CENTRE FOR EUROPEAN REFORM

working paper

Manufacturing first

A new way forward for global trade

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Foreword

We warmly welcome the publication of Bruce Stokes' working paper, 'Manufacturing first – A new way forward for global trade'. It fits well with the tradition whereby the Centre for European Reform provides a unique forum to debate innovative approaches to intractable international issues. Few would disagree with Bruce Stokes' claim that the challenges facing the WTO's Doha development round are daunting, and may worsen in light of the upcoming elections in the US and the arrival of a new European Commission in November 2004.

Bruce Stokes' proposal for a zero-for-zero tariff agreement involving 90 per cent of world trade in manufactured goods deserves serious examination as a means of providing fresh impetus for the Doha round. However, for such a proposal to succeed or create momentum, political leaders must take several fundamental issues into account.

First, agriculture is at the heart of the round, and the log-jam on agriculture must be broken as a matter of urgency. Thus, it is critically important that a proposal relating to trade in manufactured goods takes shape in the context of, and as a means of reviving, the Doha round. Any suggestion that the US and Europe are walking away from agriculture, services, anti-dumping and other important issues would scuttle the Doha round – and could even bring down the WTO. More fundamentally, from a US standpoint alone, the US Congress is unlikely to approve a manufacturing deal that is negotiated separately from agriculture and services.

Constructive discussions are taking place between the US, the EU and the G-20, G-90 and Cairns groups, with the aim of striking a balanced deal. The recent WTO panel decision against America's cotton subsidies, plus the pending WTO case against EU sugar practices may provide further incentive for movement on agriculture in the Doha round. Recent EU proposals to scrap export subsidies for agricultural products, provided other countries reciprocate, suggest that progress on agriculture is possible.

Second, the prospects for Stokes' manufacturing proposal would strengthen enormously if key developing countries, alongside the US and the EU, would champion the idea.

Third, the zero-for-zero manufacturing initiative would work only if the least developed countries get sufficient time and flexibility to implement their commitments.

As a final comment, we want to stress that the world trading system has reached a supremely difficult juncture at which there is no 'single right answer'. Bruce Stokes has made a valuable contribution, and the Centre for European Reform is performing an important function, by stimulating new ideas to advance the cause of free trade.

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1 Introduction

Multilateral trade liberalisation, which has progressively cut trade barriers around the world and contributed to a dramatic increase in trade and prosperity worldwide, is now in serious trouble. The World Trade Organisation's 'Doha development round' of trade negotiations has stalled. Recent efforts by the United States and the European Union to breathe new life into the talks have revived discussions in Geneva, but with faint hope of a breakthrough any time soon. Many countries, concerned at the slow pace of the World Trade Organisation (WTO) talks, are increasingly resorting to bilateral or regional trade agreements. For example, the United States has made agreements with the countries of Central America and Australia, while Japan has struck a deal with Mexico. Protectionist sentiments are on the rise, especially in the US, where growing numbers of Americans worry that their jobs will be 'out-sourced' to India or China. As a result, WTO members risk postponing the economic benefits of further trade liberalisation, especially for the poor, far into the future.

The United States and the European Union, in particular, need to reaffirm their commitment to multilateral trade. The US and the EU are both the leading beneficiaries of the world trading system and the principal creators of the WTO. They should infuse energy into the process of market liberalisation by launching a new multilateral initiative for free trade in manufacturing.

Manufacturing constitutes the lion's share of world trade. Further trade liberalisation in the manufacturing sector would deliver huge benefits to large numbers of people around the world, even if tariffs are already relatively low. For this reason, the EU and the US should propose a bold initiative: free trade in manufactured goods by 2015 for a critical mass of countries constituting 90 per cent of world manufacturing trade. This 90 per cent threshold is important because it will ensure that enough countries are involved in the effort to make it economically worthwhile. But the 90 per cent criterion would also prevent a small group of relatively minor trading countries from blocking progress for everybody else.

Concretely, the US and the EU should offer to cut their tariffs on manufactured goods to zero in return for other countries doing the same: a 'zero-for-zero' initiative in trade jargon. In this manner, Brussels and Washington would lay down a challenge to the other members of the WTO, particularly those countries such as India and Brazil which appear reluctant to make progress in the Doha round. Those countries can either focus on finishing the Doha negotiations, in which case the manufacturing initiative would be dropped. Or they should stop holding up progress and allow those countries that want to liberalise trade to forge ahead.

This type of manufacturing initiative would sidestep the divisive issue of agriculture, which has long blocked progress in the Doha round. Ideally, the WTO should reach a broad agreement, which would include a reduction in agricultural subsidies. The May 2004 proposals of the EU to scrap export subsidies for agricultural goods if other countries reciprocate, could inject momentum into the Doha round. But, thus far, the strategy of holding manufacturing trade hostage to progress in agriculture has not worked. It may be time that political leaders acknowledged this painful reality and revised their strategies accordingly. Moreover, by seizing the high ground, the EU and the US would deny some developing countries the ability to delay further trade liberalisation by others. At the same time, this proposal would grant the very poorest countries gradual 'phase-in periods', giving them more time to cut import tariffs. The least developed countries would thus benefit from greater access to the markets of rich countries without having to expose their infant industries immediately to devastating foreign competition.

The EU and the US would send a clear political message that they remain committed to multilateral trade liberalisation by insisting on the 90 per cent requirement for the manufacturing initiative. The fact that the initiative would be open to all countries should help reverse the current momentum towards bilateral and regional trade deals. Such narrow agreements threaten to splinter the world marketplace into a US-dominated western hemisphere block, an EU-dominated European block and a China-dominated Asian block.

A joint US-European project on trade would inaugurate a new era of co-operation after the most difficult period for transatlantic relations in two generations. Brussels and Washington should put behind them the recent dispute over Iraq and other foreign policy disagreements. They must rise above the long list of bilateral trade disputes – over tax systems, steel and genetically modified organisms (GMOs). The goal for Europe and America is to demonstrate, once again, their shared leadership in world trade.

Politically, a US-EU initiative on tariff-free trade in manufacturing is very attractive because it could be the first step on the long road towards a truly integrated transatlantic marketplace. It would either lead to multilateral free trade in manufacturing, including that between the US and EU. Or, if other countries declined to join in, their refusal would free Washington and Brussels from any moral obligation to await progress within the WTO, giving them the green light to negotiate transatlantic trade liberalisation deals.

This idea of a transatlantic free trade area (TAFTA) has a long pedigree. In the 1990s, Commission president Jacques Santer and former UK foreign secretary Malcolm Rifkind propounded a vision of a transatlantic marketplace. The then speaker of the US House of Representatives Newt Gingrich and ex-Senate majority leader Robert Dole echoed their calls. More recently Jose María Aznar, the former Spanish prime minister, and Gordon Brown, the British chancellor, have revived the transatlantic trade area proposal. A manufacturing initiative could set a precedent for one day achieving transatlantic free trade in services and possibly even agriculture. Brussels and Washington would give the signal that they can and will liberalise the transatlantic market: they can do so multilaterally in all sectors or, if they have to, one sector at a time. But to prevent a guaranteed backlash from Asian and other governments, it is best to opt for a functional and not a geographic approach as the next step in trade liberalisation. The EU and the US must try to galvanise the rest of the world into multilateral action, not seek refuge in smaller groupings. But Washington and Brussels should not foreswear bilateral market liberalisation either, if multilateral liberalisation proves elusive.

Of course, a zero-for-zero manufacturing initiative in the WTO would meet resistance from some American and European industries which still benefit from trade barriers. In particular, clothing and textile manufacturers in the United States and some parts of the car industry in Europe are likely to oppose such a deal. Similarly, some developing countries may fear losing preferential access to American and European markets and new competition for their infant industries. But the potential benefits – both directly to the manufacturing sector and in terms of kick-starting the moribund Doha round – far outweigh the costs. The only alternative is continued delay in realising the full benefits of open markets and the continued proliferation of bilateral trade deals that are smaller, economically insignificant and politically divisive.

The EU and the US are not in a position to push a multilateral manufacturing initiative immediately. Trade negotiators in Geneva deserve one last chance to rescue the Doha round. In a letter to all WTO members in January 2004, US Trade Representative Robert Zoellick called on them to reconvene in Geneva in spring 2004 because he did "not want 2004 to be a lost year for the WTO negotiations". Negotiations have recommenced in Geneva, but negotiators from all sides express doubts about how much they expect to accomplish in 2004. Washington and Brussels should make it clear that they expect timely and substantive progress. If

not, they should opt for a deal on manufacturing as their preferred 'Plan B'.

Zoellick and EU Trade Commissioner Pascal Lamy should propose that the EU and US push for a zero-for-zero manufacturing initiative, if WTO ministers have not achieved significant progress by early 2005. In the meantime, the European Commission and the Bush administration should convene a summit of transatlantic business leaders, under the auspices of the newly revived Transatlantic Business Dialogue, to enlist support for such an effort.

The EU and the US have little to lose and much to gain from seizing the initiative in this manner. The Bush administration and the European Commission were instrumental in launching the Doha round. As Zoellick and Lamy leave office at the end of 2004, they run the risk that they will be remembered for the failure of the Cancún WTO summit in September 2003. They need to reassert themselves in trade negotiations. A zero-for-zero manufacturing proposal is their best chance to break the current deadlock in Geneva and capture the benefits for the whole world of further trade liberalisation.

2 Why the Doha round matters – and why Cancún failed

The successful outcome of the current set of trade negotiations is hugely important to all participants. If the Doha round succeeds in cutting tariffs on farm products, industrial goods and services by one-third, the US economy could grow by $144 billion while the European economy would increase by $210 billion, creating hundreds of thousands of new jobs.[1]

The potential benefits of trade liberalisation for the poor are perhaps even more significant. Low-income countries now account for less than 3 per cent of world trade. Oxfam, the British-based charity, estimates that a 1 per cent increase in developing countries' share of trade could lift 128 million people out of poverty.[2] Overall, a one-third reduction in farm, industrial and services barriers would boost developing country economies by $122 billion.

[1] *Drusilla K. Brown, Alan V. Deardorff and Robert M. Stern 'Computational analysis of multilateral trade liberalisation in the Uruguay round and Doha development round', University of Michigan, December 8th 2002.*

[2] *Oxfam International, 'Rigged rules and double standards: trade, globalization, and the fight against poverty', 2002, available at www.maketradefair.com.*

But these potential gains are now in jeopardy, following the breakdown of trade negotiations in Cancún in September 2003, and the failure to re-launch the talks in Geneva in December 2003.

The Cancún failure

The WTO ministerial meeting that collapsed in Cancún on September 14th 2003 marked a watershed in global efforts to liberalise trade. Developing countries demonstrated unprecedented solidarity, power and influence, although perhaps not the required responsibility. Moreover, the failure at Cancún called into question the leadership credentials of the EU and the US, the two trading powers that have long been the driving force behind multilateral trade negotiations.

"World trade negotiations will never be the same again," claimed Phil Bloomer, head of Oxfam's 'Make Trade Fair Campaign' in the immediate aftermath of Cancún. "On paper, this meeting has failed, but the new power of developing countries has made Cancún a turning point." Paradoxically perhaps, international business leaders agreed. "This represents the transition to the co-equal WTO," was the verdict of Calman Cohen, president of the Emergency Committee for American Trade, a trade association of the 50 largest US multinational corporations.

What this means for the EU and the United States, as well as for the cause of trade liberalisation, depends on the lessons that leaders draw from the Cancún débâcle. Like the characters in Agatha Christie's 'Murder on the Orient Express', everyone shares the blame, and no one alone can be held responsible for the Cancún collapse. The European Union – thanks to the highly contentious nature of its farm policies and its laborious, lowest-common-denominator decision-making process – could only offer limited reforms of its Common Agricultural Policy. In the end, the EU's proposals fell far short of the kinds of cuts in domestic support and export subsidies that other countries demanded. The EU was also unwilling to compromise until the last day in Cancún on the 'Singapore issues' – competition policy, investment, trade facilitation (customs and port management) and public procurement.[3] The EU is keen to 'update the global rulebook' on trade but developing countries fear that new rules on investment and competition policy will have protectionist effects. Late in the negotiations, the EU signalled its willingness to compromise. But the developing countries, lacking the political and negotiating flexibility to adapt to such last-minute changes in tactics, simply walked out of the meeting.

[3] *These are called Singapore issues because they first arose at a WTO trade ministerial in that city in 2001.*

The United States, wary of offending influential domestic farm interests, failed to take the needs of four cotton-producing West African countries – Benin, Burkina Faso, Chad and Mali – seriously. These four had demanded that Washington provide them with $300 million in compensation for the damage their farmers had suffered from US cotton subsidies. They also asked Washington to eliminate immediately all trade-distorting export and domestic cotton subsidies. Rather than directly responding to the African demands, Zoellick dodged the issue, proposing a broad negotiation in the context of the Doha round on cotton, man-made fibres and textiles, and clothing exports. The US further alienated developing countries by joining forces with the EU to forge a compromise position on agricultural liberalisation. This position appeared to backtrack on the long-standing US offer to eliminate all farm subsidies and trade barriers. The EU-US proposal also angered the 'Cairns group', which includes grain producers such as Australia, Argentina and Canada and seeks to abolish all farm subsidies. Entirely predictably, a group of developing countries, led by Brazil, India and South Africa, in turn called for the elimination of all American and European farm support. Neither proposal stood any chance of success.

It is true that the 'G-20' countries, which are the low and middle-income economies, exhibited unprecedented influence at Cancún. But the G-20's superficial success masks profound differences among the key members of the group. Brazil, the group's leader, has growing export interests in agricultural commodities and some industrial goods. India came to Cancún intent on shielding its market from further import flows for the time being. China wanted to avoid making further liberalisation commitments so soon after the painful changes it had to make to join the WTO. The compromises that were necessary to hold this disparate group together created such sweeping demands – such as the complete elimination of US and EU farm support, while developing countries kept their markets closed – that the Cancún meeting was probably doomed before it began.

These internal contradictions raise doubts as to whether the G-20 has a future as a cohesive force in the WTO. But as EU trade commissioner Pascal Lamy warned in a speech after Cancún, "It is a mistake to see the G-20 as simply an agricultural phenomenon which emerged in response to the perceived inequities of the EU-US text. If the mother of the G-20 is agriculture, the father is clearly geopolitics. The G-20 is self-consciously positioning itself as a counterweight to the G8 in terms of global economic governance."[4]

[4] *The G8 comprises Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States.*

Finally, a group of poor African, Caribbean and Pacific countries – the 'G-90' in trade jargon – delivered the *coup de grace* to the negotiations by refusing to compromise on the Singapore issues. One important reason for their hardline stance was the fear that talks on trade facilitation and government procurement reform would strike at the corruption that still plays such a prominent role in many developing country economies. More broadly, this rather inchoate group of WTO members did not have a sufficient stake in the Doha negotiations to want the talks to succeed. The G-90 was particularly worried that further trade liberalisation would undermine their hard-won trade preferences, such as the Cotonou agreement which offers these countries privileged access to EU markets. Many were also worried that if they opened their markets to other developing countries' exports, competition from China would swamp their domestic producers.

Governments invariably blamed each other for the collapse of Cancún. But as Lamy noted, the blame game is neither productive nor useful. It is clear that the WTO's structural problems, highlighted by Cancún, pose a great threat to the organisation's future. In addition, the G-20 confrontation with the US and the EU

revealed a culture clash. Rich and poor countries, and even developing countries themselves, are bitterly divided about how best to capture the benefits and redress the inequities of globalisation.

Many developing countries, particularly those from Africa, treated Cancún as a morality play, a political stage upon which to air their grievances. Americans and Europeans stuck to the notion that the Cancún meeting was a trade negotiation in which participants should give and take. But the G-20's claims that its members had gained recognition and respect underscored their view that the Cancún summit was as much about political symbolism as about commercial progress. The debates in Cancún ominously reminded participants from some industrial countries of the bitter North-South disputes that blocked the United Nations Commission on Trade and Development (UNCTAD) in the 1970s. The WTO may never be able to deal effectively with such profound differences.

Moreover, the unwieldy nature of a club with 148 members, whose constituents have unequal stakes in the outcome of the deliberations and yet which operates by consensus, was exposed for the entire world to see. "The WTO is a medieval organisation," Lamy concluded after Cancún. "The procedures and rules of this organisation have not supported the weight of the task. There is no way to structure and steer discussions among [so many] members in a manner that is conducive to consensus. The decision-making process needs to be revamped."

It is clear that traditional methods in international negotiations now need serious reform. The EU had a strategy of keeping its cards close to its chest, refusing to compromise on the Singapore issues until the very last minute. But this strategy required trade officials from developing countries to respond with similar flexibility, which they could not. In future, leaders will have to signal their positions clearly and well in advance – a significant change in negotiating practice.

The Cancún meeting also showed that WTO members are too ready to place controversial topics on the agenda without thinking through their implications fully. In particular, ministers initially dubbed the negotiations the 'Doha development round'. But despite all the official rhetoric, governments could not agree in Cancún, either substantively or politically, about the role of development issues in the talks. The WTO failed to reach a consensus on how to ensure that trade benefits the poor; or on what kind of special treatment developing countries might enjoy, such as more time to implement intellectual property commitments.

American and European officials reasserted their long-held conviction that more trade is needed to boost economic growth in Africa, Asia and Latin America. But most developing countries rejected that argument. They claimed that they never gained many of the promised rewards of the Uruguay round, the last set of global trade negotiations. They argued instead that their desire to shelter infant industries was no different from the protectionism which the United States practiced in the 19^{th} century when it was establishing an industrial base. India, in particular, claimed that its 600 million poor farmers could not survive if exposed to competition from America's corporate farmers.

Finally, the Cancún ministerial meeting tested the patience of a key stakeholder in the Doha round: the business community. In an era when companies face intense scrutiny of their performance in quarterly, bottom-line results, the business community is increasingly frustrated that trade negotiations now take years to complete. The Uruguay round, finalised in 1993, took no less than seven years. By the time governments had settled on international rules to protect intellectual property, new methods of reproduction and transmission of copyrighted material had undermined these rules. For example, the explosive growth of the internet in the last decade has made it infinitely easier to ship pirated movies or music from one country to another.

Businesses are thinking more short-term. If governments proceed too slowly with multilateral trade talks, companies will consider other options. Many now consider it more worthwhile to cut deals directly with individual governments; or to support bilateral and regional trade deals; or even to file their own court trade cases to open foreign markets or protect their own. Trade negotiations that cannot keep pace with the evolving needs of the private sector risk losing business support. In the wake of the failure in Cancún, it is clear that both the American and European business communities are now far less committed to the Doha round than they were to the Uruguay round in the 1980s.

In Washington and Brussels, corporate trade associations such as UNICE have all issued obligatory statements encouraging governments to get back to the negotiating table. But trade negotiators and their political masters privately acknowledge that they feel little pressure from their respective business lobbies to strike a deal on the Doha round.

After the débâcle at Cancún, senior negotiators intended to resume talks in Geneva in December 2003. They hoped it might be possible to complete the round by January 2005. Initially, there were grounds for optimism. The Pacific Rim countries, at their APEC meeting in October 2003, endorsed the text they had failed to accept in Cancún. The European Union for its part said it would compromise on the Singapore issues. The US too signalled its readiness to start talking again.

But at that December meeting, the chairman of the WTO's General Council delivered a bleak report. Carlos Peres de Castillo concluded that there had been little progress since Cancún to bridge the wide gaps between WTO members. "We have witnessed little real negotiation. Gaps remain wide and there does not seem to be a sense of urgency," the chairman told the meeting. The EU, US and developing countries remained at odds over a series of substantive issues. In particular, governments were still divided over curbing agricultural subsidies and how far to open up developing countries' markets.

Then on January 11th 2004, Zoellick sent a letter to the trade ministers of other WTO member countries suggesting "ideas on how we might advance together". He called on trade negotiators to reconvene in Geneva in the spring of 2004. He proposed "an agreement to eliminate [agricultural] export subsidies". He restated his willingness to propose ambitious reductions in domestic farm support and improved market access for agricultural products. And he reaffirmed the US goal of "total elimination of trade-distorting subsidies and barriers to market access". On manufactured goods, Zoellick supported ambitious tariff cuts and reiterated American support for total elimination of tariffs for goods as soon as politically possible. Zoellick also called for trade negotiators to agree on 'negotiating frameworks' by mid-year (a task that was supposed to have been completed in Cancún).

On substance, Zoellick's proposal largely restated the existing US position on a range of issues. It contained no new initiatives. Its political significance lay in the attempt to breath new life into the Doha negotiations that were rapidly drifting into stasis. The positive response the letter elicited around the world suggests it accomplished this purpose.

The European Union immediately endorsed the bid to revive talks, suggesting that Zoellick's initiative had been choreographed in advance with Lamy. "We want to ensure that the round moves forward rapidly," Lamy said in a speech on January 19th in New Delhi. "2004 is a year of opportunity. The EU is ready to move."

The Indians, who were clearly blocking progress in Cancún, said they were willing to re-engage, along with the East Asian countries. Most importantly, many countries indicated they would be willing to resume talks using the text from Cancún – ensuring the WTO does not have to start from scratch again.

Governments reconvened discussions in early 2004 with the aim of devising a 'negotiating framework' for agriculture and other issues, by the summer. The Commission's proposal, announced in May 2004, to eliminate all export subsidies if other countries do the same, could inject momentum into the Doha negotiations. Many member-states have backed the Commission, although France, Ireland, Italy and others have reacted sceptically. Around the world, reactions to the proposals ranged from American enthusiasm to cautious optimism in the case of developing countries and the Cairns group. With these new EU proposals, the chances for reviving the Doha round have improved somewhat. But many serious obstables remain and the political window of opportunity is closing rapidly. Washington is unlikely to make additional concessions with the US presidential and congressional elections looming in November 2004. Lamy and the rest of the Commission will step down in October 2004, making it hard for the EU to focus on these talks for long. The uncertain effects of elections in India and South Africa further complicate the picture. It is a myth that there can be no progress on trade talks in election years. But the power of myths is that since everyone believes them, they become self-fulfilling prophecies.

Despite US and EU ambitions, few trade experts believe negotiators will manage to finish the Doha round by January 2005. At the very least, the WTO is likely to need to extend the timetable by a minimum of one year. Many trade experts doubt whether an ambitious new agreement is feasible, given the profound differences that surfaced in Cancún. Zoellick's letter of January 2004 proposed granting countries 15-20 years to implement some of the required reforms. For political leaders, such long transition periods buy time for electorates to adjust to change. Conveniently, they also ensure that those who negotiate trade-opening agreements do not have to deal with its consequences. But businesses increasingly operate on 18-month product cycles. Such lengthy delays in implementation would only add to the growing frustration among leading companies with the multilateral approach to trade liberalisation.

Meanwhile, trade negotiators are likely to expend as much energy in 2004 on finding a successor to WTO Director-General Supachai Panitchpakdi as they will on restarting the Doha round. The press will focus on the WTO's opaque dispute settlement mechanism, which is undermining public faith in the institution. And whoever is the American president in 2005 will have to work hard to persuade Congress to renew the 'fast-track' negotiating authority.[5]

[5] *Fast-track authority means that Congress can only accept or reject a trade agreement, not amend it.*

None of these problems are new. Multilateral trade negotiations have faced crisis and drift before. The Tokyo round of talks in the 1970s went into hibernation for more than two years. The Uruguay round dragged on well beyond its deadline. This current round had an aborted take off in Seattle in 1999, before governments agreed to a proper start in Doha in 2001. Global trade deliberations tend to have their own internal dynamic and pace. History suggests that at some point countries will reach a consensus, make reciprocal concessions and agree on measures to liberalise trade.

In the meantime, some governments are showing great interest in bilateral and regional trade agreements as a means of opening markets and boosting economic growth. Japan, for example, has negotiated free trade agreements with Singapore and Mexico. Tokyo is negotiating similar deals with several other Asian countries. Most importantly, the United States, once the driving force behind the multilateral trading system, has become the leading proponent of more limited deals. US Trade Representative Zoellick has described this new approach as a strategy of 'competitive liberalisation': the US will pursue trade liberalisation wherever and whenever possible – at the WTO, in regional or bilateral agreements – and use one set of negotiations to help make progress in the others.

In this vein, the US completed free trade agreements with Chile and Singapore in 2003. It has finalised negotiations with five Central American republics: Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua; as well as with Australia, the Dominican Republic and Morocco. And the United States has announced its intentions to seek market-opening arrangements with Bahrain, Thailand, Peru, Colombia and Bolivia. At the same time, the US is trying to finalise a comprehensive free trade agreement with all the countries of the Western hemisphere: the 'Free Trade Area of the Americas' (FTAA) initiative.

The FTAA talks, which began in 1994, have moved at a glacial speed, reflecting the difficulty in reaching agreement among such a disparate group of countries. The Miami summit of trade ministers of the Western hemisphere in November 2003 was supposed to give impetus to the negotiations. In the end, ministers could do little more than 'agree to disagree' on key issues such as agriculture and investment.

The failure at Miami, after nine years of discussions, has raised serious questions about whether trade talks can continue to succeed on the premise of the 'single undertaking'. Trade negotiations involving large numbers of countries have traditionally followed the principle that, at least in theory, every sector of the economy is under consideration and that 'nothing is agreed upon until everything is agreed'. In other words, there could be no separate deals for particular sectors of the economy. The aim of the single undertaking was to promote broad agreements across many sectors, thus enabling governments to make trade-offs and maximise the economic benefits of any agreement.

But in the wake of the disappointing outcome in Miami, the US has begun to talk about the possibility of a 'two-speed FTAA'. Those countries that can only accept minimal trade liberalisation should sign a basic agreement. Others would press ahead with a more ambitious deal, involving contentious issues such as investment and intellectual property protection. Washington's implicit threat has been clear: either governments agree to a single, comprehensive agreement at a high level of ambition, or the United States strikes its own deal with like-minded countries. In either case, foot-draggers –

even major trading powers such as Brazil – would not be allowed to hold back trade liberalisation for others.

Bilateral and regional trade agreements are, by their very nature, economically sub-optimal. They do not allow countries to maximise their comparative advantage in the global market. And they distort trade by shifting or retaining production in countries that might not be the most efficient producers of particular products. Moreover, the proliferation of these bilateral free trade agreements threatens to leave the poorest countries behind. They run the risk of losing out on the benefits of preferential access to the markets of rich countries because of their own, small markets; a lack of negotiating leverage; or simple accidents of geography or history that place them outside the orbit of large markets.

Nevertheless, the profusion of bilateral and regional trade agreements in the past few years suggests that many countries are not willing to let the pursuit of the perfect trade deal stand in the way of achieving good agreements. Economists note correctly – but somewhat idealistically – that multilateral trade liberalisation delivers far greater benefits than deals involving a limited number of countries. But business leaders and elected officials live in a more pragmatic world where half a loaf may be better than none. In a rapidly changing global economy, pragmatism may be a more realistic, productive and successful way forward for trade negotiations.

3 Manufacturing first: a proposal to move the trade agenda forward

The European Union and the United States must consider their next trade moves against a background of slow-moving WTO negotiations. Both have publicly stated they are still committed to reaching a meaningful Doha agreement. But after more than two and a half years of talk and very little action, it would be foolish for the EU and the US to place all their eggs in the one Doha-centred basket.

Europe and America need to shake up the somnambulant WTO and send a signal that ‘business as usual’ in Geneva is not acceptable. They must underline that they have every intention of working with like-minded countries to open markets and that the inhibitions of those which lack a similar commitment to free trade will not constrain them. And they need to remind WTO members of the lesson of the Miami FTAA meeting, namely that those governments who want more free trade can always go it alone. A two-speed WTO is clearly sub-optimal. But it may be the only alternative if some countries continue to block any further trade liberalisation.

The US and the EU should focus their efforts on reaching a more comprehensive deal in the manufacturing sector. Manufactured goods account for over 70 per cent of world trade. The WTO will only make a success of the Doha negotiations by concluding deep and comprehensive cuts in industrial trade barriers, which, despite repeated cuts over the years, remain a substantial obstacle to trade.

Governments might find a new initiative in agriculture a more attractive option. But differences on farm subsidies and market access have stymied the Doha round. A way around this brick wall is needed, not another effort to break through it. Equally, a services initiative might provide an even greater boost to a range of economies. Services account for a growing share not just of the European, American and Japanese economies but also of some developing countries, such as India. The US and EU should consider measures to boost transatlantic trade in services. But the WTO has not made much progress in this area, which means there is little to build upon. Developing countries, in particular, fear that if they opened their services markets prematurely to foreign competition, EU and the US firms would overwhelm domestic businesses.

Hence, manufacturing is the best option for a new, multilateral market-opening initiative. Since 1947, eight rounds of multilateral trade negotiations have cut industrial tariffs in developed countries from an average of 25 per cent to less than 4 per cent today. But although most industrial tariffs are low, they still represent a substantial proportion of the total duties collected by governments because of the sheer volumes of trade involved. US tariffs on EU products, for example, average only 1.5 per cent. But in 2001 they accounted for one-fifth of all US duties collected, which effectively represents a $3 billion tax on EU products sold in the United States.

Developing countries have, by and large, made much smaller tariff reductions over the years. Currently, their average tariff rates are 12 per cent. But in some countries they can be much higher. Pakistan's duties average 47 per cent and India's 32 per cent. A reduction in these high barriers would primarily benefit other developing countries. 'South-South' trade is becoming one of the fastest-growing parts of world trade, accounting for over 40 per cent of developing country exports and for 70 per cent of the tariffs which consumers in the developing world pay.

Finally, global manufacturing trade is in the doldrums and needs a jump-start. In 2002, merchandise exports from the EU to the rest of the world grew by only 2 per cent, just half the average rate of growth between 1990 and 2000. Worse, EU imports actually shrunk by 1 per cent in 2002, after growing on average 5 per cent per year during the 1990s. Similarly US exports (in volume terms) declined in 2002 by 4 per cent, after expanding 7 per cent per year in the 1990s. Imports grew by only 5 per cent, after average annual growth of 9 per cent in the 1990s.[6]

[6] *WTO, 'International Trade Statistics', 2003.*

Moreover, there is a precedent for a manufacturing initiative. In the Uruguay round of trade negotiations, governments of a small number of major trading partners decided to phase out import duties in 10 industrial sectors, such as pharmaceuticals, farm equipment and distilled spirits. The impact on trade was demonstrable. US exports in the 10 'zero-for-zero' categories grew 20 per cent between 1996 and 2001.

Similarly, in 1996, 29 countries signed an information technology agreement (ITA), designed to eliminate all tariffs on products such as office machines, scientific instruments and telecommunications equipment. Governments stipulated that the agreement would only come into effect when countries representing at least 90 per cent of all world IT trade had ratified it. The political impact of this requirement was remarkable: it became clear that a train was leaving the station – and no one wanted to be left behind. By the end of 2003, 61 countries were ITA signatories and the ITA is now benefiting both rich and poor countries.

While there is no overall estimate of the economic impact of the ITA agreement, the US Information Technology Industry Council has estimated that the deal encompassed IT trade of $500 billion in 1996 alone.[7] As another measure of the agreement's impact, between 1995 – before the ITA deal – and 2002, global trade in office machines and telecommunications equipment grew 39 per cent.

[7] *See http://www.itic.org/sections/docs_trade.html.*

A joint US-EU initiative to create truly 'zero-for-zero' trade in manufacturing could draw on a number of existing proposals. In December 2002, the US government proposed to eliminate by 2010 all tariffs on a range of products, including construction machinery, furniture, medical equipment, paper, steel, toys and electronics goods. All other tariffs would disappear by 2015. At the same time, Washington proposed to eliminate non-tariff barriers to trade, such as time-consuming import procedures.

The US proposal closely resembled ideas which private sector organisations had put forward. For example, the National Foreign Trade Council, which represents nearly 400 US companies, called in May 2002 for the elimination of all tariffs on industrial goods by 2020, with no exclusion for any product or country.[8] The Council proposed a four-step process, with most of the cuts coming in the first few years. Under its proposal, developing countries would have more time to phase in tariff cuts, but they too would eventually have to abolish all industrial tariffs eventually.

[8] *The National Foreign Trade Council, 'Vision 2005: free trade and beyond', Washington DC, May 2002.*

The Zero Tariff Coalition in the United States, which represents major manufacturing interests including the powerful National Association of Manufacturers, has proposed a sector-by-sector elimination of tariffs. An important aim of their proposal was to tackle the huge disparity between low US and EU industrial tariffs and the high tariffs in many developing countries. Under this plan, countries comprising a 'critical mass' of trade in a particular sector would agree to eliminate tariffs in that sector as soon as possible. By requiring a critical mass of countries in each sector, the plan allowed the least developed countries to opt out, while ensuring the agreement remained commercially meaningful. In addition, the Zero Tariff Coalition proposed an across-the-board goal of cutting all other tariffs (apart from agriculture) in half. They considered this a stepping-stone towards the eventual elimination of as many non-agricultural tariffs as possible.

Most recently, Ernest H. Preeg, a senior fellow at the Manufacturers Alliance, has put forward an innovative scheme under which countries would agree to cut manufacturing tariffs by 10 per cent per year for 10 years until they were eliminated.[9] Preeg argues that moving any faster would cause highly protected industries to suffer disproportionate pain, which would only evoke a protectionist reaction.

[9] *Ernest Preeg, 'From here to free trade in manufactures: why and how', ITA/Manufacturers' Alliance/MAPI, Washington DC, July 2003.*

An EU-US initiative on free trade in manufacturing

Drawing on all these proposals, a joint EU-US 'zero-for-zero' initiative on manufacturing to kick-start the Doha round would:

★ Create genuine free trade in manufactured goods by 2015. Government could choose two routes to achieve this goal: an all-inclusive agreement or one that pursues sector-by-sector negotiations. But to limit foot-dragging, the US and EU should set a six-month deadline for determining which approach to pursue.

★ Require agreement of a critical mass of countries, constituting 90 per cent of total trade, before any deal could take effect. In concrete terms, this requires the participation of at least 15 key players – including the European Union, the United States, Japan and China. Brazil and India may need to take part to ensure broad support from the business community in America and Europe. But if Brazilian and Indian obduracy threatened to slow negotiations, Washington and Brussels should negotiate only in those sectors where Brazilian and Indian industry are not significant players, leaving them out in the cold.

★ Phase out duties over ten years, with 10 per cent cuts each year. This proposal would only be politically viable if very poor countries obtained longer phase-ins. It is probable that this approach – unlike the complicated tariff-cutting formulas now under consideration in the Doha round – would meet resistance from countries with particularly high tariffs. But many of those countries could opt out of the process. Moreover, since they represent such a small portion of manufacturing trade they could not form a blocking minority. And a straight tariff cut has the huge advantage of simplicity. It would be intelligible to the average citizen, lending much-needed credibility to the WTO negotiations. Some industries should quickly reap the benefits of the tariff cuts, ensuring that they would lend their support to the initiative. A decision not to leave tariff cuts largely to the end of the process, as the WTO did with the current phasing out of textile quotas, would mean that political opposition would decrease rather than escalate over time.

The economic benefits of eliminating manufacturing tariffs would be substantial. US trade officials work privately with estimates indicating that industrial duties amount to a $190 billion tax on world consumers. Developing countries pay $57 billion in duties for their trade flows with other developing countries. Consumers in industrial countries pay $16 billion extra for goods imported from other industrial countries. Governments should be able to eliminate most, if not all, of this tax.

But these savings on duties, welcome though they would be, represent only a small part of the total economic benefits of a further round of tariff cuts. Economists variously estimate the removal of tariffs would stimulate extra economic activity worth between $632 billion and close to $2 trillion.[10] Developed and newly industrialised countries would share the economic benefits roughly equally, raising GDP by up to 4 per cent in the former and 8-12 per cent in the latter.

[10] *See Drusilla K. Brown, Alan V. Deardorff and Robert M. Stern 'Computational analysis of multilateral trade liberalisation in the Uruguay round and Doha development round', University of Michigan, December 8th 2002.*

Many Europeans and Americans, especially in the NGO sector, are concerned that trade policy should be more explicitly geared towards

promoting economic development in poor countries. Hence it is worth underlining that the least developed economies would reap particular rewards from a manufacturing initiative because they would gain duty-free access to the American, European and Japanese markets. Under the WTO's 'most favoured nation' (MFN) principle, they could receive the benefits of market opening without necessarily having to reciprocate by lowering their own tariffs. (The MFN principle requires WTO members to extend the lowest tariff they offer to another country to all WTO members). However, they would forgo important benefits to their consumers by keeping their tariffs in place.

Most importantly, the value of a manufacturing initiative is not purely commercial, but tactical. Nothing concentrates the minds of people around a table like the fear of being dealt out of the game. The impasse in the Uruguay round finally ended when it became clear to the EU and Japan that the US was willing to pursue trade liberalisation through initiatives such as the North American Free Trade Agreement (NAFTA) and Asia-Pacific Economic Co-operation (APEC).

A manufacturing initiative in the context of the Doha round would send a similar signal to other countries that Washington and Brussels want results, not endless talk and procrastination. It would indicate that if, by the end of 2004, the United States and Europe saw no chance for progress on the broad Doha agenda, they would pursue a narrower deal that is fully WTO consistent. At that point, the G-20 and others would have to make a choice. They would have to decide whether to reach a broad multilateral agreement, even if they did not get everything they wanted on agriculture. The Doha round could then finish quickly. Or they could refuse to deal with Washington and Brussels. But the experience of the Information Technology Agreement, and the other examples outlined above, suggest that few countries are willing to walk away from the negotiating table.

Both the United States and Europe could also gain significant political advantage from such an initiative. At the start of the Doha negotiations, the EU insisted that it required progress on the Singapore issues to balance out the concessions it would have to make on agriculture. The EU has subsequently had to scale back its ambitions in the wake of the disaster in Cancún. It is unlikely to achieve much on the Singapore issues during the current round of trade talks. But progress on manufacturing issues could be a helpful compensating result.

In the United States, the business community has demonstrated only very limited enthusiasm for the Doha round. The benefits of success are not as clear-cut as they were for the Uruguay round, when they included new global rules for intellectual property protection and the liberalisation of trade in services. But a manufacturing initiative would quickly yield concrete commercial benefits.

Obstacles are real but not insurmountable

A zero-for-zero manufacturing initiative would face both technical and political obstacles. The WTO's MFN principle means that, in theory, all WTO members could take advantage of the zero tariffs, whether they have agreed to the deal or not. The MFN rule exists to ensure that preferential agreements among a subset of countries do not disadvantage others. Moreover, countries stuck to the MFN principle when they implemented the Information Technology Agreement, so even though only 61 countries signed the deal, all countries get duty-free access to those markets.

Washington and Brussels could choose to ignore the MFN principle. There are previous examples of breaches of the MFN commitment. For instance, the EU offered trade advantages to the countries of Eastern Europe after the end of the Cold War and it has trade deals with the EFTA countries – Iceland, Liechtenstein, Norway and Switzerland – whose benefits it does not extend to all countries. No country has challenged such agreements in the WTO. But a defiant 'sue us if you don't like it' stance by the world's two largest trading entities would risk driving the final nail in the Doha coffin. And one

key purpose of the zero-for-zero initiative would be to breathe new life into the WTO talks, not to kill them. At the same time, it would be a useful negotiating strategy to remind foot-dragging countries that, when there are compelling reasons, a precedent exists for ignoring the MFN principle. For that reason the EU and the US should, if the Doha round continued to drift, consider the elimination of trade barriers in the manufacturing sector on a non-MFN basis.

Supporters of multilateral trade liberalisation will argue that the pursuit of an agreement limited to cutting manufacturing tariffs across the board or sector by sector, would undermine the single undertaking in the Doha round. But that argument presumes that governments will make real progress in the Doha round. Sadly, that does not look very likely. More importantly, history disproves the objection that countries can only forge sectoral deals as part of a broader round of multilateral negotiations. WTO members have agreed numerous sectoral arrangements, covering trade in most information technology products, telecommunications and finance, which have not been part of a broader negotiation. Why should manufacturing be the exception?

The Cairns group and many developing countries, which have insisted that the Doha round should cut farm subsidies, will object to a manufacturing initiative. They are bound to argue this is yet another delaying tactic, reflecting the unwillingness of the EU and the United States to end trade distorting farm payments. Their strategy is to hold up progress in other sectors to achieve concessions in agriculture. But the history of the Uruguay round disproves the effectiveness of such a strategy of 'issue linkage'. The November 1992 Blair House agreement on agriculture – the deal on farm subsidies that broke the log-jam in the Uruguay round – did not come about because of pressure from the manufacturing or service sectors. It was a minimalist deal that fell far short of the Cairns group's ambitions. But it was the most that farmers in Europe and the United States could live with. Moreover, budgetary constraints in the US and Europe at that time made some cuts in farm support necessary for domestic reasons.

Thus, a strategy of holding up progress on manufacturing in the Doha round will merely punish the manufacturing sector in both rich and poor countries without helping farmers outside Europe and the United States. Moreover, such objections from Cairns group members are mostly tactical, rather than based on principle. Australia, the leader of the Cairns group, demonstrated a pragmatic willingness to accept minimal concessions on agriculture in return for progress in manufacturing in the free trade agreement it signed with the United States in February 2004. In this deal with Washington, Canberra received no new access to the US market for its sugar producers; an insignificant increase in access for its dairy farmers; and an 18-year phase in period for greater access for its cattle producers.

Domestic opposition in America and Europe is a much greater threat to the manufacturing initiative. A plan to eliminate manufacturing tariffs would remove the last formal barriers inhibiting imports from China, which is globally competitive across a range of manufactured products. China accounted for 10.4 per cent of all US imports in 2003, up from 8.6 per cent in 2000. During that period the US manufacturing sector shed nearly 3 million jobs. Most job cuts are not attributable to imports from China, but to the economic downturn, computerisation in American factories and changes in consumer demand. However, American anger that an undervalued Chinese currency fuelled that country's export success has sparked calls in the US Congress for new import tariffs that are probably illegal under WTO rules. The prospect of even easier Chinese access to the US market would likely trigger widespread scepticism, if not outright hostility. Opposition can also be expected in the EU. In 2003-03, Chinese-made imports have grown from 6.8 per cent of total European imports to 8.3 per cent. A zero-for-zero tariff deal would accelerate such trade, sparking a potentially protectionist European outcry as well.

For these reasons alone, China cannot be a free rider, gaining market share in America and Europe without granting reciprocal access. Manufacturers in the United States and Europe would need to increase their sales in the Chinese market to counter protectionist fears in their home markets. Beijing will have to do more than simply cut its import duties to permit European and US exporters equal access to its markets. It must foreswear the temptation to replace tariffs with non-tariff barriers and also accelerate its long-overdue appreciation of its currency to make imports more affordable. Without such Chinese commitments, a manufacturing initiative in the WTO would have no chance of gaining political support in Europe and America.

Many developing countries are also likely to balk at a manufacturing initiative, claiming that cutting tariffs would hurt infant industries and rob them of much-needed government revenues. It is true that import duties accounted for roughly 15 per cent of total public revenue in the developing world in 2000-2001, according to the International Monetary Fund. But a 2003 IMF study concluded that "there is in principle no great difficulty in devising a policy mix to replace tariffs by indirect taxes in such a way as to preserve revenue without jeopardising other economic and social objectives." To cite just one example, over the last decade, Pakistan has weaned itself off a heavy dependence on tariff revenues, cutting the portion of total government revenue derived from import duties from 29 per cent in 1992 to 8 per cent a decade later.

Developing countries might also worry that a zero-for-zero initiative on manufactured products would eliminate the benefits that some of them now enjoy from preferential access to the US and EU markets. But three recent studies have shown that the loss of preferences would cut the value of developing country exports only slightly – between 0.2 and 1.7 per cent. This is because "many developing country exports are concentrated in non-industrial natural resource commodities, the overall export impact of the gradual elimination of tariffs for industrial goods would likely be even smaller".[11] And if poor countries in Africa, Asia and Latin America joined in cutting their manufacturing tariffs, the benefits which developing countries would gain through greater access to each other's markets would far outweigh their loss of preferential access to European and American markets. In sum, a zero-for-zero manufacturing initiative, if there is still no significant progress in the Doha negotiations by early 2005, should be able to draw on wide international support.

[11] *Mathew J. Slaughter, 'Tariff elimination for industrial goods: why the gains will far outweigh any losses', The National Foreign Trade Council, Washington DC, August 2003.*

4 Conclusions

Global trade negotiations inside the WTO are adrift. As a result, important European and American interests are in jeopardy. It is time for policy-makers in Brussels and Washington to engage in some creative thinking. The first priority should be a revival of the WTO Doha development round. To that end, the EU and US should show greater flexibility in their negotiating strategies, especially in the areas of agricultural subsidies and the so-called Singapore issues. The latest proposals of the European Commission to eliminate export subsidies, provided other countries follow suit, are a hopeful sign: they could unblock the long-stalled Doha talks. For their part, developing countries should demonstrate they are genuinely willing to agree to further trade liberalisation, including eventually a progressive opening of their own markets.

While highly desirable, a breakthrough in the WTO negotiations will be an uphill struggle. That is why Brussels and Washington should signal they would be ready to push a multilateral, zero-for-zero initiative in manufacturing if there is still no significant progress in the Doha negotiations by early 2005. The aim of such a bold initiative is simple: free trade in manufactured goods by 2015 for a critical mass of countries constituting 90 per cent of world manufacturing trade.

By seizing the high ground, the EU and the US would deny some developing countries, such as Brazil and India, the ability to delay further trade liberalisation by others. At the same time, the very poorest countries would obtain long 'phase-in periods', giving them more time to cut import tariffs. This initiative would thus help the least developed countries because they would benefit from greater access to the markets of rich countries without having to expose their infant industries immediately to devastating foreign competition. And the EU and the US would send a clear political message that they remain committed to multilateral trade liberalisation, by insisting that any initiative must involve 90 per cent of all manufacturing trade.

Such a tightly focused trade liberalisation initiative would be controversial. That is why the EU and the US should underline that their initiative is primarily aimed at injecting new momentum into the WTO negotiations, not at killing them. But it is both tactically wise and strategically prudent for policy-makers to develop a 'Plan B'. In trade, as in other negotiations, half a loaf is better than none. And the threat of a joint US-EU initiative on manufacturing may jolt trade negotiators into action and unlock progress in the Doha round.

The potential benefits from a EU-US initiative to liberalise trade in manufacturing products far outweigh the costs, especially since the alternatives would be persistent deadlock in the WTO; a rise in protectionism worldwide; and continued foot-dragging by reluctant trading partners. One of the key attractions of a manufacturing initiative is that it would be functional rather than geographical in scope. The EU and the US would thus stem the drift toward bilateral and regional trading arrangements and put the multilateral trading system back at the centre of trade liberalisation.

In jointly launching the initiative, the EU and the US would renew their leadership role in the WTO and reassert their common interest in a global marketplace free of trade impediments. The principal benefits would be economic, but a bold and innovative trade initiative would also have positive political side-effects. The EU and the US would also forge a new transatlantic purpose, rooted in economic self-interest, to offset the geo-political tensions that have so damaged the relationship in recent years.

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