Another Global Trade Crisis

The multilateral trading system has been seriously weakened by four worrying trends. **David Robertson** reports

The global trading system is facing serious problems. Ever since the General Agreement on Tariffs and Trade (GATT) was established in 1947, the primordial forces of mercantilism in various guises have threatened to bring it down. The failure of the last four World Trade Organisation (WTO) Ministerial Council meetings to open a new round of trade negotiations has encouraged discrimination, trade disputes, political mischief-making and myopic self-interest which weaken the multilateral system.

The breakdown of the Cancun meeting in September 2003 undermined the progress made at Doha two years earlier. Hopes that the WTO General Council meeting in Geneva in December would repair the damage were not fulfilled. Until the G20 and other developing countries are convinced that the Doha 'development agenda' is on the table, negotiations are likely to remain blocked. The two key sectors where developing countries are most competitive are agriculture and textiles, clothing and footwear, but eight rounds of tariff negotiations have failed to make inroads into protection of these sectors. Indeed, new trade protection and domestic subsidies have made matters worse.

To divert attention, OECD governments want to focus on modifying existing WTO rules to permit trade regulations to protect economic and scientific standards. Some EU officials would also like to extend 'multifunctionality'[1] as applied to agriculture under the Common Agricultural Policy (CAP) to protect other social and political values. These rule changes could then be legitimised by amendments to the dispute settlement procedures.

On the other hand, developing countries want more 'special and differential' treatment to allow them preferential access to developed economies and freedom to protect their own markets to promote 'import substitution'. These differences may not be reconcilable.

The GATT/WTO system requires commitments to three basic principles:

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- most-favoured nation treatment (MFN);
- national treatment for imported goods inside national frontiers;
- reciprocity in tariff dismantling, with rates 'bound' to give stability.

When developing countries accede to GATT/WTO they are granted MFN and national treatment without being required to give reciprocal tariff reductions. This 'special and differential' treatment has extended discrimination, a concession that OECD countries were prepared to grant because it provided an excuse to continue their own discrimination in favour of agriculture and labour-intensive manufactures.

The success of the GATT/WTO system is evident from the low tariffs that now apply to developed countries' imports, with the notable exceptions. Since the 1950s, the volume of world trade has increased at three times the rate of world output. Gains in productivity have resulted from specialisation according to comparative advantage resulting from trade liberalisation. Even developing countries have gained from improved access to OECD markets as import barriers were lowered. The Asian 'Tigers', and more recently China and India, have benefited by specialising in producing goods and services for export to the US, Europe and Japan. These export earnings in turn, finance more imported materials and equipment to raise further productivity and living standards.

Since the end of the Uruguay Round negotiations in 1994—and some would say earlier—conflicts and tensions in trade relations, and resort to so-called 'trade remedies' have increased. Repeated failures to open a new round of multilateral trade negotiations and increasing numbers of trade disputes over interpretations of WTO rules and articles have increased frustration and provoked unilateral and discriminatory actions. In particular, regional trade arrangements have multiplied as one way to pursue (discriminatory) liberalisation with like-minded countries. While registered as agreements according to GATT Article XXIV, they do not cover 'substantially all trade', nor remove all trade barriers in a prescribed period among the signatories. Hence, they are not free trade areas or customs unions according to Article XXIV and are more appropriately regarded as preferential trade arrangements (PTA).

Many observers are concerned about the deterioration in trade relations. More sanguine commentators argue that self-correcting mechanisms in the WTO agreements will preserve multilateral order. There is general agreement, however, that a new WTO round of trade negotiations is in everyone's interest.

Four worrying features of the global trading system deserve attention before any assessment can be made:

1. PTAs are multiplying, increasing discrimination, introducing unforeseen side effects and undermining multilateralism;
2. The dispute settlement processes are in the hands of lawyers, with decisions enforced using trade sanctions;
3. Development strategies in the Doha 'development agenda' will increase discrimination;
4. Attacks on the principles, modalities and governance of the WTO by anti-globalisation NGOs weaken the institution.

These will be considered in turn.

1. Regional (preferential) trade agreements (PTAs)

Article XXIV in GATT (1947) allowed customs unions and free trade areas as exceptions to the MFN principle. This exception was designed to allow the countries of Western Europe to establish economic cooperation, which the 23 original contracting partners (including the US) regarded as strategically important in the early stages of the Cold War. Once included however, this exception could not be denied to other members.

For over 40 years, customs unions and free trade areas were mainly pursued by the Europeans, as they absorbed neighbouring countries into economic union, or looser preferential trade arrangements in the case of Mediterranean and African countries. (Some developing countries have also experimented with such integration, but with little success.)

Since the WTO was established, agreements under GATT Article XXIV have proliferated, with almost 300 PTAs proposed since 1995. This form of discrimination (extending preferences to selected countries) became popular after the US Congress approved NAFTA in 1993, and has continued following the 2002 Trade Promotion Authority (TPA) which granted the US Administration authority to 'fast track' multilateral trade negotiations and to negotiate bilateral trade agreements. Preferential access to the largest and richest market

in the world is attractive to other countries and it gives US negotiators leverage to pursue the interests of US lobbies that are more difficult to achieve in multilateral negotiations—for example, protection of intellectual property rights, increased market penetration for audio-visual products and other services, and liberalising capital flows.

PTAs are not, however, a substitute for multilateral trade negotiations. They do not lead to universal free trade because they maintain trade barriers (including tariffs) against non-participating countries. While they do lower trade barriers between willing partners, as each PTA is established trade rules become more complicated. With so much intra-industry trade in components and services, it is difficult to define a country of origin for most products. Hence, which products passing between economies in a PTA should be eligible for 'preferences'? To define this intra-area trade, rules of origin are created, relating to 'value-added' content, statistical definitions or declared processes.

Determining rules of origin has become one of the most contentious topics when finalising PTAs.[2] In many ways, rules of origin provide more protection from competition than tariffs because they regulate which goods (and services) are eligible for preferential treatment. It took several months longer to reach agreement on rules of origin in the Australia-Thailand PTA than it did to sign the basic agreement. Some of the origin rules in the NAFTA texts are particularly onerous and amount to bans on US imports of textiles and clothing from third countries (for example, the so-called 'yarn forward' requirement).

The rules of origin for the US-Australia PTA were not available at the time of writing. The US record, however, suggests this could take some time to finalise. Australian media criticism is already evident. Yet at this stage it is difficult to believe that access to the richest market in the world would not bring Australian industries economic benefits, stimulating innovation and providing new market opportunities.

Once PTAs began to proliferate there was a strong incentive for other countries to join in, especially when access to large economies, such as the EU, were at stake. This is why the United States and Japan began to negotiate PTAs. They will quickly form 'hubs' for a series of bilateral agreements ('spokes') with other countries. The bargaining power rests with the 'hubs' which can decide on the scope, rules and liberalisation schedules.[3] For example, Japan excluded all agriculture from its PTA with Singapore and is pursuing the same path with Thailand. Moreover, once a bilateral PTA is signed with details on tariff schedules, it becomes a *fait accompli* for the 'spoke'. On the other hand, the 'hub' can negotiate an agreement with another 'spoke' country that offers better terms (e.g. a larger quota for, say, sugar, at a higher price). In other words, bilateral agreements give power to the major players.

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Recent research shows that, historically, trade diversion has often outweighed trade creation in PTAs; that is, tariff discrimination displaces imports from low-cost non-PTA sources with higher cost imports from partner countries and that this outweighs gains from more efficient distribution of production among the PTA members. Hence, the global allocation of production may be less efficient than under multilateral liberalisation.[4] When allowance is made for growth effects (dynamic analysis) and differences in consumer tastes, the analysis becomes more complicated, but losses are still possible.

On the other hand, administrative and other transaction costs can be lower in a PTA, which is particularly important for trade in services, the area where most economic growth is now occurring. With average tariffs on most manufactures and raw materials low, and few quantitative restrictions remaining, trade discrimination is becoming less important. However, the partiality of the major players to exclude agriculture and other sensitive sectors from their PTAs indicates that they are not willing to act in conformity with GATT article XXIV. Because the prospects for a comprehensive Doha Round are not good, the PTA option offers a second best option, even to countries such as Australia which remains committed to multilateralism.

One reason for the increased interest in PTAs—apart from fear of being left out—is the interest in extending liberalisation and market access beyond industrial tariffs to include services. Negotiations

in the WTO incorporate all members, proceed at the speed of the slowest participant and are agreed on an MFN basis. This tends to slow liberalisation in fast growing, innovative service sectors.

Ultimately, whether a bilateral PTA will bring net economic benefits to member countries depends on the conditions in the agreement, but non-members are likely to lose. Ratifying such agreements is always a political decision which accentuates the positives.

More and more PTAs are being proposed. If uniform rules could be devised to apply to all PTAs, requiring for example, uniform rules of origin, schedules for complete liberalisation and comprehensive commodity coverage (much of which is required by GATT Article XXIV) discrimination would be minimised. The need for uniform rules for PTAs was raised at the last APEC trade ministers meeting in July 2003. Such harmonisation of rules may become possible once the complex relations with 'spokes' becomes too cumbersome for the 'hubs'.

2. Resolving trade disputes

In the preliminary stages of the Uruguay Round negotiations, disputes between major players (US, EU, Japan, Brazil) were a major threat to the GATT system. Hence, it was a significant advance when the Dispute Settlement Understanding (DSU) was agreed, which set down procedures to resolve disputes about WTO agreements. Previously, differences over GATT articles were left to negotiations between interested parties. These were seldom fruitful.

The DSU provides deadlines and procedures for resolving disputes. It has created a feast for lawyers, while seriously stretching WTO resources. Inevitably, a legal decision leaves a winner and a loser, and disgruntled losers have to be persuaded to comply with the final decision of the Dispute Settlement Body (the WTO Council wearing a different hat), after reports by panels and decisions on appeals. Once negotiations over the decisions are exhausted, penalties are imposed if the party at fault refuses to amend the offending policy. These can only take the form of trade sanctions or compensation, both of which reduce openness to trade and hence make little economic sense because they create losses to both sides.

Sanctions are unsatisfactory because GATT requires trade measures to be 'non-discriminatory'. This means products subject to penalties (for example, tariff increases) must be narrowly defined to affect only suppliers from the infringing member country, up to a declared value. Not only is this difficult to achieve and to supervise, but sanctions are against the interests of both parties. The only alternative is for compensation to be paid to the successful complainant. Naturally, it can take many years to decide what penalties should apply if the 'illegal' practice is not revoked.

Diplomatic tensions between the parties to a dispute—for example, the US complaints over EU banana imports and EU import bans on hormone-treated US beef, the EU case against US Federal Sales Corporation tax provisions and the 2001 US steel tariffs, etc.—can last for years and seriously disrupt trade relations. Australia had to modify its quarantine restrictions on imports of fresh salmon after a DSU decision, and other complaints remain to be resolved. Many notifications by major countries remain to be adjudicated. Often offending measures receive strong domestic political support, which brings international processes into conflicts within national legislatures; an explosive mixture.

Antidumping actions have become increasingly popular instruments against competitive imports for developing countries. This is the trade remedy most frequently adopted by the US Congress. The EU Commission is threatening to complain to the WTO about features of US antidumping procedures, which would lead to another action under the DSU. At the same time, the EU proposes to take antidumping action itself against China's exports of textiles and clothing. A review of the antidumping agreement is on the Doha agenda and without some revisions it presents a major threat to liberal trade policies. However, the EU Commission and the US Congress seem blind to even the domestic damage caused by antidumping actions.

More generally, the imminent termination of the Uruguay Round 'peace clause' on agricultural support policies (which prevented complaints for nine years from 1995) will produce an avalanche of complaints from developing countries against US and EU subsidies on rice, dairy products and sugar—to name a few. This will seriously stretch WTO resources.

3. The development agenda

The Doha accord was reported as a formula for successful trade negotiations, because developing

countries' interests were the focus of the communiqué. However, there were many opaque passages in the text where differences among the major players were reconciled. The 9/11 attacks and the fiasco at the Seattle meeting made it essential to reach an accord at Doha.

Hence, the Doha text flattered to deceive. Shortly after the accord, the EU announced that any changes to CAP depended on internal EU negotiations, while decisions on food labelling were an internal matter and any negotiations on trade in agriculture would depend on extending 'geographical indications'. Nothing in the Doha accord was a commitment. It promised more market access for developing countries' exports in OECD economies, but this depended on fundamental changes in policies. At the same time, many developing countries expected to pursue their own domestic growth using import substitution behind tariff walls—the UNCTAD recipe for the past 40 years.

Even the Uruguay Round commitment by the OECD countries to remove import quotas on textiles, clothing and footwear by 2005 seems likely to be undermined by antidumping measures, while reducing agricultural supports faces strong domestic opposition. In the EU, agricultural supports account for 50 per cent of the EU budget, and most small OECD countries have even higher protection (Norway, Korea, Switzerland, etc). The US Farm Bill 2003 also raised agricultural support.

Hence, the trade problems of developing countries relate to residual—yet still increasing—protection in developed economies and their own protection policies. These are serious domestic political problems for OECD governments that must be resolved before trade can assist developing countries' economic progress.

The second half of the development agenda is that developing countries should be allowed to reduce trade barriers more slowly than OECD countries. This is consistent with the principles of special and differential treatment (GATT Part IV), one of the major violations of the MFN principle. However, trade protection distorts domestic prices, misallocates resources and impedes economic growth. Dismantling their own trade barriers and domestic impediments is the key to their economic development.[5]

Slow liberalisation is also a barrier to trade with other developing countries. The scope to increase intra-developing countries' trade (South-South trade) should not be neglected. It offers wide scope for specialisation and efficiency gains.

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4. A new global order

The WTO has become a target for NGOs of all persuasions and complexions. Learning from their experiences in Seattle in 1999, at Cancun the NGOs targeted the delegations of developing countries and encouraged a coordinated approach to 'the development agenda'. This campaign was led by Oxfam, Food First, Focus on Global South and others. It concentrated on demands for reductions in agricultural protection and improving access for TCF and other labour-intensive exports. These have been pursued for more than 40 years, in one form or another, and with every justification. The political and popular opposition to relaxing this protection in the OECD economies means that the developing countries must remain engaged in WTO negotiations if progress is to be made.

The G20, led by Brazil, China and India, recognise the need for negotiations, but many NGOs showed their true colours when they claimed that the collapse of the Cancun meeting was a 'political victory' against the WTO. It did not take long for the G20 to react and to reiterate the crucial role of the WTO.

The role of the development NGOs at Cancun has raised their profile, as it did after Seattle. However, their objectives appear to be inimical to the requirements for economic development and trade access for developing countries. Development NGOs, together with environmental NGOs and social justice organisations, have daily contacts with the WTO Secretariat, so are well informed about the ways and means of the organisation. Interestingly, they spend little time with the national governments that form the WTO General Council and conduct trade negotiations.

The NGOs and single issue lobbies seem to be irritated by recitation of the basic principles of the GATT/WTO, but they forget that

international agreements are reached between sovereign governments. To become effective, such agreements need to be ratified by national legislatures. In consequence, the agreed articles are hedged around with exceptions and escape clauses to cover special circumstances. All decisions in the WTO council (as in the GATT before) are subject to consensus (that is no contrary vote). These conditions allow governments to argue at home that safeguards exist against any action that might be contrary to 'the national interest'. Without such provisions agreements would not be made. The WTO Secretariat has no independent power outside that granted by the Council.

This fundamental balance which sustains any international agreement is ignored by NGOs and anti-globalisation forces. This is convenient because they propose global governance and the sacrifice of national sovereignty.[6] This is, of course, happening in the European Union from choice, but it does not have global relevance—though one can see why the EU pursues the same arguments to get wider acceptance for some of its schemes, such as the Kyoto protocol, opposition to GM crops and foods, and inclusion of labour and environment standards and competition policy in WTO agreements. Of course, all these issues are high on NGO agendas too.

Advocates of world governance without democratic legitimacy, however, make little attempt to understand the genesis or the function of the WTO. While ignoring economics, politically motivated NGOs' arguments for globalisation also fail to consider the political origins of international agreements, such as GATT/WTO. They get away with this because national governments do not engage them at home, perhaps because they consider it electorally dangerous.

The WTO has failed to reform trade relations as expected when the Uruguay Round was concluded. The resources committed to the organisation are not adequate for its membership of 148 countries, and member governments have not only failed to give it whole-hearted support but they have left it vulnerable to NGOs and failed to defend the organisation, which depends on the effort of its members. The four areas considered here demonstrate how evading commitments and responsibilities have weakened the basic principles of the GATT/WTO.

Even so, the WTO is the only global forum for trade negotiations and, whatever its failings, it provides a framework of rules and procedures for negotiations and dispute resolution. Differences between major players persist but the processes for reconciliation exist in the WTO. It is the failure to make progress with multilateral trade negotiations that exposes and aggravates differences, and makes attractive such second-best alternatives as PTAs.

In the process, it is the small, poor developing countries that suffer most, exacerbated by the mercantilism and mendicity of their own political elites. Until the OECD countries are prepared to tackle their protection of labour-intensive manufacturing and unjustified budgetary supports for agriculture, the prospects for multilateral liberalisation are not good. These matters have deep political roots and raise difficult domestic issues. However, the lessons of the past 60 years may yet convince governments to act in the interest of global economic development.

World trade remains a major source of economic growth; past liberalisation is still influencing productivity and specialisation. Some discrimination in trade has always existed and the political satisfaction of signing PTAs may even be trade-creating. The Doha round could sink under repeated US and EU statements of good intent. On the other hand, increasing discrimination by the powerful 'hubs' of the PTAs may yet persuade the majority of WTO members to return to the negotiations to avoid further pain. That must be the hope.

Endnotes

1 'Multifunctionality' refers to joint products and externalities 'allegedly' produced by the agricultural sector, such as rural employment, food security, protection of the environment, and recreational facilities. (Of course, these 'attributes' are just an excuse to protect agriculture and large landowners!)

2 Rules of Origin under the Australia-New Zealand Closer Economic Relations Trade Agreement (Productivity Commission Interim Research Report, Dec. 2003).

3 R.J. Wonnacott, 'Trade and Investment in a Hub-and-Spoke System versus a Free Trade Area', *The World Economy* 19:3 (May 1996).

4 The Trade and Investment Effects of Preferential Trading Arrangements—Old and New Evidence (Productivity Commission Staff Working Paper, May, 2003).

5 J. Morris (ed), *Sustainable Development: Promoting Progress or Perpetuating Poverty?* (London: Profile Books, 2002).

6 J. Rabkin, *Euro-Globalism: How Global Accord Promotes EU Priorities into Global Governance—and Global Hazards* (Brussels: Centre for the New Europe, 2000).