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Doha: No Miracle Formula

The 28th of July, the WTO General Council supported Pascal Lamy's proposal to suspend the ongoing Doha negotiations across the Round as a whole. The member countries had not reached a compromise that would have matched the expectations of the major actors: the U.S., the G20 led by Brazil, the European Union and the G90. An assessment of the gains potentially associated with the compromise contemplated by the negotiating parties sheds light upon the reasons of the current impasse. It shows that some Members were to get nothing from an agreement characterised by a low level of ambition, even though the induced concessions would have had an important political cost. The resumption of the negotiations will impose them to widen their scopes.

Turbulences during take-off: a difficult compromise

The idea was appealing: let us start by reaching an agreement on the more conflictual issues, i.e. the balance between concessions about liberalisation in agricultural goods on the one hand, and non-agricultural market access (NAMA) on the other. This having been fixed, it would be simple to address the remaining topics (services, trade facilitation). A deadline had been set to the end of July as a first step. Some progresses have been recorded: the poorest countries will be conceded a duty-free and quota-free access, but only for 97% of their exports; an agreement has been reached on the agricultural export subsidies. It remained to narrow the gap between the EU and G20's positions on market access for agricultural goods, to downsize the expectations of rich countries with regards to the openness of emerging countries' industrial markets, and to cap US agricultural domestic support. The combination of a Swiss formula for NAMA imposing a cap of 20% for the South, of distortive US subsidies capped to a yearly USD 20 billions, with the G20's proposal on market access in agriculture might have solved this intricate equation. It has been popularised by the Pascal Lamy short cut 20-20-20.[1]

Why did such a solution failed to meet support? An assessment of the associated economic impacts makes it possible to answer. Let us start by summarising the technicalities of this compromise.

Concerning the tariff cut,[2] we have considered that:

✦ Small and Vulnerable Economies,[3] the "paragraph 6"[4] countries and the least developing countries (LDCs) will not apply any cut.

✦ Regarding the non-agricultural products, a "Swiss formula", implying that high tariffs be reduced more than proportionally, is applied to Southern and Northern countries. The coefficient of reduction is ambitious for the North.[5] Moreover, Southern countries are authorised to carry out only half of the effort induced by the formula for "sensitive sectors" (10% of their tariff headings up, to 10% of their imports in value).

1. The G20 proposal for Agricultural Market Access, A tariff cap of 20% in manufacturing sectors for developping countries and 20 USD billions of USD for the US Agricultural Domestic Support.

2. *La lettre du CEPII* N°253, http://www.cepii.fr/francgraph/publications/lettre/pdf/2006/let253.pdf , presents an in-depth discussion of alternative tariff cutting formulas.

3. Potential victims of preferences erosion are: Antigua and Barbuda, Barbados, Bolivia, Dominica, Dominican Republic, Salvador, Fidji, Grenada, Guatemala, Honduras, Mauritius, Mongolia, Nicaragua, Papouasia New Guinea, Paraguay, Saint Kitts and Nevis, Sainte Lucia, Saint Vincent and the Grenades, Trinidad and Tobago.

4. The "paragraph 6" countries of the agreement of Non agricultural Market Access are WTO members with a low level of binding coverage (smaller to 35%): Cameroon, Congo, Côte dIvoire, Cuba, Ghana, Kenya, Macao, Mauritius, Nigeria, Sri Lanka, Surinam, Zimbabwe. Mauritius is also a LDC.

5. Swiss Formula: Final rate = (Initial rate x coefficient)/(initial rate + coefficient). The coefficient determines the objective of tariff capping. The chosen coefficients are 10 for the developed countries and 20 for developing countries.

✦ Concerning agricultural products, tariffs are reduced by a "tiered" formula based on the bands and coefficients of reduction suggested by the G20. For the North, the cuts start from 45% in the lowest band (rates below 20%) and peak to 75% for the duties above 75%. In the South, the cuts range from 25% to 40%. After the application of this formula, a capping is used in order to ceil the duties to 100% in the North and 150% in the South. Both regions are entitled to 4% agricultural "sensitive products", selected according to their political sensitivity. The South has also been conceded 10% of tariff lines associated with "special" products, selected in accordance to food safety objectives as well as the protection of the vulnerable farmer populations. Protection for sensitive products will face only half the cut;[6] the special products will not be liberalised.

✦ Tariff cuts[7] are applied linearly between 2007 and 2010 for the North, and over 6 years for the South.

Concerning subsidies:

✦ Export subsidies are removed.

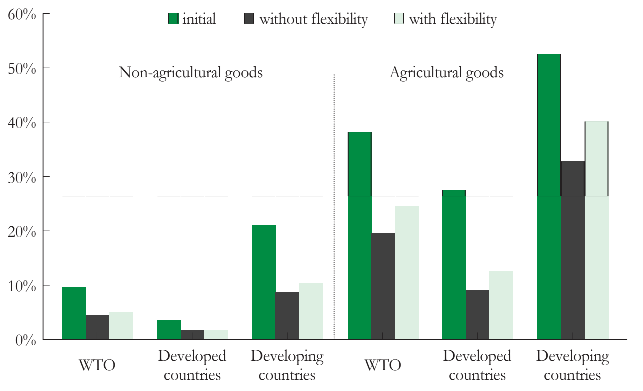
✦ Commitments regarding trade-distorting domestic support are reduced by 75% in Europe and by 53% in the United States, in order to cap US domestic support to USD 20 billion per annum. The reduction is linear over the period running from 2007 to 2013.

Ambitions for tariff reductions fail to spread their wings

Changes in bound duties are displayed in Graph 1.[8] Current tariffs are compared to the ones that would have emerged from the July compromise, with or without the flexibility associated with the possibility of selecting sensitive and special products.

For non-agricultural goods, the impact of sensitive products is reduced since this possibility is limited to the South. However, cuts in the bound rates are still sizeable: more than 10 points on average in the South, a reduction by almost half. In agriculture, the introduction of 4% of sensitive products[8] is more critical: for the North, the average bound duty is reduced by half instead of two-thirds without flexibility; in the South, the impact of sensitive products is even more important: the tariff reduction is finally only about one third and, after liberalisation, the average tariff remains around 40%. We identify here one of the perverse impacts of conceding a wide "Special and Differentiated Treatment" to developing countries: their protection will remain high, hampering South-South trade.

Graph 1 – Impact of tariff cutting formula on bound rates



Note: Figures have been computed using a weighted average ("reference groups" method, CEPII) of the WTO Members protection. Flexibility refers to the special and sensitive products.
Source: Bound duties database, CEPII, Authors' calculations .

The impact is much more limited in terms of applied duties, as a result of the actual binding overhang. The average rate of protection in the South drops from 7.3% to 5.7% in manufacturing, and from 19.8% to 19.1% in agriculture, where the formula has nearly no effect. Considering the average cuts in tariffs across countries (Table 1) confirms this result. For non-agricultural goods, protection in the North is cut by 40%, and by 21% in the South. In this latter group of countries, the presence of "sensitive" industrial sectors has a strong impact. In agriculture, the average rate is cut by 35.6% in the North (instead of 54.2% without sensitive products), and 3.4% in the South (instead of 19.4% without sensitive products). Thus, the combination of the binding overhang,

Table 1 – Impact on applied protection for G6 countries and groups of countries

	Applied	Cut (points)		Percentage of cut	
	2001	with flex.	without flex.	with flex.	without flex.
Agricultural goods					
Australia	2.7	0.9	0.5	34.2	18.2
Brazil	11.0	0.1	0.0	0.5	0.0
European Union	19.3	10.9	7.6	56.4	39.3
India	56.5	7.7	0.1	13.6	0.2
Japan	35.4	21.2	13.8	60.0	38.9
USA	5.2	2.0	1.3	39.1	25.9
WTO	17.9	6.9	3.8	38.4	21.3
Developed countries	16.8	9.1	6.0	54.2	35.6
Developing countries	19.8	3.8	0.7	19.4	3.4
Non-agricultural goods					
Australia	4.9	2.0	2.0	40.9	40.9
Brazil	12.4	3.0	1.9	24.3	15.5
European Union	2.3	0.9	0.9	40.4	40.4
India	28.4	16.6	12.2	58.4	42.9
Japan	1.3	0.5	0.5	42.4	42.4
USA	2.1	0.9	0.9	41.6	41.6
WTO	3.9	1.4	1.1	36.8	27.8
Developed countries	2.2	0.9	0.9	40.5	40.5
Developing countries	7.3	2.6	1.6	36.0	21.2

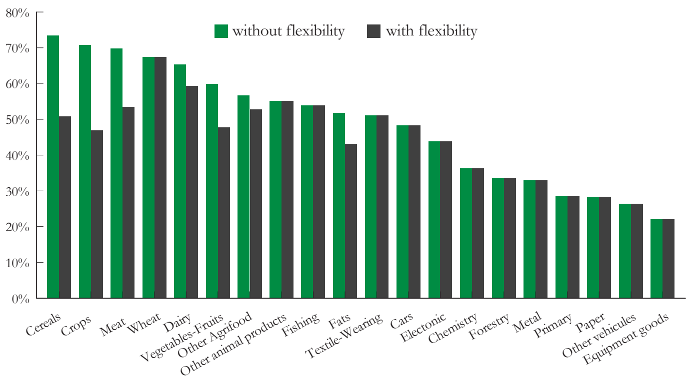
Note: Figures are computed using a weighted average ("reference groups" method, CEPII) WTO members. Flexibility refers to the special and sensitive products.
Source: Bound duties database and MAcMapHS6v1, CEPII, Authors' calculations.

6. The products already covered by a tariff quota will see the quota volume increased.
7. Cuts are applied on the consolidated tariffs, at the HS6 level, using MAcMapHS6 and 2001 as the reference year. For unbound lines, a base rate is computed by adding 30 points of percentage to the most favoured nation 2001 applied duties.
8. Details concerning all numerical applications considered here can be downloaded on the CEPII web site: http://www.cepii.fr/francgraph/publicatios/lettres/resumes/2006/let257.htm
9. See also S.Jean, D.Laborde et W.Martin, "Consequences for Alternative Tariff Cutting Formulas for Agricultural Products", CEPII Working Paper CEPII N°15, 2005. http://www.cepii.fr/anglaisgraph/workpap/pdf/2005/wp05-15.pdf

exceptions and the special and differentiated treatment profoundly limits the ambitions of the Round: while formulas would have led to a reduction by half of the customs duties, it will be limited to only one quarter on average. Not surprisingly, the expected benefits of the liberalisation will not be very large.

However, this average is actually hiding important heterogeneity among categories of products (Graph 2). For example in the European case, the average bound duties on cereals would be cut by 72% without sensitive products; their introduction limits this cut to 51%. The applied duty is cut by 30% (instead of 53% without flexibility). Sensitive agricultural products appear as an essential element of the domestic political game which will make the agreement acceptable or not, even if they are the source of a strong limitation of the expected benefits of the Round.

Graphique 2 – Cut rate of bound duties, by sector, for the European Union



Note: Figures given are computed using a weighted average ("reference groups" method, CEPII) of WTO members. Flexibility refers to the special and sensitive products.
Source: Bound duties database, CEPII, Authors' calculations.

The weakness of the gains killed the Round

We used the CEPII's model MIRAGE to assess the benefits associated with this central scenario.

On average, trade volume increases by 1.6%, suggesting that the Round has landed at the end of the runway, in a desert area. The increase of the global real income just reach a few thousandths in 2020 (variation expressed as a percentage compared to the trajectory of reference of the world economy). The most optimistic observers will conclude that this failure is not so serious: the losses amount to USD 37 billion, i.e. 6 times less than the potential gain of total trade liberalisation.

Of course, some trade flows, currently very limited by high levels of protection, could have been strongly impacted. Table 2 illustrates this for the enlarged European Union (27 members): not surprisingly, EU imports from the rest of the world, in 2020, would have strongly increased in several agricultural sectors, and this in spite of the presence of less liberalised sensitive products. Accordingly, imports of meat would have increased by 125%. Nevertheless, taking into account the initial low level of the extra-EU imports, this would have resulted in a reduction of the value added by only 5% in this sector. Thus, it would have been possible to combine better access to the European market for third countries and limited decline of the activity in the affected sectors.

The most striking result is the uneven distribution of the gains in real income across countries, as displayed below on the map. The United States suffer a slight loss, which justifies the lack of eagerness of the Bush administration to pay the political cost of a confrontation with its farmers. Brazil does not earn the point and would be hardly granted for its activism in this Round. The gains are concentrated in Asia and to a lesser extent in Europe. Lastly, and this confirms previous works, several parts of Africa lose, as well as other countries already benefiting from preferences would have been eroded (e.g. Mexico on the American market).

Flight plan to be reconsidered before a new take-off

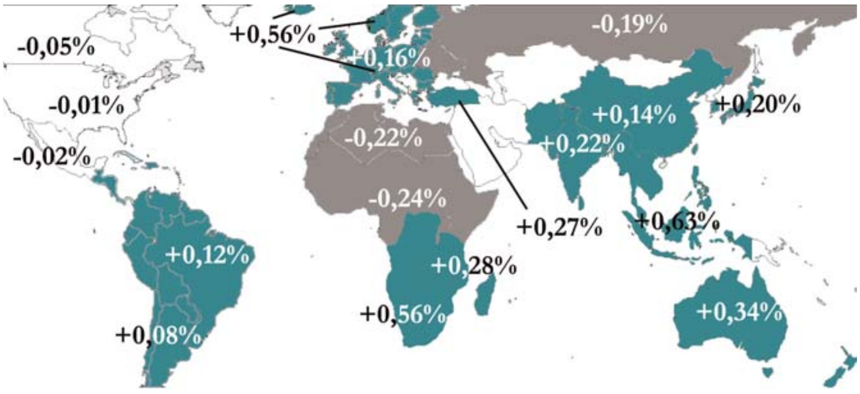
It will not be enough for George Bush to successfully pass the "mid-term elections" and obtain an extension of the "fast track" to unlock the negotiations. The weakness of the current American administration currently prevents it from

Table 2 – Main Scenario: Changes in %, from the 2020 baseline without a WTO agreement, of European Union's extra-EU trade and value added (volume)

	Agriculture	Cereals	Dairy products	Wheat	Other crops	Meat	Other anamal products	Fruits and Vegetables	Forestry	Other agrifood industries	Oils and Fats
Exports	-12.8	-51.6	64.0	-35.7	2.5	-46	6.0	3.4	3.6	-0.1	7.3
Imports	16.8	7.1	141.7	-10.2	26.1	124.5	-7.3	7.0	0.0	7.5	6.9
Value added	-3.1	-10.7	-6.9	-6.7	-6.2	-5.3	-4.9	-2.3	0.8	-0.6	-0.6
	Manufacturing	Textile-Wearing	Cars	Fishing	Chemistry	Paper	Metals	Equipment Goods	Electronic	Other vehicles	Primary
Exports	4.6	11.4	6.8	2.7	3.8	2.7	4.6	3	2.2	2.3	9.9
Imports	2.0	8.9	17.7	1	3.0	-0.8	0.1	-0.2	-1.3	0.4	0.5
Value added	0.7	-0.9	0.0	0.1	0.2	0.3	0.9	1.2	1.2	1.2	1.7
	Services	Finance-Insurance	Other Services	Communication	Business Services	Transport					
Exports	1.1	0.7	1.2	1.0	1.2	0.9					
Imports	-0.8	-0.5	-0.8	-0.7	-0.9	-0.6					
Value added	0.3	0.2	0.2	0.2	0.3	0.8					

Source: MIRAGE simulations, CEPII, Authors' calculations

Figure 1 – Main scenario: Real Income Changes (%)



Note: Green areas indicate potential winners of the scenario and grey areas the main losers.
Source: Main scenario: Real Income Changes (%).

facing its agricultural vested interests; but a new deal in 2008 will hardly change this situation. The stumbling block is not the calendar but the agenda. By trying to balance agricultural concessions only by concessions on NAMA, the negotiators have reached a dead end: the lowest common denominator does not bring gains large enough to pay for the pains of liberalisation. Since large gains are potentially associated with a liberalisation in services and progress on the front of trade facilitation,[9] their integration is likely to deeply affect not only the total amount, but also the distribution of the gains. Thus, it is necessary to re-connect all the topics of the negotiations and to come up with other reduction formulas of domestic support and tariffs.

This is a difficult move and some suggest the achievement of the pro-development goal of the Cycle, by validating the concessions granted to the poor countries without foreseeing the continuation of the negotiations: free access (zero right, zero quota) conceded to 97% (or even 100%) of the LDCs products, an "Aid for Trade" package, progress on trade facilitation, a package for technical aid, a reform of rules of origin and a simplification of the access of the developing countries to the Dispute Settlement Body. But Peter Mandelson's proposal along these lines has been discarded by Pascal Lamy, who interprets it as a too large loosening of the principle of the "single undertaking" in the negotiations: "Nothing is concluded until everything is concluded".

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9. We have for instance demonstrated (Y. Decreux & L. Fontagné (2006), *Document de travail du CEPII*, n° 10), http://www.cepii.fr/anglaisgraph/workpap/pdf/2006/wp06-10.pdf) that gauns associated with trade facilitation are potentially sizeable for Africa, and world anyway cancel the losses envisaged here.

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