CENTRE FOR EUROPEAN REFORM
briefing note

THE DOHA TRADE ROUND: WHAT HOPE FOR HONG KONG?

By Aurore Wanlin

The Doha round of trade talks, launched in the Qatar capital in 2001, is in trouble. The members of the World Trade Organisation (WTO) have little time left to meet their ambition of helping developing countries trade their way out of poverty. George Bush's fast-track negotiating authority – which limits the ability of America's Congress to unravel any trade agreement – runs out in July 2007. Given rising protectionist sentiments among America's lawmakers, another renewal in 2007 looks extremely unlikely. For this reason, trade negotiators had hoped to agree on the big political bargain at the next WTO ministerial conference in Hong Kong this month, leaving about a year to wrap up the deal.

But WTO members remain heavily divided over key issues. Agriculture in particular is a major bottleneck, with the EU being pushed into a corner by its negotiating partners. The US and developing countries have rejected successive European offers on agricultural tariffs as insufficient. As a result, negotiations in other areas, in particular services and manufactured goods, are stalled. Trade ministers are now busy downplaying expectations of a major breakthrough in Hong Kong. They have the much more modest aim of trying to prevent a complete breakdown in negotiations.

US trade secretary, Rob Portman, has warned against the "danger of backtracking on current offers that could lead to a complete unravelling of the talks".[1] Some will argue that there is nothing new in this crisis. Brinkmanship is part of any trade negotiation. The Doha round has run into trouble before. At the previous ministerial conference in Cancùn in 2003, strong dissent between trade negotiators seemed to leave the whole round dead in the water – only for the talks to be revived less than a year later.

[1] *"Make or break' week for draft trade declaration', Financial Times, November 6th 2005.*

However, a second ministerial failure would probably prove fatal to Doha. WTO members need to think hard about what they can achieve in Hong Kong. Much more is at stake than simply finishing Doha negotiations on time. The Doha round is the first proper test for the WTO. The failure of talks would call its credibility into question.

What's wrong with Doha?

★ The round lacks leadership

There is a fundamental difference between the Doha and previous trade rounds: that is the emergence of developing countries as key players, in particular the fast-growing economies of Brazil, China and India. Cancùn showed that it was no longer enough for the EU and the US to agree a deal and expect the rest of the WTO countries to fall into line.

But developing countries do not form a homogeneous group. For example, the G20 group was formed to give major developing economies such as Brazil and India greater clout in trade talks. But while Brazil has a competitive agricultural industry and wants greater market access, the Indian government

Centre for European Reform
29 Tufton Street
London SW1P 3QL UK

T: 00 44 20 7233 1199
F: 00 44 20 7233 1117
info@cer.org.uk / www.cer.org.uk

fears that agricultural liberalisation will devastate its millions of subsistence farmers. That makes it very difficult for trade negotiators to find the common ground needed to move the round forward.

Another reason for the lack of leadership is that some countries are not playing a role proportionate to their economic weight. China has a lot to gain from more trade liberalisation, but argues that it made enough concessions when it joined the WTO in 2001. China is only just starting to implement its WTO commitments and does not want to further complicate the task. It is happy to benefit from whatever the EU and the US will get in the negotiations, without putting any offers of its own on the table. It is particularly reluctant to open up its highly protected services markets, such as telecoms and banking.

The EU has sought to play a leading role in the Doha round. The Union had favoured a broad round that would also cover foreign investment, competition policy, government purchases and 'trade facilitation' (things like customs clearance) – the so-called Singapore issues. But strong opposition from developing countries forced the European Commission to abandon the idea of trying to make progress in those areas, except for the innocuous issue of trade facilitation.

Internal divisions between countries are making it impossible for the commission to offer convincing leadership. Trade is the exclusive competence of the EU. Its trade commissioner, Peter Mandelson, negotiates on behalf of all EU countries, although he must stick to a mandate collectively defined by their governments. Some member-states, led by France, insist that Mandelson must stick rigidly to this mandate when negotiating on agriculture.

The French government has accused the trade commissioner of betraying his mandate by giving away everything the EU has to offer on agriculture without securing enough in return. France is threatening to veto any trade deal that would lead to substantial reform of the EU's Common Agricultural Policy (CAP). But further radical reform of the CAP is precisely what the UK government would like.

The Hong Kong summit will take place around the same time as the December European Council, which will discuss the EU budget for the period from 2007 to 2013. Most EU member-states are calling for the UK to give up its 'rebate' – a discount originally designed as compensation for the relatively high contribution of the British to the EU budget. But British public opinion is in no mood to accept a substantial reduction of the rebate, unless the EU also commits to a radical overhaul of the CAP.

Such tensions between the member-states considerably constrain Peter Mandelson's room for manoeuvre. In contrast, the US is only planning to reform its agricultural policy in 2007. Therefore the US negotiator is free to make ambitious proposals that are not yet translated into a policy and which the Congress will only approve at the end of the negotiations. The administration is only held to account at the end of the round when it can clearly show what the US has gained in return for any concessions.

Another major handicap in the Doha talks is the lack of active support from businesses. This is partly due to the fact that big companies have already managed to find ways to enter highly protected markets in developing countries, and thus would benefit only marginally from a successful trade round. The main beneficiaries are likely to be the small- and medium-sized enterprises which lack the resources to effectively lobby governments or international institutions. Many EU and US businesses also know that regional or bilateral trade agreements offer another effective route to gaining greater market access abroad.

★ Agriculture is the main bottleneck

The lack of progress on the agricultural talks is at the heart of the current impasse. Trade negotiations in agriculture cover three kinds of issues: export subsidies, domestic subsidies and so-called market access issues, such as quotas and tariffs. In particular, the EU and the US support for agriculture is coming under scrutiny.

Following the Cancùn debacle, the EU succeeded in getting negotiations restarted by offering to phase out all remaining EU agricultural export subsidies. WTO members still need to agree when and exactly how this phasing out should take place, but there is agreement that such support needs to go.

Domestic subsidies, the second pillar of the agricultural negotiations, relate to the money that a state gives to its farmers to support them. The EU has long provided its farmers with price supports, that is fixing its internal prices at higher levels than those on world markets. But successive CAP reforms have moved subsidies away from such trade-distorting price fixing and towards direct income payments to farmers. Since the 2003 CAP reform, 90 per cent of EU support to farmers does not distort trade and can no longer be discussed in the round. Meanwhile, the US showers very generous subsidies on American farmers, but has offered to reduce domestic support in 2007.

WTO members are sufficiently close together on domestic support and export subsidies to sketch the shape of a deal in Hong Kong. Therefore all the attention is now focused on getting access to agricultural markets. According to a report by the World Bank, poor countries would benefit twelve times more from a reduction in agricultural tariffs than from the abolition of export subsidies and domestic support.[2] Gains in agricultural market access are central to the round's objective of boosting development. But the very poorest countries could lose out: they currently enjoy what is called preferential access to EU markets for produce such as bananas and sugar. But they will have to face direct competition from major agricultural exporters such as Brazil if a deal is done.

2 *'Agricultural trade reform and the Doha development agenda', World Bank, November 2005.*

Trade ministers have made some progress on market access issues. In May 2005 they agreed on a formula on how they would apply tariff cuts to farm products. Since then, however, negotiations have stalled. On October 10th 2005, the US offered to cut its tariffs by an average of 50 per cent. Meanwhile, the EU proposed only an average reduction of 38 per cent. In the face of growing criticism, the EU upgraded its offer to an average cut of 44 per cent, adding that it was reaching the limits of its mandate. But even this offer has failed to meet expectations – the G20 for example is calling for a 54 per cent cut. Developing countries are also unhappy that the EU is proposing to define as many as 160 of its agricultural products as 'sensitive', meaning they can apply reductions far below the headline rate.

The US administration's ambitious proposal has pushed the EU into a corner. There are several reasons for Washington's bold offer. The US is in favour of agricultural reform. Its agricultural industry is more competitive and less reliant on trade barriers than the EU. Washington also fears a flood of costly legal challenges to its subsidy regimes, following a recent WTO judgement against the US cotton regime. However, the reform of the US domestic support will not be submitted to the congress before 2007. Its trade partners are entitled to wonder whether Washington's commitment to reform will endure, given growing protectionist sentiment within the Congress.

★ **There is insufficient progress on industrial goods and services**

Strong emerging economies such as Brazil, China and India need to make serious offers in the areas of manufactured goods and services. Brazil, for example, has so far refused to open its industrial markets to more competition though it stands to benefit greatly from agricultural trade liberalisation. Estimates show that full agricultural liberalisation would boost the real value of Brazil's agricultural output by 34 per cent and real net farm income by 46 per cent.[3] Meanwhile, the EU has very low average tariffs of about 4 per cent on industrial goods which make up 85 per cent of its exports. Thus it has a lot to gain from greater access to highly protected markets in countries such as Brazil and India.

3 *'Brazilian agriculture, the harnessing of nature's bounty', The Economist, November 3rd 2005.*

The Europeans and Americans argue that increased free trade would speed up reform in developing countries and help indigenous industries become more competitive. But governments in the developing world remain worried that their nascent industrial sector would suffer greatly from opening to global competition too soon. They are asking therefore for transition periods and further protection for 'sensitive' products. While the EU is prepared to compromise on this issue, the US is pushing for a bolder agreement. The same problems are blocking discussions on services.

Some suspect that Brazilian and Indian governments are trying to defend the vested interests of a few powerful families. The EU has also criticised Brazil and other countries for putting only symbolic cuts on the table. In trade negotiations, WTO members offer not to raise tariffs above a certain level, which is the so-called bound tariff. Bound tariffs are often much higher than the levels that WTO countries apply in practice. So far the Brazilians' offers would lower the bound tariffs but not cut the applied tariffs.

Is Doha still a development round?

More and more observers fear the Doha round will harm rather than help the poorest countries. The focus of the round, though branded the 'Doha development agenda', has shifted significantly from development to agriculture.

But such criticism is partly unfair. WTO members have already agreed some measures to help developing countries. In Cancùn, the EU and the US decided to ease restrictions imposed by an earlier trade agreement on intellectual property rights. This would allow developing countries to produce and use generic drugs. The EU and US have also committed themselves to reform some of their worst trade-distorting subsidies, such as their sugar regimes. Negotiators have agreed that Doha would be a 'round for free': the poorest countries will not have to make any offer, apart from binding the tariffs that they currently apply.

Trade ministers are currently trying to agree on a development package for Hong Kong, including the so-called aid-for-trade programme and preferential treatments for the least developed countries (LDCs). The aid-for-trade programme aims, for instance, to help the LDCs develop the infrastructure necessary to reap the benefits from trade liberalisation. Meanwhile, the EU is putting pressure on Australia, Japan, New Zealand, South Korea and the US to adopt its own 'everything but arms' initiative, which allows the LDCs tariff-free and quota-free access for all exports, bar military hardware.[4]

4 Jack Thurston, 'Why the EU deserves a better farm policy', CER policy brief, December 2005.

However, the poorest countries will ultimately lose from the round if they don't receive compensation for the erosion of their preferential access to EU markets. The opening of the EU and US markets to fast-growing economies will mean more competition for them. This year's upsurge of Chinese textiles in Europe, for instance, inflicted major economic pain on poor countries such as Mauritius. To compensate for their losses, the LDCs need to gain quota-free and tariff-free access to strong emerging economies in Brazil, China or India. China is increasingly willing to make some concessions, having seen the impact of its economic domination on its neighbours. But a lot remains to be done to convince Brazil, India and others to come on board.

Poor countries would also suffer if WTO members failed to conclude the round. The EU and the US, among others, are likely to place greater emphasis on bilateral free trade agreements (FTAs), which would largely exclude the LDCs. The EU, for example, is keen to strike deals with Korea and Thailand, ending its commitment to pursue only multilateral talks.

Bilateral free trade agreements can promote trade, but they will also leave developing countries vulnerable. At least in the WTO, each member-state, whatever its size or economic weight, has a veto. Free trade agreements also tend to spawn new regulatory barriers in an inconsistent way. For instance, by signing separate FTAs with trading partners, the EU and the US risk setting up conflicting trade regimes.[5] In the long run, the development of FTAs could therefore make future multilateral trade liberalisation more difficult.

5 Jean-Marie Paugam, Dorothée Schmid, 'Une nouvelle rivalité transatlantique en Méditerranée ?', Politique étrangère, April 2004.

The collapse of the Doha round would also call into question the future of the WTO itself. The organisation is still young and in need of further institutional reform. Developed countries criticise the WTO heavily for not taking into account the economic importance of its member-states. NGOs and developing countries also accuse it of promoting economic liberalisation at the expense of development, social and environmental goals. Doha is the WTO's first round of negotiations. Their success would strengthen the position of Pascal Lamy, director-general, and make internal reform easier. Doha's failure would weaken the organisation and boost those who wish to undermine multilateral trade.

What will be the final outcome at Hong Kong?

The Hong Kong ministerial conference will not deliver any major breakthrough. The EU will not make any new proposals. Trade ministers will probably tweak the so-called framework agreement or Doha work programme agreed in July 2004, and endorse a development package for LDCs. They will probably decide to meet again early next year to agree on the big political bargain, hoping to conclude the round before the American government's trade authority expires in mid-2007. Should they fail to do so, Doha is likely to fall apart.

The EU and the US need to get agriculture off the agenda and persuade Brazil, China and India to open their markets, in particular to the LDCs. Otherwise the Doha round could prove more harmful than beneficial to the poorest countries, through undermining their preferential access to EU and US markets. For this reason, Australia, Canada, Japan and New Zealand should also agree on adopting the EU's 'everything but arms' initiative. All trade negotiators should also remember that a fundamental principle of the WTO is that negotiations in every area need to progress at the same time. Global trade talks cannot just benefit those countries who are strong agricultural exporters.

The EU still has some room for manoeuvre. Its trade commissioner, Peter Mandelson, has declared that he can move further on tariffs and sensitive products like beef.[6] Also a review of the CAP is due to start in 2008, which should lead to a further reform from 2013 onwards. The member-states should set ambitious objectives for this mid-term review, which could serve as a basis for the commission to make new commitments on agriculture. However, Mandelson should not rush into putting a new offer on the table. Negotiations have still months to go and some countries like Brazil may delay until the very last minute to make any concessions. The EU would do well not to show its hand until then.

[6] *'EU has room to move on tariffs', BBC news, November 23rd 2005.*

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Aurore Wanlin is a research fellow at the Centre for European Reform.
2nd December 2005