World Trade And The Doha Round

Final Report of the High-Level Trade Experts Group

HIGH LEVEL TRADE EXPERTS GROUP

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Note: This report includes a wide range of views from panel members and not all necessarily agree with each and every statement. But the group is unanimous on the urgent need to conclude the Doha Round.

Executive Summary

1. This report was conceived four months ago as a mild corrective. It is being published as an urgent warning. Over the last month the most important moving piece of the global trade agenda, the World Trade Organization (WTO) Doha Round of multilateral trade talks launched in 2001 has moved from lasting progress to imminent and permanent failure. Against a crowded and volatile international backdrop this might seem a prosaic and peripheral crisis. The message of this report is that it is not.

2. This report traces the imminent failure of the Doha Round back to a deficit of political leadership. It is a failure at the level of national governments to engage with a multilateral process that ranks alongside the emerging climate change negotiations and the global reform agenda for financial markets after the banking crisis in its capacity to shape the global economy for the better. It is a failure above all of national leaders, who are ultimately the only players who can provide the legitimacy and room for maneuver that is required to close a negotiation at a level of ambition that will require compromise from all.

3. This argument about political leadership runs through this overview of the global trading system and its future. This is not an insider's analysis of the institutional tinkering that would make the WTO a more effective institution – these are vital arguments, and inevitably linked to its wider role, but they have been made well by others. Nor does it set out to restate the academic analysis of the case for free trade – again, this is widely available, not least in the work of members of this group. This is a report for the political leaders who must own and nurture the global trading system.

4. The fundamental role of the WTO, and of the GATT before it, has been to provide a legal and diplomatic framework in which the principles of open trade could be established and liberalization can be agreed, managed and enforced. In this it has been notably successful. As an institution and as a defender of the idea of open trade the WTO played an important role in ensuring that the banking crisis did not lead to a resurgence of protectionism of the kind that helped create the economic disaster of the 1930s.

5. Yet, the WTO remains vulnerable. Successive G20 Summits have repeated conventional mantras about the value of the open trading system and the need to bring the Doha negotiation to a successful conclusion. The follow through from these statements has been incomplete or non-existent. Politicians have talked up the value of multilateral trade while focusing their political energy on bilateral agreements. This report implicitly assesses the costs of that.

6. We have chosen to put the Doha Round and its success or failure at the centre of that analysis because we believe that it is emblematic of this wider failure. Doha captures many of the basic political problems the wider multilateral trading system faces: a changing political economy among the largest and most influential members, driven above all by the rise of the growing economies of Asia and Latin America; a political tension between the multilateral agenda and regional and bilateral trade agreements; and above all, a deficit in political leadership at the level of the states that actually make up the WTO and who must ultimately be the engine of its forward movement.

7. For political leaders to commit time and resources to a body like the WTO, they need to understand why it matters. This report is an attempt to set that case out as compellingly – and economically – as possible.

Chapter 1: Nineteenth century arguments for a 21st century trade agenda

8. Chapter 1 is a call to widen the political foundations on which the case for open trade is made. Defenders of open trade are often caricatured as pursuing free trade for its own sake. The case made here is that open trade must be a policy instrument, not an objective in itself. Open trade matters only to the extent that it can help us deliver political, economic and moral outcomes.

The political case for open trade is not just economic but moral

9. The case for open trade is usually made on economic grounds. At its core open trade creates an imperative to innovate. Exposed to Japanese car manufacturers competition, Detroit car makers recognized that their system of vertical integration was less efficient than a competitive supply chain model. European farmers respond to developing world agricultural imports by moving out of bulk commodities and into boutique and specialist farm goods and foods. India's car industry has been transformed by external competition to the extent that the worlds' smallest and cheapest car – the Tata Nano - is a world class Indian innovation.

10. Open trade encourages economies to allocate resources to where they can be most productively used. The relationship between open trade and economic growth is an empirical one, and has been widely demonstrated. For the four decades at the end of the last century, developing countries that grew at 3% or greater annual growth had commensurate increase in trade. By contrast, those that stagnated or declined also had atrophied links to the global economy. In OECD countries, a 10% increase in trade exposure has been linked to 4% increase in labor productivity.

11. But an equally important case for open trade can and should be made on moral grounds. Indeed before the twentieth century the conventional case for trade was a moral one: that it promoted economic integration and therefore peace, and that the efficient allocation of resources that it encourages pushes down prices for clothes, food and consumer goods. The argument that open trade damages the interest of workers in

developed countries too often misses completely the fact that it has rendered the goods they buy cheaper, more diverse and in many cases more sophisticated than at any previous point in human history.

12. Open trade has also played a key role in the economic growth that has lifted hundreds of millions of people out of poverty in developing countries since the Second World War. That this is a morally desirable outcome is hard to argue against. For the community of nations, it has also been the most effective peace-keeping policy tool for the last 60 years. This report encourages today's politicians to look back to the political case for open trade that dominated the late 19th century, which placed the moral case at the heart of its political arguments.

Chapter 2: The trade agenda

13. Chapter 2 of this report focuses on the substance of the international trade agenda. A number of key arguments dominate this chapter.

Keeping protectionism at bay

14. Between the end of 2008 and mid 2009, the imports and exports of almost every nation fell by double digits and most of the world slipped into recession. Fortunately, the outbreak of protectionism did not follow nor triggered the trade collapse during the crisis. One lesson of the crisis is indeed that WTO disciplines, bilateral agreements and self-restraint have been reasonably successful in avoiding a repeat of the dire scenario of the 1930s.

15. However, in practice, G20 countries, like others, have not been perfect: when disciplines were loose, they have in many instances succumbed to domestic pressures for short term political gains. Their commitment to avoid protectionism and the monitoring of it by the WTO and other organizations have however greatly helped limit the spread of new protectionist measures by increasing transparency and peer pressure.

16. As fiscal stimuli are withdrawn, pressures for protection may increase in countries where unemployment stays high. Protection may then take more complex and more subtle forms, imperfectly covered by WTO disciplines. This illustrates the need for strengthening and updating the WTO rule-book, in particular by drawing on lessons of the crisis and recent developments.

17. One important lesson is that monitoring is not enough. The WTO should have more power to assess the possible detrimental impact of those new forms of protectionism when they arise, and to advise on the less-trade distorting ways to achieve legitimate domestic objectives.

Trade is changing; so are trade barriers

18. The nature of international trade has changed out of all recognition over the last fifty years. Fragmented models of production based on international supply chains mean that the bulk of modern trade is in intermediate goods, often traded between different arms of the same company. The barriers faced by these goods are in many cases more complex than the simple tariffs that were the focus of early trade rounds. This report focuses on the need for focus or fresh impetus in a number of areas including services, behind-the-border barriers to trade and the capacity of poor countries to take advantage of trade opportunities.

Trade in services is crucial for growth

19. Services barely registered with the original signatories of the GATT are now increasingly central to the global economy. Because of the role of the services sector in the productivity and efficiency of an economy, this is an area where the slow progress of openness to international trade is of particular concern. To maximize the benefits of open services trade, services liberalization needs to be combined with effective competition policy and effective regulation.

20. This report proposes the creation of a new Services Knowledge Platform that would bring together sectoral regulators, stakeholders and trade negotiators to create new momentum for services trade. This report identifies Mode 4 services trade which covers the temporary movement of persons between markets and which is critical for many developing countries as a key priority, although all modes of services trade should be liberalized in step.

Behind the border barriers

21. As tariff barriers have been progressively reduced over the last four decades, the focus has increasingly shifted to regulatory barriers that act as a check on external competition with domestic producers. These measures can range from customs procedures, through product authorization or export licensing requirements. In many cases the costs imposed by these mechanisms on importers are greater than import tariffs on the same goods. For many developing country exporters they can be all but impossible to meet.

22. This report argues that these regulations present a new challenge for trade policy. Unlike tariffs, which are rarely of any genuine long term utility as policy tool, regulation is an essential part of the fabric of any market. The perception that liberalization is inimical to effective regulation is, in fact, one of the most persistent arguments used against it by its critics.

23. Except where they blatantly discriminate against third country competition, the aim of trade policy cannot be simply to reduce or eliminate regulation. Rather it must be to pursue the greatest possible degree of harmonization or mutual recognition. This report advocates a sustained new

push for mutual recognition agreements, backed with capacity building assistance for developing countries.

Capacity to trade as a barrier to trade

24. The greatest barrier to trade for many developing countries, especially the poorest, is often their capacity to shift goods to market or absorb them effectively into their economy. No rules-based system of trade can be regarded as adequate without concerted action to remove some of these asymmetries, especially as trade rules begin to move into complex areas such as intellectual property.

25. This report advocates a range of measures to maintain the momentum behind the growing trend for focusing development aid on trade capacity and a review of the focus of existing flows, which are too focused on markets like India, Turkey, Vietnam and not nearly enough on the Least Developed Countries that really need it.

Chapter 3: Why failure must not be an option for the Doha Round

26. The Doha negotiation has reached a critical impasse. Only national leaders can prevent a failure that would be a huge setback for the world economy and global governance.

27. Chapter 3 contains this report's most urgent recommendations. In our interim report, which is included in its entirety here, this expert group set out the case for completing the Doha Round in 2011 and sketched out a basic deal that would make that possible. Our message was directed not at the negotiators at the WTO in Geneva; to a considerable extent they are already familiar with the parameters of the only really credible endgame that has emerged from talks over the last four years. It was directed at the political leaders who must now drive the final compromises required to complete the Round.

28. This report weighs the costs of a failure in the Doha Round and finds them to be unacceptably high. Ten years of negotiation has produced the most far-ranging and substantial package of trade liberalization ever put within reach. It would lock in and render irreversible the unilateral liberalization of the last decade, fundamentally reform global farm trade, and provide new market access in almost all the world's largest markets. It would put in place the conditions for a further decade of multilateral trade growth, much as the Uruguay Round did in 1994. Nothing like these gains could ever be achieved bilaterally in any other format.

29. Unfairly or not, Doha's failure would stand as the basic benchmark for the WTO's success or failure fifteen years after its creation. The collapse of the Doha round would inevitably accelerate the drive to bilateral preferential trade agreements that have done much to distract WTO members from the wider goal of a multilateral pact. As an institution, the

WTO and multilateralism in general can only emerge from the failure of Doha substantially weakened.

30. In January this group proposed the setting of a firm deadline of the end of 2011 to secure an agreement, and insisted that that deadline must bind WTO members at the level of Heads of State. We set out a basic framework for a final deal that would require additional concessions from all major WTO members and create the necessary balance of ambition between the different chapters of the negotiation. We stand by that analysis here. The progress of negotiations in Geneva since then has left the Doha process stalled and this reinforces the central plank of our interim analysis: the Doha Round will die without explicit political leadership. Negotiators do not have the authority or legitimacy to make the final political compromises that are now required.

Chapter 4: The future of the WTO

31. Chapter 4 focuses on the future of the WTO as an institution. These are difficult topics which require further study, and will need to be considered in the light of the progress we are able to make to overcome the current negotiation crisis. Nevertheless, we have included in the present report some preliminary thinking as we believe they make the case even stronger for finishing the Doha Round this year. Fifteen years after its creation the WTO stands as one of the most successful multilateral institutions ever created. Its membership is virtually universal, its character based firmly on consensus. It is a unique supplier of a unique public good: a system of rules for open trade that are generally accepted and respected. It has been a crucial enabling factor in the fastest and strongest economic growth in human history experienced over the last 60 years. In no other area have states ceded such a large element of their sovereignty – their freedom to block or distort trade – to an international collective agreement and governance structure. The WTO's future depends on ensuring that this precious authority is retained, and that it retains the full political support of its diverse membership.

The WTO's rulebook needs to be updated to ensure that its judicial function rests on a wide acceptance of its reach and authority

32. The WTO's Dispute Settlement Body has built up unique authority and a body of case law in resolving trade disputes and is one of the most effective innovations in international law. However its work is increasingly extending into areas where the WTO's consensually-agreed rule book is still ambiguous or silent. While any court of final appeal might sometimes be expected to be on the interpreting edge of law, this underlap between arbitration and the consensus on the rules has the potential to erode confidence in the WTO and its legitimacy. This is especially true because many of the contentious areas are closely related to sensitive areas of social and public policy such as environmental protection and public health.

33. This report advocates a more granular approach to updating the WTO's rulebook than the current once-a-decade trade round. This means

carving out a new deliberative capability for WTO members in the 'missing middle' between litigation and major negotiations in which rules can be deliberated and clarified. This is especially important in areas such as environmental protection and climate change where the failure of the WTO rulebook to reflect societal priorities could undermine its legitimacy. This implies greater resources for the WTO Secretariat and targeted help for weaker members to ensure full participation.

Preferential trade agreements are a distraction from the greater goal of a multilateral trade deal. Political leaders must take the blame for this

34. Over the last twenty years the political focus on the multilateral trading system and the GATT has increasingly shared the agenda with a dramatic proliferation of regional and bilateral preferential trade agreements. The exact degree to which these agreements create distortions within international trade flows, or damage the interests of countries left outside them is a contentious debate, but they are not cost free, as we demonstrate in the report.

35. What is beyond doubt is that these smaller preferential deals have affected the political economy of the WTO, sucking energy away from a wider multilateral agreement like the Doha Round. The political temptation to seek trade concessions bilaterally is easy to understand, but politicians who choose this over the harder but more fundamental exercise of negotiating a multilateral agreement are putting at risk the very principle and framework of multilateral non-discrimination, on which the future of the trading system ultimately rests.

36. Where these preferential agreements are already agreed there needs to be a concerted effort to multilateralize them as much as possible, and the WTO needs to use its developing transparency powers to subject new deals to the greatest possible scrutiny.

China, India and Brazil can break the WTO. But they cannot save it alone

37. The WTO will never fulfill its potential without genuine political ownership by the member states it represents. Negotiators are rightly frequently frustrated by the absence of political will to drive the final compromises required in a multilateral trade round. All members, including the large developing countries that are now required to make a new level of concessions to match the benefits they have extracted from liberalization by other members, need to play a more statesman-like role in strengthening the WTO. The economic weight of these rising powers is such that they have the clear capacity to make or break the WTO, much as the EU and the US have had for the last two decades.

38. The evidence from the Doha negotiation is that it will take time before the powerful developing economies like India, China and Brazil play a role that is fully commensurate with the benefits that they have extracted from

the openness of the global economy over the last two decades. However this is clearly not a situation that can persist indefinitely.

39. It must also be recognized that the fault does not lie solely with these big new WTO members. It is to be expected that they will make pragmatic judgments about the nature of their participation in the WTO system and they will be suspicious of demands placed on them by a system that has historically been dominated by the prerogatives of the US and the EU.

40. It falls to these last two players in particular to demonstrate their own willingness to engage and to recognize the challenges faced by the emerging economies. While the US in particular takes a skeptical line on the potential for multilateral trade liberalization and focuses on its bilateral arrangements, it is hard to find fault with others for their decision to take a back seat.

Conclusion: Wanted - Political leadership

41. Running through this report is a warning about political leadership. The greatest threat to the Doha Round, the WTO and the multilateral trading system is the failure of political leaders to understand why it matters for the growth and the governance of the 21st century economy and why it is worth fighting to defend. There has always been and probably will always be trade. A system of trade based on rules that bind the big as well as the small is a public good without historical precedent, and probably the most successful experiment in multilateralism ever undertaken.

42. The WTO and the multilateral trading system are not, have never been, and cannot be just about opening markets. It is about keeping the global economy open, and progressively widening the scope of that openness over time in a way that promotes development above and beyond all. That is a long game, subject to complex domestic politics. But the WTO is also about preserving the consensus around openness in a range of ways.

43. Part of the weakness of the confrontational format of a negotiation like the Doha Round is its intense focus on concessions, which makes all sides defensive rather than constructive. We need to see the WTO not just as a driver of liberalization, but as a consolidator of liberalization, a forum for efforts to move forward liberalization in sectors where there is evolving confidence and ambition and the guardian of a dynamic and respected rule book for international trade, especially where it touches on vital issues such as climate change, the protection of the environment, the role of the state in the economy and the protection of public health.

44. Like any institution with aspirations to longevity the WTO and the multilateral trading system need people invested in their future. In the case of the WTO that investment would ideally be wide across civil society and business, but fundamentally it needs the political backing of its member governments. This requires that political leaders understand why the WTO matters so much for the economic governance of the twenty first century

global economy and what it can achieve over the next decade and beyond, if it is infused with fresh energy and a new agenda. It is hard to conclude they do. It is necessary to insist that they now must.

45. This report focuses on the politicians. In particular it addresses a political failure to understand what the WTO is for, what it has achieved over the last fifteen years and during the global downturn

46. As we argue in this report, if Doha fails it would have not only a clear and direct impact on trade, but also on economic confidence, and more widely on stability and global governance. The report sketches out the collective set of actions needed to preserve this precious public good provided by the rule-based world trading system. Today, only US and China leaders can unlock the stalemate. Thereafter, all the leading players need to make an additional contribution. But most of what needs to be done is of relatively small size, involving limited political pain. The prize of this, as set out in this report, would go way beyond the most ambitious liberalization package ever negotiated. It would also mean a huge step forward for global governance, stability and the rule of law.

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Abbreviations

DSB	Dispute Settlement Body
EU	European Union
GATS	General Agreement on Trade in Services
GATT	General Agreement on Trade and Tariffs
GNP	Gross National Product
IMF	International Monetary Fund
ITC	International Trade Centre
LDCs	Least Developed Countries
MFN	Most Favored Nation
NGOs	Non Governmental Organizations
ODA	Official Development Assistance
OECD	Organization for Economic Co-operation and Development
PTA	Preferential Trade Agreement
TRIPS	Trade Related Aspects of Intellectual Property Rights
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
WTO	World Trade Organization

Contents

1 The Case for Free Trade

Political consensus on free trade

1.1 The case for free trade as a policy that advances economic prosperity is now widely appreciated. Free trade is accepted today by most policymakers worldwide, not as an article of faith or as a matter of ideology. Rather, its acceptance, indeed strong embrace, reflects both theoretical analysis and practical experience.

1.2 Witness the repeated declarations by the G-20 meetings in recent years, which are a testament to the importance of free trade, and the earlier pronouncements by G-7 leaders in the years prior to the completion of the Uruguay Round of multilateral trade negotiations in 1995. They declare support for both resisting protectionism, i.e. to avoid a "sliding backwards" on protectionism, and for the more ambitious policy of "moving forward", i.e. for further liberalization, especially by concluding the long-standing Doha Round of multilateral trade negotiations. For example, in London, the communiqué of the G-20 meeting in April 2009 included the statements:

"We will not repeat the historic mistake of protectionism of previous eras."

"We remain committed to reaching an ambitious and balanced conclusion to the Doha Development Round, which is urgently needed."

The moral case for free trade

1.3 The case for free trade is often made on economic grounds. It is important however to note that the conventional case for free trade during its years of triumph in 19th century Britain was on moral grounds. Free trade was held to promote justice, fairness and peace, and it was considered to be superior to protectionism and mercantilism on these grounds.

1.4 It is also worth recalling that US Secretary of State Cordell Hull was awarded the Nobel Peace Prize in 1945 for his tireless efforts on behalf of policies which included the strong advocacy of multilateral free trade. Multilateral free trade was seen by him as an antidote to the fragmentation of trade in the world economy and its descent into beggar-my-neighbor policies in the 1930s that promoted acrimony rather than harmony, confrontation rather than cooperation, conflict rather than conciliation. That argument holds today as it did then.

1.5 Besides, can one honestly argue against the experience of European economic integration which has contributed to putting behind Europe the centuries of warfare among its member countries? Moreover, the economic prosperity that free trade has brought in the postwar period has rescued several hundred million from extreme poverty in the developing

countries in the last quarter of a century when freer trade began to replace autarkic attitudes. If this is not a compelling reason to claim virtue, and indeed higher moral ground, for free trade, what is?

1.6 Clearly therefore our leaders too often abandon the higher moral ground to the critics of free trade who arrogate to themselves the greater virtue when their opposition to free trade ought to cloak them instead in a mantle of unwitting wickedness. Boldness of assertion of higher moral ground than that claimed by the critics of free trade is both justified and necessary as our leaders enter the public debate in defense of free trade.

The economic case for free trade: an engine of prosperity

1.7 The nexus between freer trade and economic prosperity is strong. It can be demonstrated in several ways. For instance, evidence shows that if one considers two groups of developing countries, the “miracle” countries that had 3% or greater annual growth rate of GDP per capita, and “debacle” countries that had zero or negative growth rates, trade has expanded commensurately for each of two periods: 1961-1980 and 1980-1999.

1.8 For a group of developed countries, the OECD has observed that an increase in 10% trade exposure has been associated with a 4% increase in output per working-age person. While association does not imply causality, and greater trade may be the result of higher growth rather than its cause, this is a possibility that has no general plausibility as familiarity with the intensive analysis of many of the countries underlines.

1.9 Besides, the higher trade growth rates generally reflect, not just dramatic fall in transport costs but also a steady postwar erosion of trade barriers during these periods, suggesting in turn a link between freer trade and prosperity.

1.10 The developing countries which turned outwards from the 1960s experienced phenomenal growth in incomes whereas the ones that turned inwards (most notably India and China) had abysmal growth rates; the latter caught up with impressive growth rates once they had abandoned autarkic attitudes and simultaneously embraced a range of market-oriented reforms.

1.11 Also, the history of the postwar period shows that the developed countries steadily liberalized trade to their advantage, with the interruptions in prosperity resulting from trade-unrelated factors such as the sevenfold rise in oil prices afflicting the 1970s and the Volcker-led deflation in the 1980s. In a similar manner, the popular argument that historical experience in the 19th century supports protectionism is flawed.

The economic case for trade: it also helps the poor

1.12 But the argument for free trade is stronger than that concerning overall prosperity. It also helps the poor.

1.13 In the major developing countries, particularly India and China, several hundred million have been lifted above the extreme-poverty line. While Indian critics have suggested that there is no link between trade and poverty reduction, recent analyses refute this forcefully. For China, there has been an attempt at arguing that the major poverty-reducing impact came from de-collectivization in the 1980s. But it would be absurd to conclude that the phenomenal growth in exports and therewith in the demand for labor has had negligible impact on China's successful assault on poverty. What is true, of course, is that exploiting access to world markets, as against the previous preference for autarky, has come alongside many other liberal reforms: a number of good policy changes have occurred together over the years since reforms began.

1.14 A symmetrical argument can be made that trade with the developing countries has benefited, not harmed, the developed countries' workers. Some argue that trade has been responsible for the stagnation in the unskilled workers' wages in the last quarter of a century. But this belief is strongly disputed by several economists who argue that the adverse impacts on workers' wages have resulted from causes such as labor-saving technical change and declining union membership, which can be explained in ways that have no relationship to increased integration into the world economy. On the contrary, trade has moderated these impacts, in particular by cheapening the goods that workers chiefly demand.

1.15 The evidence in favor of the latter narrative is strong, even though belief in the former is held with great conviction by certain influential labor unions and constrains politicians from embracing free trade policies with the enthusiasm that is required.

Misunderstandings regarding the case for free trade

1.16 Despite the compelling case for free trade, several misunderstandings undermine the pursuit of free trade. Chief among them are the following:

(a) Free trade in services is considered by some as not as important as free trade in manufactures. Services are increasingly tradable and have become a large fraction of world trade, as is exemplified by the addition of GATS (General Agreement on Trade in Services) to the GATT in 1995 when the WTO came into being as a tripod resting on three legs: GATT, GATS and TRIPS (on intellectual property). Unfortunately, thanks to the current financial crisis, there has been a resurrection of the "manufactures fetish", going back

to Adam Smith, which sees manufactures as productive and services as unproductive.

It needs to be emphasized that recent research in fact shows that the most technically innovative sector is retail services. There is no reason therefore to assume that services do not matter and that free trade in services should not be a shared objective.

(b) Free traders are often portrayed as pursuing free trade (and indeed other forms of openness to the world economy) for its own sake, i.e. that trade is an objective, not a policy instrument. This common caricature is surely wrong. No serious economist pursues free trade for its own sake; it is sought because it advances desirable political, moral and economic objectives.

(c) Free traders do not believe that all trade is good. For example, trade economists have argued since the 1940s, and with increasing sophistication, that Preferential Trade Agreements (PTAs) which include Free Trade Agreements among a subset of countries can divert trade from least-cost non-member countries to higher-cost partner countries, thus distorting trade and possibly creating harm rather than good.

1.17 Again, students of trade policy in developing countries have long understood that trade maximization can easily create social loss rather than gain. This is a lesson that needs to be learnt even in the developed countries which have recently embraced a goal of export maximization rather than openness in trade.

1.18 Free trade does not guarantee that the gains from trade will be large, only that they are non-negative (i.e. positive or negligible). Free trade is wrongly criticized in cases when the results are seen to be small. Thus, free trade provides the incentive to reallocate resources to activities that yield greater returns. But the resources may be specific to different sectors, or they (e.g. labor) may not be willing to move to other sectors, so that the reallocation leads to low returns.

1.19 Again, there may be institutional obstacles that offset the changed incentives resulting from free trade being implemented, preventing therefore significant gains from freeing trade. Thus, in India and Pakistan, there were licensing restrictions on investment which often prevented the ability to invest in more profitable sectors, so that freeing of trade led to little reallocation gains.

1.20 The offsetting factors that nullify the freeing of trade may also consist of domestic anti-competitive practices. The original provisions on State Trading were inserted into the GATT precisely because it was feared that the institution of state trading could be used to nullify the effects of trade liberalization.

1.21 Thus, freer trade will lead to gains from trade, but not necessarily. It is best regarded as an opportunity for gains, not as a guarantor of them. This observation can also be made from the related perspective of increased market access for the developing countries by using an analogy. When effective market access is offered, it is as if a door is being opened through

which these countries can enter. But if they do not have traction in their legs, they cannot.

1.22 "Aid for trade" programs where these countries are offered funds and technical assistance for developing the missing or inadequate institutional and physical infrastructure necessary to undertake increased trade are best seen as a way of giving these countries that traction. There is growing realization of this "supply side" constraint on effective trade performance rather than the "demand side" constraint resulting from lack of market access.

1.23 We also need to bear in mind the fact that an opening of the door, and the opportunity trade and profit, can itself provide the incentive for these countries to develop the traction, reinforcing their getting their act together to use the "aid for trade" programs to advantage, as many of them are doing now.

The case for multilateralism in trade

1.24 Multilateral (i.e. non-discriminatory, MFN-based) trade, as distinct from trade, requires additional justification. It also blends, in the present instance, into the case for concluding Doha (which is addressed more fully in Chapter 3).

1.25 Multilateralism can be examined in two ways: first, preferential trade arrangements (PTAs) such as Free Trade Areas, which are discriminatory (since they necessarily discriminate between members and non-members, the latter carrying more onerous trade restrictions when they access the markets of the members), can be evaluated by contrast to MFN-based trade; second, one may ask what is known now as a "time-path" question: are PTAs to be considered as a desirable way of liberalizing world trade if MFN-based liberalization, as at Doha, is blocked or sluggish?

1.26 As noted earlier, specific PTAs can create trade diversion. Where they do not also lead to offsetting trade creation, the net result can be welfare-reducing even for member countries. Discriminatory trade arrangements can also misallocate world resources by shifting production from non-member lower-cost suppliers to higher-cost member country suppliers.

1.27 This is the appropriate way to think about individual PTAs and their economic desirability. Since Article 24 of GATT, from the very inception of the GATT, provides exemption from the MFN rule, much analysis has been devoted to an analytical examination of the rules of qualification it provides, its working in practice, and how it may be modified in order to ensure that these rules reflect the analysis of the ideal rules which would ensure that Article 24, if enforced, would guarantee that the qualifying PTA was welfare-enhancing.

1.28 Largely because the rules laid down to qualify under Article 24 were ignored in practice, and also because the Enabling Clause allowed the developing countries to have purely intra-developing-country preferential trade arrangements without any rules whatsoever (under the theory that developing countries needed "policy space"), PTAs proliferated. This created a "systemic" problem where the number of PTAs became large and also has kept increasing, thereby making the world trading system far less MFN-based than was envisaged when GATT and Article 24 exception were drafted. The result, in turn, has been what has been called a "spaghetti bowl" phenomenon where discriminatory trade arrangements dominate, with preferential tariffs by source and differential rules of origin in different sectors and in different PTAs now the norm.

1.29 Also, whereas the PTAs are between the powerful countries like the US or entities like the EU, the PTAs with weaker nations typically involve agreements on tangential issues like labor standards or for what are euphemistically called WTO+ requirements on issues like intellectual property rights. Many developing countries and NGOs recognize this development and argue that PTAs threaten the world trading system by letting developed-country interest groups gain the upper hand in their lobbying-led demands in such one-on-one trade negotiations. In contrast, the multilateral system, overseen by the WTO, allows concerted response and allows such demands to be resisted in cases where they are simply designed to serve narrow interests but are characterized as being "trade-related" and hence argued to be in the general, cosmopolitan interest.

Standing still versus moving forward

1.30 Openness in trade is therefore a public good. In turn, good trade policy requires that we resist protectionism (what is called a standstill) and that we liberalize further (what is called trade liberalization). In the next Chapter, we discuss how protectionism can be resisted and what has been the experience of it, through the recent crisis. We next discuss the alternative ways in which trade can be liberalized and their respective merits, leading up in Chapter 3 to why the multilateral trade negotiations at Doha need our support and how they can be brought to a close after ten years of negotiations.

2 A SELECTION OF ISSUES FACING THE WORLD TRADING SYSTEM

Resisting protectionism

2.1. While the strong case for openness in trade provides ample justification for both resisting protectionism and moving forward with trade liberalization, the experience with the former objective has been marked by good news whereas that with the latter has been characterized by bad news.

2.2. The key test of the ability to resist protectionism today was provided by the current crisis. This crisis was deep because it was twofold: it affected Wall Street and Main Street — that is, both finance and the real economy. It was also accompanied by a sharp decline in trade. The reasons for this decline — manifested not only in absolute trade volumes but also in the decline of trade to national income (GNP) — involve factors other than protectionism, which has been held at bay in several ways.

2.3. Thus, consider that product components are increasingly outsourced to other parts of the world and then assembled in one place. Therefore, even if the value of the final product changes little, the trade in components needed to manufacture that product can rise substantially. So, one may expect that trade will rise disproportionately to national income as components are increasingly outsourced to foreign countries. If there has been a rising trend of such outsourcing, a reversal of incomes will lead to a reduction in trade to national income.

2.4. These factors are a function of how globalization has changed the structure of the world economy. But there are two additional trends that undermined trade volumes since the onset of the crisis. First, falling incomes (the Main Street side of the crisis) caused trade to decline as people generally buy fewer imports (and domestic goods) when incomes fall. Second, on Wall Street, the financial crisis meant that the working capital necessary to finance economic activity was unavailable. The sudden, severe and globally synchronized postponement of purchases, especially of durable consumer and investment goods (and their parts and components) triggered the collapse of international trade. Between the end of 2008 and mid 2009, the imports and exports of almost every nation trade fell by double digits and most of the world slipped into a recession – not anywhere deep as the Great Depression, but more sudden more globally synchronized.

2.5. Fortunately, the outbreak of protectionism was not at the heart of the trade collapse during the crisis. Rather, the three I’s — ideas, institutions,

and interests — combined to keep protectionism mostly in check. Consider each, in turn.

(a) Ideas: No policy-maker today believes that a recession should be addressed by raising trade barriers. A country can impose barriers to divert world demand to its own goods; however, other countries can do the same with their own tariffs. The result, then, would be to burden the world with trade barriers without addressing the real problem: the insufficiency of world demand. Thus, increasing world demand is now generally agreed to be the correct Keynesian answer.

(b) Institutions: Whereas trade barriers spread during the 1930s after the United States passed the Smoot-Hawley Tariff Act in 1930, the architects of the postwar world economy built roadblocks to stop such a freewheeling spread of tariff barriers in the General Agreement on Tariffs and Trade of 1947. Successive changes have strengthened these anti-protectionist disciplines.

(c) Interests: The world economy is more interdependent than ever before. In many firms, jobs and profits depend on foreign markets. Thus, when companies that compete with imports want protection, they will be countervailed by firms that fear retaliation.

2.6. But if, for these reasons, protectionism has been held at bay, it does not mean that one can be complacent. Indeed, behind an overall positive picture, a good deal of “murky” protectionism has happened. WTO disciplines only very imperfectly cover non-tariff and ‘behind the border’ protectionist measures. To some respect, countries have exploited these loopholes and resorted to indirect protectionist measures such as discriminatory public procurement policies (in US and China in particular), export restrictions (in Argentina and India for instance), and domestic support schemes (in Europe and the US in particular). Jointly with the OECD and UNCTAD, the WTO has well documented this trend in the successive monitoring reports to the G20. The G20 pledged at the June 2010 summit and later on in Seoul to remove these measures, though progress has been slow. Only 15% of crisis measures have so far been removed according to the joint monitoring report.

2.7. One lesson of the crisis is that WTO disciplines, bilateral agreements and self-restraint have been reasonably successful in avoiding a repeat of the dire scenario of the 1930s. However, in practice, G20 countries, like others, have not been perfect: when disciplines were loose, they have in many instances succumbed to domestic pressures for short term political gains. Their commitment to avoid protectionism and the monitoring of it by the WTO and other organizations such as Global Trade Alert have however helped limit the spread of new protectionist measures by making information easily available. By increasing transparency and peer pressure, this monitoring has been successful in helping to contain protectionism.

2.8. Now that global trade has recovered, it is important to encourage the lifting of the crisis-related protectionist measures. Experience demonstrates that the longer such measures are in place, the harder it is to repeal them. There is also a need to remain vigilant against the introduction

of new protectionist measures. As fiscal stimulus measures are withdrawn, we could easily see increased pressure for protection especially in countries where unemployment stays high. Protection would then risk taking more complex and more subtle forms, for instance by justifying trade restrictions on social or environmental grounds or through the use of 'monetary dumping. Domestic pressures are already strong in that direction and therefore, the world trading system needs to be strengthened to avoid new forms of protectionism.

2.9. Another important lesson is that monitoring is not enough. As requested by India and Brazil during the crisis, countries should give the WTO Secretariat more power to assess the possible detrimental impact of those new forms of protectionism when they arise. With the help of other relevant international institutions which have the appropriate expertise, the WTO Secretariat could advise on less trade-distorting ways to achieve domestic objectives. Some guidelines could be prepared by the WTO and form the basis of a voluntary set of new disciplines among the G20 members. This could encompass new voluntarily rules for the rescue of financial institutions or ailing companies in the context of an economic downturn, two areas where the lack of rules have translated into classic beggar-thy-neighbor policies during the crisis. If not kept at bay, these measures could have serious consequences for smaller and more vulnerable economies. They also bear the risk of an escalation in reciprocal and equally damaging measures for world trade.

The risk of currency wars

2.10. Popular arguments about currency misalignments and currency wars grossly overstate the effectiveness of using the exchange rate for the purpose of trade policy. Including exchange rate policies in the scope of the Doha Round would be of little use for solving trade conflicts while, at the same time, adding unnecessary complexity to the negotiations. Instead, this might be better left to the IMF. Since all WTO countries are members of the IMF, they have all signed a commitment not to abuse exchange rate policies for trade purposes. Membership of the IMF, therefore, offers ways to deal with international disagreements about exchange rate policies outside the WTO framework.

2.11. The link between trade policy and exchange rate policy seems obvious: changes in the exchange rate affect export prices and import prices and the level of trade between countries. This gives rise to an apparent complementarity between the two policies. In particular, an international agreement to cut tariffs and reduce non-tariff barriers might be undermined by a unilateral devaluation of the exchange rate. Furthermore, perceived exchange rate misalignments, i.e. large and persistent deviations of the exchange rate from the rate deemed consistent with current account balance, are often met with the threat of protective trade policies especially in the presence of large trade deficits, e.g. the famous "voluntary export restraints" the Reagan administration negotiated with Japanese car makers in the 1980s, when the Japanese yen seemed to be too weak against the dollar.

Recently, there has been concern that some countries might seek to start "currency wars" engaging in currency devaluations to gain trade advantages.

2.12. At a closer look, however, the link between trade policy and exchange rate policy is much less strong than it may appear at first. A first point is that exchange rates are very unwieldy as an instrument for trade policy. Exchange rate changes cannot differentiate between different markets for tradable goods. Therefore, they cannot be targeted specifically at those markets where governments wish to obtain most protection from foreign imports.

2.13. A second point is that firms will not automatically adjust their prices in foreign currency for changes in exchange rates. Especially if exchange rate changes are expected to be temporary, firms may well prefer to keep their prices in foreign currency constant, adjusting their margins instead.

2.14. A third point is that, while exchange rate devaluation may make export goods more competitive in foreign markets, it raises the prices of imported raw materials and intermediate goods as well as the cost of production as wages react to its effect on the general price level. Once these second-round effects have been taken into account, especially in countries whose exports have a high import content, it is not clear at all that devaluation will lead to trade advantages except, perhaps in the very short run. The faster the pass-through of exchange rate changes to the general price level and wages, the shorter-lived any trade advantages the resulting from them will be.

2.15. A fourth point is that, unless a central bank can isolate its domestic monetary policy from its exchange rate policy, an exchange rate devaluation will lead to an internal monetary expansion and an increase in inflation. Thus, the use of the exchange rate for trade policy purposes has important macroeconomic costs, whilst the inflation can quickly erode any gain in competitiveness gained from the devaluation. Avoiding such costs would require the ability to sterilize foreign exchange market interventions, i.e. to offset their effects on the domestic money supply via the use of counteracting open market or other monetary policy operations. Empirical research suggests that central banks cannot fully sterilize foreign exchange market interventions unless the government imposes sufficiently strong capital controls. Such controls, however, have adverse efficiency effects and, therefore, are not costless, either.

2.16. A fifth point is that currency misalignments are notoriously difficult to identify. Doing so requires a notion of what is an equilibrium exchange rate, i.e. a level of the exchange rate that would lead to a balanced current account. Empirical estimates of equilibrium exchange rates are plagued with a lack of precision and robustness, leaving policy makers with little more than vague guesses of where the equilibrium might be. They do not provide enough guidance for exchange rate policies in practice. Whether or not a currency misalignment prevails in any given situation is, therefore, extremely hard to tell. In any case, this assessment should be left to the IMF since it is

the only international institution with the capacity and the legitimacy to undertake such complex analysis.

2.17. A final point is that, in the presence of international capital mobility, the current account balance is determined by the gap between national savings and national investment. The exchange rate determines at what level of trade this gap occurs, but it is not the appropriate policy instrument to close the gap. Large and persistent current account imbalances require adjustments in national savings and investment rather than exchange rate changes.

How to progress services trade liberalization?

2.18. Barriers to services trade lead to inefficiencies in service sectors and to high costs of services. This affects firms' productivity and competitiveness, which depends largely on having access to low cost and high-quality services such as transportation, distribution, telecommunications and finance. In turn, productivity has a powerful influence on economic growth. It is therefore of utmost importance to increase the efficiency of service industries. Liberalization is a key means of achieving this.

2.19. During the last two decades there has been significant unilateral liberalization in services by different countries driven by the prospects of large welfare gains. Many countries have taken action to increase competition in services markets by liberalizing foreign investments and privatizing state-owned or controlled service providers.

2.20. In parallel, the multiplication of plurilateral trade agreements in recent years has not delivered a great deal of actual liberalization in services, with the exception of the European Union and a small number of agreements between high-income countries.

2.21. For their part, multilateral negotiations on services began during the Uruguay Round, which culminated in the signing of the GATS in 1995. Article XIX GATS required members to launch new negotiations on services no later than 2000, and periodically thereafter. Initial negotiations were launched in 2000, which later became part of the Doha Development Agenda.

2.22. Between 2000 and the end of 2005, WTO members pursued a bilateral approach to negotiations in services in the Doha Round, submitting requests to others and responding to requests with offers. But large asymmetries in interest across membership impeded progress. In 2006 WTO members launched an effort to complement the bilateral request offer process with a plurilateral or 'collective' approach. This involved subsets of the WTO membership seeking to agree to a common 'minimum' set of policy commitments for a given sector. But even with the new approach not much progress could be achieved until now.

2.23. Why was there so little progress to liberalize trade in services through the WTO in Doha, although potential gains from trade liberalization are considerably large? The most important reason for lack of interest in multilateral services negotiations is the concern on the part of developing countries about possible market failures. Since GATS is mainly concerned in the reduction of regulatory barriers to market access and discriminatory national treatment across all four modes of supply of services between the countries, there is no guarantee that liberalization of services through GATS will lead to welfare gains unless

- competition/contestability of markets is enhanced,
- effective regulation that will deal with market failures is insured, and
- equity objectives such as access to services for disadvantaged regions, communities or households are attained.

2.24. Hence, improved prudential and pro-competitive regulation will be necessary to deliver the full benefits of liberalization. Since these are challenging objectives, international efforts to achieve these goals should be enhanced. One mechanism that could help to achieve these objectives is the development of 'services knowledge platform' that would bring together sectoral regulators, trade officials and stakeholders to assess current policies and identify beneficial reforms. The platforms could be assisted by external assistance from development partners as part of multilateral technical assistance initiatives.[1]

2.25. In addition, it is emphasized that in case of injury arising from liberalization commitments undertaken by Members, a 'safety valve' should be provided through safeguards. But such an approach, although feasible in the cases of mode 1 (cross border supply) and mode 4 (presence of natural persons), does not work for mode 2 (consumption abroad) and mode 3 (commercial presence).

2.26. Furthermore, sectors such as maritime transport, audiovisuals and education are excluded from negotiations, and the more sectors are excluded from negotiations, fewer possibilities exist for possible trade-offs among Members.

2.27. The mode that is of great relevance to developing countries is mode 4 (the movement of persons). But almost all countries impose high barriers to mode 4. Research indicates that global gains would be over US$150 billion if industrial countries were to allow temporary access to foreign service providers equal to just three percent of their labor force, and that potential gains could be shared equally by the industrial and developing

1 B. Hoekman and Mattoo (2011) "Services Trade Liberalization and Regulatory Reform: Reinvigorating International Cooperation", Centre for Economic Policy Research Discussion Paper No. 8181.

countries.[2] However, it is unlikely that much can be achieved on mode 4 access to high income countries unless a package would be balanced from a mercantilist perspective.[3]

2.28. Finally, it should be noted that there is nothing in the GATS or WTO that encourages and assists countries in generating comprehensive information on applied policies in different service sectors.[4] Data on all applied policies, whether scheduled or not, could best be collected by the WTO. The WTO could make this information publicly available together with improved statistics on services which are essential for any meaningful policy discussion.

2.29. In a multilateral context, a package to be negotiated among a critical mass of major players on services could be developed. These countries should move to greatly increase their binding coverage and also pre-commit to liberalization by a certain date in the future. The signatories should then extend the benefits to non-participants. The package to be negotiated among these countries within the WTO could span the elements:

- A pledge not to impose any new restrictions, especially on cross border trade and investment, by inscribing binding language to this effect in the schedules of specific commitments in the GATS;

- Inscribing in each country's specific commitments to implement reforms by a certain date in the future to liberalize trade in services, especially on foreign investments and in the air and maritime transport sectors;

- Establishing a credible mechanism for regulatory assistance to support liberalization commitments by developing countries through a 'services knowledge platform';

- Agreement to expand the scope for temporary movement of services suppliers, conditional on a set of source country obligations and transparent criteria relating to host country economic conditions; and

- Mandating the WTO Secretariat to collect and report data on all applied policies by different service sectors for all the participating countries.

2 Winters, Walmsley, Wang and Grynberg (2003) "Liberalizing Temporary Movement of Natural Persons: An Agenda for the Development Round", World Economy, 26(8): 1137-61.

3 Mattoo (2005) "Services in a Development Round: Three Goals and Three Proposals", Journal of World Trade, 39, 1223-38.

4 Commitments and relevant domestic regulations could be usefully linked [Jara and Dominguez (2006) "Liberalization of Trade in Services and Trade Negotiations", Journal of World Trade, 40, 113-127].

How to tackle regulatory barriers to trade?

2.30. In successive multilateral trade negotiations the reduction of tariff barriers has been considered as a core task in improving market access to all countries. As tariff barriers are gradually reduced through multilateral and bilateral trade negotiations (and autonomous preferences for the poorest countries), other types of obstacles to trade are becoming relatively more important.

2.31. Chief among them are regulatory obstacles to trade which cover a wide variety of measures, from customs procedures at the border, to sanitary & phyto-sanitary measures, technical barriers to trade, export licensing requirements, and domestic rules and regulations that may adversely affect trade.

2.32. However, these measures are essential ingredients of functioning modern economies. They often perform important functions for societies and usually pursue legitimate public policy objectives. They can also, intentionally or unintentionally, lead to discrimination against foreign imports.

2.33. Some countries claim that regulatory obstacles constitute a greater barrier to their exports than tariffs. As a matter of fact economic studies confirm this position: estimated trade costs of regulatory obstacles are usually considerably higher than the corresponding import tariffs. Hence, considerably more attention should be paid to reducing this type of obstacles to trade.

2.34. But unlike tariffs, the overall objective to deal with regulatory obstacles and private voluntary standards cannot simply be to reduce or eliminate regulations. Their main aim is to protect human health and safety, defend animal and plant life, and preserve the environment. They usually increase the benefits that consumers derive from goods and services purchased.

2.35. There are essentially two ways to reduce or eliminate these unnecessary barriers to trade without jeopardizing legitimate goals they pursue: international harmonization of regulations and mutual recognition. Aligning domestic regulations with international standards whenever available is a promising way of making progress like for instance as has happened in electronics and automotive.

2.36. Under a mutual recognition agreement, countries agree to recognize each other’s standards and conformity assessment procedures. Developing countries can consider this approach for the sectors where they have comparative advantage and concentrate their efforts to signing mutual recognition agreements with their major trading partners covering those product sectors.

2.37. These are however challenging objectives. To sign a mutual recognition agreement or to comply with international standards, developing

countries need to increase their capacity to formulate and implement technical regulations. Hence, technical assistance for capacity building is an essential component.

2.38. One mechanism that could help to achieve these objectives is the development of 'standards knowledge platform' within WTO that would bring together standardization and conformity assessment officials, trade officials, and stakeholders to assess current policies and identify beneficial reforms. The platform could be assisted by external assistance from development partners as part of multilateral 'aid for trade' initiative.

Fostering Aid for Trade

2.39. Aid for Trade was agreed by WTO members as a mechanism to enable developing countries to participate in the international trading system. It does so by recognizing that capital-starved economies, deficient and lacking in capabilities to effectively benefit from their integration to global markets, require external support in the form of funds, capacity building and technical assistance. Also, out of the realization that a rules-based international framework could not be expected to optimally function without addressing fundamental asymmetries among its members.

2.40. Indeed, many developing countries, particularly the Least Developed Countries (LDCs) face special difficulties participating in the international trading system, given their supply-side bottlenecks, poor infrastructure endowments, and weak institutional capacities. Furthermore, with the Uruguay Round and the inception of the WTO, the cost of engaging in the multilateral trading system has become a major concern for many developing countries. In fact, the extension of trade rules beyond the border to areas such as intellectual property and trade in services and the tightening of rules on existing areas have led to complaints for the high cost of compliance. Another major concern is about preference erosion. Those countries such as the LDCs or the African, Caribbean and Pacific group of states, which historically have benefited by favorable preferential market access, fear that they will lose from multilateral liberalization. Equally acute is the difficulties faced by many members to avail themselves from the tools provided by the WTO to ensure fairness in trade relations (i.e. safeguards, antidumping, dispute settlement) and to address societal concerns regarding food safety, public health and the like.

2.41. To address these challenges and concerns, the Aid for Trade initiative launched at the Hong Kong ministerial in 2005, aims also at offering a coherent and institutionalized approach to trade related development assistance programs. In the aftermath of the ministerial, a WTO Task Force on Aid for Trade recommended that the initiative should be organized to cover six broad categories, namely:

a) **Trade policy and regulation**, which includes training trade officials, helping governments implement trade agreements and strengthening institutions to comply with rules and standards.

b) **Trade development**, including trade and investment promotion, business facilitation, and trade finance.

c) **Trade-related infrastructure**, such as building or strengthening of roads, ports, transport and storage, communications, and energy facilities.

d) **Building productive capacity**, which includes all activities aimed at improving a country's capacity to produce goods and services.

e) **Trade-related adjustment**, defined as accompanying measures that mitigate the economic costs of trade liberalization, including financial assistance to losers and fiscal and balance-of-payments support.

f) **Other trade-related needs**.

2.42. In the 2009 OECD-WTO Aid for Trade at a Glance report, the two institutions stressed that "the Aid for Trade Initiative has succeeded in raising awareness about the support that developing countries, and in particular the least developed, need to overcome the barriers that constrain their ability to benefit from trade expansion and reduce poverty. As a result, developing countries are raising the profile of trade in their development strategies and donors are responding by providing increasing resources to build trade capacity – whether in terms of policies, institutions or infrastructure." Financial flows have reached US$ 25.42 billion, which represents an increase of US$4.3 billion (21%) over the baseline period (2002-2005)[5]. The OECD recently reported that there has been a 62% increase in Aid for Trade commitment during the period from 2006-2008 compared to the baseline period with the total figure having reached US$ 41.3 billion in 2008.

2.43 These large numbers are based on a very broad definition of what constitutes Aid for Trade. While developing countries have correctly argued that they need resources to augment their productive capacity before they can trade, the resulting broad definition — which suggests that one out of three dollars of ODA benefits trade — does not permit a useful evaluation of donor performance relative to recipient needs. It leads to evident anomalies, as when it appears that India and Turkey are huge recipients of Aid for Trade funds — while they clearly have far less needs to be effectively integrated into world trade than poor countries in Africa and elsewhere. Moreover the funds provided for Aid for Trade are not additional to but part of the overall envelop of donor aid commitments. With respect to Africa and the LDCs, they disguise the fact that donor performance has fallen short of overall donor commitments as articulated in Gleneagles (2005) and the Brussels Program for Action for LDCs (2001). The next Aid for Trade review scheduled for July 2011 should address these issues.

2.44 More and truly additional resources need to be directed to LDCs and other low income countries, which are the most in need. At the same time these countries need to develop solid ownership of their trade strategy, mainstream their Aid for Trade needs into their national development

5 WTO and OECD, 2009. Aid for Trade at a Glance 2009. Maintaining Momentum. Available at: http://www.oecd.org/document/0/0,3746,en_2649_34665_42835064_1_1_1_1,00.html

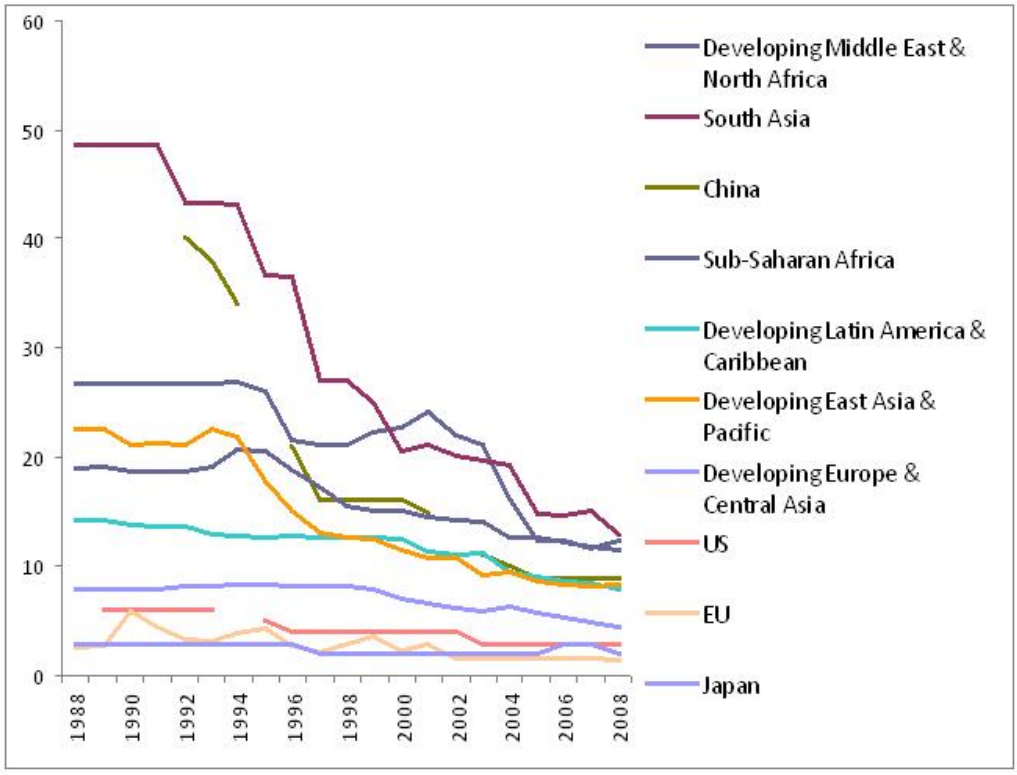
strategies, and articulate them in their Poverty Reduction Strategy Papers. For the LDCs, the full operationalization of the WTO's twin program, the Enhanced Integrated Framework, bringing together the World Bank, IMF, UNDP, ITC, UNCTAD and the WTO, can be expected to provide countries with useful technical assistance to achieve these objectives; but the main financial burden has to be borne by the countries themselves and their main bilateral and multilateral aid partners.

3 THE DOHA ROUND: SETTING A DEADLINE, DEFINING A FINAL DEAL

Why has Doha stalled?

3.1. One of the most striking features – arguably the defining feature - of the global economy over the last two decades has been its progressive liberalization. For thirty years, between 1960 and 1990, the number of people on the planet living in economically open societies was largely steady at one person in five. Today with China and India in the WTO and Russia partially integrated into global trade it is more than nine in ten. For the last two decades the ratio of global trade to global GDP, which can be taken as a rough measure of global economic integration has not fallen below 40%, and had risen as high as 55% before the downturn. Applied tariffs at national borders have fallen, in many cases dramatically, and the dominant trend in markets for services and investment has been greater access for foreign funds and foreign competition.

Fig 1: The liberalizing decades: major economies average applied manufacturing tariffs (%) 1988-2009



Source: databank.worldbank.org.

3.2. The GATT/WTO has very successfully accompanied this process, in particular in comparison to other international cooperation efforts on climate change, human rights, development assistance, nuclear proliferation, etc. The GATT/WTO has established a rule-based trading system based on norms that are almost universally accepted. Disputes are adjudicated by an international court whose rulings are almost universally implemented. Its membership is now almost universal and it makes decision by consensus. In short, the GATT/WTO achieved its mission – the establishment of an open and rules-based trading system.

3.3. So why is it that against the backdrop of a global economy that has been liberalizing at an unprecedented rate over the last twenty years that a multilateral negotiation dedicated to consolidating and accelerating precisely that process has stalled? What is regarded as sound economic policy when it is conducted unilaterally or bilaterally becomes intensely difficult when it is reframed as a series of political concessions of market access to be traded in a multilateral setting. This is especially so given the fact that this is done under the close scrutiny of both the media and defensive domestic constituencies. This has been the basic dynamic of the Doha Round since it was launched in 2001.

3.4. However, the reasons for Doha's slow progress are also tied to the changing nature of the WTO and the states it represents as much as to any specific detail of the negotiation. From the 1960s, developing nations formed a majority of GATT membership, but divergent views between developed and developing nations did little to hinder progress. GATT negotiations up to the 1980s were between self-identified 'liberalizers', mainly industrialized nations. Developing countries were not expected to cut their own tariffs, yet they had a stake in success; the GATT's MFN principle meant their exporters benefitted 'for free'. As these poor nations were also small economically, their lack of tariff-cutting had little impact on the value of Rounds to the developed nation liberalizers. This systemic free riding – which was critical to building consensus in earlier Rounds – was justified under the legal principle of 'special and differential treatment' and economically under the now discredited theory that high tariffs fostered industrialization. 21st century economic realities, however, changed this.

3.5. The rapid growth of emerging economies – due in no small measure to the GATT's success at lowering industrial nations' tariffs – has changed the relationship between poor and small. Emerging markets are now big enough to rule out free riding. China, for example, is the world's largest exporter and second largest importer, and the ranks of India, Brazil and other emerging nations are rapidly rising.

3.6. The expansion of negotiations into areas such as agriculture – which is important to many developing countries and highly sensitive for many developed countries – has complicated this picture. The expectation that in most cases developing countries should be entitled to flexibilities in the application of tariff cuts that are not available to developed WTO states has also followed from the widening of the membership and the

development of a body of thinking about the pace and depth of liberalization that is appropriate for developing countries. This assumption – that a development friendly trade deal must demand less of countries in a way that is proportionate to their state of development - permeates the Doha Round and the final package will rightly have to be measured against it.

3.7. This means that developed countries have to accept that the outcome will be asymmetrical, even vis-à-vis large and competitive exporters like China and Brazil who remain in development. This makes the Doha Round a difficult proposition for some domestic constituencies, even if it does not in itself imply a reduction in the economic value of the package for developed economies, due to the beneficial impact of new access for imports. The EU in particular has had to accept that the price of the Doha Round is the complete renovation of its system of agricultural supports and tariffs with no expectation of proportionate action from developing countries. It also recognizes that such reform will be the price of similar reform in the US, Japan and Switzerland, and that its competitiveness in processed agriculture products means that reform of its primary farm goods regime can be offset to some extent against new access to markets for these goods.

3.8. So the Doha Round's development mandate will be delivered in two key ways: 1) complete exclusion of all Least Developed Countries from any obligations except binding their tariff schedules at the current level - the so called 'Round for Free' and 2) the concept of agreed 'modalities' for tariff cuts (and in the case of agriculture, subsidy reductions) in principle agreed by all members, but in practice tempered by various forms of 'flexibility' for developed and developing countries. Defensive interests have been exploiting the relative imprecision of the end result due to the flexibilities to block further progress. It was in defining one of these flexibilities – a special safeguard mechanism for agricultural exports to developing countries – that the last serious push to close the negotiation stalled in 2008.

3.9. The use of formulae plus flexibilities to define cuts in both agriculture and manufactures has two key implications, one positive, and one negative. The first is that even after agreed flexibilities are employed, the tariff landscape will be compressed across the board, with the highest tariffs cut most. This is particularly important for farm tariffs in the developed world, where the compressive formulae will suppress some of the highest tariffs in the world for the first time. It is also crucial for industrial tariffs in developing countries, some of which remain very high.

3.10. The second is that while the modalities provide a basic level of ambition, the devil is in the detail: until it is clear where all countries will exercise their flexibilities to shield tariff lines from cuts through exclusions or where the special safeguard mechanism will apply, it is impossible, or at least very difficult, to value a final package in a way that makes it possible to sell to domestic constituencies. The formula plus flexibility system is both the greatest potential strength of the Doha Round, and potentially its fatal weakness.

Doha: the case for completion

3.11. The decision to sacrifice the gains embedded in the current Doha texts or plausible with a final concerted push by negotiators has far-reaching consequences for the global economy and should be treated commensurately. At present it is largely being made by default. The Doha Round is dying of political neglect. It is impossible to overstate the fact that no increment in value will close the deal in the absence of political will. Because of the political concessions involved, the Doha Round cannot be completed solely by trade negotiators; it needs a much stronger and direct involvement of political leaders. The protestations of commitment offered periodically by G8 and G20 leaders have consistently translated into little new impetus in Geneva.

3.12. The renewed leaders' commitment during the Seoul G20 meeting last November would have this time to translate in the coming weeks into genuine new engagement in Geneva and concrete signs of flexibility.

3.13. So why a final effort to revive and finally complete the Round, given the political capital it will require? There are four basic arguments for completing the Doha Round:

- An insurance policy against future protectionism. Doha would act as a consolidation agreement for the large amount of unilateral liberalization that has occurred since the end of the Uruguay Round in 1994. In this sense by binding this openness into an international agreement it acts as an insurance policy against possible reduction of market access. The "water", in negotiating parlance (i.e. the difference between the current level of tariffs and their WTO bound ceilings), is found in the tariff schedules of developing countries, and is especially high for India and Brazil. This water is also found in the subsidies of developed countries and in services.

- Reform of farm trade. A Doha Agreement would have the same constraining effect on the subsidization of farming in the developed world. It would make the 2003 reform of the European Union's Common Agricultural Policy irreversible, and while it would not bite into current levels of US counter-cyclical price support – because farm commodity prices are high – it would seriously constrain any future US Farm Bill from increasing supports should commodity prices fall. A Doha agreement would also eliminate all export subsidies for agricultural goods.

- New market access. It would provide new market access through tariff reductions and the contraction of market share of those countries whose agriculture subsidies will be withdrawn. Even in its current unfinished form the Doha Round represents the most ambitious package of trade

liberalization ever negotiated multilaterally[6]. Estimates point to $360bn new trade as a result of the current Doha modalities[7], and this would be substantially increased by a proper package of new market access in services and trade facilitation[8]. These numbers are small when set against current trade volumes but they could be substantially increased by a final and ambitious push by WTO states, and they are not insignificant when set against the wider benefits of the Round.

- The reinforcing of the WTO system. It would protect the WTO and the multilateral trading system itself, which could be seriously damaged by the failure of a Round, especially a Round explicitly designed to integrate the emerging economies into the multilateral trading system and give many developing countries a stake in the system's success. The permanent collapse of the Doha Round is likely to provoke a wave of preferential trading agreements that would fragment rather than integrate the multilateral trading system. The WTO's function as a legitimate mechanism for resolving trade disputes is also to some extent contingent on its wider credibility as a forum for trade negotiation. If it fails in this wider mandate, it will be weakened in its judicial function.

3.14. Much of world trade is more complex than it was during the last GATT/WTO talks (the Uruguay Round). The most dynamic part of 21st century trade comes from the internationalization of supply chains. As today's WTO rules are based on the results of earlier rounds including the Uruguay Round which started in 1986, a growing gap is emerging between 20th century trade governance and 21st century trade. While the WTO is focused very much on the legitimate and necessary objective of concluding the Doha Round, this gap is being filled by advanced industrialized nations and emerging economies making more and more use of the possibility in the GATT of signing regional trade agreements with disciplines going well beyond multilateral rules. These deals are often complemented by bilateral investment treaties and through the discretionary and inventive use of the existing gaps in the multilateral rulebook to regulate bilateral trade relations. Three sets of deep preferential trade agreements (PTAs) and networks of bilateral investment treaties have arisen: those signed by the US, those signed by Japan and those signed by the EU.

3.15. To date, the development of the gap-filling governance seems more like a challenge than a threat. The key players seem to believe that the world trade system would continue to be anchored by the WTO's shared values. This allows each member to view its own policies as minor derogations. Yet, at some point derogations could become the new norm. In

6 Overall applied protection would be cut by 26% (trade weighted average based on the assumption that countries will use the whole range of flexibilities in the most restrictive way). Bouët and Laborde. "Eight Years. Of Doha Trade Talks. Where Do We Stand?", IFPRI Issue Brief 61 • November 2009, http://www.ifpri.org/publication/eight-years-doha-trade-talks)

7 Ibid.

8 Hoekman, Martin and Mattoo (2010), "conclude Doha – It matters!", World Trade Review, IX 03, 505-530.

this case the steady erosion of the WTO's centricity could sooner or later bring the world to a tipping point – a point beyond which expectations become unmoored and nations feel justified in ignoring WTO norms since everyone else does. This would put the world trade system back to power politics as usual – a 19th-century-style "Great Powers" trade system. The GATT/WTO would go down in future history books as a 70-year experiment where world trade was rules-based instead of power-based. This is an extreme scenario that all WTO members should have an interest in avoiding.

3.16. One thing is however clear at this stage. For the time being the momentum is behind the PTA solution. Unless the WTO membership finishes the Doha Round and moves on to 21st century trade issues, the WTO will find itself stuck with out-dated disciplines while deeper disciplines are established by the EU's, the US's and Japan's deep PTAs, with new sets added when China, India and Brazil internationalize their own supply chains.

3.17. In weighing the benefits of the Doha Round it is also necessary to attempt to assess the opportunity costs of failure at this point. Would equivalent gains be achievable in other negotiating formats or through other channels? The simple answer is no. Abandoning the Doha Round and attempting to re-launch a WTO agenda around new negotiating objectives would be extremely unlikely to succeed. The Doha negotiation represents a delicate balance of issues and interests that make up a 'Single Undertaking' (nothing is agreed until everything is agreed). Pick apart that careful balance and the chance of consensual agreement retreats rather than advances. While tariff reductions and the dismantling of non-tariff barriers can of course be achieved in bilateral negotiations, the multiplier effect of a multilateral agreement is considerably higher. Agricultural subsidy reform will be agreed multilaterally or not at all.

3.18. In time when the world is facing huge economic, social and environmental challenges, the fate of the Doha Round can have defining consequences on the capacity of nations to act cooperatively or not on more difficult issues like environment, poverty and peace-keeping. These other fields of complex international cooperation would be seriously affected by the failure of such a crucial deal for development and global growth. The shock-waves of the failure would be felt durably and in many different areas, with immeasurable consequences. New multilateral trade negotiations would not be re-opened anytime soon, leaving an increasing gap between the reality of international economic relations and their governing rules. The WTO itself could be dangerously affected by such a serious blow.

The case for a deadline

3.19. What will focus minds sufficiently to break the deadlock? The lesson of the last two years is that the prospect of 'deferred success' is clearly not enough. Political leaders are unwilling to invest the required political capital to salvage and ultimately save the Round in part because they do not understand or are not being asked to bear the immediate costs of failure. No individual player is willing to be the first to declare the Round moribund, knowing that they will then be accused of precipitating its demise. At the same time, there is not sufficient political momentum to push for a final deal. The only way to change this is to make the prospect of failure concrete, collective and unavoidable. At the G20 level political leaders should set themselves a deadline within 2011 by which the Round must be completed or declared a failure. This deadline should be inflexible and bind all players at the level of Heads of Government.

The structure of a final package

3.20. Creation of new trade opportunities would take place in the Doha Round as a result of the negotiations in three main chapters – agriculture, industrial goods and services. Other areas for negotiations conceal great potential for improving the rulebook for international trade, reducing distortions and fostering development. The modalities of the Round accept that the ultimate balance of the outcome, taking into account the privileged treatment of developing countries, will be sought across the chapters, not within individual chapters.

Agriculture

3.21. For many years the Doha negotiations were focused chiefly on the difficult issue of reductions of world tariffs and subsidies in agriculture, as this was rightly perceived as an area sheltered from previous trade negotiations. It was also regarded as disproportionately important for developing countries, many of which competed both domestically and internationally with subsidized farm goods from the developed world. The reality is that increased market access will benefit developed and developing country agriculture exporters and the proposed disciplines on subsidies will help level the playing field between the two groups.

3.22. This focus has made agriculture the most developed part of the Doha negotiation. On all criteria, negotiators have been extremely successful in this area. To take only one example, under current draft texts the EU would reduce its MFN duties on agricultural imports by close to 60%[9]. Because of the compressive nature of the tariff formula in the agriculture chapter, the highest and most distorting tariffs will be cut proportionally more, with only 4% of tariff lines treated as sensitive and therefore subject to smaller cuts. As a compensation for these partial exemptions import quotas

9 Source: http://gatt.ifpri.info/dda0/

amounting to 4% of domestic consumption must be opened and subjected to zero or very low duties.

3.23. This is the most radical opening of a market of this size ever negotiated in GATT history. It would transform the EU's farm trade profile. Other protected markets like Norway, Switzerland, Canada and Japan would also undergo radical market opening. Unlike in many other negotiating areas, these concessions constitute genuine market openings because the tariffs effectively levied are very close to the WTO ceilings under negotiation. Therefore, a reduction of the bound tariff will translate into real new market access opportunities from day one of implementation.

3.24. Two main groups of countries are likely to benefit the most from this opening up of new market access: agricultural exporters in developing countries, in particular Brazil and Argentina, and those in developed countries, in particular Australia, New Zealand and the US. For instance, it would mean for Brazil a reduction of 27% of agricultural tariffs levied on its agricultural exports by all foreign governments - US$2.3bn of tariffs saved annually[10]. This figure is based on current export volumes, and will be even higher when the increase in Brazilian exports triggered by tariff reform is accounted for. US exporters would see the amount of tax levied by foreign governments on their agricultural exports reduced by US$2.2bn[11]. Countries exporting farm goods into the United States would see the tariffs levied by the US falling by US$1.5bn - or 38% of current levels - to just 3% of the value of US agricultural imports.

3.25. In the part of the negotiation focused on trade distorting domestic support to agriculture, developed countries have accepted the need to reduce substantially the ceilings currently applied: by up to 80% in the case of the EU and up to 70% in the case of the US. For both countries, the reduction in the ceiling would impact only modestly the level of support currently granted to their farmers, but in both cases would force them to change the design of farm policy to reduce its adverse impact on farm trade. To be sure, additional disciplines in this area are needed given the increase in recent years of the use of domestic price support by the US in particular[12].

3.26. More specifically, the overall level of supports to some key products like cotton and sugar in the US would be severely constrained as a result of the deal, in particular in the event of a fall in international food prices. In the case of the EU, new international disciplines have the considerable value of locking in recent reforms which could otherwise be reversed in future. EU farm policy is due again for reform in 2013 and in the absence of more stringent international disciplines brought by a successful Doha Round, nothing would prevent EU policy makers from changing their farm policy in a way detrimental to international trade.

10 Ibid.

11 Ibid.

12 Blanford, Laborde and Martin (2008), "Implications for the US of the May 2008 Draft Agricultural Modalities", ICTSD-IFPRI-IPC, http://www.ifpri.org/sites/default/files/publications/ictsd_wto_us.pdf

3.27. Other areas for negotiations in agriculture have also seen substantial progress and sizeable commitments are already included in the draft Doha modalities. For instance, the current text foresees the complete elimination of all forms of export subsidies by 2013 by developed countries and by 2016 by most developing countries, with the remainder by 2021. The EU has been among the main offenders here. As was again experienced in the aftermath of the financial crisis, countries tend to resort to export subsidies when world prices are falling, accentuating the depression of prices, increasing price volatility and harming developing world producers and those dependent on stable food prices, chiefly the world's urban poor. The complete elimination of this type of particularly distorting trade instruments would therefore constitute a very valuable legacy of the Doha Round.

3.28. Negotiators still have to tackle the reduction of subsidies on cotton. Without a meaningful agreement on cotton, African countries can not be expected to sign up to an overall deal. After all, the Hong Kong Ministerial six years ago stated that cotton "should be addressed, ambitiously, expeditiously and specifically". Six years later, there is still no agreement on the proposals put forth by the Chair in 2008. Agreement is needed to ensure that: (a) domestic supports are reduced more than for other agricultural products; (b) that no developed or developing country designates cotton as a "sensitive' product for market access purposes; and (c) that all export subsidies or equivalent export credits or guarantees are eliminated.

3.29. Work also remains on the form and functioning of the special safeguard measure for developing countries, as well as in the designation of where flexibilities of both developed and developing countries will apply.

3.30. What can be said is that the agriculture chapter of the Doha Round constitutes a substantial package of considerable importance to the global economy and to developing countries in particular.

Industrial goods

3.31. In the industrial goods chapter negotiators have also achieved substantial commitments to further market opening. Among developed countries, which represent two thirds of the world final demand, tariffs would be virtually eliminated, with no tariff remaining above 8%. Duties levied by the EU on its total imports of industrial products would go down by 44%, more than in any previous round, amounting to $12.5bn saved on exports to the EU. On the US market, the amount of duties paid on imports would go down by $12bn[13], almost halving the current amount of duties paid. Given the large number of preferential trade agreements that the US and the EU have in place, the rate applied to those partners not covered by preferential arrangements such as Japan or China would go down even more steeply, and be proportionately even more valuable.

13 Source: http://gatt.ifpri.info/dda0/

3.32. Here the onus is on the emerging economies to demonstrate a willingness to make some contribution to a trading system from which they have been key beneficiaries. To some extent this has been achieved. In the current modalities package China would contribute substantially, largely because the duties it currently levies are very close to those bound in its WTO schedule. China has relatively low levels of duties – currently around 5.6% of the value of imports, well below India and Brazil at 12.9% and 8.5% respectively. However, as the world's largest exporter and as such one of the largest overall beneficiaries of the Doha Round, China has a particular responsibility here. The current draft modalities would lead to a 22% reduction of duties levied on imports, well below the 36% cut that Chinese exporters would face on foreign markets[14].

3.33. Other big emerging economies would undertake much less new market opening, chiefly because their current applied tariffs are much lower than the rates they bound into their WTO schedules in the previous Uruguay Round. Brazil would cut its current level of duties by just 8%, from 8.5% to 7.8% of the value of imports. It would also be an 8% reduction on the part of India, from 13% to 12% of the value of imports of industrial products. India can argue that it has reduced its tariffs substantially over the last decade, and it deserves some credit for this. Brazil however currently levies duties at almost the same level as at the end of the Uruguay Round.

3.34. This is a critical area of the Doha negotiation, covering by far the largest area of global trade. Developed economies understandably expect a meaningful outcome here. Under the terms of the current package the protection faced by EU and US exporters would be reduced by 22%, but this is largely as a result of the reduction of other industrialized countries' protection. This drop in duties paid to foreign governments is sizeable, but faced with a reduction of their own duties in the range of 40% to 50%, their need to see more new market access in other large trading nations is understandable.

Sectoral agreements

3.35. A further necessary complement to the current modalities package in industrial goods should come in the form of a set of sectoral agreements. These would further reduce or zero tariffs among the main trading partners in key defined sectors of goods. The WTO system already includes a number of voluntary agreements that pursue deeper levels of trade openness in individual sectors such as this. The 1994 Chemical Tariffs Harmonization Agreement and the 1996 Information Technology Agreement are the basic models for this. They offer considerable potential for new market access, and could increase the ambition and balance of the Doha Round.

3.36. 14 industrial sectors are currently listed in the draft negotiating texts. They have all received various levels of support from WTO members.

14 The percentages presented in this section come from Laborde, Martin, van der Mensbrugghe (2010), Implications of the 2008 Doha Draft Agricultural and Non-Agricultural Market Access Modalities for Developing Countries, Mimeo.

In 7 out of 14 sectors, the countries which expressly support the initiative represent at least a third of world trade in the sector. This is the case for chemicals, electronics and electrical products, industrial machinery, enhanced health care, forest products, gems and jewelry and sports equipment. For another sector (textiles, clothing and footwear), the official sponsor countries, namely the EU countries, represent less than 25% of world trade in the sector. Other sectoral proposals in fish and fish products, hand tools, raw materials, toys, bicycles and parts, and vehicles and parts all only have the official support of WTO members representing 10% of world trade or less. Realistically, these are unlikely to succeed as part of a final Doha package, although they may be included in the final list if sufficient support develops.

3.37. Among the 7 sectors having received substantial support, 3 sectors (chemicals; electronic and electrical products; and industrial machinery) cover 50% of world trade of industrial products and therefore represent considerable potential economic gain. If these sectoral initiatives were to go ahead the annual economic gains from the industrial goods chapter could double to an estimated $700bn[15].

3.38. The key challenge with sectorals lies in the need to respect the voluntary participation principle while ensuring they cover a critical mass of participants. This high threshold inevitably means that many countries representing a very small share of world trade in a given product would have to buy in. That seems likely to prove very difficult or even impossible in most cases. Negotiators should consider an alternative or complementary criterion that countries representing less than 1% of world trade in a given sector would sign up to the sectoral agreement but not be required to participate until they account for more than 1%. This means that Chinese participation would be required for chemicals, electronic and electrical products, enhanced healthcare, forest products, and industrial machinery. The EU would have to participate in electronics and electronic products; enhanced healthcare; forestry; and sports equipment on top of the sectors the EU is already officially supporting. Brazil would be required to participate only in the initiative covering chemicals, and Japan in forest products and enhanced health care, on top of the sectors this country is already promoting.

3.39. The case is also strong for Doha to include a new package on Environmental Goods and Services. This would further reduce or zero the tariffs for a range of goods categorized as environmentally friendly or contributing materially to decarbonization. This would be hugely economically valuable – the global market for environmental goods is worth more than $150bn annually. It would also ensure that the Doha Round made a substantial contribution to the post-Copenhagen framework for addressing climate change. The World Bank has already defined a list of 43 Environmental Goods that can form the basis for negotiation, to be added to if the ambition is there. This package could also be extended to cover certain environmental services and possibly certain biofuels.

15 The figures quoted in this section come from Laborde (2011),"Sectoral initiatives in the Doha Round", Mimeo.

Services

3.40. The negotiations on services in Doha offer some of the largest potential gains for both developed and developing countries. The current public offers tabled by WTO members would improve on existing commitments in services trade schedules but would still fall short of the actual openness provided by states in practice, meaning that while the Round would consolidate a new level of openness, it would create only few new opportunities for trade. Given the fundamental role of services such as transport, telecommunications, construction, IT and financial services in the effective and efficient management of an economy, a strong outcome in services has huge potential spillover benefits for both developed and developing WTO members.

3.41. At a "signaling conference" organized in Geneva in July 2008, a group of 31 countries exchanged indications on their own new and improved commitments in this area, as well as the contributions expected from others. The report made public at the end of the conference and the impressions shared by the negotiators suggest clearly that a number of developed and developing countries showed real willingness to contribute substantially in this area. This ambition needs to be captured and capitalized on, and the services negotiation now needs to be the chief focus of the energies of all negotiators.

A package for Least Developed Countries

3.42. The 49 Least Developed Countries have an accepted privileged position at the centre of the Doha Round. They are not expected to implement any tariff reductions, and requested only to bind their tariffs at the level they currently apply. Because many of them currently depend on preferential market access to economies such as the EU, multilateral liberalization presents them with a short-term challenge. It erodes the preferential margin for their exports, sharpening the extent to which they compete with more advanced developing countries such as China and Brazil. For this reason the Doha negotiation has agreed the principal that for certain products implicated in this way tariff reductions will be staggered over extended periods. All developed economies can and should be expected to shoulder a share of the responsibility for generating a sizeable package. The most important addition to this should be the granting of Duty Free Quota Free market access for all exports from all LDCs to all OECD countries and a set of major emerging economies. While some economies such as the EU already offer such access, in most cases it excludes key exports or does not cover all LDCs, as for example in the US. If all developed and major emerging economies were to agree to eliminate all tariffs on all LDCs' exports, it would boost those exports by 44% or $7bn a year[16]. The reduction of the complexity and the bureaucratic requirements linked to the rules of origin is also needed for LDCs to take advantage of the trade preferences they are granted.

16 Hoekman, Martin and Mattoo (2010), "Conclude Doha – It matters!", World Trade Review, IX 03, 505-530.

3.43. Of crucial importance for several LDCs, the Doha Round will also have to address trade distortions caused by subsidies to cotton farmers in developed countries. Here the US in particular has a responsibility to take the lead.

3.44. In addition to the Doha Round outcome for the LDCs, "Aid for trade" should be maintained as a necessary complement to boost their productive capacity and help them reap the benefits of the Doha Round. Crucially, the third Aid for Trade review is to take place in Geneva in July 2011.

Trade facilitation

3.45. The Trade Facilitation negotiation is a clear success story of the Doha Round. WTO members have tabled more than 70 new proposals for improving the transit of goods between markets, charges levied for transit, penalties for minor breaches of customs regulations, the standardization of customs documentation and prompt publication of conditions for import and export. Even for a developed market like the US, the World Bank estimates that the costs of shipping a standard cargo container are about 5% of the average shipment value for exporters and 6% of average shipment value for importers. These costs far outstrip most US industrial tariffs. Additional costs in less efficient markets add a significant cost to trade[17].

3.46. Projections for increased trade due to the proposed improvements in trade facilitation are substantial – perhaps $130-$450billion annually[18]. These gains accrue disproportionately to developing countries. For Sub-Saharan Africa it is worth €10bn in additional economic activity each year (+2% of national income), half the annual inflows of Official Development Assistance (ODA) [19]. In this area, the benefits for developing countries could by far exceed the gains in other areas for negotiation. It will however much depend on their own commitment to reform domestic policies and infrastructure to ease border-crossing for goods and services and the development aid that will be provided by developed countries to help implement these reforms. These commitments need to be explicit, as well as linked, in a final Doha package.

17 Portugal-Perez and Wilson (2010), "Export Performance and Trade Facilitation Reform – Hard and soft infrastructure", World Bank Policy Research Working Paper No5261.

18 Hoekman, Martin and Mattoo (2010), "Conclude Doha – It matters!", World Trade Review, IX 03, 505-530.

19 Decreux and Fontagné (2009), "Economic Impact of Potential Outcome of the DDA", CEPII Research Report No 2009-1.

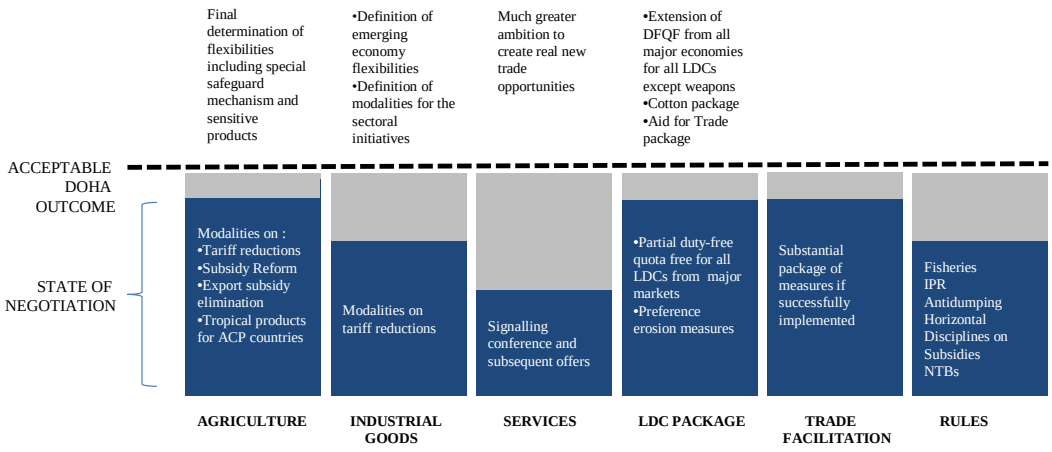
Remaining loopholes must be closed in other negotiating areas

3.47. The Doha negotiation also extends to a range of issues that relate to the WTO's core rulebook or which touch on important aspects of the international trading system. The discussions taking place in the negotiating groups on rules, fishery subsidies, non-tariff barriers, intellectual property rights, and dispute settlement understanding, are all of crucial importance to the finalization of a balanced final deal in which all members see value.

Conclusion: moving to a final deal

3.48. The current Doha package is substantial and a great deal has already been achieved. However, it is incomplete. To close the remaining gaps every member needs to be ready to make an additional contribution. The Doha package must be measured in terms of the balance across negotiating groups and in terms of developed, emerging, developing and least developed countries. It must weight both bound and consolidated unilateral liberalization and new market access. The task of achieving this is not as substantial as it may appear and, given good faith and a little more openness in the negotiation can undoubtedly be concluded still this year.

Fig. 2: 'Topping Up': completing the Doha negotiation in 2011



3.49. While the agriculture and trade facilitation chapters are very advanced, other chapters require either further advances or complementary additions in order to maximize their potential outcome. In industrial goods, the core of an ambitious agreement is already there. However, some further work is needed. Sectoral agreements seem achievable in at least the seven areas where momentum genuinely exists. Those should be negotiated and closed on a voluntary basis among the countries which have a stake in each of them. Adapted criteria could certainly be defined to accommodate the necessity of special and differential treatment for developing countries. A sectoral agreement covering genuine environmental goods should be added to this outcome, all countries should be ready to show flexibility to agree an

ambitious list in an area where environmental necessity clearly aligns with growth objectives.

3.50. In services, both developed and developing countries need to produce a text that creates real new opportunities for exporters, building on the constructive engagement shown during summer 2008 at the Signaling Conference. This agreement would do more than any other element to significantly raise the value of the Doha Round and close the deal. Accompanied by agreement on duty free quota free access for all least developed countries from all developed and emerging economies, Doha would be by far the most ambitious multilateral trade deal ever negotiated and an important element in a new framework of multilateral economic governance. It would also help to spare the global economy at a time when fresh impetus is badly needed.

3.51. The contours of this package will not come as a surprise to Doha technical negotiators: something like it has been the only credible landing zone for the Doha negotiation since 2008 or earlier. Compared to what negotiators have already achieved, additional concessions needed are balanced, and they would lead to an outcome that is balanced relative to the starting point. Much of what needs to be done is of relatively small size, involving limited political pain. The key now lies with political leaders willing to mandate a deal on these terms.

3.52. Both in preparing the ground for this Doha agreement and in defending open trade more widely, politicians must be willing to explain the value of liberalization, not just in terms of new market access for exports but in terms of the value of imports to widen choice and competition and drive productivity and growth. This means breaking the habit that describes every new import as a concession, simply because it often comes with a price in adaptation. Without this willingness, the politics of open trade will always be hobbled and incompletely honest. Only this explicit political leadership will create the context in which negotiators feel able to move from defensive positions to deal-making.

3.53. The resulting deal would lock in the liberalization of the global economy over the last ten years and lay the framework for another decade of liberalization. It will not be perfect, but given the inherent compromises of negotiating multilaterally with a diverse WTO membership, and given the opportunity costs of failure, perfect cannot be allowed to be the enemy of unprecedentedly good.

4 THE FUTURE OF THE WTO

4.1 The vantage point of fifteen years experience allows us to put the WTO's record into some perspective. The WTO presides over a rule-based trading system based on norms that are generally accepted and respected. It is a unique supplier of this global public-good. It has developed a body of case law around trade and the disputes it adjudicates produce rulings that are almost universally implemented.

4.2 Its membership is virtually universal, and contains the full spectrum of size and economic strength of the worlds' economies. Yet decisions continue to be made by consensus. No other international forum has reduced as effectively the asymmetry between big and small nations, between rich and relatively poor nations. These states have ceded their sovereign control of significant parts of their economic governance to an international collective agreement in favor of openness to trade.

4.3 Above all the GATT/WTO has achieved its mission – the establishment of an open and rules-based trading system. The worth of these universal norms became clear during the course of 2008-2009 and the worst economic downturn since the 1930s. While some protectionism was observed, the crisis was not accompanied by an outbreak of beggar-thy-neighbor trade policies (chapter 2 of this report). Given the GATT's deep intellectual origins in the memory of the damage caused by protectionism following the Great Depression of the 1930s, this is no small measure of success.

Challenges facing the WTO

4.4 It is however important to recognize that the WTO remains in some respects a vulnerable institution. On the one hand, Member States work with a consensus-based decision making process that ensures that all sign off on the rules that will constrain them. This can make the WTO appear to be endlessly trapped by the search for compromise. These compromises can also lead to ambiguities that put excessive strain on the WTO's judicial function which, asked to resolve these ambiguities, puts strain on the WTO's ability to direct sovereign member states to accept its findings.

4.5 Equally, the search for compromise among many and a growing number of Member States has meant that, measured against what many might regard as its fundamental brief – the greater liberalization of global trade – the WTO has been something of an underperformer. The global economy has liberalized substantially over the fifteen years since its creation, but much of this has been the result of unilateral or bi- or pluri-lateral trade liberalization outside of the WTO. The multilateral Doha Round has dragged on for almost a decade. This underperformance needs some explaining, and may condition how we see the role of the WTO in the future.

4.6 In particular:

- The WTO's role at the centre of the world trade system has been eroded over the past decade. Many of these difficulties are linked to the WTO's failure to conclude the Doha Round negotiations despite a decade's effort. This shifted political attention and action to other forms and levels of trade negotiation, especially Preferential Trade Agreements (PTAs). The WTO's real challenge lies in the fact that WTO members have allowed this focus on bilateral initiatives to drain energy and momentum for much more valuable – if more challenging – multilateral negotiations.

- The valuable work of the WTO's judicial wing is extending into areas where its consensually-agreed rule book is still ambiguous or silent. While any court of final appeal might sometimes be expected to be on the interpreting edge of law, this underlap between arbitration and the consensus on the rules has the potential to erode confidence in the WTO and its legitimacy. This is especially true because many of the contentious areas are closely related to sensitive areas of social and public policy such as environmental protection and public health.

- The WTO lacks political patronage at the highest levels in its Member States. The WTO will never fulfill its potential without genuine political ownership by its members. Negotiators are rightly frequently frustrated by the absence of political will to drive the final compromises required in a multilateral trade round. All members, including the large developing countries that are now required to make a new level of concessions to match the benefits they have extracted from liberalization by other members, need to play a more statesman-like role in strengthening the WTO.

- The general perception of the WTO is too focused on liberalization, and the confrontational political dynamic of trade talks. Although the WTO, like the GATT before it, has always focused on wider issues than the elimination of trade barriers, it is important to widen the political and public perception of the institution as it has scope to achieve considerable valuable progress in other areas.

This chapter focuses on practical solutions to addressing these four fundamental issues.

Liberalization outside the WTO: how much of a threat?

4.7 For advocates of a multilateral trading system the dramatic surge in bilateral and plurilateral trade agreements over the last two decades has been a persistent cause for concern. While there are disagreements on the damage that these discriminatory trade agreements do to the multilateral system, there is agreement that discrimination in trade poses a risk that cannot be ignored.

4.8 The real challenges that PTAs pose to the WTO stem from their systemic implications and the way that they shape the domestic politics of trade liberalization. They divert energies of negotiators from the multilateral trade negotiations. A key challenge facing the WTO is that developed country exporters may now view bilateral agreements as an easier way of getting what they would otherwise have to fight for in the WTO. Where key concessions can be achieved bilaterally, parties have less incentive to multilateralize those same concessions, irrespective of the wider value. In these respects they can sap the energy from multilateral efforts such as the Doha Round.

Ruling in confidence: closing the gap between the rules and judges

4.9 The WTO has attracted accusations of poor accountability for as long at it has exercised genuine constraint as a supranational body on the actions of sovereign governments. This is especially the case for the rulings of its Dispute Settlement Body, which can find countries in breach of their WTO obligations and require remedies from them. This neither diminishes the principle of pooled sovereignty nor the integrity of the decisions made in its name: the Dispute Settlement Body is one of the most important and effective innovations in international law. But it does require that the question of legitimacy be taken seriously when we reflect on the WTO's rulebook and its future.

4.10 The WTO should be seen as approaching this problem from two directions. The first is through the embedding of the consensus principle at the rule-making stage. This helps preserve the legitimacy of the directive powers of the WTO's litigation function, because it ensures that all states have signed up to the rules to which they are subsequently held accountable. It is for this basic reason that the consensus principle in the WTO for rules that bind all members should be preserved, irrespective of its efficiency costs.

4.11 However it is also important to recognize that if the consensus approach of the negotiating arm of the WTO underwrites the legitimacy of the judicial function, so does the capacity of the negotiating arm to deliver results – especially where it aims to update rules in the light of evolving case law.

4.12 The Uruguay Round agreement included new WTO rules on 'behind the border barriers' which often placed new international restrictions on domestic regulatory policies. This combined with the hardened Dispute Settlement Body (DSB) meant that foreign judges were in a position to rule on domestic regulations. Such constraints on national health, safety and environmental standards elicited political activism from many non-governmental organizations (NGOs) – especially consumer groups and environmental groups.

4.13 There will always be some extent to which the DSB will be operating at the interpretive frontier of WTO law – that is one of the functions of an appeal court. But the legitimacy of the WTO's rulebook, and the perception that the judicial wing of the institution is not getting too far ahead of the membership in its rulings, will depend on the perception that the negotiating process can deliver the periodic updating of that rulebook. This is especially true now that many judgments are hinging on grey areas of public health, or environmental protection under Article XX. In these areas the WTO membership need to find ways of deliberating on and clarifying rules in these areas, if necessary outside of the framework of a full multilateral trade round negotiation.

4.14 The second and related key to legitimacy is through the pursuit of the greatest possible degree of transparency and openness to direct advocacy. While the relationship with advocacy organizations and civil society must be chiefly a question for the governments of the WTO member states, there is nevertheless a case for direct engagement at the WTO level for representatives of civil society, in a way that is dynamic and adaptive, and does not ossify into a dialogue between 'approved' voices and the WTO.

4.15 In particular there is a very strong case for assisting civil society voices from least developed countries dealing with trade and development issues. This will require a greater allocation of financial resources if it is to be sufficiently sustainable and useful.

The WTO's political leadership deficit

4.16 The nature of GATT membership made the GATT's job in governing the politics and practice of global trade easier than the WTO's. The key change, however, is not the number or diversity, but the fact that where earlier rounds attracted the consensus of developing countries largely by exempting them from any disciplines, some of the key developing nations – especially China, India and Brazil are now too large to overlook. In the past, the large rich leadership nations were able to go around the necessity of consensus by giving developing nations a free-ride on their tariff cuts. A free ride for China and its growth market peers is no longer politically or economically practical.

4.17 Within the WTO rules and procedures now apply to all members (with some flexibility but no broad opt-outs), the rules were enforceable by the Dispute Settlement Body, and everyone has to agree every rule. This fact has raised the stakes for developing countries in an obvious way. This both

changed the membership and dynamic of the leadership group steering the trade round, but also created a clear new incentive for developing countries to assert themselves much more aggressively. They can no longer free-ride on the GATT and the WTO. But neither can they be dictated to.

4.18 How this plays out has the potential to be an existential issue for the WTO. The level of leadership and engagement that China, India, Brazil and the other rapidly expanding economies of Asia and South America will be able to demonstrate is crucial for the WTO's capacity to deliver.

4.19 But this brings us to a general point about the future of the WTO. The failure to conclude the Doha Round reinforces the fact that the WTO has a critical deficit of political leadership from the states that make it up. Negotiators and trade ministers too often find themselves unable to demonstrate flexibility or build consensus because they lack domestic political backing to do so.

More than just liberalization: raising the profile of the wider role of the WTO

4.20 Why does the WTO struggle to agree liberalization, especially when set against the earlier tariff-cutting record of the GATT? The key to this success has to do both with the nature of the barriers and the changing dynamic of the WTO membership. It is also the result of a change in the complexity of trade.

4.21 In the GATT's early days, trade generally meant things made in a factory in one nation being sold to customers in another nation. As tariffs came down, and transportation and communication got faster, cheaper, and more reliable, the complexity of international commerce deepened, increasingly raising complex issues of cross border investment and location. Tariffs are easily measured and bargained over. When the GATT turned to more complex issue in the Tokyo and Uruguay Round, progress slowed (the Tokyo and Uruguay Rounds lasted 74 and 91 months as opposed to the Kennedy Round's 42). This experience has been repeated with the Doha Round.

4.22 A further political problem is the confrontational nature of trade negotiations, which reduces market opening to a set of traded concessions. The shots are inevitably called by defensive domestic industries whose desire for protection is usually more forcefully expressed than the offensive interests of their exporting counterparts. This perception that the Doha Round in particular has been dominated by defensive positions is one of the reasons why so many businesses and business advocacy groups have become relatively disengaged from the process.

4.23 In large part this is a flaw with the selling rather than the product. It devalues the focus that the WTO has always had on wider trade issues. The perception of the WTO as an institution whose core mandate is market opening leaves it unloved by a certain kind of critic and a disappointment for those who do not recognize its wider role in the open global trading system.

This insistence on the value of ‘new market access’ above and, to the exclusion of, all else has contributed to the stalemate in the Doha Round – and badly misunderstands what the WTO is for and why it matters.

4.24 Expecting the WTO machinery to deliver ‘Big Bang’ doses of liberalization once a decade has probably always been unrealistic and is certainly improbable now. But this is to ignore the real value of the institution and the rules it protects. It undervalues the valuable role that the WTO can play in consolidating unilateral liberalization in the global economy. It periodically insures the openness of the global trading system against backsliding or protectionism by locking unilateral liberalization into binding international agreements. It regularly allows all members to benefit from the multilateralization on a MFN basis of liberalization previously conceded in preferential agreements, i.e. only on a discriminatory basis. This is a key element of the Doha package, and needs to be recognized as such.

4.25 A more pragmatic understanding of the role of the WTO would see it as inhering five basic functions: deliberation, negotiation, consolidation, litigation and liberalization. Recent experience probably puts too much emphasis on liberalization and litigation and too little on the value of consolidating global openness, and providing a forum for deliberation and negotiation on the evolving details and dynamic of the global trading system.

4.26 It also ignores the extent to which these things can interact – for example the way in which the deliberative function can underwrite the litigation function, as described above. Or the way in which the consolidation function can insure and underwrite the mandate for deepening liberalization.

4.27 The WTO also has one other quality that is critical to its importance and generally underappreciated. There are a range of issues in trade policy – some long standing, some emerging - that can only be addressed effectively multilaterally.

4.28 An issue like agricultural subsidy reform is intrinsically non-discriminatory – it affects all trading partners equally, at least in principle. They cannot be addressed through bilateral agreements, but must be tackled multilaterally. Politicians who undermine the WTO by prioritizing bilateral over multilateral action are weakening a mechanism that has no credible replacement.

Conclusion: A WTO for the 21st century

4.29 At the start of the 21st century's second decade, the WTO faces a serious need for reform. Here are three key tracks for change.

WTO reforms must bring preferential trade agreements back into the multilateral system

4.30 Since WTO members will not agree to undo the hundreds of PTAs already signed or halt the hundreds more under negotiations, the pragmatic way forward is to multilateralize them to the greatest extent possible. That is to find ways to lessen the discrimination contained in PTAs and to agree WTO guidelines or rules that bring some order to the emerging pattern of deeper disciplines – especially those in the deep PTAs signed by the US, the EU and Japan as these cover such a large share of world trade.

4.31 The WTO needs to use its developing transparency mechanism to put real scrutiny on PTAs, and to actively advise on how they could be made more conducive to long term multilateral openness.

Protecting the legitimacy of the WTO and the Dispute Settlement Body by strengthening and speeding up WTO deliberative and rule-making function

4.32 The WTO has managed to be regarded simultaneously – if not generally by the same observer – as both unaccountable and hopelessly democratic and indecisive in its decision making. There is no question that the WTO must continue to be open and responsive to public criticism and to treat its legitimacy as having to be constantly earned.

4.33 The consensus principle in the WTO is central to this and should be protected and more widely understood. No WTO member is bound by rules to which they have not willingly signed up. However it is also important to recognize that if the consensus approach of the negotiating arm of the WTO underwrites the legitimacy of the judicial function, so does the capacity of the negotiating arm to deliver results – especially where it aims to update rules in the light of evolving case law. This is particularly important in areas where the WTO's judicial function is getting ahead of its agreed rules.

4.34 These issues cannot wait for another multilateral trade round. Assuming Doha does finish in 2011, the next Round – if it happens on the Single Undertaking model at all - is unlikely to be concluded before 2020 or 2025. That will not be soon enough to address the pressing problems facing the world trade system, such as sorting out conflicts between national climate policies and WTO rules, or updating trade rules to match modern commercial realities, or magnifying the trade system's contribution to climate adaptation and mitigation. Solving the consensus problem with the big-package tactic will not be fast enough.

4.35 This means carving out a big new capability for the WTO between litigation and Single Undertaking negotiation. As things stand there is a

'missing middle' of policy debate and formulation that needs to be nurtured by the WTO Secretariat with the chief purpose of seeding the wider debate, establishing best practice and creating much greater sense of political ownership around the rules in grey areas such as the debate around policy space, public health and environmental protection under Article XX.

4.36 The Secretariat should be more systematic in its attempts to shape public debate and protect the judicial function of the WTO from overreach by spurring Members to deliberate on and clarify the WTO rule book. It must also draw large new members into the evolving culture of the institution and the trading system, as it has started to do during the downturn in coordination with the G20. This implies greater resources for the Secretariat and targeted resources to equip smaller countries to engage fully in this debate.

We must recognize that India, China and Brazil will make or break the WTO – but all members need to demonstrate a new level of political ownership

4.37 The evidence from the Doha negotiation is that it will take time before the powerful developing economies like India, China and Brazil play a role that is fully commensurate with the benefits that they have extracted form the openness of the global economy over the last two decades. Due in part to domestic constraints and lack of capacity, their commitment to global governance is developing at a lag to their commercial capacity to benefit from it.

4.38 However, this is clearly not a situation that can persist indefinitely and there are some welcome signs that the large emerging economies both see value in the conclusion of the Doha Round and are willing to demonstrate some leadership in order to achieve it.

4.39 It must also be recognized that the fault does not lie solely with these big new WTO members. It is to be expected that they will make pragmatic judgments about the nature of their participation in the WTO system. They are understandingly suspicious of demands placed on them by a system that has historically been dominated by the prerogatives of the US and the EU.

4.40 It falls to these last two players in particular to demonstrate their own willingness to engage and to recognize the challenges faced by the emerging economies. While the US in particular takes a skeptical line on the potential for multilateral trade liberalization and focuses on its bilateral arrangements it is hard to find fault with others for their decision to take a back seat.

4.41 Finally, much of this chapter has focused on challenging the widespread assumption among politicians and the general public that the core role of the WTO is simply driving the liberalization of trade. The WTO is not, has never been, and cannot be just about opening markets. It is about keeping the global economy open, and progressively widening the scope of that openness over time in a way that promotes development above and beyond all. That is a long game, subject to complex domestic politics. But the

WTO is also about preserving the consensus around openness in a range of ways.

4.42 Every time we set up the WTO as a confrontational forum for mediating liberalization we will lead it to at least partial failure. Rather we need to see the WTO not just as a driver of liberalization, but as a consolidator of liberalization, a forum for efforts to move liberalization forward in sectors where there is evolving confidence and ambition, and the guardian of a dynamic and respected rule book for international trade, especially where it touches on vital issues such as climate change, the protection of the environment, the role of the state in the economy and the protection of public health.

4.43 Like any institution with aspirations to longevity the WTO needs people invested in its future. In the case of the WTO that investment would ideally be wide across civil society and business, but fundamentally it needs the political backing of its member governments. This requires that political leaders understand why the WTO matters so much for the economic governance of the twenty first century global economy. It is hard to conclude they do. It is necessary to insist that they now must.