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## THREE VARIATIONS ON ‘THE FUTURE OF THE WTO’

*Patrick A. Messerlin*<sup>\*</sup>

### INTRODUCTION

The Report on ‘The Future of the WTO’ had a serious challenge to face. On the one hand, it had to avoid Charybdis – the temptation of a cozy *status quo*, natural in such a complex institution shaped by fifty years of ‘creative ambiguity’ and customary practices that evolved into quasi-rules. But it also had to avoid Scylla – the temptation of a cheap idealism leading to simplistic and/or unrealistic proposals for reform, of which there were so many doing the rounds in Geneva and in some European capitals when the Consultative Board began its work.

The end result is highly commendable. The Report addresses all the critical issues – preferential trade agreements, sovereignty, policy space, Single Undertaking, special and differential treatment, graduation, etc. – which are major sources of controversy, both amongst WTO Members themselves, and between individual Members and their ‘civil societies’. Moreover, it manages to give the layman a very lively overview of the WTO’s functioning, as illustrated by the frank look at the critics of globalization in Chapter I. Last but not least, it makes it clear just how difficult it will be to make meaningful and acceptable reforms – how ‘grands desseins’ are misplaced, if not counterproductive, and how reforms which may, at first glance, seem rather modest can in fact go a long way.

Having said all this, a commentary is useful only to the extent that it offers variations on the Report’s analysis and conclusions. This note presents three such variations. First, it focuses on ‘domestic’ sovereignty, rather than on ‘external’ sovereignty as the Report does. Second, it is more cautious on the erosion of non-discrimination – not by complacency, but for efficiency’s sake. Third, it is more forthcoming on the issue of the ‘Single Undertaking’. Together, these variations provide a different perspective that helps to prioritize the Report’s many recommendations in three key domains – making WTO improvements subservient to the improvement of domestic WTO-related institutions in each Member, re-ordering the three tracks suggested by the Report in terms of organizational changes (Summits, Ministerials and the senior officials’ consultative body), and suggesting a new approach on special and differential treatment.

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### I. SOVEREIGNTY

At a first glance, the future of the WTO seems an international issue. But this leaves out a key point: from an economic as well as a political perspective, international trade issues are a reflection of domestic issues. This proposition is best illustrated by the intrinsic conflicts of economic interest between exporting and import-competing activities in every country. For instance, focusing on the opposition between European farmers and those from the rest of the world in Geneva is only half of the story – and not the most interesting one. The fate of the Doha negotiations will primarily depend on what happens in Brussels to the extent that, when European farmers block the Doha negotiations on agriculture, they inevitably harm the interests of European manufacturers and service providers who would gain from better access to foreign markets, were farm liberalization to be implemented. Similarly, when a developing country does not liberalize its trade regime, it favors its most protected sectors, which can generally count on well-established and powerful entrenched interests, to the detriment of others that could have flourished under freer trade. In sum, any ambassador to the WTO negotiates on two fronts – against his/her colleagues in Geneva, and against conflicting domestic coalitions in his/her capital city – and the fights in the capital cities are generally harder and more decisive.

Trade matters involve thus a ‘domestic’ dimension of sovereignty. They test the ability of a government to take into account the most ‘global’ welfare possible, to go beyond narrow vested interests and to favor long term – often infant or even potential – interests. Domestic sovereignty is at least as important as external sovereignty – to a large extent, the former determines the latter.

The Report refers *en passant* to domestic sovereignty, but it does not use it as a pivotal argument. Its chapter on sovereignty relies on a definition expressed in an international, ‘external’ context (monopoly over the legitimate use of force, border control, policy autonomy and non-intervention between sovereign Members). This exclusivity of approach inevitably puts the Report on the defensive because the WTO limits the external sovereignty of its Members. The Report puts forward the best defense available in the circumstances. But from the point of view of a layman, just how convincing is it to emphasize the balance between, on the one hand, some loss of policy space and, on the other, the advantages of cooperation and the rule of law at the multilateral level?

In sharp contrast, emphasizing domestic sovereignty presents the WTO in a very favorable light because the WTO actually *increases* the domestic sovereignty of its Members – a positive argument of considerable value in our world which is less preoccupied with international conflicts than with good domestic governance. For instance, when the WTO bans quantitative restrictions and makes clear its ‘preference’ for tariffs as an instrument of protection,



it helps Members' governments avoid decisions that would give money and power to entrenched private interests, leading almost inevitably to the governments' capture by these private interests. When it provides incentives to adopt a uniform and moderate tariff schedule, it makes more difficult the life of lobbies (a lobby willing to get a tariff which would be higher than the existing uniform rate has to fight all the other lobbies) and it contributes to the public coffers of its Members, thereby enlarging their 'policy space' to include subsidies on production and consumption of goods, services and factors of production – all instruments much more efficient to achieve desirable goals in the context of an economic development strategy.

As a result, focusing on domestic sovereignty inverts the conventional wisdom on freer trade versus protectionism. Too often, a government is perceived by laymen as a benevolent and impartial actor: when it actively protects a sector, it is expressing some kind of 'public' interest; freer trade (i.e. less protection) must therefore favor narrow 'private' interests. Most studies on protection, however, show exactly the opposite: it is apparently mighty governments that are captured by tiny but very powerful interest groups, to the detriment of the vast majority – and in particular, to the detriment of the poorest people who are, by definition, politically powerless. Today, there is no better illustration of this reality than the capture of farm policy in the EC and US: we see two mammoth governments held hostage by a relatively small number of very determined, large farmers. Who loses? Small, disorganized and/or poor farmers in the EU and US and elsewhere and, of course, almost all the consumers in the world.

In sum, emphasizing domestic sovereignty allows to move away from the image of a government that is limited in its use of (often inefficient) tariffs and quantitative restrictions, to that of a sophisticated government anxious to spell out in detail the precise objectives of the country and to choose the best instruments for achieving them. And, it presents the WTO as a machine producing a more enlightened choice of instruments for achieving a country's preferred goals.

Such an approach has an essential consequence for the institutional design of the world trading system. It highlights the crucial importance of *domestic* institutions (public or private) capable of revealing the opposing domestic interests at stake. Such institutions can serve both to better inform public opinion on the issues at stake and the forces present, and to enhance the government's capacity to make more independent decisions, as best illustrated by the Productivity Commission in Australia, a country far from convinced of the gains to be had from freer trade three decades ago. During these last three decades, this institution has carefully weighted the pros and cons of the alternative available policies for achieving a desirable goal. This culture of 'evaluation' has almost always led to the *substantiated* conclusion that trade policy is, at best, a second-ranking option which generates too many costs without even achieving the desired goal.



All this sheds new light on the Report's recommendations in favor of a 'stronger' WTO Secretariat. First, recognizing that funding will probably never be abundant for WTO-related matters leads to the conclusion that as many resources as possible should be kept for favoring the emergence of the above-mentioned domestic institutions within WTO Members. These institutions constitute an integral part of the WTO system to the same extent as the WTO Secretariat *per se*. A more analytical WTO Secretariat will never be able to change the turn of negotiations if the governments of WTO Members are too much captured by their domestic vested interests. It will very rarely have the capacity of being sufficiently critical when monitoring the Members' trade policy. The WTO Secretariat will be much more efficient in these core businesses if Members' governments are freer at home and criticized by their own nationals – and that depends critically on analytical capacity within WTO Members. The priority should therefore be on developing these domestic institutions, which ultimately underpin domestic sovereignty.

Second, funding scarcity suggests concentrating the reinforcement of the WTO Secretariat's capabilities on its core activities: supporting trade negotiations and monitoring Members' trade policy. Other trade-related topics can be covered by better placed international institutions (such as the World Bank or the OECD) or by independent initiatives. The Report pays little attention to the latter (for instance, it recognizes explicitly their role only in the concluding paragraph on the dispute settlement system, and without drawing lessons from it). These initiatives differ from the 'civil society' to the extent that they have no strong advocacy role, but rather participate in the much-desired culture of evaluating the WTO system and the related public (international and domestic) policies. They are likely to offer a much more flexible, timely and independent analyses than *ad hoc* special expert groups to be immersed in the WTO machinery – in the very much Member-driven WTO, independence may often have a too high price. Improving the interactions between these initiatives and the WTO Secretariat is thus essential, and there is a need for additional recommendations in this respect.

## II. EROSION OF NON-DISCRIMINATION

The Report tackles the erosion of non-discrimination head on. This highest priority shows great concern for the serious dangers that preferential trade agreements (PTAs) represent for the WTO architecture and development. The Report's general thrust on this topic is very convincing, and it does not require any debate. However, there is room to introduce some nuances, which are useful in so far as they help prioritize several of the Report's recommendations. More precisely, if there is little doubt that PTAs are troublemakers, the key question is to assess where these troubles are the most serious, and, in this respect, the Report paints a picture of the current situation that is somewhat darker than it need be.



First, the number of PTAs is an unreliable indicator of the amount of trouble they cause, as best illustrated by the following examples. Among the 169 PTAs notified to the WTO and in force, roughly 30 have been required to create a single European PTA, centered on the EC and a few other participants (the EFTA countries, Turkey, the Faroe Islands). That 30 treaties were needed instead of one simply reflects the intrinsically duplicative nature of a trade diplomacy based on bilateral agreements (for instance, the EC-Turkey customs union requires Turkey to sign a PTA with every country signing a PTA with the EC, and similarly with the EFTA countries). Another interesting case is the ten PTAs involving Balkan countries (to become 28 in the near future!). This situation is the consequence of the decision – echoing the recent wars in the region – made by the countries of that region to sign bilateral PTAs rather than a regional PTA. All these bilateral PTAs are very similar, they are between signatories with low (and often similar) MFN tariffs, and the current signatories are examining the possibility of consolidating all these PTAs into one single act.

In all these cases, it is hard to say whether discrimination has increased or decreased following the increased number of PTAs. Similar difficulties are encountered when one looks at the number of trade partners under MFN status. This number may be low, but it has increased during the last decade, if only by including a big, and rapidly expanding, share of the world economy and trade, namely China.

Second, recent experience suggests that it seems difficult to successfully negotiate PTAs between large trading partners. It is reassuring that there are economic and political forces at work behind these difficulties, as illustrated by the negotiations between the EU and Mercosur, or among the countries covered by the FTAA. From the EU and US perspective, the vast efficiency of Brazilian agriculture, both in sugar-type products (i.e. products with powerful protectionist lobbies in the US and the EC) and in soybean-type products (i.e. products with traditionally export-oriented, free trade-friendly lobbies, at least in the US) makes the FTAA and the EC-Mercosur FTA politically unattractive options in the US and the EU. Both PTAs would require the opening of these EU-US farm markets, confronting EC-US domestic farmers directly with their strongest world competitors (those from Brazil) while, in exchange, EU-US exporting interests would only gain access to Brazilian markets. In other words, adjustment costs for – and hence, political opposition from – the EC and US farmers are the same, whether the US or EC farm market opening be negotiated in preferential agreements or at the WTO level. In sharp contrast, the benefits for US and EC exporters from regional or multilateral liberalization are very different because Mercosur markets, while they are large, are nevertheless much smaller than the world markets that would be opened by a WTO deal.

Problems from a Brazilian (Mercosur) perspective are quite different, but equally serious. From an economic point of view, tariff-rate quotas which



might be offered by the US or the EC as a compromise are likely to be a trap for Mercosur exporters and governments. It is by no means sure that Mercosur exporters will in fact be able to obtain the rents associated with such tariff-rate quotas (it is much more likely that they will go to European importing or producing firms). From a political perspective, it may be difficult for Brazil to leave the coalition that it has done so much to create in the Doha negotiations in exchange for limited tariff-rate quotas in PTAs: such a move could only have a negative, and long-lasting, impact on Brazil's reputation as a coalition leader in the WTO.

Finally, PTAs between large trading partners are triggering increasing hostility amongst businessmen who might feel protected by some agreements, but excluded by the others – prompting them to ultimately prefer the multilateral approach.

As a result, the most pressing and serious danger to focus on comes from PTAs involving *small* signatories. If, in the short run, their costs are mostly borne by the small partners, these PTAs have, in the long run, the capacity to block the whole WTO machinery, with small countries belonging to these various PTAs joining together to protect their small – sometimes practically nonexistent – preferences by opposing any multilateral deal.

The fact that small countries fearful of liberalization decide to liberalize anyway, but in the context of blatantly 'unequal' PTAs, whereas large trading powers tend to rely on non-discrimination amongst themselves, is a puzzling development. How can one rationalize such a bizarre situation? How can one explain the logic of the many small country Trade Ministers who, after having made impassioned speeches against multilateral liberalization in the Cancun Ministerial, made every effort to leave the negotiating room with an appointment in Brussels and/or Washington in order to negotiate a PTA with provisions more severe than those tabled in Cancun? Many of these PTAs will take as long to negotiate as the Doha Round (that PTAs are faster to negotiate than WTO deals is largely a myth). Many others will impose reciprocity and thereby consign special and differential treatment to the wastebasket of history, as best illustrated by the negotiations between the African-Caribbean-Pacific countries and the EC. Finally, an increasing number of these PTAs include provisions emblazoned with a friendly 'WTO-Plus' label (labor, patents, geographical indications, etc.) but which would be better described as somewhat crude evidence of the hegemonic signatory's throwing its weight around. Needless to say, such provisions are anathemas in the WTO, and would have triggered an outcry if they had been negotiated there.

This awkward situation may largely reflect two factors which interact in a negative way. On the one hand, Trade Ministers are not usually senior politicians. Rarely having a good sense of domestic sovereignty, and even more rarely supported by robust domestic analytical capacities, they tend to 'bluff' too much – asking for excessively deep concessions from their partners in exchange for excessively limited concessions from their own side – in speeches



that are mostly written before coming to the Ministerials. On the other hand, the WTO pays a price for its public prominence. Trade Ministers apprehensive of trade liberalization (the vast majority in the case of small developing countries) because they will be blamed for the unavoidable adjustment costs in the first years of the liberalization process do not want, or cannot afford, to negotiate in the spotlight. In sum, PTAs offer the secretive atmosphere that the GATT used to grant, but that the WTO does not provide any more, and that most Trade Ministers desperately need to survive at home.

If this view is correct, it suggests a criterion for examining the three recommendations suggested by the Report for improving the WTO process. Firstly, the Report proposes Ministerial Conferences on an annual basis. But what has just been said does not augur well for that proposal. Such Ministerials will simply make more permanent the exposure of apprehensive Trade Ministers to the glare of public opinion, and especially to aggressive NGOs. Failures at such Ministerials are likely to become more frequent than successes (nowadays, failures and successes are almost balanced) and the whole system will have severe difficulties coping with this negative development. In other words, WTO Ministerials do not need to be more frequent. What they really need is to be 'monitored' from above (the Summits) and from below (the senior officials' body).

Second, the Report suggests a WTO Summit of World Leaders every five years. This recommendation is much in tune with the theme of domestic sovereignty: heads of state or government should, out of all politicians, be the most inclined to look at the broadest possible picture. Compared with Trade Ministers, they have the luxury of controlling the all-important issue of timing – when they can launch trade reforms in order to reap their benefits, when they can bear the adjustment costs, etc. However, creating Summits specific to the WTO forum may not be the best way to get the most out of this idea. After all, many heads of state or government have shown their inability to promote trade reforms in the past – trade is a 'petty-knotty' topic – and holding Summits only every five years (almost an eternity in most political careers) is a too low a reward for attracting most of the heads of state or governments.

Why not turn to the existing G7-G8 Summits, and extend them to the ten or so largest economies when they address trade issues – in other words, an annual 'trade day' of twenty or so heads of state and government? This formula has many merits. It relies on an existing, well-oiled process which is run on an annual basis (making annual Ministerials even less necessary). It would include developing countries with a large number of poor people, and hence a real political legitimacy *vis-à-vis* the poorest developing countries. Most of these developing countries are successful, and their leaders have experienced the net benefits of trade liberalization. They are eager to continue their liberalization process at the multilateral level, so they are well placed to undercut PTAs by eroding preferences through multilateral liberalization. Finally, these Summits could invite non-permanent heads of state





and government in a strategic manner – focusing on the regions or on the kind of issues which are expected to be the most sensitive on the trade front for the year to come.

The Summit layer will impose an institutional condition on the WTO. It will require from future WTO Directors-General more than competence and experience, the two qualities underlined by the Report. It will require a political stature allowing the Director-General to participate in these Summits with the ease and the confidence that can exist only if the Director-General has himself or herself previously been a head of state or government.

Finally, the Report suggests the creation of a senior officials' consultative body which could indeed be an effective way of monitoring the Ministerials from below. As the Report provides an exhaustive analysis of the very robust reasons for creating such a body, what is left for discussion is its composition. The Report suggests that it should include officials from the 'ministries of trade and agriculture and, perhaps, economy'. This looks like a recipe for protection (why a representative from the ministry of agriculture, and not one from the ministry of steel or from the ministry of culture?). Rather, it is essential to have senior officials from the offices of heads of state or government and from economics ministries, in addition to trade ministries. This composition would be all the more critical because these senior officials will largely work as 'sherpas' for the Summits and the Ministerials.

### III. SINGLE UNDERTAKING

There is no doubt that the Single Undertaking adopted at the end of the Uruguay Round has profoundly changed the nature and the scope of the WTO. It is a quantum leap, with all the positive connotations that such a word may have, and that the Report underlines. But it is also a leap that a vast majority of WTO Members have had difficulties coping with. The Emperor has clothes, but they are much too large.

In these circumstances, the worst approach would be to stick rigidly to the Single Undertaking concept. In fact, although the WTO Members have signed 'constitutional' agreements (on services, on TRIPs, etc.) all these agreements have built-in flexibilities which, if fully used, go a long way in the direction of a 'variable geometry' in the WTO system.

The question is whether more should be done. The Report seems to bend in this direction in its Chapter VII on variable geometry. But, it adopts a more cautious attitude when it evokes 'special and differential treatment' (S&D) – the fact that developing countries have different rights and obligations than developed countries – in its Chapter II on the erosion of non-discrimination. (To be fair, Chapter II developments are more about the past and Chapter VII is more about the future.) As S&D can be seen as variable geometry applied to developing countries, what follows tries to outline a new S&D in line with the Report's developments on variable geometry.



S&D has always been a difficult issue in the multilateral trade regime. Problems are even more acute in the current Doha Round because developing and developed countries alike face a situation largely unknown before. When S&D was established forty years ago, developing countries constituted a relatively homogeneous group of countries – so much so that it did not matter that being a developing country in the WTO was a self-selection process. And the strongest glue uniting all the developing countries was a profound reluctance to liberalize. Meanwhile industrial countries, although they were only marginally concerned by competition from developing countries, granted S&D with little consideration for development, and they did not hesitate to exclude the few key sectors for developing countries – shoes, clothing or agriculture. No wonder then that S&D did not work in these conditions, as underlined by the Report.

Today, one third of the 'developing countries' in the WTO have a GDP per capita higher than the poorest Member states of the European Union. That makes it increasingly harder for industrial countries – and the poorest countries alike – to still consider them as developing countries. Even in countries such as India or China, there are regions with a level of wealth and activity comparable to what exists in industrial countries. Moreover, recent years have shown that developing countries can rapidly enter sectors which, only a few years ago, were seen as the exclusive territory of rich economies, such as a broad range of services. Finally, all the success stories – from Korea to Singapore to China to India – have very little to do with S&D. Rather, they reflect better domestic governance and classic economic recipes for growth – a sound macroeconomic policy, a progressive but firm pace towards freer trade, and an ever wider set of improved domestic regulatory policies.

Does that mean that the S&D days are over? No. But, it definitely requires a much more subtle approach than the black-and-white picture to which too many trade negotiators are still overly attached today.

Focusing first on the poorest countries, most of them lack the key input for growth: a critical level of good governance. As a result, they still need preferential access to rich markets – indeed, rich countries can still do a lot in this respect, such as opening their farm and clothing markets. That does not mean that the poorest countries should make no concessions. As shown by a recent UNCTAD study, these countries will gain mostly from trade liberalization amongst developing countries – a situation reflecting the substantial but still largely incomplete move of many developing countries towards freer trade over the last decade. The poorest countries should thus focus on cutting their high tariffs and binding them – hence, a progressive but firm move towards a uniform and moderate tariff, as recently done *de facto* (and largely unilaterally) by countries such as China or India. Ideally, S&D could be made less costly and potentially more beneficial for the poorest countries if set up in an environment superseding all the existing schemes (in order to avoid the costly trade barriers, such as rules of origin, which fragment preferences) and based



on three pillars: a joint group of donors; a joint group of beneficiaries (to be defined by relatively objective criteria, hence to be graduated when the time is ripe, according to well defined rules); and asymmetrical market access requiring limited reciprocity from the poorest countries.

Second, if developing countries want ‘policy space’ in order to implement their development strategy, they have plenty of instruments at their disposal – production and consumption subsidies or taxes on goods, services and factors of production – which can better reach the desired objectives, and at a much lower cost for the country, than trade barriers. Trade liberalization and domestic instruments should be seen as complementary: without freer trade, domestic instruments can easily be useless, or even harmful; without domestic instruments, the benefits of trade liberalization can be negligible (for instance, dismantling trade barriers will have a limited impact if domestic firms are not well connected to domestic markets). In general, WTO rules do not constrain domestic instruments. However, there are cases where WTO rules are ambiguous – when domestic instruments are ‘too’ sector-specific, when they distort trade flows ‘too much’, etc. And there are cases where WTO rules on domestic instruments are so lax for rich countries that they have generated a ‘reverse’ S&D, such as in the Uruguay Round Agreement on Agriculture. One should therefore aim to eliminate such uncertainties and reversals.

Third, as underlined by the Report, the Uruguay Round has massively expanded the WTO’s scope, with the Agreements on services, on standards, on trade-related intellectual property rights, etc. This expansion has generated a lot of fears. However, WTO disciplines on such matters are often greatly exaggerated. The Agreement on services is probably the most flexible of all WTO agreements. The core of the WTO Agreements on standards is to protect developed and developing countries alike against an abusive use of standards. The TRIPS Agreement is the one going the farthest in terms of ‘harmonization’, but it only sets minimum standards and it includes ‘escape’ clauses. All these WTO Agreements are less constraining and more flexible than the corresponding provisions introduced in the recently signed PTAs – indeed, these WTO rules could help limit the costs of ‘unequal’ PTAs for developing countries that are trapped in them. Having said this, the fact remains that all these WTO agreements are intrinsically intensive in domestic regulatory policies, and this feature opens a completely new chapter in S&D for the following reason: if improving market access in goods (reducing tariffs or quotas) improves domestic welfare *and* reduces regulatory costs, opening markets in services improves domestic welfare *but* it may also increase regulatory costs.

As a result, the emergence of regulatory policies in the multilateral trading system tends to magnify the key handicap of many developing countries – good domestic governance – and to amplify the differences among them. Introducing an economically sound and politically acceptable S&D into this



context will be no easy task. As a starting point, two broad principles are of vital importance. First, attention should be on regulatory creativity – do not ask developing countries to mimic rich countries' regulations inherited from decades of the rule of law. Second, the Doha negotiations should focus on a well-defined cluster of services offering the largest net benefits from consumers' gains and regulatory costs (a promising starting point for such a cluster of services could be trade facilitation).

#### CONCLUDING REMARKS

The Report may have been too humble in two ways. First, it took great pains to look at the critics of globalization – that was necessary and very well done. But, why not to have mentioned that, according to the available polls, there is a strong support for freer trade (80 percent and above) in all the countries surveyed, and that the fear of globalization refers to perceptions beyond the realm of trade (capitalist 'crises,' 'evil' firms, 'immigration', cultural 'uniformity', etc.)? In other words, these polls suggest that the burden of the proof is on the 'anti-globalizers' more than on the supporters of freer trade – a fact hidden by a too-generous use of the term of 'civil society' by the Report.

Second, this Report did not explicitly raise the issue of its aftermath. It should not remain an isolated endeavor. It calls for monitoring what will be done (if anything), how it works in practice, etc. In sum, it should lay the foundations of a culture of evaluation of the WTO system – its institutional architecture and rules. The difficult question is: how to do it? Annual reports are not the answer: there is a need for some distance between two reports in order to get a good sense of the ongoing changes, and their impact. Reports on a regular basis (every 'x' years) run the risk of not being in harmony with the WTO's needs (if 'x' is too big), or of becoming routine (if 'x' is too small). On the other hand, it is not even sure that future WTO Directors-General will be interested or willing to launch similar endeavors when they are really needed. Independent initiatives may thus have to play a key role. If so, they should keep an important feature of this Report – the involvement of previous Directors- General who, by the mere nature of their function, are among the very few to have a full view of all the aspects of the WTO life – from the smoky negotiating rooms to the lonely role of international advocate of freer trade.

