

## WTO Reform: The Time to Start Is Now

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## SUMMARY

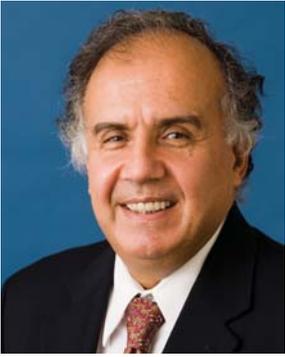
- Since its inception in 1995, the World Trade Organization has been the guardian of stability and predictability in world trade, but it has failed to fulfill its promise as a source of new trade rules and liberalization.
- Conclusion of the diluted Doha Development Agenda will not end the need for WTO reform.
- At the heart of WTO reform must be a more flexible approach to negotiations, one more tailored to the needs of individual countries and groups.
- The process of reflection and consultation on WTO reform should begin with the WTO Ministerial in Geneva in November.

The World Trade Organization (WTO) is an essential plank of globalization. Imperfect and incomplete as WTO disciplines are, they provide a degree of predictability and stability to trade relations, the value of which has been brought home yet again by the global financial crisis. In a world of sluggish growth and burgeoning protectionist pressures, the importance of rules increases and the need to strengthen them becomes more urgent.

But, to a worrying degree, the WTO is today living off the gains of its predecessor, the GATT (General Agreement on Tariffs and Trade) system. In crucial aspects of its traditional mission, namely reducing actual and bound (which is to say, maximum allowable) tariffs, the WTO has become increasingly ineffectual. In newer areas, such as cutting agricultural subsidies and opening up markets for services trade, it has so far failed to

deliver. Sluggish WTO negotiations have been overtaken by unilateral (that is, autonomous) liberalization as well as by bilateral and regional processes. Furthermore, in areas of crucial concern to the international community, such as food security, international financial regulation in the wake of the global financial crisis, and the trade aspects of climate change, the WTO is nowhere to be found.

Though the Doha Development Agenda, or Doha Round, is a greatly diluted version of what was launched in December 2001, its conclusion is critical to capturing the gains still on the table and to preserving the credibility of the WTO system. The recent G8 meeting called for a conclusion of the negotiations by the end of 2010. Given the long history of missed deadlines and the time needed for ratification, it is unlikely that implementation can begin before the end of 2011—the tenth



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A French citizen, Dadush previously served as the World Bank's director of international trade for six years and before that as director of economic policy for three years. He has also served concurrently as the director of the Bank's world economy group over the last eleven years, leading the preparation of the Bank's flagship reports on the international economy over that period.

Prior to joining the World Bank, he was president and CEO of the Economist Intelligence Unit and Business International, part of the Economist Group (1986–1992); group vice president, international, for Data Resources, Inc. (1982–1986), now Global Insight; and a consultant with McKinsey and Co. in Europe.

anniversary of the start of the negotiations. While Doha's conclusion—assuming there is one—would undeniably be a plus for the world economy and for the institution, it will not end the need for reform. On the contrary, as members confront the need to address issues barely touched by the past decade's Doha negotiations, they will be looking hard for a better way, making WTO reform even more crucial.

### An Essential Plank of Globalization

The system of rules and trade disciplines embodied in the WTO represents a unique and hugely important underpinning of international economic relations. Since its creation as an outgrowth of the Uruguay Round in 1995, the WTO has made negotiations more transparent and has increasingly involved its developing country members. It has also achieved concrete successes in four main arenas.

First, it has often provided effective bounds on raising tariffs, increasing subsidies, and imposing nontariff barriers. Nations have used the WTO's dispute settlement system frequently to arbitrate disagreements; of some 370 disputes that have been filed, just 84 rulings have been appealed, and most disputes have been settled by the parties. Increasingly, developing countries have resorted to the WTO's dispute settlement system; they have been involved in 80 percent of all cases. Even when the rulings found against the largest trading nations and genuine legal disagreements existed, the disputes were resolved amicably with compliance or the stated intention to comply, as in Brazil's cotton case against the United States and Norway's salmon case against the European Union.

Second, twenty-five new countries have been brought into the fold, taking the total membership to over 150 countries. China's accession provided improved access to a fast-growing market that, with 9 percent of world imports, is soon expected to be the largest trading nation. The framework of China's accession not only helped liberalize its trade

massively but also contributed to reshaping its economy along market lines. Three recent additions—Saudi Arabia, Ukraine, and Vietnam—each account for more than 0.5 percent of world trade.

Third, under the General Agreement on Trade in Services (GATS), economically significant agreements have been concluded among a large plurality of WTO members in telecommunications and financial services.

Fourth, thanks to incessant prodding by Director-General Pascal Lamy, the Aid for Trade initiative, which includes trade-related technical assistance to the poorest countries, has become established as a significant vehicle in several development agencies.

These undeniable successes have helped cement the institution's central role in fostering globalization. In the midst of a terrible global financial crisis, it was the WTO Secretariat to which leaders of the G20 turned to monitor protectionist measures and provide advice.

Yet the crisis has also exposed the inadequacy of WTO disciplines in areas ranging from government procurement and antidumping practices to industrial tariffs in developing countries. The spat earlier this year over "Buy America," for example, revealed the limitations of a government procurement agreement that did not include Brazil, Russia, India, or China among its signatories. That meant that the so-called BRIC countries with large and fast-growing economies had no obligations under the treaty (and also no recourse against discriminatory practices). The ease with which tariffs were raised in the EU (on antidumping grounds) on Chinese steel products, and in India on various products, illustrated the weakness of antidumping disciplines and the large gap that still exists between bound and actual tariffs in most developing countries. And the financial crisis has underscored the dangers of a prolonged stall in the extension of WTO disciplines to the most pressing areas of incomplete liberalization. These include, among others, the huge agenda of codifying and opening

up trade in services; reforming agricultural protection regimes in both industrial and developing countries; and lowering actual and bound manufacturing tariffs in developing countries.

### Sidelined on Liberalization

In the decades preceding the current crisis, world trade boomed, tariffs came down to a fraction of their historical levels, and the GATT/WTO often acted as a crucial bulwark against backsliding. During the fifteen years of the WTO's existence, however, trade liberalization has occurred everywhere *except* Geneva. While countries cut tariffs autonomously and signed hundreds of new regional agreements, the multilateral system sputtered. The last general multilateral agreement goes back to the Uruguay Round in 1994 (before widespread use of the Internet and ubiquitous use of cell phones). An analysis by the World Bank concluded that reductions of applied tariffs on trade in goods since 1995 is predominantly attributable to autonomous liberalization (65 percent), followed distantly by the implementation of the Uruguay Round (25 percent), and regional arrangements (10 percent). In other words, no significant new liberalization

of trade in goods (or reductions in bound tariffs) has come from multilateral negotiations since the WTO's inception in 1995.

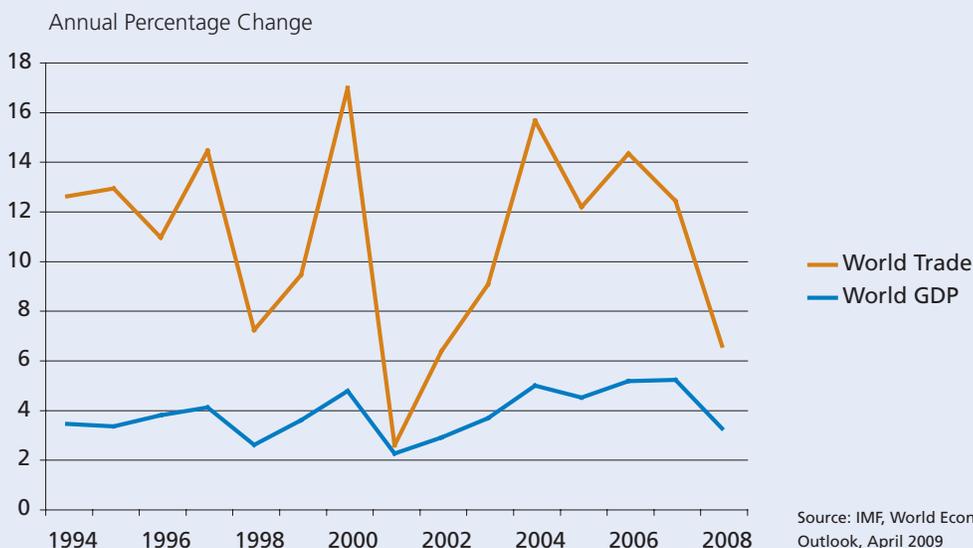
A review of eight rounds of multilateral liberalization suggests that each round has taken progressively longer and yielded less per month of negotiation. The first round (which involved twenty-three members) was

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concluded in less than a year and yielded cuts in bound tariffs of 26 percent from very high initial levels. The Uruguay Round (which involved 123 members) yielded cuts in bound tariffs of 38 percent from much lower initial levels; it took seven years to conclude. The outcome of the ninth round, the Doha Round (which involves more than 150 countries), is uncertain as it approaches the ninth year of negotiations.

Many reasons have been put forward to explain why rounds have become successively more difficult and why the difficulties have culminated in a stagnated Doha. The most

CHART 1 World Real GDP and Trade



compelling explanations underscore the effect of various forces in combination: the increased sensitivity of the issues (agriculture); the complexity of trade-offs in behind-the-border regulations (services); the growing number and diversity of players; and the increased influence and assertiveness of large players (India, Brazil) and of groupings (the least developed countries) have all combined to make the process unwieldy. Against this background, the need to decide on a consensus (read: unanimous) basis on a single undertaking (no opt-outs from any part of the agreement) has made negotiations a daunting task. Progress has been possible,

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but only by converging toward a very low common denominator. Private sector interests have recognized the negotiations' unfavorable effort-to-results ratio and have been largely absent. Predictably, the highly diluted benefits that would result from such a process have—so far, at least—reduced the appetite of large players such as the United States and India to make the modest, but politically costly, concessions needed to close the deal.

Still, concluding the Doha Round is essential to preserving the credibility of the WTO as an institution and to avoid writing off the fruits of eight—or perhaps ten—years of costly negotiations. But it is also difficult to escape the conclusion that far from confirming the value of the current process, any eventual deal will lead to a chorus of demands to reform it. Although Doha is touted as a “development round,” estimates of the annual gains to developing countries have been progressively whittled down from more than \$100 billion, when the negotiations were launched in 2001, to less than \$20 billion—about the cost of

bailing out a medium-sized U.S. bank—today. Moreover, the binding commitments—not to mention the real liberalization—of developing country barriers in the current proposal are nearly inconsequential.

### **Outlining the Reform Agenda**

The WTO is driven entirely by the political and economic interests of its many member states. Not surprisingly, there is no agreed blueprint for WTO reform. However, the following steps are evidently needed and would amount to a wave of progress that would bring the WTO back to the center of global economic integration.

The first step in dealing with a problem, of course, is to recognize its existence. Some have argued that actual negotiations on reforming the WTO cannot be initiated before concluding Doha. But, short of negotiations, it is surely possible to begin a serious process of analysis, reflection, and consultation on WTO reform now without compromising Doha. Serious discussions on the functioning of the organization would enhance its credibility and might actually encourage negotiators to conclude Doha so as to move on to the next phase. WTO reform is likely to be at the top of the agenda of any realistic post-Doha scenario anyway. Taking a cue from financial regulation, perhaps a good place to kick-start the process is at a G20 summit, outside the bounds of the WTO itself.

Second, the WTO must break away from its splendid isolation amid a sea of fast-changing trade relations. It must move from a single-minded focus on reciprocal multilateral concessions based on consensus—negotiations that are bearing insufficient fruit—and find ways to contribute actively in arenas where actual liberalization is taking place. This implies addressing the following issues:

**1. How can the institution assist its members in enacting autonomous trade reforms?** Experience shows that they are inclined to engage in autonomous reform, and—contrary to the

prevailing mercantilist logic of negotiators—trade theory and empirical evidence point overwhelmingly to the benefits that countries derive from opening to global markets. How can the WTO draw on the experience of the World Bank and the International Monetary Fund and work with them on programs of trade and complementary reforms at the level of individual countries? In this regard, how can the WTO exploit its Trade Policy Review Mechanism? The trade review mechanism is now a useful diagnostic instrument, and it has the potential to provide the basis for an ongoing dialogue on trade reform.

**2. How can the WTO reduce its reliance on the consensus rule and instead promote agreements among a critical mass of members that establish new rules or achieve new market access in important sectors; comply with some well-identified criteria to minimize the adverse effects on nonmembers; can be extended to nonmembers on reasonable terms, including favorable treatment for the poorest countries; and are subject to dispute settlement?** Such “plurilateral” agreements will be challenged—especially by the smallest and poorest countries—on the grounds that they discriminate or that they can preempt the broader agenda. Yet the alternatives of vacuous global deals or immobility are surely worse. Moreover, small and poor countries may find that there are agreements of primary interest to them. The answer is not to forbid plurilateral agreements but to proceed on a small set of such agreements that reflects the interests of smaller and poorer countries as well as those of larger and richer ones. It is also important to promote procedures that make plurilateral agreements less exclusive and subject to an effective dispute settlement process that protects the weakest.

**3. How can the WTO harness the energy behind regional agreements?** While research has shown that many regional agreements are badly designed and implemented (and

that some exist only on paper), it has also shown that others—starting with the EU, the North and Central American free trade agreements, and even some South-South agreements, such as the Pan-Arab Free Trade Area, the Gulf Cooperation Council, and the Southern Africa Customs Union—have been genuinely successful in removing barriers, increasing the certainty of access, and creating trade. Regional agreements can also more eas-

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ily deal with difficult behind-the-border impediments to trade, and they provide fertile ground for experimentation and advancing disciplines that can be adopted more broadly. How can the WTO cease viewing regional trade agreements solely as a threat and start treating them—as do large segments of the business community around the world—as an opportunity to advance trade? A large body of research has identified the essential characteristics of welfare-enhancing regional agreements that minimize discrimination: a low external tariff; simplified rules of origin; and coverage of all forms of trade. How can the WTO promote and even encourage—rather than ignore or frown upon—the formation of well-designed, welfare-enhancing regional and bilateral agreements among its members? How can it facilitate the harmonization and reduction of their external tariffs, and how can it foster accession to them of smaller and poorer countries that might otherwise be excluded? Establishing effective rules to govern regional agreements should be the WTO’s long-term objective, but its constructive engagement with regional processes is a prerequisite to achieving that goal.

Third, the WTO must decide on how the progress achieved along the unilateral, plurilateral, and regional channels can eventually be “multilateralized” and translated

into a set of enforceable rules. Recent experience demonstrates conclusively that a good way *not* to do this is to have a big, comprehensive trade round.

A realistic approach to multilateralization must first recognize that its principles (such as most-favored nation status and nondiscrimination) exist only as ideals. WTO multilateral agreements, not least the current Doha drafts, are rife with exceptions, special

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treatment, and nonreciprocity. Thus, the real choice is not between partial agreements and all-encompassing ones that treat everyone the same. It is between partial agreements that are negotiated separately among a subset of members or partial agreements that are bundled together into one package that everyone agrees to. There are at least three nonexclusive ways to achieve multilateralization:

- One approach is to encourage the “flexible geometries” of agreements to become wider when possible, by extending plurilaterals to a larger group of members. China and the United States, for example, have agreed to pursue China’s inclusion in the WTO’s Government Procurement Agreement. Over many years, great advances in open trade have been made on the basis of autonomous and regional processes alone, but the WTO can make a big contribution by consolidating the gains made under these

agreements (see below) and complementing them with plurilateral approaches.

- Another response is to seek specific opportunities to consolidate liberalization that has already occurred or that requires only modest steps across the board. WTO members might act to, among other things, agree to eliminate all tariffs under 3 percent; ban export subsidies in agriculture; adopt a unified code for rules of origin (or at least adopt a voluntary code on rules of origin); or provide duty-free, quota-free access to least developed countries. More than one of these steps could be promoted simultaneously to address a diversity of interests without going through a full-fledged negotiation on everything.

- Yet another approach is to promote agreements in which one country or a group of countries bind actual tariff levels or service schedules in specific sectors, both as a self-restraint mechanism and as an inducement to others to do the same. One could imagine, for example, a G6 group consisting of the United States, EU, Japan, China, India, and Brazil—which together account for more than 80 percent of world trade—agreeing on such a step and adopting a common approach to induce other countries to do the same.

Fourth, implementing a more flexible, multidimensional, and opportunistic program of global trade reform requires both a more empowered WTO Secretariat and a more engaged membership, including more active and ongoing (rather than sporadic) participation of ministers. The involvement of ministers would be especially critical if

the WTO is to play a more constructive role in promoting and reforming regional trade agreements. At the same time, the institution would need to become more idea driven. The Secretariat's expertise, which is already considerable, would have to be strengthened in specific areas, including country and behind-the-border reform. Its research and policy functions should aim to become *the* centers of excellence on matters related to trade reform, such that they become obligatory ports of call for countries contemplating trade reforms or trade negotiations generally.

This outline of a reform agenda is intentionally limited to badly needed reforms that go to the heart of the WTO's mission. A more comprehensive treatment of WTO reform would include improvements in areas where the institution is already delivering, for example, dispute settlement (making it faster, less costly, and less reliant on trade sanctions), and accession (making negotiations more transparent, and achieving a better balance between the acceding country's commitments and the benefits it receives).

### The Time to Start Is Now

Urgent new issues, including climate change, trade in clean technology, and financial regulation, confront the international community, and these are issues on which the WTO could be making major contributions. However, it is unrealistic to ask an organization to tackle major new challenges when its ability to deliver on such a large part of its core mission is unproven. As already argued, a conclusion of Doha would not dispel these doubts and indeed would lend even greater urgency to reform.

Yet in an institution as complex and deeply entrenched as the WTO, far-reaching reforms along the lines set out in this brief would take time to define and implement. Furthermore, these reforms will have to be driven by the member states. The Secretariat

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has limited capacity even to raise these issues for discussion, let alone to decide on them.

The G20 heads of state, meeting in Pittsburgh in September, could mandate their ministers to kick-start the process. But with or without G20 prodding, the coming WTO ministerial in Geneva in November, whose declared purpose is to discuss all issues other than Doha, would be a good place to start a formal discussion and launch a member-endorsed process of reflection and analysis. Ministers would probably find such a process an easy sell to constituencies back home. Given the importance of the institution and the disappointment with results so far, an opportunity to enact reform is not to be missed. ■

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## RESOURCES

Visit [www.CarnegieEndowment.org/pubs](http://www.CarnegieEndowment.org/pubs) for these and other publications.

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