

OECD Trade Policy Working Paper No. 27

**AFTER THE WTO HONG KONG MINISTERIAL
MEETING: WHAT IS AT STAKE?**

by
Ken Heydon



ABSTRACT

The WTO Ministerial Meeting in Hong Kong in December 2005 made some progress in advancing the Doha Development Agenda. But much remains to be done, particularly in settling negotiating modalities in agriculture and NAMA and in putting some flesh onto the bones of the GATS. And where progress was made it was qualified, whether in dealing with the concerns of African cotton producers or in improving market access for the products of the least developed countries. Given the work still to do, it is not guaranteed that new deadlines will be met or that the DDA will be concluded on time. There is much at stake should the momentum of multilateral liberalisation stall; analysis at the OECD points to the risk of both major opportunities forgone and of systemic strains to the multilateral trading framework. Developing countries would be amongst the principal losers. Charting the way ahead will require that trade policy be seen in a broader domestic context which recognises that market opening works best when it is backed by sound macroeconomic policies, flexible labour markets, a culture of competition and strong institutions. Through this lens, trade reform can be promoted as a necessary tool of growth and development rather than as a concession paid to others.

Keywords: development, growth, structural adjustment, agriculture, cotton, services, goods, trade facilitation, liberalisation, negotiating modalities, trade barriers, regionalism, macroeconomic, labour market

ACKNOWLEDGEMENTS

This study was prepared by Ken Heydon of the OECD Trade Directorate. The paper is published on the responsibility of the author. It is available on the OECD website at the following address: <http://www.oecd.org/trade>.

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After the WTO Hong Kong Ministerial Meeting: What is at stake?

by Ken Heydon¹

Keeping the train on the rails

A week before Hong Kong, the Financial Times journalist Guy de Jonquieres said two things could be predicted about the meeting. First, it would not succeed in resolving the outstanding deadlock in key areas. And second, it would be declared a success! He was right on the first point, and maybe half right on the second. At least the train has been kept on the rails.

Indeed, the story is not entirely gloomy. Progress has been made both in the lead up to Hong Kong and at the meeting itself. Let's first look at the lead up:

- If we take one of the more problematic areas, agriculture, the report of the negotiating chair, Crawford Falconer, referred to “genuine and material progress” having been made. The report talks of convergence having been achieved on disciplines on export credits and of the attainment of a working hypothesis of four bands for structuring tariff cuts.
- In the area of trade facilitation, the report by the chair of the negotiating group – the only report to be approved by Members ahead of Hong Kong - says, with reason, that “good progress has been made in all areas covered by the mandate”.
- On the eve of the meeting, WTO Members agreed to amend the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) to allow countries with insufficient pharmaceutical manufacturing capacity to import generic versions of drugs still under patent.
- Also on the eve of the meeting, Japan announced a \$10bn programme to promote poor countries' exports. And the EU committed to step up annual spending on aid for trade to €2bn by 2010.
- Over a somewhat longer period, we know from the OECD-WTO trade capacity building database that, since the launch of the Doha Development Agenda, the total volume of trade-related assistance has increased steadily to reach \$3 billion in 2004.

What about the meeting itself? Here we start to get to the heart of things.

The Hong Kong ministerial did indeed achieve some forward movement.

In **agriculture**, some progress was made under all three pillars. In market access, the revised ministerial text formalises the “working hypothesis” on structuring Members tariffs for reduction within four bands, with bigger cuts on higher tariffs. On domestic support, the text confirms the “working hypothesis” that the Aggregate Measure of Support would be classified in three bands. The EU will be in the top band, facing the highest linear tariff cuts, the US and Japan in the middle and everyone else in the bottom band. Notably, the text specifies that overall cuts in trade-distorting domestic support must be at least equal to or greater than the sum of the reductions in Amber Box, Blue Box and de minimis (exempted) support. This should make it more difficult for countries to simply re-classify subsidies in order to dodge reduction commitments. And for export

¹ This paper was presented by Ken Heydon at the Groupe d'Economie Mondiale, Sciences-Po on 20 December, 2005. The views expressed are those of the author and are not necessarily shared by the Members of the OECD.

competition, the text calls for the “parallel elimination of all forms of export subsidies and disciplines on all export measures with equivalent effect” by the end of 2013, with a substantial part of the elimination to be realised by the end of the first half of the implementation period.

Cotton was for many the litmus test of success in Hong Kong. Here, agreement was reached that developed countries will give duty free and quota free access to least developed country exports as of the conclusion of Doha Round negotiations. Developed countries (ie, the US) will eliminate export subsidies in 2006. The text also provides for faster and deeper reductions in trade-distorting domestic subsidies to cotton than those that will be achieved through the general schedules for domestic farm subsidies.

In **NAMA**, the text provides for a “Swiss” formula for tariff reduction, with bigger cuts for higher tariffs. Importantly, the text links the level of ambition for agriculture and NAMA, specifying that this ambition is to be achieved in a balanced and proportionate manner consistent with the principle of special and differential treatment.

And, in a key element of the development package, agreement was reached on the principle that developed countries, and developing countries declaring themselves able to do so, should provide, on a lasting basis, duty free and quota free access for exports from **least developed countries** by 2008.

Still a long journey ahead

Notwithstanding this progress, the overall result leaves an enormous amount of work still to do. And in some respects, the outcome is weaker than might appear at first sight.

In agriculture, the so-called core modalities, the formulas for cutting tariffs and subsidies, are left unresolved. This task, which was originally set for Hong Kong is now deferred until 30 April 2006, with the submission of draft schedules no later than 31 July 2006. This unfinished business includes the so far intractable issues of the relevant liberalisation thresholds for developed and developing countries, the treatment of sensitive products, developing countries’ self-designated Special Products, the Special Safeguard Mechanism, as well as disciplines on food aid, which the EU regards as tantamount to an export subsidy, export credits and the practices of state trading enterprises.

In cotton, it would seem that the overall reductions and the implementation schedules for domestic farm subsidies must be agreed before the depth and speed of cotton subsidy cuts can be negotiated. There will be no early harvest. And it is worth recalling that domestic subsidies make up 80-90% of total US support for cotton.

In NAMA, as in agriculture, the core modalities remain to be negotiated, within the same time period, including the vexed questions of the number of coefficients in the Swiss formula, the meaning of “less than full reciprocity” for developing countries, the development of sectoral initiatives and the treatment of preference erosion.

In services, there seems to have been a step backwards. The new text, instead of obliging members to enter into plurilateral market access negotiations, simply requires that they “shall consider such requests”. Genuine progress in the GATS will call for an intensified request-offer process, augmented by action within plurilateral groups with shared sectoral interests, leading though to multilateral commitments. Opportunities might be taken to draw on approaches

embodied in the Basic Telecoms and Financial Services Agreements. And there may be a role for some form of quantitative targets. None of these ideas were advanced in Hong Kong.

Even in trade facilitation, there is considerable unfinished business. While negotiating modalities had been broadly agreed prior to Hong Kong, developing countries are not ready to move to legal drafting on the substantive provisions of the agreement before more progress is made on the issue of technical assistance and capacity building. And further clarity is needed on how developing country commitments would relate to issues such as their development needs and implementation capacities.

And finally, the commitment in respect of market access for the products of least developed countries is weakened by the fact that the obligation relates only to, at least, 97% of products originating from LDCs (defined at the tariff line level) and there is no deadline set for the call to progressively achieve compliance with the Hong Kong obligation. The three percent reservation would account for some 330 tariff lines and for some countries this could effectively deprive them of market access for all of their products – it would certainly be highly restrictive on products such as textiles from Bangladesh or Cambodia.

At the centre of the challenge ahead is the fact that the blockages that we saw before Hong Kong are still with us. As one US Senator put it, negotiators have simply kicked the can down the road. Most critically, some parties (such as the EU) say they will not move further on agriculture until others move on services and NAMA, while others (including some developing countries) say the contrary. There are also stand-offs within sectors, as in services for example, where developing country demands on mode 4 (the movement of natural persons) are pitted against developed country expectations on mode 3 (commercial presence). Nor are stand-offs an exclusively North-South affair. In agriculture, the demands of some OECD countries (notably the US) that others (notably the EU) do more on market access, are matched by demands from some (notably the EU) that others (notably the US) do more to discipline food aid.

Why is progress so difficult?

One explanation that we hear is that of complexity. The agenda is just too full, some would argue. It is true that in contrast with successive GATT rounds, we are now engaged in real negotiations on agriculture, on opening up markets for trade in services and in dealing with the one Singapore issue that remains on the negotiating table, trade facilitation.

This complexity, it might be said, is now compounded by the greater diversity of negotiating parties. Developing countries and economies in transition are now much more active participants in the negotiating process. The range of players is certainly wider than during the Uruguay Round, with the G20, which includes Brazil, China, India and South Africa, playing a crucial role in seeking to secure developing country interests, especially in agriculture.

And while it may still be felt that progress in the DDA remains dependent on a broad measure of prior agreement between the United States and the EU, it is significant that the real motor of negotiations – albeit spluttering - has been the so-called New Quad of the US, EU, India and Brazil, augmented on occasions into the Five Interested Parties, including Australia. It was after all the FIPs who put together the 2004 July Framework Agreement that revived the Doha round. And on occasions, the FIPs are further augmented into the G6, which includes Japan.

Beyond this core, we have the G90, which draws together the poorer developing countries and the G10, with defensive interests in agriculture. And then there is a whole range of specific interest groups, carrying such splendid names as Friends of Fish, or Very Close Friends of Services.

One of the interesting dynamics at Hong Kong was the extent to which the G20 sought to find common cause with the G90, in furthering the interests of developing countries.

This greater complexity and diversity, together with a spoiling role played by many non-governmental organisations, may have contributed to the stand-offs that we saw before and at Hong Kong.

But stand-offs can lead to trade-offs, which are the very bread and butter of multilateral trade negotiations; I am not so convinced by the complexity argument.

The underlying problem is lack of the political will that is needed to surmount technical problems and to face up to some difficult adjustment strains likely to occur in the short term. And underlying the lack of political will is the widespread anti-globalisation sentiment among those in the advanced industrialised economies who elect our political leaders.

What we end up with is a potent mix of fear and complacency. Fear on the part of those who feel vulnerable to change. And complacency on the part of governments who are tempted to believe that trade and investment will keep booming, regardless of what happens, or doesn't happen, at the WTO. There is also complacency on the part of business. They have been much less engaged than during the Uruguay Round, and may feel, mistakenly, that they can get what they want from bilateral deals.

This is not just a lesson from Hong Kong. The same forces were at play in Cancun, two years ago, and risk being with us for some time.

The risks ahead – an enfeebled multilateral trading system?

A new deadline has been set for 30 April. But success then will be no more assured than it was in Hong Kong. And the timetable is becoming tight. If agreement on core modalities is not reached by the end of April, it will be very hard to finish the complex process of completing and negotiating actual liberalisation schedules in time to conclude negotiations by the end of the year. And if that deadline is missed, it will be very difficult to sign off on the DDA before the expiry of Fast Track (Trade Promotion Authority) in mid 2007. That in turn could spell a protracted period of drift, as it is by no means likely – after the bruising experience of CAFTA negotiation - that Fast Track will be renewed.

Nature hates a vacuum. If multilateral action stalls, other initiatives will fill the gap. Bilateral and regional deals will proliferate even more than in recent years. And plurilateral agreements, covering just specific sectors or disciplines, will be reached.

In the last ten years, almost 200 regional trade agreements (RTAs) have been notified to the World Trade Organisation. Thirty three new agreements were notified in 2004 alone, and 20 more in the first six months of 2005.

The imagery is striking. The first thing that happened immediately after the failed Cancun ministerial came to a sudden halt was that the Mexican hosts sat down with their Korean counterparts to work on a bilateral deal. In Hong Kong, the Egyptian trade minister used this

multilateral forum to announce that Egypt was about to embark on the negotiation of an FTA with the United States.

Does an enfeebled multilateral trading system matter? Let us consider what is at stake.

How much at stake?

I will suggest that there is a great deal at stake. But we should be careful not to exaggerate the cost, at least in the short term. If the multilateral system stalls, the world will not fall apart. Farms, factories and service providers will continue to produce. And international trade and investment will continue to grow. According to the latest OECD Economic Outlook, world trade grew by 7.3% in 2005. It is expected to grow by 9.1% in 2006.

But there will be a cost. And it will come in two forms: opportunities forgone and systemic strains

Opportunities forgone

Only a comprehensive multilateral process of negotiation will realise the full benefits of market opening and rules strengthening, where the political and economic trade-offs are maximised. Let's look at the potential gains from a successful DDA, and the consequential price of failure, in the four key areas of negotiation – agriculture, non-agricultural market access, services and trade facilitation. In doing so, I will focus particularly on the interests of developing countries; this is after all the Doha *Development Agenda*.

Agriculture. A lot of work has been done on measuring the potential gains from agricultural trade liberalisation. But this does not, by any means, guarantee certainty of prediction.

There has in fact been a scaling back of estimated gains, particularly for developing countries, as greater account is taken of the situation of net food importers, the effects of preference erosion and the fact that cuts in bound tariffs will not translate into corresponding cuts in applied rates. Bringing the impact on net food importers into the equation is important as market projections suggest that developing countries as a whole, and the least developed in particular, will face growing net imports of agricultural products.

As part of this re-assessment, it has also become clearer that the gains to developing countries from agricultural trade liberalisation will be rather concentrated among a small group of countries, with Brazil among the biggest beneficiaries.

But there are gains to be made. Recent work by Kym Anderson and Will Martin at the World Bank suggests that a Doha scenario involving a 75% tiered cut to bound agricultural tariffs, a 75% tiered cut to agricultural subsidy ceilings and abolition of agricultural export subsidies would raise developing country incomes by some \$23 billion, with GDP rising by 0.3% in Latin America, South Asia and Sub-Saharan Africa.

Identifying the source of gains is important, and will remain important as we try to generate momentum in the DDA. Fully one half of developing country gains come from their own liberalisation. And, according to the Bank, over 90% of gains come from tariff cuts, because of the favourable second-best welfare effects of export subsidies.

Moreover, as my colleague Stefan Tangermann has pointed out, even where OECD countries' agricultural policies do not harm *overall* economic welfare in developing countries, they certainly harm the economic and social well being of farmers in developing countries. And from a development perspective that is an important consideration.

And the quantification pendulum may swing back again. Most of the modelling work on which current estimates are based are static. As dynamic effects through productivity improvements are brought into the picture it is possible that we will see the estimates of potential gains increased.

Non-agricultural market access. Of the estimated \$97 billion gains from full tariff liberalisation for industrial goods under NAMA, some \$68 billion would accrue to developing countries. Fully unrestricted access to all the Quad countries (United States, EU, Japan and Canada) would produce substantial benefits for Sub-Saharan Africa, leading to a 14% increase in non-oil exports and boosting real income by about 1%. Looked at from another perspective, it is worth recalling that in 2002, Bangladesh was charged the same amount of tariffs (around \$330M) on its two and a half billion dollars of exports to the United States as France, whose exports to the US were worth \$30 billion.

The question of preference erosion looms large here, as it does in agriculture. However, we find that for all but a handful of developing countries, the gains from across the board MFN liberalisation more than offset the losses from preference erosion. And where there are net losses, the answer is not to forgo liberalisation but rather to provide development assistance to the developing countries concerned to enable them to diversify their exports.

Services. The measurement of potential gains from the liberalisation of trade in services is still in its infancy. The estimation of tariff equivalents for services barriers remains imprecise. And there is a growing realisation that costs incurred by foreign suppliers in order to overcome natural barriers, such as different languages and institutions, are mainly one-off fixed costs of entering the foreign market and cannot therefore be transformed into tariff equivalents.

But the modelling methodology is getting better and the data are becoming more reliable. And out of these improvements is a growing sense that the potential gains from open service markets are very great. This is not surprising. The service sector is now the biggest area of economic activity in all country groupings. Service barriers – usually in the form of behind-the-border regulatory requirements – are particularly high. And services liberalisation acts as a proxy for increased factor mobility – of labour (via mode 4 of the GATS) and of capital (via mode 3).

On some counts, the gains from services liberalisation could exceed gains in the area of goods by a factor of five. Developing countries stand to be amongst the major beneficiaries, not least because of their growing role as exporters of services. Developing countries are particularly successful in sectors such as port and shipping services, audiovisual, construction, and health services. And while developing countries have a clear comparative advantage in labour-intensive services, such as construction, technological advances in the telecommunications and computer industries has enabled them to become highly successful in skill-intensive computer-related activities.

But it may be through the opening up of *imports* that the greatest welfare gains will be realised – or forgone - from services liberalisation. This is because of the critical effects of services barriers on downstream users. Ongoing OECD analysis finds that if account is taken of services barriers, the effective rate of protection for some agricultural and manufacturing sectors actually turns negative, meaning that services barriers contribute to effective taxation of these industries, further

compounding the overall distortions to the economy. Examples of manufacturing industry in developing countries that are effectively taxed by services barriers include motor vehicles in Brazil, chemical products in Romania and mineral products in Thailand.

As we saw in agriculture, the sources of liberalisation gains are important and provide a pointer as to where negotiating effort should be directed. Modelling work suggests that considerably greater gains are likely to come from the liberalisation of market access than from the provision of national treatment. This is intuitively reasonable given that market access restrictions impact on all potential suppliers, foreign and domestic, while national treatment restrictions impact only on foreigners. This is not though the priority allocated by GATS negotiators; again this is not surprising given the central role of non discrimination in the WTO system.

Trade facilitation. We calculate that developing countries would capture two thirds of the gains from a DDA agreement on trade facilitation. Furthermore, if trade facilitation reforms are restricted to OECD countries, we estimate that the resulting trade diversion would cause a 3% income drop in developing countries. You will have noticed that it is becoming a recurring theme of this presentation that we are not doing developing countries a favour by allowing them to opt out of liberalisation commitments.

A particular, and legitimate, concern of developing countries in the area of trade facilitation relates to the costs that are likely to be associated with, say, customs reform. Even the most costly trade facilitation measures, however, bring cost savings elsewhere and generate additional government revenue through increased efficiency in revenue collection and improved customs effectiveness. Mid-way through a five year customs modernisation programme, Angola has increased revenue by 150%.

Nevertheless, some upfront costs need to be underwritten by the donor community. And coherence and sequencing are important, as some trade facilitation measures are prerequisites for others.

A multilateral agreement on trade facilitation would help lock in domestic reform while also providing a framework for international coordination and necessary technical assistance. The key here will be to ensure that necessary development assistance is offered, without holding the actual process of negotiation hostage to the aid-for-trade debate.

Another concern expressed by developing countries is that any commitments entered into as part of the trade facilitation negotiations could become subject to dispute settlement. However, as WTO Members are not bound to implement trade facilitation commitments for which they lack the necessary capacity, they would be shielded from dispute settlement proceedings.

Systemic strains

Beyond these, not inconsiderable, opportunities forgone, a stalling of the motor of multilateral trade reform would see systemic strains which, over the longer term, could prove even more costly. I see three threats: the entrenchment of existing market distortions, the downsides of bilateralism and pressures on the dispute settlement system.

The dangers of entrenched distortions are nowhere more apparent than in agriculture, and that is where I shall focus. Some 30% of OECD farmers' receipts come from a combination of government interventions in markets and budgetary payments. What is even more important, fully

three quarters of this support comes from the most trade-distorting types of policy instrument such as import tariffs and export subsidies.

Do these costly agricultural support policies meet their objective of supporting small farmers? It seems not. In the OECD area one dollar spent on price support adds a mere 25 cents to farm income. And because domestic support is still coupled to production, most of the benefits accrue to very large wealthy operators, not to the small farms. In the EU, the 25% largest farms receive 70% of all farm support. In the US the figure is 90%. And from the path breaking work that is being done here at the Groupe d'Economie Mondiale, we know that in France over a quarter of CAP support goes to just 5% of farmers.

The relationship between regionalism and the multilateral trading system is a topic in its own right and I shall only touch upon it. It is also not a black and white matter.

Regional trade agreements can be more ambitious than the WTO. Many of them, for example, provide for a negative listing approach to services liberalisation, which is generally regarded as being more comprehensive and transparent than the positive listing approach embodied in the GATS. And there can be synergies, such as the way in which the GATS Understanding on Commitments in Financial Services took advantage of insights gained in financial market opening at the regional level.

But regional and bilateral deals can introduce systemic strains through the diversion of trade and investment, and through the increased costs imposed on business by the proliferation of rules of origin and product standards. What is more, sectors that are hard to liberalise at the multilateral level are likely to prove just as intractable regionally or bilaterally; agriculture and audiovisual services are clear examples of this.

And though it is usually denied, the negotiation of RTAs does impose an opportunity cost on the scarce time of trade policy officials.

The key conclusion that we have reached in our own work in this area is that regional and bilateral agreements will only complement the multilateral trading system if that system is itself strong. Only if the WTO system is bringing down MFN trade barriers and strengthening trade rules will the risks of regional distortions be contained and the opportunities for synergies be maximised. Viewed in this way, the pursuit of regional deals as an alternative to an enfeebled WTO system is a cause for concern.

Turning to the third systemic risk, there is a danger that if the DDA process stalls the WTO will, as one observer has put it, proceed by litigation instead of legislation; in other words, there is a danger that dispute settlement will take the place of rule making. This in turn would put even more strain on the dispute settlement process and, without the underpinning of progressively strengthened rules, eventually undermine the authority of the process itself.

The dispute settlement system has not been working badly. Though the number of disputes has grown, decisions are for the most part respected and implemented. And of the over 300 disputes submitted to the WTO since its creation in 1995, only a handful of disputes have not yet been resolved. But dispute settlement cannot operate in a policy vacuum.

Charting the way ahead – not by trade alone

We should not lose sight of the promise of the Doha Development Agenda. It brings with it the chance, in agriculture, to move from trade-distorting policies to ones that do less harm to the trading system while more effectively meeting domestic farm policy objectives. In NAMA, there are opportunities to maximise the gains from international specialisation. In services, some flesh might finally be put on the bones of the GATS, with genuine market opening commitments. And in trade facilitation, very large efficiency gains could be realised within a framework of development cooperation.

It may be possible in the months ahead to stitch together a deal that will, through scaled down ambition, avoid a total setback and keep the train on the track. But this will not fulfil the promise of the Doha Development Agenda, nor reap the gains on offer from global trade and investment.

This brings us back to the question of political will. If the DDA is to be brought to a genuinely successful conclusion, as the Secretary General of OECD said at Hong Kong, there needs to be a change of mindset. Trade policy needs to be seen in a broader domestic context which recognises that market opening works best when it is backed by sound macroeconomic policies, flexible labour markets, a culture of competition and strong institutions. Market opening works best – and maybe only works at all - in a coherent policy environment which facilitates the movement of labour and capital from declining to expanding areas of activity.

Through this lens, trade reform can be promoted as a necessary tool of growth and development rather than as a concession paid to others. And through this lens it might then be possible to agree on a mechanism whereby once a country's trade under regional deals reached a certain level, preferences embodied in those deals would be multilateralised on an MFN basis.

Policies at the national level must acknowledge that globalisation does result in a decline in certain areas of activity, and that measures are needed to smooth the necessary adjustment for the people concerned.

In some cases targeted measures may prove effective in correcting for market failure, but when used such measures should be transparent and cost-effective. In particular, should it be considered necessary to use safeguard measures, it should be on the basis that their potential benefit in providing breathing space for – and public acceptance of – structural adjustment exceeds the costs they entail.

Let me give just one example. In the mid-1980s, Harley-Davidson was allowed safeguard protection against imports from Japan as part of a restructuring package. The restructuring worked – the number of Harleys is testimony to that. But there was a cost. To be precise - \$150,000 for every job saved. The important thing though is that the cost was known, and so an informed decision could be taken about the merits of assistance.

Nowhere is policy coherence more important than at the interface between trade and development. This is partly a question of international cooperation, not least among aid donors. But it is also a question of pursuing whole-of-government policies at the national level.

The main outcome of Hong Kong was a strengthened commitment to the development dimension of the Doha round and to the need for aid for trade. But the fact remains that the best way to lift countries out of poverty is through reduced barriers to market access. This should include developing countries' own barrier reduction, as an exercise of enlightened self interest in a framework of domestic policy coherence. Improving market access continues to be a very elusive goal and failure to seriously address this goal was undoubtedly Hong Kong's biggest shortcoming.