant countries foot-dragging on implementation, it can also enable reform-willing countries to make progress that would otherwise be impossible. In its new foreign trade strategy of October 2015 the European Union now for the first time includes a chapter on implementation of free trade agreements, after recognising the existence of deficits in this area, where small and medium-sized enterprises in particular experience difficulties in realising the benefits offered by trade agreements. For example a year after the EU-South Korea free trade agreement came into force, only 40 percent of European exporters had profited from the tariff concessions it grants. This example implies that successful implementation of agreements will be a great deal more difficult for poorer countries.

► **Addressing the Issues of the Twenty-first Century, in the Interest of All**

Many actors, especially the governments of the more developed members, believe that the WTO is failing to discuss the pressing issues of the twenty-first century. That is one reason why interest in bilateral and regional trade agreements has grown so strongly in recent years. There is certainly a need for international discussion on many topics, such as digital commerce, aspects of sustainability, compatibility of the trade system with climate targets, and the development of a multilateral framework for trade-related investment.

Countries with weaker administrative capacities in particular find it difficult to define their negotiating interests on these questions and to assess potential impacts. That is also one of the main reasons why the developing countries have recently blocked the introduction of new topics. They feared being rushed into outcomes that are not in their interests. In fact, it would be important for the developing countries to play a role in shaping new rules by participating actively in negotiations. There are numerous points that poorer countries should be asserting in the interests of their own development, and that could otherwise end up being ignored. When foreign direct investment is discussed, for example, the investing countries (which are today by no means only the industrialised countries) prioritise the aspects of investment protection and profit transfer. Poorer countries, on the other hand, are interested in restricting the international competition to attract investors through subsidies, which their meagre state budgets leave them unable to win against industrialised countries. The issue of multinational companies using profit transfers for tax avoidance is also of great interest. Africa alone loses more than \$40 billion annually by this route, or more than 4 percent of its GDP.

In this connection it is worth noting that the African, Pacific and Caribbean (ACP) states did propose discussing one subsidy issue in Nairobi – seeking an agreement to

restrict fishery subsidies. Although full discussion of the issue was prevented by the resistance of the major fishing nations, the example does show that developing countries are capable of actively pursuing their rule-setting interests in talks.

► **With More Focussed Targets and More Leadership**

The climate conference was frequently discussed in Nairobi as the yardstick of success: agreeing targets at the *political* level, analogously to the 1.5 degree target set in Paris. However, that comparison overlooks an important difference between the two areas. On the climate question, the issue is to establish a functioning international regime in the first place. At this level, and for a global public good, it is easy to formulate a general objective such as limiting global warming. The world trade system, on the other hand, already possesses a sophisticated set of rules defining a firm framework for economic actors and contributing to expanding foreign trade and economic growth. At this level it is no longer so easy to formulate general objectives. Nonetheless, one should seek to learn from the climate successes and draw on new approaches for tackling trade talks.

The issues negotiated at the WTO are so complex that many areas are comprehensible to few outside the involved government experts and lobby groups. This makes it harder to reach decisions at the political level. Politicians find themselves dependent on the advice of their civil servants, who are often guided by specific interests. This tends to stand in the way of the trade-offs between topics that are necessary to achieve results.

Following the example of the climate talks, targets for trade talks could be formulated at the highest political level, rather than negotiating particular political issues at the technical level. This would generate significant political pressure to prevent talks from failing. One example of such an approach discussed in the press is the ban

on subsidising fossil fuels, on which the G20 countries spend \$452 billion annually; coherence with the Paris climate decisions demands that these subsidies be reduced. Although this would not appear to be a particularly promising example in view of the enormous differences, the approach should be tested. However, if such targets are to be arrived at, new formats for bringing decision-makers together will be needed.

The willingness of political actors to assume leadership in a positive sense will certainly be central to the success of future talks. Basically, they will have to place greater weight on their duty to the general good than on their interest in the next election result. That would change certain decisions, because short-term interests in subsidies and protectionism enjoy great attention from lobby groups and the media, but often run counter to the long-term objectives of sustainable development.

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