

## **The World Trade System: Trends and Challenges**

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# The World Trade System: Trends and Challenges

## I. Introduction

When the Uruguay Round was successfully closed in 1994, and the General Agreement on Tariffs and Trade (GATT) metamorphosed into the World Trade Organization (WTO), the despondency that had characterized the protracted multilateral trade negotiations (MTN) was replaced by euphoria. The GATT had been an “agreement” on tariff reduction with an improvised set of rules governing goods trade rather than the International Trade Organization (ITO) that many had sought as the third pillar of the international economic superstructure following the Second World War. While the International Monetary Fund and the World Bank, the other two pillars of this superstructure, had emerged with sparkling colors out of the Bretton Woods conference, the ITO did not do so well. The Havana Charter creating the ITO was signed in March 1948 but it was never ratified by the United States Congress and was, thus, stillborn. On January 1, 1995, the WTO finally emerged as that missing institution.

A key function of the WTO is the implementation of existing agreements among member countries. When the WTO replaced GATT, it greatly expanded the scope of multilateral discipline. It expanded sectoral coverage by bringing textiles, agriculture and services into the fold of multilateral rules.<sup>1</sup> It created a uniform intellectual property rights (IPRs) regime. And it replaced the relatively weak dispute settlement mechanism of the GATT with a system that made dispute resolution virtually binding on member governments.

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<sup>1</sup> While the textile sector was significantly liberalized in the Uruguay Round, both Agriculture and Services remain subject to enormous distortions and thus offer the potential for significant economic gains, if suitably liberalized – a fact that appears to have been overlooked by the recent commentators expressing the concern that multilateral liberalization has little to offer, as much of the liberalization has already been undertaken in preceding multilateral negotiation rounds.

But the failure of the member countries to comprehensively close the Doha Round of trade negotiations initiated in the year 2001 for an extended period and the simultaneous breaking out of bilateral and plurilateral preferential trade arrangements (PTAs) as the preferred option of major powers such as the U.S. and the E.U. have cast a shadow over the future of the WTO. Some preliminary but important successes in improving trade facilitation, the reduction of trade barriers against imports from the LDCs and shielding, on an interim basis, food security programs in developing countries, were achieved in the WTO meetings at Bali in December 2003. This hopeful development has been marred, however, by at least a temporary failure to ratify the Bali accord. As such the situation remains a challenging one and calls for a critical assessment of the prospects for the world trading system.

Against this background, we analyze here the major trends in international trade in recent years, as well as the opportunities they present and the challenges they pose to the world trade system.

We begin in Section II by noting that there is much to celebrate about the progress achieved under the WTO toward establishing a liberal trading system. We analyze the trends in world trade protection and trade flows in recent years and discuss the important role played by the WTO in supporting further liberalization of trade, in the implementation of existing agreements and the settling of disputes between member countries through its dispute settlement mechanism (DSM).

We next discuss, in Section III, the enhanced participation of the developing countries in world trade in recent years. Overall, low- and middle-income countries in the “South” more than doubled their share of global trade in the last two decades. In parallel, South-South trade flows have expanded substantially: the share of exports from Southern countries going to other countries in the South has nearly doubled. There has also been a growing appreciation among the developing countries of the need to safeguard their trade interests and they have accomplished

it through more effective participation in the WTO. All in all, developing countries now represent a much greater share in global trade and, importantly, constitute a new set of influential players for the system to engage and accommodate.

Preferential trade areas form the subject of our analysis in Section IV. Despite the successes of the multilateral process in expanding trade, both developed and developing countries have systematically moved in the direction of these arrangements. In recent years, both sets of countries have negotiated with their gaze at least partially deflected away from the multilateral system and oriented towards bilateral processes. Developed countries have also found it more attractive to either sign agreements with each other or negotiate bilaterally with individual or small groups of developing countries than to substantially engage the multilateral process. Indeed, the threat of proceeding on the bilateral track has also been used by them to bend the multilateral process in their preferred direction. As the then United States Trade Representative (USTR) Susan Schwab pointedly noted in June 2006, “Everyone knows that if there is no Doha Agreement, we are perfectly capable of moving ahead on the bilateral track.”

While bilateral initiatives have resulted, in most cases, in only limited expansion of intra-PTA trade, thus, suggesting the continued importance of multilateral initiatives, the momentum towards bilateral agreements has accelerated over time. Indeed the Obama Administration has been pursuing both a “Transatlantic Trade and Investment Partnership” (TTIP) with the European Union and a “Trans-Pacific Partnership” (TPP) with countries in the Asia Pacific region, while significantly diminishing U.S. investment in rescuing the Doha round. Developing countries have found bilateral agreements to be increasingly appealing as well, especially because South-South agreements may be entered into via the “Enabling Clause” whose requirements are far less stringent than the restrictions imposed by GATT Article XXIV on North-North and North-South Agreements. We argue that this rising trend towards preferential trade arrangements greatly risks undermining the global trading system.

In Section V, we turn to the current state of negotiations, focusing on the Doha Round, TPP and TIPP. While some progress was made in the Doha negotiations at the latest 2013 ministerial meeting in Bali, not only does the resulting agreement remain unratified, the latter remains far from the original agenda at the time of the launch of the round. As regards TPP, we take a skeptical view of its intellectual property provisions that seek to raise the standards, not just above those in the WTO TRIPS Agreement but also those in the previous United States bilateral agreements. Given this provision and the labor standards clauses, it is unlikely that two of the largest countries in Asia, China and India, will join this agreement. As such if the TPP is successfully signed—by no means a done deal—it will only lead to fragmentation of the trading system. We also argue that the prospects for a successful negotiation of the TTIP are quite poor. In Section VI, we discuss how the proliferation of preferential agreements may have adverse consequences on the essential functions of the WTO such as rule-making and dispute settlement. We conclude the paper in Section VII.

## **II. Multilateral Trade Liberalization a Success**

The multilateral trading system has had great success in the last two decades. World trade in goods and services is much freer today than in the pre-WTO world. Tariff barriers and non-tariff barriers have been significantly reduced with tariff protection against industrial products at historically lowest level in almost all countries.<sup>2</sup>

Developed countries have bound virtually all their tariffs, while developing countries have bound a substantial proportion of their tariff lines. Further, applied tariffs have dropped to their lowest levels in the recent history. In developed

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<sup>2</sup> For details on trade liberalization going beyond what we report below, see Panagariya (2013).

countries, simple average tariffs uniformly stands below 5 percent. India, which is often depicted as a highly protected country, has applied tariffs averaging around 10 percent, while the corresponding figure in China stands even lower at 8.7 percent. Even Latin America, where tariffs are higher, now averages below 15 percent.

Furthermore, the proportion of applied tariff rates exceeding 15 percent is also generally low. In the developed countries, the proportion is uniformly below 3 percent, with Canada being the major exception. Remarkably, this proportion in India stands at 6.7 percent and is significantly below the 11.6 percent in China.

Trade outcomes have mirrored this liberalization, with goods as well as services trade expanding at accelerated pace. The simple average of annual growth rates of world merchandise exports rose from 5.6 percent during 1981-94 to 8.9 percent during 1995-10.<sup>3</sup> Trade has grown faster than GDP (which grew globally at a n annual average of 2.2 percent annually during both periods). Further, merchandise exports have shown remarkable growth in the three major regions of the world: Europe, North America and Asia. In Europe, they have more than doubled and in Asia, they have almost tripled during the last decade. Growth in North America has been slower but still impressive with exports rising from \$1225 billion in 2000 to \$1965 billion in 2010. Remarkably, though exports are much smaller in magnitude, export growth in the remaining three regions—Africa, Middle East and Commonwealth of Independent States—has been as impressive as in Asia. In each case, merchandise exports have more than tripled during the decade.

Growth in the exports of commercial services has been similarly spectacular. In North America, they have almost doubled; in Europe, they have more than doubled; and In Asia, they have more than tripled between 2000 and 2010. The remaining three regions have also seen their commercial services exports nearly or more than

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<sup>3</sup> These rates have been calculated using the annual growth rates, appendix table A1 in *International Trade Statistics 2011*, Geneva: World Trade Organization.

tripled. Thus, from the viewpoint of facilitating trade, the WTO has been a huge success.

A key function of the WTO is to implement the existing agreements among member countries. When the WTO replaced GATT on January 1, 1995, it replaced the relatively weak dispute settlement system of the GATT with a binding system backed by the right to retaliate on the part of the damaged party in case of non-compliance by the offending party. Davey (2012) discusses in detail the functioning of WTO dispute settlement and concludes that despite some shortcomings, it has lived up to expectation. First, after an initial surge, the number of cases brought for consultations has been cut to half of their level in the 1990s. The number of cases has been reasonably steady during the 2000s suggesting that a steady state may have been reached. Second, only relatively few cases have experienced delays (the two massive subsidy cases involving Airbus and Boeing being the major examples). Third, rulings in almost all cases have been implemented, even if with some delay. Finally, developing countries in general and smaller countries in particular have been able to access to the system and use it effectively to protect their trading rights.

It is also noteworthy that despite the major financial crisis, which created prolonged and still continuing high levels of unemployment in the major industrial economies, trade disruption has been minimal. This was in contrast to the Great Depression when similar dislocations led to a virtual trade war between Europe and the United States that led to the enactment of the infamous Smoot-Hawley tariffs in the latter. On the whole, trade has recovered relatively quickly in the aftermath of the crisis.

### **III. Developing Countries Embrace Liberalization and the WTO**

The last two decades have also seen a serious shift in the attitudes and policies of developing countries towards international trade. In the 1950s and 1960s,

development thinking was dominated by the view that developing countries needed to foster industrialization and that this required protection to manufacturing against competition from well-established foreign suppliers. Reliance on exports was seen as a non-starter because it was thought that the demand for developing country exports, which consisted of largely primary products, exhibited low elasticity with respect to both price and income. Low price elasticity meant that any efforts by the developing countries to expand exports would be frustrated by such large endogenous decline in the terms of trade that expanded exports would end up fetching reduced revenues. And the low income elasticity meant that over time, as incomes rose in the industrial countries, their demand would shift in favor of manufactures and services and away from developing country exports with the result that the developing countries will experience an exogenous secular decline in their terms of trade.

This line of thinking inevitably led the developing countries to seek “special and differential” (S&D) treatment in framing the rules of international trade under the auspices of GATT. Under S&D, developing countries enjoyed automatic extension of any tariff reductions undertaken by developed countries, without having to reciprocate with matching trade concessions. Two outcomes followed. First, since tariff reductions “bought” them nothing at the GATT, many developing countries chose egregiously high levels of protection for many decades, with disastrous economic outcomes. Second, developed countries, in turn, negotiated multilateral tariff reductions only on products of interest to themselves (ignoring, for instance, textiles and agriculture until recently).

By the late 1980s, however, three factors led to a change in the ethos in the developing countries in favor of trade liberalization. First, the outstanding economic performance of the few developing countries such as South Korea, Taiwan and Singapore, which switched to liberal trade regime early on, demonstrated that liberal trade was beneficial. Second, the failure of their own wholesale protection to produce industrialization and growth reinforced this view. And finally, writings by



trade economists articulating the lessons of the experience of successful early liberalizers, their embrace by international development and financial institutions such as the World Bank and the International Monetary Fund and the aggressive push, in turn, by these institutions towards liberal trade under loan conditionality, though initially resented, eventually helped shift the developing country attitudes.

The outcomes have been impressive. Spurred by trade liberalization and other market-friendly reforms, China and India both experienced double-digit growth in their exports averaging around 15 percent annually between 1990 and 2010. Middle-income economies like Brazil, Turkey, South Korea, Indonesia and Thailand grew their exports at nearly 10 percent annually. Overall, low- and middle-income countries more than doubled their share of global trade, from roughly 20 percent in 1990 to over 40 percent in 2010. In parallel, with the increased importance of the South in overall world trade, South-South trade flows have also increased substantially.<sup>4</sup> Specifically, the share of exports from low-income countries going to low- and middle-income markets has nearly doubled from around 22 percent to over 40 percent of the total and the share of exports from middle-income countries to low- and middle-income markets has increased from around 30 percent to nearly 50 percent. Furthermore, overall trade shares of those countries have risen much faster than the growth in their output.

While special and differential treatment for developing countries continues at the WTO, developing countries today participate much more effectively in the activities of the WTO. This is observed in three principal dimensions.

First, developing country membership has increased considerably over time. Over 30 countries have joined the system after the WTO was formed and over 20 countries are currently negotiating accession. A number of interrelated factors have contributed to this development. Developing countries have become major

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<sup>4</sup> Further details on these patterns of South-South trade can be found in Krishna and Matthias (2014).

exporters of manufactures and have thus favored an outward orientation. The establishment of the WTO has resulted in a number of changes requiring additional participation by developing countries. The WTO covers a variety of new areas, such as services, standards, intellectual property rights and it has been engaging in a number of on-going negotiations in the liberalization of different sectors which require continuous active involvement by member countries.

Second, the extent of the engagement of developing countries in multilateral negotiation, i.e., the Doha Round, has been a far more substantial than it was in the past. To begin with, the Doha round, billed the Doha “development” round, has focused significant attention on a sector that is of key importance to developing countries, i.e., agriculture, thus automatically increasing developing interest in effectively representing their interest in the proceedings. The emergence of the G-20 grouping prior to the 2003 WTO ministerial meeting and its success in getting the developed countries to drop three of the four “Singapore issues” from the Doha negotiating agenda, offers one example of their involvement in the negotiating process. Their continued involvement at Hong Kong ministerial meeting in 2005 and then again in the 2008 negotiations in Geneva that produced a deadlock between developed and developing countries offers another example of the intensity and relevance of their engagement.

Third, developing countries have also come to use the dispute settlement body (DSB) to assert and defend their trading rights. Hoekman (2012), who makes this point cogently, points out that while developing countries were defendants in only 8 percent of the cases under the GATT, under the WTO, they have been defendants in 35 percent of the cases. Developing countries have also emerged as complainants, accounting for one-third of all cases brought to DSB during 1995-11. Even more interestingly, as many as 44 percent of the developing country cases have been against other developing countries. In a highly visible case, India challenged the EU’s GSP plus program in 2003 with adverse implications for the neighboring Pakistan who benefited from the program. In another similar case, Brazil

challenged the EU export subsidy on sugar that had benefited the African, Caribbean and Pacific (ACP) countries through guaranteed access to the highly protected EU market.

Finally, we note that although nearly all developing countries have moved away from anti-trade policies of the 1950s and 1960s, there are vast differences among them in their trade interests and in their approaches towards trade policy. At one extreme, we have the least developed countries (LDCs) that still insist on, and enjoy, overwhelming one-way trade preferences without offering reciprocal liberalization. They have tariff-free access to the internal EU market under “everything but arms” (EBA) initiative. Developing countries in Sub-Saharan Africa, vast majority of them also LDCs, enjoy significant one-way preferences in the United States market under the Africa Growth and Opportunity Act (AGOA). At the other extreme, larger developing countries such as China, Brazil, India and Indonesia have become vocal demanders of concessions in the negotiations. Cairns Group developing countries including Brazil, Argentina, Indonesia and Colombia played an important role in bringing agriculture into the negotiations even under the Uruguay Round.

This emergence of developing countries as significant players in the world trade system and the heterogeneity of interests among them has had its own impact on the multilateral process, as we will discuss in greater detail in Section V.

#### **IV. Preferential Agreements Proliferate Derailing Multilateralism**

A cornerstone of the World Trade Organization (WTO) is the principle of non-discrimination: member countries may not discriminate against goods entering their borders based upon the country of origin. However, in an important exception to its own central prescript, the WTO, through Article XXIV of GATT and Article V of the General Agreement on Trade in Services, does permit countries to enter into

preferential trade agreements (PTAs) in the form of Free Trade Areas (FTAs) and Customs Unions (CUs) with one another. Additional derogation of the principle of non-discrimination is included in the Enabling Clause, which allows one-way tariff preferences to be granted by developed to developing countries and permits preferential trade agreements among developing countries that are not subject to the disciplines imposed by the GATT Article XXIV.

Such preferential agreements are now in vogue, with hundreds of them having been negotiated during the last two decades and with every member country belonging to several of them. Nevertheless, ever since PTAs began gathering momentum, it has been argued, that they were an unfortunate development and posed a threat to multilateral liberalization.<sup>5</sup> The proponents of bilateral agreements have argued that PTAs would complement rather than supplant multilateral liberalization and that bilateral approaches may yield faster liberalization than what can be achieved through multilateral negotiation. They also defend then a “WTO Plus” approach to trade liberalization.

The actual record on trade liberalization undertaken through bilateral negotiations suggests a different picture, however, and the analysis provided by the recent World Trade Report (WTR) 2011 is instructive in this regard. The WTR reports that there has been a significant increase in the value of trade taking place between PTA members. In 1990, trade between PTA partners (excluding intra-EU trade) made up around 18 percent of world trade and that this figure rose to 35 percent by 2008. When the intra-EU trade is included, intra-PTA trade is placed at 28 percent in 1990 and 50 percent in 2008. In dollar terms, the value of intra-PTA trade, excluding intra-EU trade, rose from 537 billion USD in 1990 to 4 trillion USD by 2008 and from 966 billion to nearly 8 trillion once the intra-EU trade is included.

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<sup>5</sup> Bhagwati (1993) provided the earliest systematic critique of the PTAs in the context of the second wave of these arrangements. Subsequent contributions in this spirit include Bhagwati and Panagariya (1996), Panagariya (1996, 1999) and Krishna (2013). Panagariya (2000) provides an accessible survey of the theory of preferential trading.

Looked this way, a large share of world trade is now taking place between PTA members. However, as the WTR points out, these statistics vastly overstate the role of preferential trade liberalization. This is because much of the trade between PTA members is in goods on which they impose MFN tariffs of zero in the first place. And goods which are subject to high MFN tariffs are also often subject to exemptions from liberalization under PTAs, so that the volume of trade that benefits from preferences is, on average, quite low.

Specifically, WTR calculations indicate that despite the recent explosion in PTAs, only about 16 percent of world trade takes place on a preferential basis when we exclude intra-EU trade and 30 percent when we include it. Furthermore, less than 2 percent of trade (4 percent when the intra-EU trade is included) takes place in goods that receive a tariff preference greater than 10 percent. For instance, well over 50 percent of Korean imports enter with zero MFN tariffs applied to them. Korea offers preferences to about 10 percent of its imports, but a preference margin greater than 10 percent on virtually none of its imports. Similarly, in India, goods entering under preference are about five percent of overall imports with over 50 percent of imports entering under zero MFN tariffs and virtually no imports receiving a preference of greater than 10 percent. A similar picture emerges on the exporting side. One country that has actively negotiated PTAs is Chile. Currently, 95 percent of Chilean exports go to countries with which it has PTAs. However, only 27 percent of Chilean exports are eligible for preferential treatment and only 3 percent of its exports benefit from preference margins greater than 10 percent. For most PTAs, the majority of their trade takes place under zero MFN tariffs. It is only a small fraction of trade that enters on a preferential basis, especially outside of the EU and NAFTA.<sup>6</sup>

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<sup>6</sup> Ironically, it is conceivable that the difficulty with complying with the rules of origin (ROO) within preferential agreements is large enough, especially for small and medium sized enterprises, to explain, at least partially, the low take up of PTA preferences by firms. See the World Trade Report, 2011, for a detailed discussion.

Importantly, it is also now clear that PTAs have become a stumbling block to multilateral liberalization. Export interests, especially in the developed countries, have learned that they get better deals through PTAs since they gain an upper hand over non-members within the union. Therefore, they prefer bilateral rather than multilateral route to liberalization. This is also often true of firms with multinational investments. For instance, it is argued that the multilateral process in the US has also suffered because large U.S. firms have increasingly turned multinational, with investments in multiple foreign countries, thus cutting their incentive to seek, through the US Trade Representative (USTR), liberalization in those countries, which would open them up to competition in these foreign markets from firms in the rest of the world. Symmetrically, their own credibility with the USTR has suffered since the USTR does not see them as necessarily pushing the purely US interests. This has worked to weaken a major lobby within the US that favored multilateral liberalization. At the same time, this has been less of an impediment to preferential liberalization, as this only extends to firms in the home country and, further, specific sectors may be chosen for liberalization and some others excluded.

That PTAs may impede multilateral liberalization is even truer in the context of developed country lobbies pushing non-trade agenda items consisting of intellectual property rights and labor standards. Large developing countries such as India, China and Brazil are strictly opposed to further proliferation of non-trade issues in the WTO. That naturally diverts the lobbies to PTAs where they face much weaker developing country partners and have a relatively free play. The United States in particular is playing the game almost entirely as Bhagwati (1994) had predicted: a hegemonic power is likely to gain a greater payoff by bargaining *sequentially* with a group of non-hegemonic powers rather than *simultaneously*.

Avoiding multilateral negotiations also allows countries to maintain distortions in agriculture. As an example, absent their consideration in multilateral negotiations, the United States cotton subsidies can continue indefinitely. Buyers of cotton such

as Bangladesh use cotton in apparel that they export and profit from the lower prices that subsidies imply. At the same time, other cotton exporters such as the small West African countries and India cannot challenge the subsidies in the WTO.

Finally, we should discuss here the link between forums for trade negotiation and the evolving phenomena of production fragmentation and trade. Production fragmentation refers to a context in which various components of a good are produced in multiple countries and possibly traverse national borders many times before being ultimately assembled into a final form that is sold to the consumer.<sup>7</sup> It has begun to be argued that the fragmentation of global production provides a new basis for countries to achieve preferential integration regionally and at a “deeper” level. While this argument is gaining currency in some quarters, it would seem that production fragmentation should provide greater incentives instead for broader multilateral liberalization.<sup>8</sup> After all, the most efficient producers of any given intermediate good need not lie within the jurisdictional boundaries of any specific preferential agreement and the identity and location of the efficient producers of intermediates may be expected to vary faster than any country's ability to sign new preferential agreements. Furthermore, with increased fragmentation, the identification of the origin of goods, so that preferences may be suitably granted, is itself a major challenge. As a practical matter, if PTAs were designed to support fragmented production networks, we might expect to see greater geographic concentration of trade over time as many production networks are regional in nature. As the WTR 2011 notes, however, the share of intra-regional trade in Europe has remained roughly constant at around 73 percent between 1990 and 2009. While

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<sup>7</sup> The fragmentation of trade and its increased relevance over time has been well documented in the economics literature. For instance, Varian (2007) points out that the popular music player, the Ipod, is made out of well over 400 parts that originate in a number of different countries and are finally assembled in China.

<sup>8</sup> Indeed, at a more basic level, the various theoretical aspects of production networks, such as trade in intermediates, foreign investment and multinational production and so on are old issues in the literature and do not interfere with the basic welfare propositions concerning the dominance of multilateral free trade over other policy alternatives.

Asia's intra-regional trade seems to have risen from 42 to 52 percent during the same period, North America's intra-regional trade shares rose from 41 percent in 1990 to 56 percent in 2000 and fell back to 48 percent in 2009.<sup>9</sup> Thus, it cannot be argued that preferential agreements have been designed to support or benefit from fragmented production networks. More importantly, the multiple crossings of borders by a single good before it takes its final form, only makes the WTO more relevant – since, in this case, knocking down tariffs multilaterally, or otherwise facilitating trade (as negotiated recently at the multilateral level in Bali), has even greater value.

## **V. Whither Trade Negotiations: Doha, TPP and TIPP**

Any consideration of the global trading system is incomplete without a discussion of the major ongoing negotiations. Three such negotiations are of particular importance in view of their coverage in terms of countries or the volume of trade or both. These include the multilateral Doha Round and the two major preferential initiatives by the United States, the TPP and the TTIP.

### *V.1. The Doha Round*

The multilateral, Doha Development Round, sometimes called the Doha Development Agenda, because of its putative focus on the improvement of the trading prospects for developing countries, was launched in 2001. The Doha ministerial declaration gave this round its mandate to negotiate liberalization on agriculture, services and intellectual property rights. To date, despite several attempts to advance the negotiations, this round has not been successfully closed,

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<sup>9</sup> The principal factor driving the rise in intra-regional trade in Asia is the liberalization and faster growth in the countries within this region. This fact also explains in large part the decline in the intra-regional trade in North America during the 2000s despite the North American Free Trade Agreement, which has worked to divert trade toward regional partners.



although a preliminary agreement on less contentious issues such as trade facilitation and removal of trade barriers against exports from the least developed countries was at last achieved at the latest December 2013 WTO ministerial meetings in Bali. Until this admittedly minor breakthrough, many observers had concluded that the round had reached an impasse, with some going so far as to suggest that it should now be officially killed.

A key question is why the Doha negotiations have stalled. Several explanations that together account for the situation as it currently stands may be advanced. Because the Doha discussions have lasted well over a decade, with the changing domestic and global economic environment and changing negotiating details, individual countries' reasons have varied over time. Below, we discuss the key reasons for the impasse.

First, having been labeled the "development round", the expectations of the developing countries for the round were at least partly based on the idea that the previous round of negotiations (the Uruguay Round) had effectively damaged them and the new round would be about treating those injuries. This impression was greatly reinforced by repeated subsequent assertions by the heads of international institutions, press, NGOs and many influential academics to the effect that agricultural protection is largely a developed country problem; developed-country subsidies and protection hurt the poorest developing countries the most; it is wrong to ask the poor countries to liberalize when rich countries heavily protect their own markets; and agricultural subsidies and protection in the rich countries reflect double standard and hypocrisy on the part of the rich countries. The effect of these assertions was to considerably harden the stance of the developing countries and to give them the false hope that they deserved one-way concessions from the developed countries, especially in agriculture.

Second, on agricultural policies, the negotiating agenda was initially driven by many agricultural exporting developing countries that expected to benefit from improved

access as well as increased prices resulting from reductions in developed country domestic and export subsidies. These countries, joined by many influential NGOs and international organizations, additionally convinced the other developing countries, the vast majority of them net agricultural importers, that the developed country subsidies hurt their farmers by driving down prices. But the food-price crisis of 2007-2008, which saw shortages of many agricultural commodities drive food prices sharply up, led these latter countries to re-evaluate their positions. Indeed many developing countries are now more interested in keeping food prices in check than in eliminating developed country subsidies. Equally, some countries have been fearful of the contrary outcome whereby imports might push agricultural prices too far down. For instance, in 2008, there was insoluble disagreement between India and China on the one hand and the United States on the other over the special safeguard mechanism (SSM), a measure ostensibly designed to protect poor farmers by allowing countries to impose a special tariff on certain agricultural goods in the event of an import surge. Thus, countries have shown a degree of ambivalence towards rationalization of the agricultural policy and perhaps see this as less of a priority than they did in the past.

Further, even without agreement at Doha, agricultural export subsidies have nearly disappeared and actionable domestic agricultural subsidies have come down considerably in both the European Union and United States due to high agricultural prices. As of February 2011, export subsidies in the EU continued to be available for cereals, beef and veal, poultry meat, pig meat, eggs, sugar, and some processed goods but they had not been used on cereals since July 2006 or on sugar since October 2008.

In the United States, actionable domestic subsidies have similarly declined. As a result of successive reforms, support for beef, olive oil, and fruits and vegetables, as measured by the current total AMS (Aggregate Measure of Support), has either declined sharply or ceased altogether. Support for cereals, dairy, and sugar remains more significant but the overall support has seen considerable decline. Between

2000-01 and 2007-08, Amber Box subsidies (which are recommended to be reduced) in the EU had dropped to 12.4 billion euros. Similarly, in the United States, the total support in 2007 fell to USD 84.65 billion, of which USD 76.2 billion was under the Green Box (permitted subsidies). The AMS was down to USD 6.3 billion.

Third, as we have previously discussed, the heft of emerging economies has increased dramatically in recent years. A much greater fraction of the addition to world GDP came from developing countries in the last decade than it did in the preceding decade. So rich countries are much more concerned about access to emerging markets than they were when the goals for the Doha round were first set. Indeed, the United States sees the Doha talks as an important opportunity to get fast-growing emerging economies to reduce their duties on imports of manufactures, which have been reduced in previous rounds but remain higher than those in developed countries.

Finally, markets in industrial goods and services in the developing countries have also undergone significant liberalization in the 2000s. This is particularly true of two major countries: China and India. As a part of the conditions for its 2001 entry into the WTO, China undertook major obligations to liberalize. It not only undertook this liberalization de facto but also bound it at the WTO giving it international legal force. India continued to bring its tariffs down and open services sectors to direct foreign investment until at least 2007-08 as a part of its national liberalization. As a result, outside of agriculture, which remains highly protected, it has a very open trade regime with the trade in goods and services as a proportion of the GDP rising to above 50 percent. These developments have perhaps left some of the major developing country players more or less satisfied in terms of market access while lacking the appetite for further opening of their own markets that would be necessary to bring the Doha round to a conclusion.

We conclude this section with a discussion of the current status of the Doha negotiations. At the last ministerial meeting at Bali, Indonesia in December 2003,

the member countries had concluded a limited agreement consisting of a multilateral agreement on trade facilitation, an agreement for the reduction of lowering barriers to exports from LDCs and a four-year peace clause shielding public stockholding programs for food security in developing countries with the promise to find a permanent solution to the problem before the expiry of this peace clause. This agreement was to be ratified in July 2014 but as luck would have it India, which had insisted on the peace clause shielding public stockpiling for food security, had a change of government in May 2014. The new government that came to power took the view that the peace clause was not good enough and the permanent solution to the public stockpiling for food security must be reached simultaneously with the signing of the remainder of the agreement.

There has been near universal condemnation of the new Indian government for going back on the word of the previous government. One of us (Panagariya 2014) has taken exception to this and we find it worthwhile to explain why. Like many other countries, India has maintained a public distribution system (PDS) under which it procures wheat and rice from farmers at a Minimum Support Price (MSP). In the negotiations for the Uruguay Round Agreement on Agriculture (URAA), the developed countries had wanted to bind their subsidies at the highest possible level. Therefore, in URAA, it was stipulated that in the case of support prices, per-unit subsidy would be measured as the difference between the latter and the average price of the product during 1986-88, years during which agricultural prices had been historically the lowest. This rule still applies so that Indian subsidy on wheat and rice must be measured as the difference between the MSP and the average prices of these products during 1986-88.

This approach to measuring subsidy defies all economic logic. As it happens, the MSP for in 2010-11 in India was just 6 percent for rice when measure against the relevant market price and negative one percent for wheat. But when measured against the 1986-88 average, it rises well above the 10 percent de minimis level permitted under India's WTO obligations. An entirely sensible reform of the

calculation method of the subsidy can effectively resolve the current dispute. And there is no reason why this reform cannot be done simultaneously with the signing of the trade facilitation agreement.

## *V.2. The Trans Pacific Partnership (TPP)*

The TPP is a trade agreement currently under negotiation among 11 additional countries: Australia, Brunei, Chile, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. The TPP is sometimes seen as a competing proposal to the Regional Comprehensive Economic Partnership (RCEP), the agreement championed by China and now being discussed by ASEAN's ten member states along with Australia, China, Japan, India, South Korea, and New Zealand. From the perspective of the United States, which has led the TPP negotiations, the agreement promises to provide a link to the dynamic economies of the Asia-Pacific and insures against its exclusion from the RCEP.

While the agreement covers many standard items such as the liberalization of trade in goods and services, several of its provisions have been criticized for being excessively restrictive. For instance, the provisions relating to intellectual property protection -- the enforcements of patent and copyrights -- provide restraints well beyond not just the WTO TRIPS Agreement but also those in previous bilateral trade agreements negotiated by the United States. In particular, concerns have been expressed that the TPP focuses on protecting intellectual property to the detriment of efforts to provide access to affordable medicine in the developing world thus going against the foreign policy goals of the Obama administration.

In addition, there have been strong domestic pressures within the United States, seeking the inclusion of a "labor chapter" that, for instance, insures that workers in

any TPP country, have the ability to unionize and engage in collective wage bargaining. This may be seen as hypocritical since the United States itself has an astonishingly small proportion of its labor force unionized today. And unlike in European Union, workers do not sit on management boards in the United States.

The TTP is widely discussed and considered as a prelude to far broader economic integration, encompassing much of the Asia-Pacific. Proponents argue that it could establish an “open regionalism” framework for other countries to sign on, without being subject to the exhausting negotiations required for bilateral agreements. Specifically, countries could simply elect to join the TPP, via what has been described as a “docking” arrangement. It has been suggested that the TPP could be the *last* trade agreement the U.S. negotiates and that from now on, other countries could simply elect to join the Trans-Pacific Partnership. However, as Bhagwati (2014) had noted, if accepting the TPPs demands on non-trade issues, such as intellectual property protection and labor standards, remains the precondition for joining TPP, it may just be that the result is a fragmentation of Asia into “TPP, China and India.”

### *V.3. Transatlantic Trade and Investment Partnership (TTIP)*

The TTIP is a trade agreement that is presently being negotiated between the European Union and the United States. Announced with an ambitious timetable for completion (end 2014), it is already clear that the agreement is highly unlikely to be achieved due to the current economic circumstances as well as the long standing differences between the United States and the European Union on a number of issues that would be key to successful negotiation of a trade agreement between these two parties.

It is clear that economic circumstances in a number of EU countries remain dire. The

Eurozone has not yet recovered from the banking and financial crisis of recent years. Unemployment stands at around 12 percent overall and is significantly higher in the hardest hit countries such as Greece (where the unemployment rate stands at nearly thirty percent with youth unemployment numbers being higher still at nearly sixty five percent). Under these circumstances, it seems highly unlikely that an ambitious trade program with potentially major distributional consequences will find support among the 27 different EU states.

Moreover, while tariff barriers between the US and the EU are already quite low, the negotiations are likely to be plagued by differences between the two on a number of economic and regulatory matters. Decades long differences of perspective and priorities exist in areas such as agricultural subsidy and protection, health and safety, cultural diversity and protection, competition policy, services regulation, genetically modified foods and environmental regulations. It is extremely unlikely that the persistent differences in viewpoints, supported by popular sentiment, entrenched interest groups and domestic regulators, will be ironed out, despite the priority evidently given to the proposed agreement by the top political leadership. Indeed, powerful political actors on both sides have already taken tough negotiating positions, insisting on their favored regulatory templates, such as on GM foods and environmental standards, while insisting that any attempts to pursue an agreement with more limited goals would be doomed to failure.

## **VI. Rule-Making and Dispute Settlement: Bilateral vs. Multilateral Settings**

Doha round negotiations cover a variety of issues and sectors such as agriculture, services, investment and intellectual property, which are now being comprehensively negotiated within the realm of the World Trade Organization (WTO). In addition to market access discussions, much needs to be done in all of these and other areas in terms of rule making. For instance, rules governing trade in services require negotiation over a number of complex issues in areas such as

competition policy, domestic regulation and government procurement.

While rule making in the past has largely been done during multilateral negotiation rounds, it is unclear how this will evolve in the future. As Bhagwati (2013) has noted, the question before the system is whether the weakening of the multilateral trade process and the popularity of bilateral processes might damage the rule-making function of the WTO and result in bilateral-agreement-specific rules that exist in an uncomfortable dis-harmony and possible legal indeterminacy with rules made in the context of negotiations in other bilateral agreements.

The problem is an especially acute one for developing countries: On the one hand, the regulatory intensity of services trade and the complexity of the consultative processes at both the domestic and international level and the informational deficit on institutional best practices and commercial interests of individual countries has implied a level of cautiousness and defensiveness in their approach to rule making in the multilateral forums. While progress on these matters has been admittedly slow at the multilateral level, the current drive for bilateral agreements implies the worrisome possibility that the developing country markets will be harvested individually by dominant trading partners who set the rules to reflect their own interests.

A similar issue arises in the context of the dispute settlement mechanism. DSM would also weaken if the WTO is seen to be weakened or merely optional and disputes are resolved in other bilateral and regional forums instead. Many of the preferential agreements that have been negotiated since the WTO came into existence cover areas that are already the subject of obligations under WTO agreements (for instance on intellectual property, services, government procurement and technical barriers to trade). These PTAs typically contain details on dispute settlement that establishes committees and detailed procedures for handling disputes between the parties to the agreement and this is potentially problematic, as these procedures and committees need not coincide with those at



the WTO. For instance, as Drahos (2005) has noted, one of the distinctive features of the PTAs that the US has signed is that the dispute settlement chapters contain “choice-of-forum” provisions that give the complaining state “choice of forum” in those cases where “the state complained against has breached an obligation under more than one trade agreement and both states are parties to the relevant trade agreements.” The ability of a dominant state to choose its legal “battleground” clearly has implications for weaker states. This is especially true if the stronger state were to choose to a setting other than that of WTO DSB to settle the case. As Drahos concludes, “weaker states are probably making themselves worse off by agreeing to such provisions.”

Finally, we note that failure of Doha will effectively lead the Dispute Settlement Body (DSB) itself to write the rules rather than to just interpret them. When the legislature (WTO Ministers) fail to clarify the rules and the cases come to the DSB, judgments would be delivered under ambiguity of the extant rules. Once these judgments are given, however, new rules are effectively created through precedence. Thus, it remains essential that multilateral negotiations succeed in the rule making.<sup>10</sup>

## **VII. Concluding Remarks**

In this paper, we have offered an overview of trends in the trading system. We began by noting that the global trading system remains open and world trade has seen healthy growth since the inception of the WTO. Remarkably, the Lehman crisis did not do any lasting damage to the institution and the global trade recovered remarkably rapidly after a brief setback. This being said, there remains a threat to the WTO as long as the Doha Round is not satisfactorily closed. Despite the recent success in Bali and the innovations that have been suggested to move the

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<sup>10</sup> As an example, experts are sharply divided on whether the current WTO rules allow a carbon tax on imports. Under these circumstances, if a country such as the United States were to introduce a carbon tax on imports and it were challenged in the WTO, the DSB will have to take a view on the matter even though the existing rules do not provide clear guidance one or the other way.

negotiations forward, such as “mini-ministerial” meetings, failure to achieve the main goals of the Doha round remains a distinct possibility. This would leave PTAs as the only game in town, which would undermine not only the trade liberalization function of the WTO, but also its rule-making role. In this context, the United States’ near singular focus on the two major PTAs—TPP and TIPP—recently is worrisome. If these arrangements become reality, they would greatly diminish the interest of the United States in the WTO, a fact that would relegate the institution to a secondary role. As it stands, the prospects for a successful negotiation of the TIPP look dim and the successful closure of even the TPP faces numerous uphill tasks. We shall see.

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