THE WTO UNDER PRESSURE

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- Multilateral trade liberalisation is in crisis. The WTO's ambitiously named Doha Development Round has been ongoing for more than a decade. Only a few limited issues remain on the negotiation agenda.

- While the round is being increasingly declared dead even by WTO members themselves, the same countries are concluding deeper trade agreements than ever before. Such progress, however, takes place at the bilateral and regional level.

- Another major development is the appearance of deep regulatory issues on the trade agenda. The shift from customs tariffs to countries' internal policies requires a certain like-mindedness from negotiation partners and poses challenges for national decision-making policies.

- Developing countries have gained less from multilateral trade liberalisation than what they had hoped for. The shift towards more fragmented trade regimes makes them even more prone to remain bystanders in global trade.

- At the WTO's next ministerial conference in Bali, progress on agriculture, trade facilitation and the treatment of the poorest countries would give a much-needed signal that the WTO can still benefit all of its members.

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On the brink of… irrelevance?

We are at a critical juncture, on the brink, at a crucial moment, the future at stake. In his inaugural speech, the WTO's new director-general, Roberto Azevêdo, admitted that he had run out of intimidating expressions to describe the state of his organization. While pledging to do everything he could to restore trust and faith in the World Trade Organization and in the multilateral trading system in general, the speech fell short of any concrete vision of how to take the system forward.[1]

The speech was yet another representation of the deadlock in trade multilateralism. The current negotiation round, notoriously referred to as the Doha Development Agenda (DDA), has been ongoing since 2001. The launch of the Doha Round was based on a consensus on the need to get all WTO members to engage actively in multilateral trade talks and in the shaping of global trade rules. As the epithet suggests, the expectations were high regarding the potential vested in world trade to generate wealth and growth across the globe.

While the round is being increasingly declared dead even by WTO members themselves, the same countries are concluding deeper trade agreements than ever before. This development, however, takes place between a limited number of countries. At the same time, the WTO, the culmination of a post-war success story in trade liberalisation, is risking becoming a mere administrator of trade reviews and disputes.

This briefing paper explores the current state of the multilateral trading system and the prospects for the upcoming negotiations at the WTO Ministerial Conference in Bali this December.[2] It concentrates on two major developments that have put the WTO in a difficult position.

The first is the rise of preferentialism: The number of regional and bilateral trade agreements concluded by a subset of WTO members has exploded since the establishment of the organization in 1995. These agreements are free trade agreements but instead of dismantling trade barriers among all WTO members, they do so only among parties to the deal in question. The Doha Round deadlock explains much of the development: in the absence of multilateral liberalisation, countries are turning to their second-best options. Alarmingly, the choice of preferential trade agreements also points to a rise in targeted protectionism. Deals that favour a limited circle of friends undermine non-discrimination, which remains the cornerstone of genuine free trade.

The second major development is the appearance of deep regulatory issues on the trade agenda. The shift from customs tariffs to countries' internal policies is happening because the nature of the obstacles to trade has evolved. Among the biggest costs for companies today are different technical standards and licences, multiple registration procedures and requirements relating to product certification and professional qualifications.

Complex investment rules are also among the key barriers to international business and trade. In today's integrated world market, the similarity and predictability of different operating environments is what matters the most. The need to focus on so-called behind-the-border issues is another explanation for the rise in preferentialism: sensitive regulatory issues are easier to approach with like-minded partners. This poses a major challenge for the majority of WTO members, which are developing countries, as well as for multilateralism at large.

WTO – the centre of multilateral trade negotiations

The WTO is an organization established in 1995 to administer trade agreements concluded by its members. Its principal function is to provide a forum for trade negotiations, in addition to which it handles trade disputes, monitors national trade policies and provides technical assistance and training, especially to developing countries. The legacy of the WTO lies in the General Agreement on Tariffs and Trade (GATT) that dates back to 1947. Since the end of the 1940s, membership of GATT, and subsequently of the WTO, has grown from 23 to nearly 160 countries.

1 Director-General Roberto Azevêdo's inaugural speech to the WTO General Council on 9 September 2013, available at http://www.wto.org/english/news_e/news13_e/gc_09sep13_e.htm.

2 The WTO Ministerial Conference is the highest decision-making body in the organization. It usually takes place once every two years, bringing together trade ministers from all WTO members.

The current body of WTO trade agreements consists of 16 different multilateral agreements among all WTO members, and two plurilateral agreements to which only some WTO members are parties. The multilateral rules address goods, services, intellectual property, disputes and trade policy reviews, whereas the two plurilateral agreements concern civil aircraft and government procurement. WTO members have also concluded certain other trade agreements often referred to as plurilaterals and based on a varying membership and sectoral coverage. One possibility is to opt for a critical mass approach: once a set threshold in participating countries is achieved, the agreement becomes effective and the benefits accrue to all WTO members. Such an approach was chosen, for example, in the Information Technology Agreement of 1996.

From an economic point of view, multilateral trade liberalisation has been a success story, particularly when it comes to rich countries' tariffs on manufactures, which have been reduced to negligible levels. The establishment of the WTO marked a rare momentum in the global consensus on trade liberalisation. After that, however, something has been lost: since 1995, WTO members have not succeeded in negotiating any new multilateral agreements.

Instead, the tide has turned in favour of a growing number of bilateral and regional trade pacts. Since the mid-1990s there has been an unprecedented rise in such preferential trade agreements. WTO law does not prevent their conclusion. It does, however, require such agreements to lead to a substantial level of liberalisation so as to prevent countries from resorting to them too casually. The rules have proved feeble as the number of preferential agreements has skyrocketed to over 350 deals in force to date.

Preferential trade in itself is not a new phenomenon. Trade relations have been secured through various arrangements throughout modern history – from colonial preferences to bilateral treaties of friendship, commerce and navigation in the 19th century, and to the 1930's litter of bilateral treaties aimed at balancing trade flows where possible. The extremely protectionist inter-war period of each trading nation acting on its own was supplanted by coordinated action with the signature of the GATT in 1947. The very foundation of the WTO rests on such multilateral coordination of international trade rules.

The mixed legacy of previous rounds

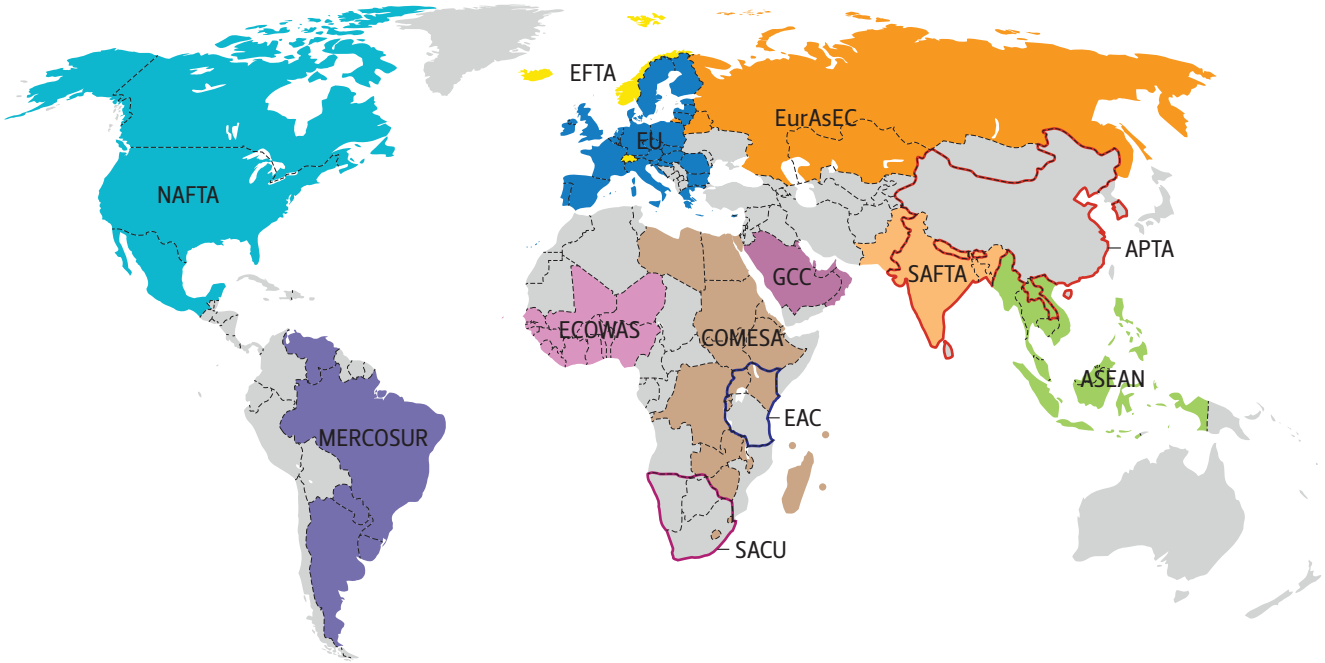
Although multilateral trade liberalisation has been a success story for international trade, the success rests on a rather fragile political consensus. As was the case with the previous WTO talks, the current Doha Development Round is paying the price of the unsettled issues that have been accumulating over the years. In this regard, the mixed legacy of the GATT Uruguay Round (1986–1994) has overshadowed the WTO as an international organization and keeps affecting the current negotiations.

At the heart of the matter lie two unsettled questions: the treatment of developing countries in international trade and the type of new rules needed to facilitate global trade. Regarding the former, developing countries have gained less than they had hoped for, especially in agriculture, textiles and clothing. At the same time, more advanced economies have adopted trade liberalisation only selectively. A notable case in point was the Uruguay Round Agreement on Agriculture, which called for developing countries to open their markets, without any significant reduction in the huge subsidies and high tariffs, especially in the United States and the European Union. On the other hand, there was increasing pressure for developing countries to take on new commitments in investment, trade in services and intellectual property rights.

In fact, WTO members share very different views on how far beyond traditional market access issues international trade should be regulated multilaterally. In this sense, the EU and the G90 Group of developing countries are worlds apart. Whereas the EU has been the strongest advocate of addressing regulatory issues at the multilateral level, the G90 group has systematically rejected the EU's proposals. As a result, the regulatory agenda has been narrowed down from rules on investment, competition policy and transparency in public procurement to include only trade facilitation measures. The function of trade facilitation is to promote smoother flows of goods through coordinated border measures and more harmonised customs practices.

These disagreements largely explain why the progress in launching the WTO's first negotiation round was so painfully slow. According to the World Bank estimation, liberalisation of merchandise trade with supportive domestic policies would result in gains of

Figure 1: Most significant existing free trade areas. Graph by Kauko Kyöstiö.



around 5 per cent of income in developing countries and lift 300 million people out of poverty by 2015. It was further argued that no other international economic cooperation – debt relief or aid – held this type of promise. With the liberalisation of services, the impact was argued to be even stronger. Nonetheless, these benefits required proper national policies, institutions, income distribution and social programmes. In addition, the success hinged on whether the protectionist developed economies would also engage in liberalisation in their sensitive sectors, such as agriculture, and guarantee better market access more generally for the poorest of the developing countries.

The steps in such a direction have been modest. Since the Hong Kong 2005 WTO ministerial conference, negotiations have addressed agricultural export subsidies and domestic support in more developed economies. While developing countries are maintaining their critical position towards regulatory issues, progress has been possible in the limited area of trade facilitation. Among the issues on the original Doha Agenda, some progress has been made to address the special needs of the poorest countries, namely through duty-free, quota-free market access and trade capacity building. In sum, the results to date are a far cry from the expectations and the promises of the Doha Development Agenda.

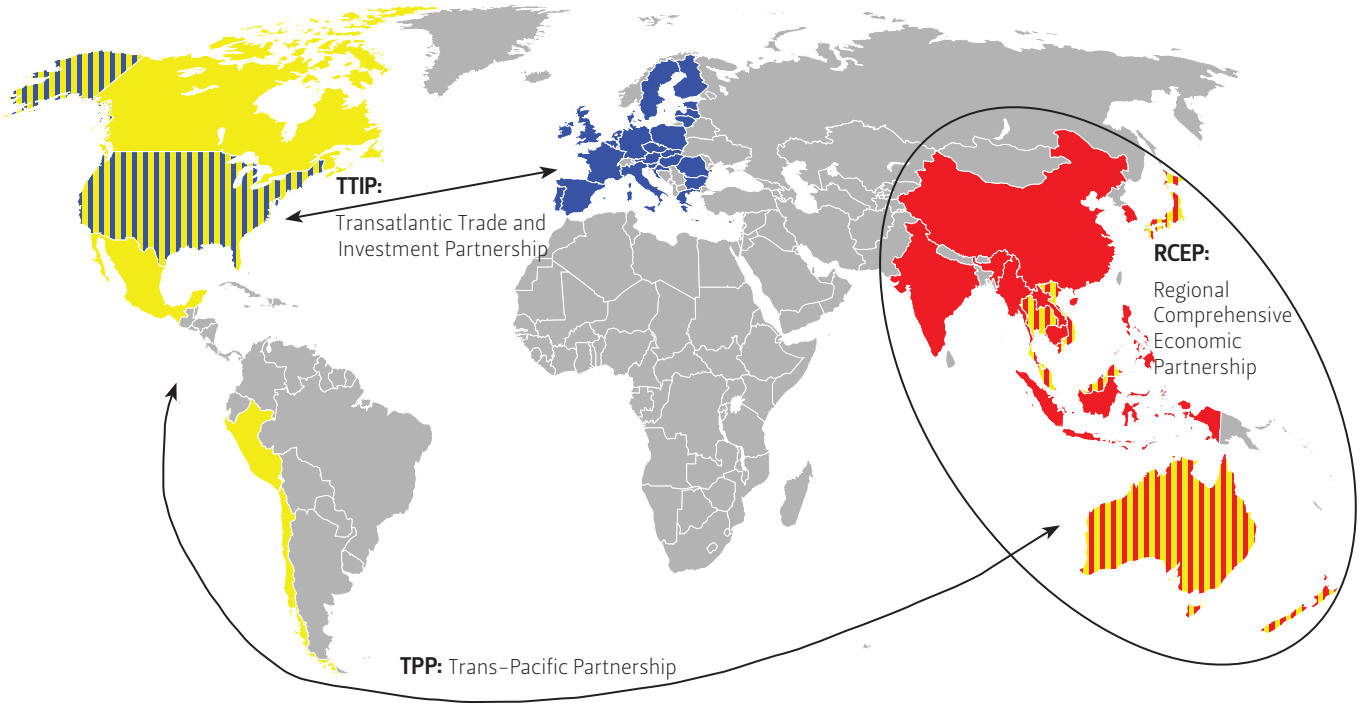
The (new) rise of preferentialism

The WTO impasse has prompted countries to turn to bilateral and regional arrangements to liberalise trade. Instead of insulating themselves completely, countries are now selective when it comes to choosing with whom to go further. This development is alarming from the point of view of multilateralism. Even though aimed at liberalising trade, preferential trade agreements are inherently discriminatory and draw governments' attention away from liberalising trade at the global level.

Outside the GATT, the most influential trade liberalisation has taken place in Europe. The Europeans have also been active promoters of regionalism elsewhere. In the 1960s, industrialisation and the post-war policy of import substitution also encouraged many developing countries to form preferential market areas among themselves.

The US refrained from the use of preferential trade agreements for a long time since it was not willing to forget the trade discrimination and protectionism lesson of the 1930s. At the beginning of the 1980s the Americans gave in, however. Europeans and developing countries were not willing to start another multilateral negotiation round whereas the US was desperate to find new markets abroad. When the Uruguay Round leading to the establishment of

Figure 2: Most significant ongoing negotiations for new preferential trade agreements. Graph by Juha Mäkinen.



the WTO kicked off in 1986, the American embrace of preferentialism had already started.

The situation is especially complex with North-South bilateral free trade agreements that imply reciprocity between different types of economies. In this regard, the EU has been the most active party to engage in regional free trade negotiations with its developing country partners. In light of its own history of regional integration and a single market, the regional level and bilateral relations have seemed a natural choice. The rationale for the EU's approach lies in the desire to create economies of scale and thereby increase the competitiveness of participating countries in the world economy.

In practice, however, regionalism has not advanced as hoped. Instead, the EU has found itself in prolonged negotiation processes and narrowly scoped agreements with individual countries. The Economic Partnership Agreements (EPA) between the EU and 78 African, Caribbean and Pacific (ACP) states have demonstrated how far apart the parties stand, especially in relation to regulatory trade issues. Whereas the EU argues that a deep regulatory agenda and reciprocity are actually important to the partner countries' economic development, the Sub-Saharan African countries in particular claim exactly the opposite.

Even though trade preferentialism poses great risks, one should not completely dismiss their potential positive effects. Even when restricted to selected countries only, they still create freer trade. Others are likely to benefit from it as well. This is true especially with today's deep trade deals that aim to make different countries' markets more compatible.

Moreover, regional and bilateral agreements can lend impetus to multilateral trade negotiations, as outsiders have an incentive to negotiate away the preferences given to a few countries only. However, with the poorest of the developing countries, trade liberalisation should go hand in hand with national development planning and priorities.

Another point worth mentioning is that regional trade and investment agreements can promote regional value chains. High transport and energy costs are the reasons why many value chains remain more regional than global in nature. Regional agreements between socio-economically like-minded countries can be especially efficient if they succeed in harmonising standards and converging social and environmental policies. Such agreements could also benefit developing countries, provided that they manage to pool their resources and govern trade at a regional level.

Whose standards will prevail?

The past couple of years have seen a change in preferentialism. Big trading nations have started to negotiate with each other, whereas earlier deals were mostly concluded with much smaller partners. The consequences are significant as such mega-agreements affect trade everywhere.

Two agreements being negotiated at the moment have the potential to become global standard-setters. The US is involved in both of them. The first, the Trans-Pacific Partnership (TPP), has been under negotiation since 2010 and involves a large group of countries from the Americas and Asia. The second is the Transatlantic Trade and Investment Partnership (TTIP), which has the ambitious goal of forming a highly integrated market area between the EU and the US. The two trading powers' negotiations have stalled somewhat due to the US government shut-down, but they are still hoping to enter into more detailed sectoral negotiations in early 2014.

The US and the EU have lost much of their influence in the global race for values, but in trade they still have the potential to set norms that others will follow. If they succeed in the extremely difficult goal of agreeing on common standards in important fields, countries all over the world will be able to adapt their production in accordance with only one, instead of two separate sets of rules. The deal is vital for the EU as it is afraid of losing out to Asia in the influence stakes. The US, on the other hand, is involved on both fronts.

The TTIP, however, has the potential to go deeper than the TPP, which must be based on common factors with a diverse group of 12 countries with different economic backgrounds and levels of development. The EU is not involved in any similar large-scale projects but, in addition to the TTIP, also has several other bilateral trade negotiations ongoing, the most significant being with Japan, India, Malaysia, Thailand and Vietnam. In October 2013, the EU reached a political agreement on the key elements of a Comprehensive Economic and Trade Agreement (CETA) with Canada.

Both emerging economies and developing countries are concerned about the US- and EU-centred isolationism that the negotiated mega-agreements represent. China, like the other BRIC countries, is not yet party to any significant preferential trade agreement, and is naturally concerned about the systemic consequences of the TPP and TTIP upon their realisation. China is trying to counterbalance these by joining the negotiations on the Regional Comprehensive Economic Partnership (RCEP). The RCEP is an initiative to link the ten ASEAN member states and the group's trade agreement partners, Australia, India, Japan, South Korea and New Zealand. The inclusion of China would make the RCEP much more powerful, but it also poses a risk to the other participating countries concerned about China's predominance in commodities.

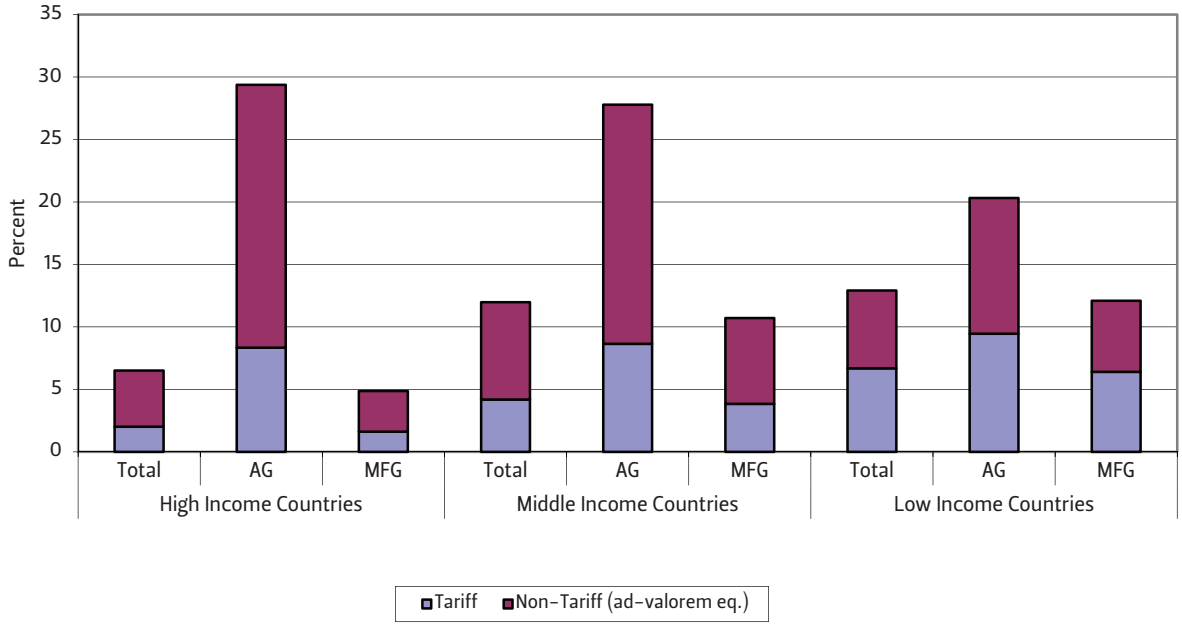
A final project worth mentioning is the Trade in Services Agreement (TiSA), which is currently being negotiated among a subset of WTO members. The initiative for a new agreement in the field of services originated from the US and Australia, which have been joined by the like-minded EU and some twenty other countries. The main aim is to bring the agreement under the WTO framework. Such integration may, however, prove difficult if China and other emerging economies are not included in the negotiations. TiSA may end up being concluded as another preferential agreement, restricted to services only. Its relationship to the existing WTO agreement on services, the GATS, remains unclear.

A shift from tariffs to regulations

Along with the rise in preferentialism, another major challenge facing global trade today is the changing nature of obstacles to trade. Customs tariffs in many countries are already low. For foreign companies willing to enter a specific market, the greatest barriers are often found in discriminatory or unnecessarily complicated local regulations. Examples of such regulatory barriers include costly audits and registrations, onerous or unnecessary certifications, inconsistent use of sanitary standards and double requirements of conformity assessments. In the field of services, discriminatory residence requirements or demanding educational and professional criteria often apply.

These so-called non-tariff barriers often constitute the greatest costs for companies as they need to adapt their products and services to different regulations in each country or region. The real challenge for today's trade liberalisation is therefore to align

Figure 3: Average level of restrictiveness imposed on imports (agricultural goods=AG and manufactured goods=MFG). Source: UNCTAD.



the trade and investment environments of countries participating in global or regional value chains. Such value chains encompass the whole range of activities that take a product from its conception to its end use and beyond. For such chains to operate smoothly, certain national policies must be converged.

Another important characteristic of today's trade flows is the increased role of services. For the last two decades, trade in services has grown faster than trade in goods. Services account for a larger share of manufacturing companies' inputs than ever before. The line between goods and services is also becoming blurred: digital products and 3D printing are perfect examples. Obstacles to trade in services, the fastest growing area of trade, are by definition regulatory in nature.

Dealing with protectionist laws and regulations is part of classical trade policy, and not too controversial as such. The largest divisive lines surround measures that affect trade but are not necessarily protectionist. Intellectual property rights, product safety and consumer rights are examples among many others.

The inclusion of such issues in trade negotiations means dabbling in one another's internal policies. This poses challenges as each country has its own cultural and societal preferences. Moreover, internal policies are subject to domestic decision-making, democratic or otherwise. In their negotiations over the TTIP, both the EU and the US stress that the TTIP is not about lowering standards or other regulations; it is only about coordinating, or converging, and making mostly technical regulations consistent with each other. Cars are as safe on both sides of the Atlantic, the partners reassure. Here, however, lies the key difficulty: how does one determine the proper level of regulatory control. Moreover, how does one justify to one's domestic constituencies the need to coordinate one's action in areas such as consumer protection, safety, and environmental protection with outsiders?

These are questions that have already been dealt with by Europeans among themselves for decades. The EU of today is the most integrated multinational economy in the world. The challenge is to take this development further. Naturally, it is most convenient with countries that share similar preferences. This is one of the reasons behind the enthusiasm for bilateral and regional agreements.

A growing number of these agreements is marked by a phenomenon referred to as "deep" integration.[3] The globalisation of value chains and the growing role of services have led to a demand for agreements that cover more than preferential tariffs. Modern preferential trade agreements cover rules

3 Baldwin, Richard E. (2012a), "Global supply chains: why they emerged, why they matter, and where they are going," London, Centre for Economic Policy Research, CEPR Discussion Paper No. 9103.

on investment, services, intellectual property and competition, and sometimes extend to coordination of social and environmental issues.

The agreements being negotiated by the EU and the US with each other and other partners go particularly far beyond traditional free trade agreements. In addition to eliminating remaining customs duties, they address the investment environment and a wide array of non-tariff trade barriers. More integrated markets are planned to be achieved by agreeing on regulatory standards and policies that cover a range of issues from the protection of foreign investments and intellectual property to opening up public procurements to foreign bids.

Such regulatory approaches adopted in bilateral and regional agreements can provide a useful setting for regulatory cooperation, and a laboratory of sorts for new trade disciplines that might be multilateralised among all WTO members later on. This is at least what the countries negotiating the agreements like to claim. The danger, however, is that the increasing number of trade agreements will create more barriers as the multitude of rules makes it harder for companies to adapt to them. In addition, regional and bilateral trade agreements can divert trade from the most efficient sources to those that are simply able to cooperate. Another essential issue is whose rules will prevail and, further, whether such rules can be adjusted to accommodate the differing needs of all WTO members.

In the current economic situation, it is hard to say where the most lucrative markets of tomorrow will be. Some of the once outsourced economic activities are now moving back westwards. Asia will remain strong but business and commerce is spreading and breaking into new countries and even continents. When drafting their trade policies, countries would be wise not to close any doors. A genuinely integrated world market would more than ever before benefit from non-discriminatory, multilateral trade opening.

How to break the deadlock in multilateralism?

What's on the table in Bali

In the light of the past 12 years of negotiations, it would be unrealistic to expect any miracles to occur in the next WTO Bali Ministerial. The issues on the table, as well as the main positions around the table, resemble those of the past. Some progress can, however, be expected in a limited number of issues that relate to trade facilitation, agriculture and the least developed countries' treatment in world trade.

The biggest expectations lie in trade facilitation, which has win-win potentiality for all WTO countries despite the level of their economic development. More efficient customs procedures save everybody's time and money. Yet many countries lack both the human and financial resources to reform their customs practices.

Regarding agriculture, the most advanced debate relates to an India-led proposal that would allow developing countries to protect their national food security programmes from being challenged under the WTO's subsidy rules. In practice, this would provide for the possibility to buy food from local farmers at higher than normal prices in order to distribute it to vulnerable populations. At this point, a group of roughly 30 WTO members, including the US and the EU, have shown willingness to continue negotiations along these lines. In fact, many developing countries want to first secure an agreement on food security before they commit themselves to trade facilitation issues.

The third promising issue on the Bali agenda relates to the proposal that advanced economies would extend the scope of their duty-free, quota-free programmes to a larger group of products originating in all least development countries. This would mark a step towards fairer trading practices. It would also help to mitigate the discriminative consequences of bilateral trade agreements towards the poorest countries.

Any progress on these three core items is welcomed, but it does not change the fact that the agenda in Bali is extremely narrow. This has decreased the WTO's relevance to the key members. The EU and the US in particular do not see their main interests being addressed in the negotiations. In practice, this means that the multilateral track will be officially maintained as the key priority, while countries advance bilaterally in issues that have been multilaterally blocked and left incomplete.

Global interdependency – a way out?

A certain paradox exists between the two developments explained in this briefing paper: while

globally fragmented industries stand to benefit the most from multilateral trade opening, there is a lack of consensus on how to tackle the difficult issues lying beyond the borders. Countries are therefore increasingly turning to those who either share their values or show willingness to adopt them.

To prove that multilateralism has not lost its purpose, the WTO needs to bring its trade policy agenda into the 21st century. The way out is a wider understanding of the interconnected nature of world trade. If countries do not work together, everybody loses. This has always been true of trade, but more so now than ever before. In the Bali Ministerial, progress on agriculture, trade facilitation, and the treatment of poorer countries would send an important signal that the WTO can benefit all its members.

Preferentialism should not always be frowned upon: new regional and bilateral deals are positive news as long as they lead to increased trade and liberalisation on a sustainable basis. The key is to make sure that the currently negotiated mega-agreements do not lead to increased fragmentation, but coordinate their rules so that they can act as a basis for more connected, not diverted markets. The same applies to the possibility of resorting to the so-called plurilateral agreements for trade liberalisation.

The third-country effects of preferential agreements should not be neglected. Special attention should be paid to the needs of the most vulnerable countries that have no markets to offer and little value to add.

Nor should one forget traditional tariff negotiations. While there is a general trend towards lower tariffs, they can still pose a significant cumulative burden when inputs into final products cross borders multiple times. Moreover, in some areas, such as textiles and agriculture, there are still significant tariff peaks. They are one of the key obstacles for developing countries' trade. The WTO should remain the main forum for tackling tariffs.

The WTO's new director-general, Roberto Azevêdo, has not yet brought anything revolutionary to the table. In his inaugural speech he nevertheless made one point that should be borne in mind: All of us need the WTO and more balanced trade rules. Ordinary people need it too, even if they do not usually realise it.

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