

WHITHER FREE TRADE?

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MORE THAN A MISSED DEADLINE

The deadlock and breakdown of trade negotiations in Cancun makes it impossible for the WTO to complete the round of global trade negotiations by the scheduled target date of December 2004. But the significance of the failure at Cancun goes beyond missing a deadline. Not only will it likely doom this round of trade liberalization for the foreseeable future, it may mean the end of a 50-year consensus on international trade built around the liberalizing results achieved by global trade negotiations.

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FAILURE WITH MANY FATHERS

The failure at Cancun has many fathers. The blow-up over U.S. cotton subsidies may have been the proverbial last straw, but it was the political constraints on all sides on the agricultural issues, a weak WTO leadership and decision-making process, and an emboldened developing country bloc that miscalculated Western flexibility that in the end doomed the round to failure.

The media have focused on the refusal of the developed countries to negotiate a fast-track removal of agricultural subsidies – in the U.S. on cotton and in Europe on a broad range of products. In fact, the U.S. was prepared to tackle the issue of agricultural subsidies (which U.S. legislation last year had aggravated considerably), but not without some flexibility in return — especially after reaching a politically difficult deal with developing countries on pharmaceutical product patents just one month prior. But with Europe, Korea, and Japan focused on investment and competition issues, which are anathema to the developing world, and developing country heavyweights Brazil and India working to prevent outcomes that would have forced them to dismantle protectionist barriers of their own, it was an uphill battle.

In the end, the U.S. delegation expected flexibility from at least some developing countries that instead rallied behind a newly formed “Group of 21” taking a politically unrealistic stand on agricultural subsidies without offering countervailing concessions. The dust-up over cotton, encouraged by anti-trade NGOs, only stirred the pot further and the process finally blew apart over the Group of 21 rejection of European/Japanese/Korean proposals to negotiate on investment and competition even as the EU was preparing to withdraw the proposals to try to keep the round going. Ultimately, all the parties decided the status quo was preferable to trying to bridge the gap.

FAILURE WITH MANY FATHERS

The implications of the failure at Cancun are far-reaching, with serious consequences for the global trading system as we know it:

☞ **A 21st Century League of Nations?** The shortcomings of the WTO as an international institution, in particular the profound difficulties of reaching consensus among 150 countries, are all the more evident. The WTO’s weak governance structure — its requirement for consensus in a “one man one veto” system that encourages small players to hold out on parochial issues — has been exacerbated by the breakdown of the so-called “green room,” the closed door sessions of the handful of countries dominating world trade that historically hammered out a consensus. Cancun provides graphic, conclusive confirmation of these shortcomings. While it may be possible to pursue trade liberalization through more modest efforts in discrete sectors, the WTO will no longer be seen for some time as a fruitful venue for negotiation of broad international agreements that rely on concessions in one sector to achieve advances in others – the so-called “single undertaking” approach. But even a scaled-down sector-by-sector agenda will not be easy, as zero-sum calculations tend to block success in narrow negotiations of this kind.

- ❧ **Bilateral Trade Also Suffers.** The U.S. already had seen merit in pursuing bilateral and regional Free Trade Agreements (FTA), and negotiation of them now will become the primary U.S. strategy going forward. However, some of the planned FTA efforts may be on shaky ground. The largest of these, the Free Trade Area of the Americas (FTAA), already looked unlikely to meet its 2005 deadline, and Brazil's role in leading the developing world charge in Cancun has assured it will not. Many of the countries with which the U.S. was negotiating, including Brazil and South Africa, participated in the Group of 21 in Cancun and will not be viewed charitably by the U.S. Even the U.S.-Australia FTA could get gummed-up over key agricultural issues.
- ❧ **The Litigious Society.** After an initial period of stocktaking, we expect a period of greater litigiousness on trade issues, both domestically and internationally. Countries may look increasingly to safeguards and anti-dumping actions to protect their trade interests. And they may be more likely to turn to the WTO Dispute Settlement panels to arbitrate differences that they had hoped to resolve during the trade round, particularly with the end of the Uruguay Round "Peace Clause" that discouraged challenges in the WTO to agricultural subsidies. But the willingness of countries to abide by decisions of Dispute Settlement panels also will be reduced because of the declining power and acceptance of WTO norms.
- ❧ **Some of the Big Losers.** U.S. services and manufacturing sectors had looked to this round to provide market-opening opportunities. Those hopes now look to be dashed, as agriculture interests overwhelmed other stakeholders. Among the Group of 21 countries, the U.S. is likely to be cool toward those countries, like India and Brazil, which it saw as most intransigent. For its part, China used its new membership in the WTO to join the Group of 21 and to burnish its credentials with the developing world. While China did not play an aggressive activist role in Cancun against U.S. positions, it still could pay a price for the WTO's failure. With increasing attention to the \$100 billion plus bilateral trade deficit, and with growing calls for reevaluation of China's currency to address U.S. manufacturing job loss, it is likely that China will get special attention from the Congress and aggrieved manufacturers, with proposals that will raise trans-Pacific temperatures. (There are already a number of legislative initiatives floating in Congress and a possible 301 investigation that would penalize the Chinese and others over currency intervention.)

THE PENDULUM SWINGS

The consensus in favor of free trade that has marked the post-World War II period is now arguably under the strongest and most effective attack it has faced to date. Governments across the globe, representing both developed and developing economies, decided in Cancun that the domestic value of concessions potentially achieved in favor of freer trade were outweighed by the costs of market opening steps they would be required to take. Such decisions by governments were facilitated by the absence of a critical mass of demands for market opening by manufacturing and service industries to offset the parochial and defensive concerns of agricultural interests among both developed and advanced developing countries.

The breakdown of this consensus is dangerous and momentum is now flowing in the wrong direction. The moral suasion provided by the WTO philosophy of trade liberalization and fair trading rules will not have the same force against protectionist actions by individual states, with potentially serious escalatory consequences.

The international free trading system is not in danger of being dismantled, but the absence of an overarching process toward global liberalization is likely to mean that protectionists in numerous countries will be able to put more barriers in place until the pendulum swings back. Many countries will be playing a waiting game, judging that not much positive can be achieved (beyond individual FTA's with the U.S.) before the United States elections and the change in EU membership and leadership in 2004, after which the potential role of the WTO and global trade negotiations may get a new look.