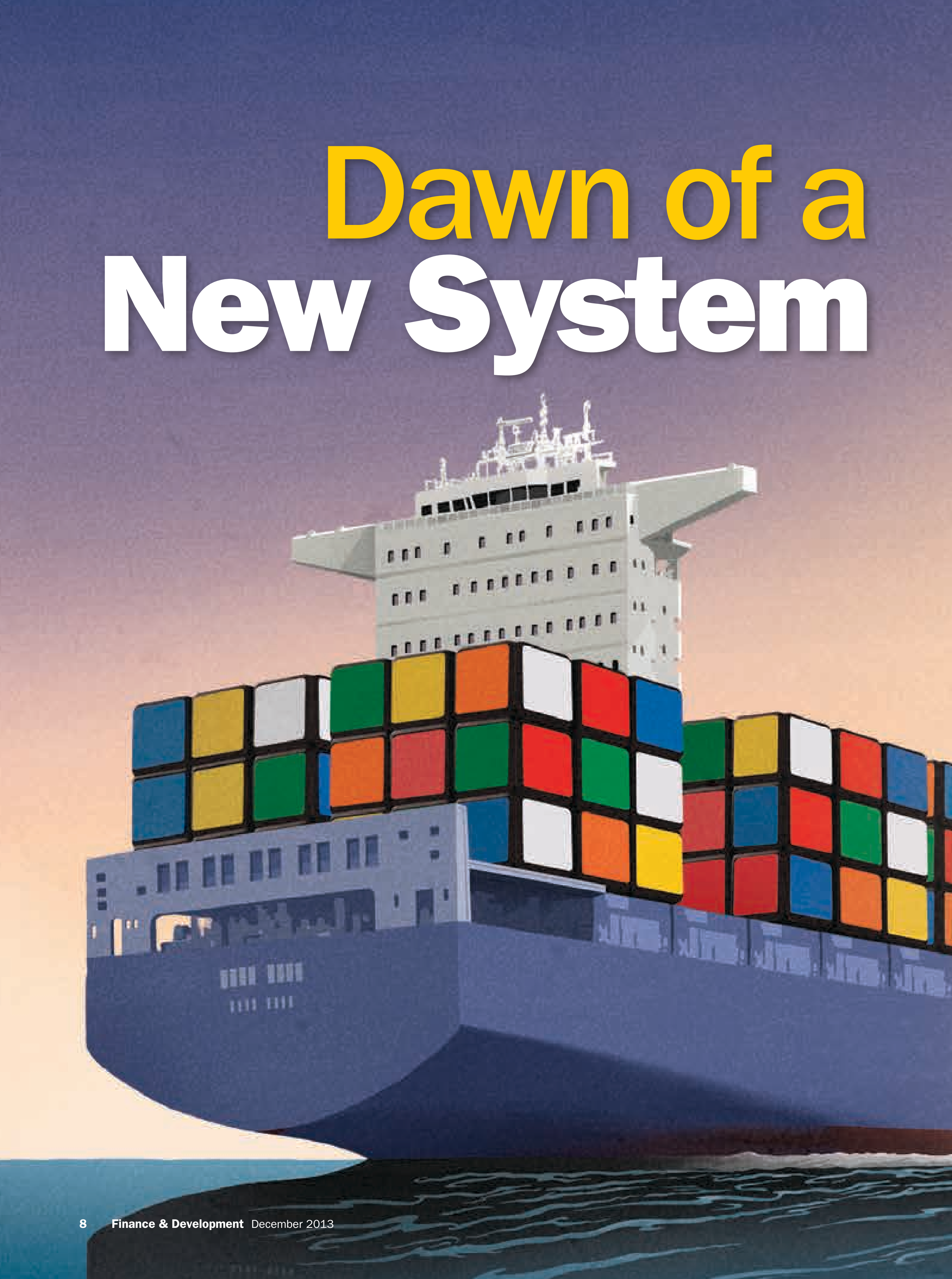
Dawn of a New System



An eminent trade economist worries that the global trading system is at risk of degenerating into a series of regional agreements

Jagdish Bhagwati

EUPHORIA replaced despondency in 1995 when—after eight years of multilateral trade negotiations—the Uruguay Round was successfully closed and the General Agreement on Tariffs and Trade (GATT) became the World Trade Organization (WTO). After repeated, failed political attempts, its resolution was indeed cause for celebration. The GATT was an agreement on tariff reduction with an improvised set of arrangements on trade issues rather than the international trade organization many had wanted but failed to secure as the “third” element of the international superstructure designed at Bretton Woods. The WTO emerged as that missing institution.

The postwar multilateral trading system, by liberalizing trade, has played an important part in creating prosperity and, in turn, reducing global poverty, since growth both raises the incomes of those below the poverty line and generates revenue for social spending on health and education, which also helps the poor (Bhagwati and Panagariya, 2013). After much debate, this nexus between trade and growth, and in turn between growth and poverty reduction, is now widely accepted.

But failure to conclude the Doha Round of multilateral trade negotiations by the final November 2011 deadline—and the simultaneous emergence of bilateral and regional trade negotiations as the preferred option of major powers like the United States and the European Union—has cast a shadow over the future of the multilateral trading system. Lester Thurow, former Dean of the Massachusetts Institute of Technology Sloan School of Management, famously proclaimed at the 1989 Davos conference that "GATT is dead," a declaration that seemed vastly exaggerated at best. Today the question might be "Is WTO dead?"

As action on trade liberalization has shifted from multilateral trade negotiations to bilateral and regional preferential trade agreements, the question before us is whether a role for the WTO can be salvaged. What are the prospects for the world trading system as it enters this problematic phase? And how can we make the best of the situation we now face?

Freight train traveling near Daggett, California, United States.

What happened to Doha?

The Doha Round of multinational trade negotiations began in Qatar's capital in 2001 and aims for major reform of the international trading system through the introduction of lower trade barriers, such as tariffs, and revised trade rules. It was seen by advanced economies as a response to those who opposed the international economic order, which included postwar trade liberalization. Developing economies, on the other hand, were convinced that their interests had been disregarded during the GATT trade talks and, under the so-called Doha Development Agenda, vowed not to let that happen in the Doha Round.

In fact, the GATT was intended to be biased in favor of—not against—developing economies, through special and differential treatment provisions. Developing economies enjoyed automatic extension of any tariff reductions without having to offer reciprocal trade concessions. The result was that, contrary to the common assertion that the world trading system was unfairly stacked against developing countries, the average manufacturing tariffs were higher there than in the advanced economies. Ironically, the fact that tariffs in advanced economies were generally lower for products of interest to themselves and higher for traditional exports of developing economies was the result of this "nonreciprocity" enjoyed by the developing countries. Although aid is often given on an unrequited basis, most countries insist on reciprocal concessions in trade. So, faced with automatic extension of their trade concessions to developing economies that were not required or expected to reciprocate, the advanced economies "fixed" the problem through product selection bias: they reduced tariffs only on products of interest to themselves. If the developing economies had been able to make reciprocal concessions, this product-selection bias would have largely disappeared.

Despite this product-selection bias, however, the developing countries profited from the trade liberalization by advanced economies. As advanced economies liberalized and increased their prosperity, the export markets of the developing countries grew too. The seven multinational trade negotiation rounds between World War II and 1986 helped the developing economies that took advantage of the growing markets resulting from advanced economies' trade liberalization. Outward-oriented countries like Korea and others in east Asia managed to develop growing markets abroad and registered remarkable growth rates of exports and income, which in turn hugely reduced poverty. Others—India, for example—failed to do so. This contrast underscores the point that trade provides an opportunity for countries to profit, but they have to seize that opportunity if they are to benefit. Often the failure to do so stems from autarkic policies that make foreign markets less profitable than domestic markets.

In the end, however, it was not the bulk of the developing countries that prevented Doha from being closed in 2011.

Rather, the negotiated concessions—so-called Doha Lite—were unacceptable to U.S. business lobbies, which felt that the more successful developing economies, such as India (in agriculture) and Brazil (in manufacturing), ought to make more concessions. They argued successfully in Washington that there was not enough benefit to warrant U.S. acceptance. Many felt that this was a myopic view. After all, minor, politically feasible adjustments—such as concessions in agriculture by both the United States and India, which had squared off against each other—would have sufficed to secure a win for Doha and its important breakthroughs, including an agreement to end agricultural export subsidies. In fact, U.S. President Barack Obama was urged by many world leaders, including Australian Prime Minister Julia Gillard, U.K. Prime Minister David Cameron, and German Chancellor Angela Merkel to settle Doha in this way. (Cameron and Merkel, in 2010, went so far as to appoint an expert group cochaired by me and the first WTO director-general, Peter Sutherland, to explore this question). But to no avail.

If one goes by his inaction on Doha, Obama was unwilling to confront the U.S. business lobbies, which held out for major new concessions by the bigger developing economies, asking for what has been called Doha Heavy. This was impractical and would have required serious new negotiations. In the end, such demands could not be met and Doha did not make it in 2011.

What next on Doha?

We have two options. If we treat Doha as dead, that would distress many governments, whose negotiated benefits, however small, would disappear. It would certainly imply an end to any future multilateral trade negotiations. And it would definitely damage the WTO. Or we could settle Doha at the Bali Ministerial in December this year—*F&D* will have gone to press before the event—with a minimum agreement, such as trade facilitation, which has been studied in depth by the Organisation for Economic Co-operation and Development (2013). Compared with Doha Lite and Doha Heavy, I call this Doha Lite and Decaffeinated. This last option is not exciting but is preferable for those who would like to minimize damage to the WTO and the multilateral trading system.

To see what damage the elimination of any prospects for new multilateral trade negotiations implies requires viewing the WTO as a three-legged stool. The first leg is multilateral trade negotiations. Doha was the first such negotiation under WTO auspices, whereas there were seven successive rounds under the GATT. The second leg is rule making—for example, setting antidumping and subsidy rules. The third leg is the dispute settlement mechanism, the definitive achievement of the 1995 agreement ending the Uruguay Round, which makes dispute resolution binding on member governments.

The issue before us is what impact the weakening—or even breaking, if Doha is killed—of the multilateral trade negotiation leg will have on the other two legs. Rule making, which has taken place largely during multilateral trade negotiations, would now be freestanding or shifted elsewhere. The dispute settlement mechanism would also be weakened if disputes are resolved in other bilateral and regional forums instead of in the WTO.

In the face of failure to conclude Doha, the damage to multilateralism has been compounded by a substantial push, led by the United States (for the Trans-Pacific Partnership, or TPP) and the European Union (for the Transatlantic Trade and Investment Partnership, or TTIP), toward discriminatory, preferential “regional” trade initiatives. The Pacific Alliance of Chile, Colombia, Mexico, and Peru is far less significant than the other two.

Across the Pacific

The TPP, now in its 19th round of negotiations, and with 12 members on board, is essentially a U.S.-led initiative that represents 30 to 40 percent of global trade. Around the turn of the millennium, the United States opted to pursue regionalism with South America, bypassing the more dynamic east Asia. East Asian countries were excluded from the proposed Free Trade Agreement of the Americas and, as a result, Asian trade initiatives typically excluded the United States.

The United States was therefore seeking a way to get back into trade with east Asia. The sense of the smaller countries, such as New Zealand, Singapore, and Vietnam, that the United States would be a counterweight to Chinese foreign policy in east and south Asia allowed the United States to reestablish its presence in the region. The TPP appears therefore to have been inspired by commercial motives and not by a desire to contain China as has sometimes been asserted.

Dispute settlement in bilateral or regional forums must allow the views of nonmembers who belong to the WTO to be heard.

But U.S. lobbies stepped in with a variety of demands that were only tangentially related to trade liberalization, describing their demands in self-serving fashion as elements of a "trade agreement for the 21st century." How could anyone object to a "modern," "high-standard" trade agreement? For example, the lobbyists sought to include labor union demands, even though only 11 percent of the U.S. labor force is unionized today. Attempts to incorporate such demands have met with resistance at the WTO by influential and democratic countries, such as Brazil and India. And even though demands for intellectual property protection were included in the agreement on trade-related aspects of intellectual property rights in 1995—see "Smart Trade," in this issue of *F&D*—the TPP reportedly seeks WTO protection substantially beyond what is already in place among WTO members.

If accepting these demands remains a precondition for joining the TPP, it is a safe bet that the partnership will fragment Asia into TPP, China, and India. That is hardly desirable. The correct policy must allow accession to the TPP provided a country liberalizes trade, without these side conditions that are unrelated to trade and without undesirable WTO demands. Acceptance of such demands should not be a prerequisite for joining the TPP. Put it this way: If I want to join a golf club, I need to play golf. But I should not have to go to church and sing hymns with the other club members.

Transatlantic Trade and Investment Partnership

The TTIP—a trade agreement proposed by U.S. President Obama, European Council President Herman Van Rompuy, and European Commission President José Manuel Barroso in June 2013 and currently under negotiation by the United States and the European Union—faces very different problems from those of the TPP. For one thing, the two markets are gigantic, whereas the TPP was essentially imposed on the small countries of Asia and only afterward were bigger countries, such as Japan and Korea, invited. Unlike in the TPP, U.S. lobbies have little influence on the European Union. And even within the European Union there are serious disagreements on several issues, which will slow down the negotiations.

Let's look at some important examples:

Cultural exception: France wants a cultural exception. The United States has never liked this idea, which it views as a poorly disguised demand for protection. But in fact almost 50 countries, not just France, have ministers of culture who see a need to protect their culture from homogenization (often U.S. influences, as it happens). The appropriate response is to grant the cultural exception but to insist that it be done through subsidies rather than import quotas. Subsidize Renoir but then let him compete with Spielberg. Protecting French cinema from competition and hence encouraging it to enjoy "monopoly rents" and a life of leisure is exactly the wrong way to go.

Genetically modified foods: Here again, the main difference of opinion is that many Americans see the technology as solving problems while Europeans tend to see it as creating problems. A cartoon in my book *In Defense of Globalization* shows an American customer telling the waiter to take away his tasteless broccoli and have it genetically modified. Unfortunately, objections by critics who call genetically modified foods "Frankenstein foods"—despite the conclusion by the World Health Organization that these foods have no adverse effect on human health (WHO, 2010)—are a threat to agricultural productivity enhancement, including in many poor countries whose citizens face starvation. Fear of an improbable Frankenstein is leading to the certain prospect of the Grim Reaper.

Tobin tax: France is deeply committed to this currency transaction tax—proposed by Nobel Prize–winning economist James Tobin to reduce the volatility of capital flows—whereas the United Kingdom and the United States have historically been against it. In France, it is also seen by many simply as a way to raise revenues. Others argue that banks seem to get bailouts while the poor do not get help with their sinking mortgages. So soaking the banks on their capital flow transactions seems eminently fair and a coup for the proletariat. It can hardly be expected that the TTIP will somehow reconcile quickly, if at all, various countries' arguments for and against such a tax.

The challenge ahead

Trade economists generally agree that preferential trade agreements are a pox on the world trading system. The vastly increased trade in intermediates, so-called value chains—a misleading term since intermediates into a product go in many directions and bend back as well: France may import steel from Japan, but Japanese steel uses intermediates from around the world, including from France, and the problem afflicts each intermediate import—requires synchronized rules that cannot be achieved with bilateral and regional agreements (see "Adding Value," in this issue of *F&D*).

Indeed, outgoing WTO Director General Pascal Lamy openly condemned the proliferation of preferential trade agreements, as did former Director General Sutherland. Ironically, the leadership in Washington, long the champion of multilateralism, has shifted its focus overwhelmingly to preferential trade initiatives.

But economic policymaking has to be an exercise in the theory of second best. Given that bilateral and—especially—big regional agreements are emerging, what should be the role of new WTO Director General Roberto Azevedo? I suggest that it must be to ensure that, with the multinational trade negotiations leg practically broken, damage to the other two legs—rule making and dispute settlement—be avoided. Azevedo must exhort the leadership of the TPP and TTIP to make rules and manage dispute settlement in these regional arrangements in a way that reflects lessons learned at the multilateral level. Rule making must not be exclusive to these forums. It must not exclude those that are not members of the regional arrangements on the pretext that the U.S. lobbies know what is best for everyone. Similarly, dispute settlement in bilateral or regional forums must allow the views of non-members who belong to the WTO to be heard.

This is a huge project. But unless Azevedo makes it his top priority in a new world where multilateral trade negotiations have probably vanished and preferential agreements are the only game in town, the steady corrosion of the WTO's leadership will continue. And that would be a pity. ■

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