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AFTER DOHA: EVOLUTION OR REVOLUTION  
IN THE WORLD TRADING SYSTEM?

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## 1.0 Introduction

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The Doha Development Round of multilateral trade negotiations (often referred as the DDR) came to a halt in July 2006. This break followed several unsuccessful attempts to agree on modalities for reducing agricultural subsidies and protection. At Davos, in January 2007, world leaders pledged to resurrect the DDR talks and reach a successful agreement. Yet, in February 2007, the outcome remains in doubt. It seems most unlikely that a robust DDR agreement will be concluded – even though, with much effort, a shallow deal is still in sight.

In this brief, we start with a short overview of the world trading system since the Second World War, emphasizing the contribution that trade liberalization makes to world growth. Next we summarize the causes of the DDR breakdown. This is followed by an examination of three different scenarios for the future of the world trading system, highlighting risks and opportunities associated with each. We conclude with bold predictions.

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## 2.0 The Evolution of World Trade

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Since the end of the Second World War, the United States and Europe have led the world's march towards progressively freer trade. Eight multilateral rounds of trade liberalization were successfully concluded under the auspices of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO). Since the mid 1980s, multilateral pacts have been complemented by numerous bilateral and regional free trade agreements (FTAs). Tables 1, 2, and 3 illustrate the increasing importance of preferential trade agreements for three major trade hubs – the United States, the European Union, and China.

Due both to progressive policy liberalization and dramatically falling transportation and communication costs, international trade has propelled world economic growth for the past 50 years. The period between 1950 and 2000 was the best half-century in recorded economic history: world GDP grew on average by four percent annually, and world trade systematically expanded by around two to four percent per year faster (Table 4). One econometric study (Yi 2003) suggests that trade policy liberalization can be credited with approximately one-half of the expansion in the trade-to-GDP ratio; the other one-half reflects improvements in transportation and communications technology.

Substantial evidence indicates that trade openness contributes importantly to economic growth (see, for example, Berg and Krueger; Cline). According to an OECD study, a permanent 10 percent increase in the two-way merchandise trade-to-GDP ratio ultimately leads to a two percent increase in the GDP level for OECD advanced economies. Developing countries likely experience greater output growth from increased trade openness, since they have far more scope for upgrading their industrial technology. One survey concludes that 40 percent emerges as a reasonable estimate of the long-term elasticity of output with respect to trade openness for developing countries. This coefficient suggests that a 10 percent increase in a

developing country's two-way trade-to-GDP ratio eventually yields a four percent increase in the GDP level (Cline).

Globally, the ratio of two-way trade (merchandise plus services) to GDP rose from 24 percent in 1960 to 49 percent in 2000 (World Bank). Conservatively assuming a global output elasticity of 30 percent, this change implies that trade was responsible for an increase in the world GDP of about eight percent in the year 2000, around US\$2.4 trillion in that year. Trade openness delivers comparable gains year after year, making a major contribution to world prosperity.<sup>1</sup>

Over several decades, the composition of world trade has gradually shifted away from agriculture toward manufactures and services. In 1980, agriculture represented 12 percent of world trade, manufactures 46 percent, and services 15 percent. In 2005, agriculture accounts for 7 percent, manufactures 57 percent, and services 19 percent (WTO). These statistics seriously undercount the growth of services trade, since much of it is delivered through local establishments of multinational enterprises (banks, insurance, retailing, etc.). Another feature not revealed in these statistics is the rapid rise of global value chains. Multinational enterprises now account for up to one-half of world trade, and much of this commerce entails the fragmentation of production between different locations, to take advantage of different cost structures and skill sets.

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### 3.0 Causes of the Doha Breakdown

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Several factors contributed to the breakdown of the DDR talks and the real possibility that they will never reach a satisfactory outcome. The original Doha Declaration, issued in November 2001, put excessive emphasis on agricultural liberalization, implicitly assigning a lower priority to barriers that hamper manufactures and services trade. Negotiators argue that the emphasis on agriculture reflects two facts of global political economy: the limited progress on agriculture made in previous GATT rounds and the significant gains that developing countries would derive from subsidy and market access reforms by OECD countries. Several World Bank studies underscore the benefits that could result from agriculture liberalization (see in particular Anderson and Martin). However, these studies do not attempt to assess the political hurdles that obstruct freer trade in agriculture, nor did they evaluate the "pain versus gain" equation for agricultural liberalization contrasted with liberalization of manufactured goods or services.<sup>2</sup>

As the DDR negotiations unfolded, it came as no surprise that the United States, the European Union, and Japan were unwilling to make deep sacrifices to further the agricultural agenda. Embedded land values resulting from agricultural subsidies and protection now exceed US\$1 trillion in North America, the European Union, and Japan combined. Farm lobbies in these and other OECD countries are unwilling to accept wholesale liberalization of market access and deep subsidy cuts; and only

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1 The multiple mechanisms by which trade promotes economic growth are summarized in Bradford, Grieco and Hufbauer.

2 Moreover, as Schott emphasizes, service reforms will often be required for developing countries to take advantage of new trading opportunities in agriculture.

grudgingly will they accept decoupled farm support.<sup>3</sup> Out of concern for the welfare of rural areas and subsistence farmers, most developing countries also refuse to open their agricultural markets. Brazil and Argentina are exceptions, but the great majority of developing countries, led by India, Indonesia, South Africa, and other members of the G-31, tout long lists of “sensitive” and “special” products that they argue should be immune from agricultural liberalization.

Moreover, while emerging economies benefit handsomely from the “public good” of open world markets, many are unwilling to contribute new liberalization in manufactures and services. The Doha Declaration encouraged many developing countries to imagine that, in terms of the mercantilist logic that governs all trade negotiations, the DDR was a one-way deal: “northern” countries would liberalize; “southern” countries would not. Living in this fantasy world, many developing countries refuse to acknowledge the crucial role that freer trade in manufactures and services can play not only in concluding a global bargain, but also in bolstering their own productivity. The list of important free-riders on the international trading system includes Brazil, China, India, Indonesia, and South Africa. Meanwhile, the least developed countries (concentrated in Africa) demand duty free access for 99 percent of their tariff lines, but are unwilling to open their own markets – even to each other.

Alongside these substantive difficulties is an important procedural hurdle. Trade Promotion Authority (TPA), granted by the Congress to President Bush in 2002, will need to be renewed to bring the Doha Round to a conclusion. Under the current legislation, the president must notify Congress by the end of March 2007 that he intends to sign an agreement, which must then be signed by the end of June 2007. These deadlines cannot be met. The prospect of important results in the Doha Round may, however, suffice to persuade a reluctant Democratic Congress to extend TPA for a short period. With an extension, limited Doha success is possible by the end of 2007.

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## 4.0 What's Next?

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Several alternative scenarios can be depicted for the future of world trade, whether or not the DDR struggles to a conclusion in 2007. In this essay we lay out three possible scenarios. Since each of our scenarios emphasizes a different dimension, the actual future of the world trading system may well include elements from more than one of our scenarios. Equally possible, the future evolution or revolution of the world trading system might reflect scenarios that we have not considered.

### **Scenario 1: Erosion of the world trading system**

A failed Doha Round, or a very weak outcome, could serve as the prelude for significant erosion of the world trading system. The initial costs associated with the erosion scenario are the forgone GDP gains that the agreement would have brought,

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<sup>3</sup> To its credit, in January 2007, the US administration proposed that Congress should disallow subsidy payments to rich farmers (those earning more than \$200,000 a year) and also recommended a shift of farm support towards the non-distorting “green box” (Morgan and Gaul).

estimated as ranging from US\$50 billion to several hundred billion dollars annually.<sup>4</sup> For developing countries, a weakened WTO system would substantially diminish the possibility of using future multilateral trade negotiations to catalyze their domestic economic reforms. The opportunity cost of a Doha failure will prove even higher if it blocks the ultimate goal of global free trade. According to Cline, global free trade – now a distant prospect – could enable more than 400 million people in the world to escape from poverty.

Dissatisfaction with the WTO as a negotiating forum could lead members to put more emphasis on the WTO's litigation functions.<sup>5</sup> Even if existing multilateral trade obligations continue to be respected, the WTO would lose its attractions as a forum for new trade agreements. This would be especially harmful to its weakest and smallest members: precisely because they have little power, these members benefit the most from the articulation of effective multilateral rules.

A weak or inconclusive DDR outcome might additionally foster protectionist pressures, especially in the United States and in the European Union. Protectionism is likely to take forms that are arguably consistent with existing WTO obligations. Possibilities include tight sanitary and phytosanitary standards in agriculture; high cost inspection systems in the name of container security; visa requirements that limit services trade; and investment restrictions justified on national security grounds, but aimed at “defending” domestic energy and transport sectors (Schott). In a worst case version of the erosion scenario, widespread perceptions that the world trading system is deteriorating could contribute to disarray in world financial markets.

### **Scenario 2: Fred Bergsten's “Plan B”**

Our second possible scenario was previewed by the announcement of exploratory talks for a Free Trade Area of the Asia Pacific (FTAAP), an agreement that would encompass all members of the Asian-Pacific Economic Cooperation group (APEC). C. Fred Bergsten has argued that the launch of an FTAAP could induce the European Union, Brazil, India, and other naysayers to restore the multilateral track. At the same time, FTAAP talks could offer an attractive “Plan B”, in case the WTO engine sputters for the next five or ten years. Faced with the prospect of exclusion from a preferential Asian-Pacific compact, however, many countries might bring meaningful concessions to the WTO bargaining table, and inspire a fresh start in global negotiations.

If exploratory FTAAP talks did not overcome the global stalemate, the ensuing creation of the FTAAP through subsequent negotiations would still represent a giant step towards global free trade, since the APEC membership encompasses about one-half of world trade and world output. Moreover, the launch of an Asian-Pacific free trade initiative might generate renewed attention on a Western Hemisphere FTA, or a Transatlantic FTA, or an East Asia FTA, or even a South Asia FTA, giving further impetus to the realization of global free trade.

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<sup>4</sup> As Schott (p. 7) points out, these estimates are at the same time “too large and too small,” because many of the models employed assume too much change in tariffs and subsidies, and too little change in services regulatory policy compared to the content of a realistic Doha agreement.

<sup>5</sup> The recent decision by Australia, the EU, Brazil, and other countries to join Canada in asking for formal consultations with the United States on US corn and other agriculture subsidies might signal this trend (Inside US Trade).



This scenario, like others, contains its own risks. The creation of an FTAAP might inspire the emergence of antagonistic rather than cooperative regional trade blocs. In addition, large regional blocs could further marginalize already marginal countries, notably the smaller nations of Africa and Central Asia.

### **Scenario 3: Proliferation of bilateral trade agreements**

The third scenario is characterized by a surge of bilateral and small regional FTAs criss-crossing the globe. In the absence of prospects for multilateral trade liberalization, major trading nations might focus their energies on negotiating bilateral FTAs with smaller partners, rather than big regional groups that encompass, in addition to smaller partners, a commercial marriage between countries of approximately equal political and economic heft (e.g., China and Japan, or the United States and China, or the European Union and India). Many of the smaller preferential deals would have limited coverage of agriculture and services. They would bring considerable complexity to the world trading system, and might, in the end, fatally undermine the WTO. China is likely to lead the advance in East Asia with multiple FTAs. Japan might try to play catch up with China. The European Union would probably negotiate with Korea and ASEAN, as well as countries closer to home. Whether the United States can stay in the "FTA game" remains an open question. Recent developments are not encouraging: ratification of FTAs with Peru and Colombia may become watershed battles in the 110<sup>th</sup> Congress, as Democrats joust with the White House over the appropriate terms of US trade policy. More than likely, the Democratic Congress will not give President Bush renewed authority to negotiate bilateral FTAs, even if the Congress grudgingly extends TPA to conclude the Doha Round.

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## **5.0 A Bold Forecast**

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Taking all this together, we forecast a six-month extension of the Trade Promotion Authority, until December 2007, so that the Doha Development Round can be brought to a conclusion. With an extension of TPA, we expect shallow results will be achieved in the DDR during the rest of 2007, with many of the negative consequences described in our first scenario. To keep the WTO in the game and to keep hope alive, we predict that, at the end of DDR negotiations, WTO ministers will announce a series of plurilateral talks for particular sectors – e.g., zero-for-zero tariffs for selected manufactured goods, continued talks on Mode 2 for selected service sectors, and additional coverage of the government procurement code.

We also expect the launch of exploratory talks on big regional deals – FTAAP, Western Hemisphere, Transatlantic, East Asia, and South Asia. But we do not expect regional talks to lead to concrete results within the next five years. The "real action" will be in bilateral FTAs, with the choice of partner selection determined as much by foreign policy considerations as economic interests. However, we think that the United States is likely to sit out the game until late 2009 or 2010, for lack of presidential negotiating authority. Enlightened countries will follow the Chilean and New Zealand models, by unilaterally reducing barriers and adopting complementary domestic reforms, without waiting for bilateral or regional negotiations.

In the meantime, driven by information technology and innovative developments in transportation, we foresee that global trade and investment will grow rapidly. If a combination of bilateral FTAs and transportation/communications technology serves to keep world trade and investment brisk, ten years from now multilateral negotiations under WTO auspices may seem less urgent than they do in 2007.

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**Table 1: US FTAs**

<b>Partner country</b>	<b>Share of total US trade</b>
<b>Current partner</b>	
Australia	0.89
Bahrain	0.03
CAFTA	0.99
Canada	19.38
Chile	0.46
Dominican Republic	0.36
Israel	1.03
Jordan	0.07
Mexico	11.27
Morocco	0.03
Oman	0.04
Singapore	1.39
Total	35.94
<b>To be ratified</b>	
Colombia	0.55
Panama	0.28
Peru	0.28
Total	1.11
<b>Under negotiation</b>	
Malaysia	4.88
South Korea	7.90
Total	12.78
<b>Grand total</b>	<b>49.83</b>

Source: TradeStats Express.

**Table 2: EU FTAs**

<b>Current partner</b>	<b>Share of EU external trade</b>
Chile	0.52
Croatia	0.64
Iceland	0.19
Liechtenstein	0.09
Macedonia	0.10
Mexico	1.16
Norway	4.50
Palestinian Authority	n.a.
Switzerland	6.46
Total	13.66
<b>Prospective partner</b>	
Albania	n.a.
Algeria	1.36
Andean Community <sup>a</sup>	0.70
Bosnia-Herzegovina	n.a.
Central America <sup>b</sup>	0.38
Egypt	0.62
Gulf Cooperation Council <sup>c</sup>	3.92
India	1.79
Israel	1.04
Lebanon	0.14
Mercosur	2.30
Morocco	0.94
Serbia and Montenegro	n.a.
Syria	0.25
South Africa	1.55
Tunisia	0.65
Turkey	3.37
Total	19.01
<b>Grand total</b>	<b>32.67</b>

a. The Andean Community comprises: Bolivia, Colombia, Ecuador, Peru, and Venezuela

b. Central America comprises: Costa Rica, El Salvador, Guatemala, Honduras, Panama and Nicaragua

c. The Gulf Cooperation Council comprises: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates

Source: European Commission.

**Table 3: China FTAs**

Partner country	Share of total Chinese trade
<b>Current partner</b>	
ASEAN	9.17
Chile	0.50
Hong Kong	9.61
Macao	0.13
Pakistan	0.30
Thailand	1.22
Total	20.93
 <b>Proposed partners<sup>a</sup></b>	
Australia	1.92
Brazil	1.04
Gulf Cooperation Council <sup>b</sup>	2.37
Iceland	0.01
India	1.32
Mexico	0.55
New Zealand	0.19
Peru	0.20
Singapore	2.33
South Africa	0.01
Total	9.94
<b>Grand total</b>	<b>30.87</b>

a. China's FTAs with APEC, South Korea and Japan are sometimes referred to as possibilities, but are excluded from the list because of their relatively low probability over a horizon of 5 years.

b. The Gulf Cooperation Council includes: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

Source: China Statistical Yearbook.

**Table 4: World Real GDP Growth and Merchandise Export Volume Growth (annual percentage change)**

	<b>GDP growth</b>	<b>Export growth</b>
1950-63	4.7	7.7
1964	7.2	10.9
1965	4.1	6.6
1966	6.5	7.7
1967	3.7	5.7
1968	5.9	10.8
1969	6.7	12.2
1970	5.1	8.7
1971	4.4	7.0
1972	5.6	8.4
1973	6.9	12.1
1974	2.1	5.4
1975	1.4	-7.3
1976	5.1	11.8
1977	4.2	4.2
1978	4.6	4.7
1979	4.0	5.2
1980	2.9	2.9
1981	2.0	-0.6
1982	0.8	-2.2
1983	2.9	2.7
1984	4.6	9.5
1985	3.5	2.6
1986	3.4	4.0
1987	3.7	5.5
1988	4.5	8.5
1989	3.8	6.4
1990	2.5	3.8
1991	0.0	3.7
1992	1.1	4.8
1993	0.9	4.2
1994	2.2	9.2
1995	2.3	7.3
1996	3.3	5.1
1997	3.4	10.0
1998	2.1	4.8
1999	2.9	5.1
2000	3.8	13.0
<b>Annual average</b>	<b>4.0</b>	<b>6.6</b>

Source: WTO, International Trade Statistics 2006.