Rescuing the Doha Round

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Summary: The Doha Round could become the first major multilateral trade talks to fail since the 1930s. To prevent a collapse, policymakers in the G-8 and key developing countries must resolve global monetary and current account imbalances, counter the backlash against globalization, and find a way to jolt the talks back to life.

WHAT AILS DOHA?

Virtually all observers concur that the Doha Round of multilateral trade negotiations in the World Trade Organization is faltering badly. Agreement may have been reached on the principle (although not the date) of eliminating export subsidies for agriculture, but very little else has been resolved since the talks were launched four years ago. Almost nothing of note has been proposed, let alone settled, in the crucial services sector. Even the necessary procedures for handling integral parts of the negotiations, including agriculture and nonagricultural market access, have yet to be worked out, although the target date for finishing the round is only a year away. Deep uncertainty prevails despite the decision in 2003 to ease the negotiations by removing two critical issues, investment and competition policy, from the agenda. Moreover, the round has never even attempted to seriously address the two largest problems facing today's global trading system: security concerns since the attacks of September 11, 2001, especially the risk that world trade would seize up in the wake of another major terrorist attack, and the absence of effective control over the increasing number of preferential pacts involving many of the world's largest trading nations.

The Doha Round may thus become the first major multilateral trade negotiation to fail since the 1930s. The collapse could even take place, or be clearly heralded, at the ministerial meeting in Hong Kong. Such an outcome could mark a historic reversal in the irregular but steady progress toward liberalizing world trade over the past sixty years. Since history clearly shows that trade policy must move forward continuously or risk sliding backward into protectionism and mercantilism (which at present also means accelerating the tendency toward bilateralism), the consequences of

Doha's failure for international security as well as economic relations around the world could be enormous. At this point, the best possible outcome would be a mini-package that would achieve modest real liberalization; by nature of its small impact, however, it might not sufficiently motivate a coalition able to overcome entrenched local interests, and so could fail to win ratification in many countries, including the United States. But even such a modest package is not guaranteed. It is thus critical to analyze the causes of the Doha malaise and devise a rescue strategy that can be implemented in time.

All major global trade negotiations flirt with collapse and succeed only at the last possible moment. Doha, however, is much more difficult than its three multilateral predecessors (the Kennedy, Tokyo, and Uruguay Rounds). The WTO now has many more members (148 at present) and is constantly expanding. The consensus-decision rule means that all of them must accept the outcome of discussions, and now a larger and more diverse group of developing nations has veto power at every stage of the process. The remaining barriers to trade, having resisted liberalization for a half century, are by definition the hardest to tackle. The proper new focus of much of the talks, behind-the-border distortions such as subsidies, raise more complex issues than do traditional tariffs and quotas. The key actors, the United States and the European Union, face even more formidable domestic obstacles to making essential concessions than they did in the past: fierce congressional hostility to any relaxation of US antidumping and immigration laws and deep popular unwillingness to significantly alter the European Union's protective agricultural regime.

The main problems that undermine the prospects for a successful Doha Round, however, lie outside the negotiations themselves. Three factors stand out: the massive current account imbalances and currency misalignments pushing trade politics in dangerously protectionist directions in both the United States and Europe; the strong and growing antiglobalization sentiments that stalemate virtually every trade debate on both sides of the Atlantic and elsewhere; and the absence of a compelling reason for the political leaders of the chief holdout countries to make the necessary concessions to reach an agreement. Progress on each front is necessary for the Doha negotiators to have a chance of succeeding.

CURRENCY IMBALANCES AND PROTECTIONISM

The US current account deficit reached an annual rate of almost $800 billion in the first half of 2005. At more than 6 percent of GDP, this is almost twice the previous record of the mid-1980s, after which the dollar fell by about 50 percent in two years. The deficit, moreover, is climbing by about $100 billion per year, a pace even more unsustainable than its level. To finance the current account deficit and its own foreign investments, the United States must now borrow $6 billion from the rest of the world every business day. Its international debt exceeds $3 trillion and will rise to at least 50 percent of GDP, well beyond all traditional danger thresholds, before it could possibly stabilize. The dollar remains overvalued by a trade-weighted average of at least 25 percent even if the goal is only to cut the United States' external imbalance to about half its current magnitude.

Most commentary on this well-known imbalance emphasizes its unsustainability in international financial terms, and this is indeed a severe risk to the US and other economies. But there is a second unsustainability that relates even more directly to Doha and other trade policy issues: the situation's domestic political impact. The history of US trade policy amply demonstrates that dollar overvaluation, and the huge and growing trade deficits that it spawns, are by far the most accurate predictors of US protectionism. When currency misalignments provide sizable advantages to their competitors, more industries look for relief from imports. When their goods and services are priced out of global markets, meanwhile, fewer exporters are credibly able, or even willing, to fight for liberalization.

The United States has already imposed extensive restraints on Chinese imports in six widely varying sectors, indicating the breadth and depth of the problem. Despite low unemployment and the US economy's robust growth, last spring the Senate supported by a two-to-one margin a substantial across-the-board import surcharge on all Chinese products. In July, the House of Representatives passed its own anti-China trade bill. The strong congressional opposition to the proposed takeover of Unocal by the China National Offshore Oil Company (also known as CNOOC) was a startling indication of the intensity of these sentiments.

It was impossible to even launch the Uruguay Round in the General Agreement on Trade and Tariffs, Doha's immediate predecessor, until after the imbalances of the mid-1980s had been corrected by the 1985 Plaza Agreement on exchange rates and the Reagan administration's simultaneous adoption of tough new trade policies against Japan. Nor could serious negotiations commence in the 1970s in the Tokyo Round, which preceded Uruguay, until protectionist pressures in the United States were quieted by several substantial currency realignments, forced by President Richard Nixon's import surcharge and the delinking of the dollar from gold in 1971. In both instances, large, indeed historic, monetary adjustments were required to clear the decks for global trade liberalization.

The situation today is distressingly similar. In particular, the politically poisonous (if economically irrelevant) US trade deficit with China now exceeds $200 billion annually. US imports from China now exceed US exports to China by a ratio of more than six to one, more than twice as large an imbalance as the United States ever experienced with Japan. This means that, just to keep the imbalance from increasing further, US exports to China must grow more than six times faster than US imports from China—something unlikely to happen anytime soon.

The protectionist implications of currency misalignments are not limited to the United States. The euro rose substantially from 2002 through 2004 and is probably near its bilateral equilibrium against the dollar. Therefore, the undervaluation of the renminbi, and of other Asian currencies kept artificially undervalued (including the yen and the Indian rupee) because governments were afraid to let their competitive positions deteriorate against China, pertain almost as much to Europe as to the United States. Protectionist attitudes are rising rapidly in Italy, France, and even traditionally liberal Germany.

Fortunately, the Doha Round was launched before the imbalances soared to their present levels. But major currency realignments are essential, starting with a revaluation of the renminbi by 20 to 30 percent and sizable upward floats against the dollar and euro throughout Asia. Substantial monetary corrections will again be required to permit trade negotiations to succeed.

THE BACKLASH AGAINST GLOBALIZATION

The current account imbalances are superimposed on a backlash against globalization in many parts of the world that had already raised formidable hurdles against further trade liberalization. In the United States, the population is split evenly over the wisdom of further integration into the world economy: workers who have only a high school education or less (such workers constitute almost half of the labor force) fear the adjustments that globalization requires (although just a small percentage of them are actually dislocated by imports and even fewer experience significant lifetime losses in earnings). Hence Congress is "voting its constituents" when it divides almost evenly on trade legislation, as it has on every major trade bill for over a decade. Relatively minor and straightforward pieces of legislation, such as Trade Promotion Authority in 2002 and the minuscule Central American Free Trade Agreement last summer, trigger intense political battles and pass by the thinnest of margins with flagrant bribes used to win the decisive votes.

There are two remedies to the problem. The more fundamental is to substantially enhance the skill level of the work force. If the average worker enrolled in school for just two more years, turning a high school graduate into a community college graduate, the overall population's ability to benefit from international trade (and thus its propensity to support globalization rather than feel victimized by it) would be greatly improved. Such a change could, in fact, provide a solid pro-globalization majority over the long run.

The shorter-run response is to expand the safety nets that cushion the transitional costs of trade-related (and other) job dislocation. The Bush administration should implement with far greater enthusiasm the innovations in trade adjustment assistance that Congress included in the Trade Act of 2002. But it is also essential to pass new legislation to make services workers, including those whose jobs are outsourced, eligible for assistance; improve the new adjustment program for farmers to facilitate needed agricultural reforms; greatly increase the benefits under those programs, especially for worker training; and substantially expand wage insurance that encourages workers to reenter the labor force quickly. Domestic policy reforms in the United States are essential to a stable foundation for international trade policy.

The backlash against globalization in Europe is more diffuse and thus more difficult to counter. The recent votes against the European constitution and the Schröder government in Germany reveal a split between deep unhappiness with the current economic situation and opposition to the very reforms that are needed to improve that situation. The specter of "Polish plumbers" and "cheap Chinese products" limits the negotiating possibilities of the European Union in the Doha talks. European support for liberalization can probably be restored only through resolute pursuit of the Lisbon agenda's structural reforms (including of agriculture) by new governments with enough time left in office to reap the benefits that would ultimately result.

THE PATH TO A SUCCESSFUL DOHA

Steps have been taken to overcome each of these hurdles to a successful completion of the Doha Round. The US budget deficit has declined significantly over the past year. The dollar fell by about 10 percent between 2002 and 2004 and the renminbi rose by 2 percent in July 2005. Educational reform is advancing in the United States. Congress adopted important improvements in trade adjustment assistance in 2002. The Schröder government in Germany and its counterparts elsewhere in Europe initiated some of the reforms that will help restore growth and self-confidence in the region.

Unfortunately, all of these measures have been very limited. Trade negotiators will need a great deal of help from elsewhere in their governments if they are to have a fighting chance. Agriculture ministers are, as usual, central to the equation. To restore at least a modicum of global equilibrium, finance ministers and central bank governors must promote an orderly adjustment of the currency misalignments and the adoption of needed economic policies. Labor ministers must adopt reforms to help workers adjust more smoothly in the United States and more effectively in Europe.

These policy changes are deeply political, however, and so must ultimately be decided and implemented by heads of government. If the major industrial nations are serious about Doha, they will have to devote important parts of their domestic policy agendas to these issues over the next few years. They will also have to use their G-8 summit in 2006 to create an environment within which it can succeed. The "finance G-7" (comprising finance ministers and central bank governors from the G-8, usually not including Russia) has repeatedly issued calls for a successful Doha and will now have to deliver policies that will enable this to happen.

But the G-8 cannot do it all. Key developing countries must participate actively in any effective effort to bring Doha to a successful conclusion. Already, an informal steering committee brings together the top trade negotiators from Brazil, the European Union, India, and the United States (and sometimes Australia). In addition, China and several other Asian countries are central to resolving the global imbalances that are a prerequisite for trade progress. Hence the time has come to realize the idea, championed by Canadian Prime Minister Paul Martin, of holding ad hoc summits of the leaders of key industrial and developing countries to address global problems that can be resolved only with their personal and collective attention. The G-8 has been inviting the main developing countries to its annual summits for several years. It should convert next year's conclave into an event at which this broader group can rescue the Doha Round.

Even if all this were done, completing a successful Doha Round by early 2007 (to enable implementation before the US president's fast-track negotiating authority expires) would still be a herculean task. Enacting the requisite policy changes, ranging from agricultural policy to exchange rates to labor-market reforms, will take time. This strategy will thus probably have to include an extension of all the deadlines for at least six months (as occurred at the end of the Uruguay Round in 1993), or, more likely, until the end of President Bush's second term.

A TRADE POLICY JOLT

What could galvanize such an admittedly ambitious set of high-level meetings and policy changes? The prospect of the Doha Round's failure might itself be enough. Despite hurdles that seemed daunting at the time, the major industrial countries did not permit any of the prior multilateral rounds to collapse. The summits of the G-5, G-7, and G-8 have addressed this issue more consistently and more successfully than any other over the groups' thirty-year history. There is a widespread recognition that failure to keep the trading system moving toward further liberalization could trigger a sharp reversal into protectionism and bilateralism and perhaps erode the WTO itself, causing substantial problems for the economies and foreign policies of all countries involved. The price could be especially high for those viewed as precipitating the failure, as the United States and European Union discovered when they were blamed (correctly) for the collapse of the Cancún ministerial meeting in 2003.

More likely, however, a direct and explicit threat to the interests of major holdout countries (on monetary as well as trade issues) will be needed to spark the wide range of policy changes required. Passage of sweeping protectionist legislation in the United States, or preemptive steps similar to those taken by Presidents Nixon and Reagan in 1971 and 1985, would be just such a "policy jolt."

A more constructive precedent can be found in the endgame of the Uruguay Round in 1993. That round was originally set to conclude in 1990, but the European Union refused to adopt the changes needed in its Common Agricultural Policy to put a final package together. The United States responded with a "shot across the bow" by negotiating the North American Free Trade Agreement with Canada and Mexico to demonstrate that it was prepared to pursue a regional path to trade liberalization if the global track were blocked. But that was inadequate to restore impetus to Uruguay, since the United States and Canada already had a bilateral free trade agreement, and Mexico and Canada were both US neighbors and relatively modest players in world trade.

The United States then found a more effective weapon when it hosted the first Asia Pacific Economic Cooperation (APEC) summit in Seattle in November 1993. That gathering stunned the world as Pacific Rim leaders, meeting for the first time, agreed to pursue "free and open trade and investment in the Asia Pacific region." One month later, the European Union agreed to an agricultural package that brought the Uruguay Round to a successful conclusion. When asked why Europe had reversed itself so abruptly, its chief negotiators testified without hesitation that "your Seattle summit showed us that you had an alternative that we did not." The risk that fully half of world trade and economic output would go its own preferential way was decisive.

A similar catalyst today would have to motivate not just the European Union but also key emerging market economies, notably Brazil and India. It would have to be at least as powerful and persuasive as the APEC strategy in 1993.

The only candidate to make this move is APEC itself. Fortunately, APEC's Business Advisory Committee is promoting just the sort of action that is needed: a serious study by APEC leaders of a Free Trade Area of the Asia Pacific that would fulfill the vision of over a decade ago. A number of APEC leaders from smaller countries endorsed the idea at last year's summit in Santiago. If it were launched by late 2006, or even in 2007 (if the Doha timetable were extended), such an initiative could be the needed impulse to get the round back on track. The three major countries in

APEC (China, Japan, and the United States) would have to agree, but this should be feasible once the international imbalances that must be worked out anyway are resolved. Such trade policy commitments could in fact be linked with the broader monetary negotiations, as occurred in 1971–73 and 1985–87.

Some APEC political leaders and trade ministers have resisted this idea on the grounds that they would undercut Doha by recommitting to the megaregional course they set over a decade ago. To the contrary, as the Uruguay Round precedent demonstrates, it may be the only tool available to bring Doha back to life. And if the strategy works, the Free Trade Area of the Asia Pacific might never need to be implemented. On the other hand, it is extremely difficult to see how Doha can be put back into serious play, let alone succeed, without a trade policy jolt along these lines. The performance of APEC itself has been disappointing in recent years, but the organization played a major role in galvanizing both regional and global trade liberalization during the mid-1990s. It is in a unique position to do so again.

Failing agreement on such a course among the major APEC countries, the United States could probably force such an initiative itself. It is already contemplating an early launch of bilateral negotiations for a free trade agreement with South Korea and at least one more country from the Association of Southeast Asian Nations in addition to Singapore and Thailand, where free trade agreements are already in place or under discussion. Japan would almost surely seek equal treatment with South Korea, for broad foreign policy reasons as well as to avoid substantial trade discrimination. China might then feel surrounded by US economic initiatives, as it is already being surrounded by US security initiatives, and opt for an Asia Pacific agreement instead. The strategy of "competitive liberalization" that has driven US trade policy throughout the Bush administration would reach its logical culmination: the rest of the world would be forced to take notice and Doha would be back on track.

GETTING TO THE FINISH LINE

If these requisite elements can be assembled, success in the Doha Round—substantively significant liberalization in all key areas of the negotiations—will take place not at Hong Kong but over the next one to three years. In light of the time lags involved from currency changes to trade flows, the international imbalances need not return to fully sustainable levels but they do need to be headed in the right direction. The backlash against globalization must be countered by forceful domestic policies in the United States and Europe, especially with regard to labor markets. A galvanizing incident, such as protectionist actions in Congress or APEC's launching a serious study of a Free Trade Area of the Asia Pacific, may be essential to round out the package.

Such bold and wide-ranging initiatives will require the attention of heads of government in the major industrial countries and key emerging market economies. These leaders will probably need to implement the new strategies through institutionally innovative summit and ministerial meetings that bring their countries together operationally for the first time. Simply stating these requirements is enough to show their difficulty. Yet without them, the Doha Round could become the first great global trade initiative to fail since the 1930s.