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## **DOHA'S NEAR DEATH EXPERIENCE AT POTSDAM: WHY IS RECIPROCAL TARIFF CUTTING SO HARD?**

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23 June 2007

*Many worry that regionalism is undermining the multilateral trading system, but are past unilateral trade reforms and fast rates of economic growth in leading emerging markets at the root of Doha's problems?*

The Doha Round came to a serious impasse on 21 June 2007 when four leading trading powers could not agree on terms to liberalise international commerce. Their failure makes it almost inconceivable that the Doha Round negotiations will be concluded favourably before the next U.S. presidential administration takes office. Officially the talks aren't dead. Last year India's trade minister said the Doha Round was in intensive care; if that was the case then, now the patient appears to be in terminal decline.

A mismatch in negotiating objectives sunk Thursday's trade negotiation in Potsdam, Germany. India and Brazil wanted Europe and the U.S. to commit to greater reforms of their agricultural sectors, while the latter insisted that the large emerging markets create more commercial opportunities for exporters by opening up their manufacturing sectors further. This time around it appears that Europe and the United States both signalled some flexibility, but it wasn't enough for India and Brazil. The Brazilian trade minister said it was "useless" to continue negotiating on the proposed terms. Early press reports said that India's trade minister abandoned the talks first without even consulting his colleagues. Last weekend I argued that the Doha Round talks were unravelling<sup>2</sup>; Potsdam confirmed that the leading trading powers hardened their negotiating positions. Under these circumstances, an impasse seems not just a matter of "if", but "when."

Now the negotiations go back to Geneva where the chairman of the negotiations in each area are supposed to issue texts that could--fingers crossed--form the basis of an agreement. Don't bet much on this particular process working out--remember the breakdown arose not within any one negotiating area but because no satisfactory trade-off across issues could be found. Realistically the only person left who can put a cross-cutting deal on the table is the WTO's Director-General. This all-or-nothing gambit is particularly risky--not least because the WTO members will likely blame Mr. Lamy if his proposals are rejected. The blame for this Round's debacle lies squarely on the shoulders of WTO member governments; Mr. Lamy and the WTO secretariat should not be made convenient scapegoats.

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<sup>2</sup> Evenett "The Doha Round: Has the Unravelling Begun?" Available at: <http://www.voxeu.org/index.php?q=node/266> and <http://www.evenett.com/articles/UnravellingDohaRound.pdf>

But why is concluding this negotiation proving to be so difficult? One unappreciated reason is that there has been so much credible (that is, irreversible) unilateral trade reform by WTO members and, for reasons explained below, this gums up the reciprocal trade negotiating machinery. According to the World Bank's *Global Economic Prospects 2005* two-thirds of tariff cutting was the result of unilateral trade reform, a quarter due to multilateral trade reform, and the rest accounted for by bilateral and regional trade agreements.

Unilateral tariff reductions widen the gap between the tariff rates that a country actually applies and the maximum (or bound) tariff rate that the country agrees to set. The latter rate is the currency of WTO negotiations and in the past countries have been willing to cut their own maximum (bound) rates in return for cuts in maximum tariff rates in trading partners. And, where cuts in maximum rates have resulted in cuts in applied rates, commercial opportunities for exporters have been created and that's why they supported multilateral trade reform. The trouble is that the percentage cut in the maximum rate necessary to cut applied rates increases with the extent of unilateral tariff cutting. Nowadays proposals for limited cuts in maximum (bound) rates attract little support from exporters, support that is critical if politicians are to successfully oppose those domestic industries fighting to keep tariffs high. Exporters can ask: why lobby for finishing Doha when unilateral reforms abroad have created commercial opportunities for free? So while our economic textbooks tell us that unilateral trade reform is desirable, paradoxically it can also undermine support for WTO trade reforms.

**Table 1: Except for China, unprecedented cuts in bound tariff rates would be needed to create new commercial opportunities.**

Rank	Emerging market	GDP (current US\$, in billions)	MFN tariffs on Manufactured imports			MFN tariffs on Agricultural imports		
			Average bound rate (%)	Average applied rate (%)	Average cut in bound rate needed to cut applied rates (%)	Average bound rate (%)	Average applied rate (%)	Average cut in bound rate needed to cut applied rates (%)
1	China	1931	9.14	8.96	1.92	15.76	15.70	0.36
2	India	695	34.94	16.44	52.96	114.25	37.55	67.13
3	Mexico	683	34.91	13.33	61.83	43.70	18.21	58.32
4	Brazil	603	30.79	12.63	58.98	35.48	10.17	71.33
5	Turkey	302	17.03	4.69	72.46	60.08	42.01	30.08
6	Indonesia	254	35.55	6.75	81.01	47.02	8.22	82.53
7	Saudi Arabia	250	10.50	4.81	54.19	21.39	7.82	63.43
8	South Africa	214	15.72	7.85	50.05	40.79	9.00	77.94
9	Thailand	161	25.55	8.17	68.01	40.69	22.07	45.75
10	Argentina	153	31.84	12.57	60.53	32.56	10.06	69.10

Notes for Table 1:

1. The source of this data are the WTO's Country Profiles, available at [www.wto.org](http://www.wto.org). The most recent data has been used.
2. These average cuts needed are well in excess of the 33 percent average cuts in bound rates agreed in many previous trade rounds.

Just how big a problem is this? Table 1 shows that apart from China, all of the other top 10 largest emerging markets have substantial gaps between their bound tariff rates and applied tariff rates for manufactured and for agricultural imports. The gap implies that, for example, Brazil would have to cut its bound tariffs on manufactured imports by at least 59 percent to create any new commercial opportunities for its trading partners. (Brazil would have to cut its agricultural tariffs by even more--71 percent--before any commercial opportunities for foreigners were created.) These numbers demonstrate precisely why the European Union and the United States have demanded substantial tariff cutting in emerging markets in return from slimmed-down Western agricultural policies. Bearing in mind that in previous multilateral trade negotiations tariffs have been cut typically by a third, then it is not surprising that many developing countries feel they are being asked to undertake an unprecedented amount of liberalisation. Moreover, some may feel that they are being punished for previously cutting their tariffs unilaterally. Worse still, these averages almost certainly include substantial tariff peaks for some protected sectors and it should not be surprising, then, that demands for large across-the-board cuts in tariffs have generated calls from many developing countries for substantial exceptions from any sweeping Doha-related tariff reform.

In recent years unilateral trade reforms have not been confined to developing countries. In response to budgetary pressures and expectations of enlargement, the member states of the European Union adopted in 2003 a ten-year plan to reform their agricultural sectors. Because these budgetary pressures have not abated and are expected to persist, many of Europe's trading partners have rightly concluded that the 2003 reforms are irreversible and may feel no need to offer better access to their own markets in return. (Why pay for something you will get anyway--and that won't get taken away from you?) Such reasoning seriously devalues what the European Union (and others too) have brought to the negotiating table during this Round. In agriculture it accounts for the many demands on Europe to commit to liberalise faster than in the 2003 plan; a request that runs straight into the brick wall of the French-led opposition.

The across-the-board unwillingness to "pay for" other nations' unilateral reforms probably goes a long way to explain why the tried-and-tested approach to reciprocal trade negotiations has failed this time around. Because of unilateral reforms proposals for small cuts in bound rates ("limited ambition" etc) garner little support from exporters and international business; meanwhile the large cuts necessary to create commercial opportunities are politically unpalatable to many WTO members and frighten too many horses.

Indeed, while so many have been worrying about how the aggressive spread of regionalism and bilateralism is undermining the multilateral trading system, in fact many of the termites eating away at the Doha Round's foundations are associated with unilateral trade reform. Worse still, since there are very good reasons for thinking that unilateral trade reform is desirable, a dilemma with system-wide implications arises.

The second underlying reason why concluding this round has been so difficult is that the major emerging markets, such as India and China, are growing so quickly that the gains from completing the Doha Round pale, relatively speaking, in significance. In Table 2 I report data from two leading studies on the maximum possible gains that might accrue to Brazil, China, and India if the Doha Round is completed. Using data on national income levels for 2000-2005 I calculated how many days of growth each of these emerging giants would effectively lose if the Doha Round is not completed. The results are pretty striking.<sup>3</sup> If Doha fails and the World Bank estimates (of the gains forgone) are correct, then China effectively loses an amount equivalent to just three days growth! India loses between 18-24 days growth, less than one month's progress. Brazil, on the other hand, would forgo the equivalent of 37-82 days of growth; at least twice as much as India.<sup>4</sup> This suggests that Brazil could well pay a high

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<sup>3</sup> They are even more striking when you take into account that growth in China and India during the last two years is probably higher than the average growth rate for 2000-2005. If anything the number of days of forgone growth reported in Table 2 is overstated.

<sup>4</sup> Since China and India have experienced accelerations in their rates of economic growth in recent years another revealing calculation is to ask how many Doha Round agreements would generate the same income increase as a one percent faster rate of economic growth. If this number is small, indeed if it is very much less than one, it

economic price for its geopolitical alliance with India. These numbers may go a long way to account for China keeping a low profile during this Round and for India's belligerence in Potsdam and elsewhere. Blocking or a nonchalant attitude to negotiating progress is surely easier in an era of accelerated economic growth. Another interpretation, and consistent with the argument above concerning unilateral reform, is that these calculations re-emphasise just how little was actually on the negotiating table in the Doha Round.

**Table 2: A failed round doesn't seem to cost China and India much; not so for Brazil.**

Country	Calculations based on largest estimates reported by CEPII staff.		Calculations based on largest estimates reported by World Bank staff.	
	Estimated gain (US \$ billions, 2005)	Days of economic growth needed to generate this gain.	Estimated gain (US \$ billions, 2005)	Days of economic growth needed to generate this gain.
Brazil	1.77	37	3.90	82
China	-0.61	n.a.	1.70	3
India	2.70	18	3.50	24

Notes for Table 2:

1. CEPII numbers taken from Yvan Decreux and Lionel Fontagné, "A Quantitative Assessment of the Outcome of the Doha Development Agenda," May 2006. This study was chosen because CEPII continued to refer to these numbers in publications in 2007.
2. The World Bank numbers were taken from a relatively recent study by three of its staff members, namely, Kym Anderson, Will Martin, and Dominique van der Mensbrugge "Market and Welfare Implications of Doha Round Scenarios," in Kym Anderson and Will Martin, editors, *Agricultural Trade Reform & The Doha Development Agenda*, Palgrave Macmillan, 2006. Chapter 12.
3. Data from the World Bank's World Development Indicators was used to compute the average daily economic growth rate for each country for the years 2000-2005.

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The Doha round is now in its terminal phase; short of discovering some miracle cure all that remains is for someone to discreetly turn off the life support machine. While some will no doubt blame protectionism, lack of "political will", and the like for Doha's trials and tribulations, are these really the underlying causes? I have argued here that sustained unilateral trade reform and high levels of economic growth in the leading emerging markets have done much to skew the cost-benefit calculus away from concluding this round of multilateral trade negotiations. For supporters of trade reform is there a dilemma here--between unilateral and multilateral reforms--or can trade diplomats better design WTO negotiations to take account of both types of reform?

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would suggest that completing the Doha Round would likely generate income gains that are much larger than a modest acceleration in economic growth. In fact the opposite is the case. A one percent acceleration in economic growth for China produces additional national income equivalent to more than completing 13 Doha Rounds! For India and Brazil the comparable numbers lie in the following ranges 2-3 and 2-4.5, respectively. These numbers highlight the relative insignificance of the potential Doha Round gains. If these considerations were the only relevant ones, or if they are given considerable weight in Beijing, Brasilia, and New Delhi, then the cost of walking away from the Doha Round could appear to some to be very low.