

# The road to Hong Kong: what's at stake for the Doha Round

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The current Doha Round of multilateral trade negotiations has the potential to deliver significant economic benefits to Australia and the rest of the world. The outcome of the Hong Kong Ministerial Conference, scheduled for 13-18 December, will determine whether these benefits are likely to be realised. In order for Doha Round negotiations to deliver an ambitious outcome by the end of 2006, it is necessary for participants at the Hong Kong meeting to agree at least on a detailed package of reforms covering agriculture and non-agricultural market access.

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## Introduction

This article provides a brief 'stock take' of the World Trade Organization's (WTO) current Doha Round of trade negotiations in the lead-up to the Hong Kong Ministerial Conference, which is scheduled for 13-18 December. It begins with an overview of the role of the WTO and the potential economic significance of the Doha Round. It then examines why the Hong Kong meeting is so important to the successful conclusion of the round. The article next discusses the three issues that are expected to dominate negotiations in Hong Kong: agriculture, non-agricultural market access (NAMA) and services. It also identifies key three issues that should be considered in assessing any agreements reached at Hong Kong. It concludes by considering how the failure of the Doha Round might affect future trade reform.

## The World Trade Organization

Established on 1 January 1995, the WTO has three key functions. Firstly, it administers a series of agreements between member countries that provide the legal framework for international commerce. The main agreements cover goods, services and intellectual property.<sup>2</sup> Under these agreements, member countries undertake to observe certain minimum standards in their trade policies. Secondly, it is responsible for resolving trade disputes between countries. The WTO's Dispute Settlement Body makes rulings about the interpretation of WTO agreements. This function is fundamental to the operation of a rules-based system of international trade. Thirdly, it provides a forum in which members are able to negotiate revised agreements on a multilateral basis. Such negotiations are known as 'rounds'. Each round enables WTO members to negotiate to reduce trade barriers on a non-discriminatory basis. At the end of each round, members typically make binding commitments to lower maximum tariffs and reduce other impediments to international trade.<sup>3</sup> Members can also agree to change the rules governing the WTO's operation. In addition to these three key functions, the WTO also monitors members' trading policies and provides technical assistance and training for developing countries.

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2 The three main WTO agreements are the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS) and the agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Other agreements deal with the establishment of the WTO, dispute settlement and trade policy reviews. There are also plurilateral agreements on civil aviation and government procurement.

3 Bound tariff rates are the maximum rates that can be applied to imports under WTO rules. Applied tariff rates are often much lower than bound rates. In addition, many WTO members offer even lower preferential tariff rates to particular countries, either because they are partners in a preferential trade agreement or to assist least developed countries. For example, Australia offers tariff and duty-free access to imported goods from around 50 least developed countries (LDCs).

## The Doha Round

The Doha Declaration, which was issued in November 2001 by the fourth Ministerial Conference of the WTO, provided a mandate for negotiations on a wide range of trade-related matters. The Doha agenda includes negotiations on agriculture and services, which commenced in 2000. Other agenda items include trade in goods and WTO rules covering dumping, subsidies, regional trade agreements and dispute resolution. These issues are required to be dealt with in a single package from which no member can selectively derogate. 1 January 2005 was initially set as the target date for concluding negotiations.

The declaration foreshadowed consideration of, but did not immediately mandate negotiations on, the four 'Singapore issues' of investment, competition policy, trade facilitation and government procurement.<sup>4</sup> However, following concerted opposition to the discussion of these issues by developing countries, all but trade facilitation were formally excluded from the Doha agenda in July 2004.

Development is a key theme of the Doha Round. This is reflected in its focus on trade in agriculture as well as issues relating to trade and development. Participation in the global trade system is an important factor in determining the economic performance of developing countries (and hence their capacity to reduce poverty and improve living standards). However, many developing countries have restricted access to developed country markets for key exports or lack the necessary institutional capacity to develop trade linkages. The Doha Round aims to address these issues so as to integrate developing countries more closely into the global trade system.

## The Doha Round in context

The characteristics of negotiating rounds have changed considerably since the initial Geneva GATT round in 1947. The number and diversity of participants have increased. While the first round involved just 23 mostly developed countries, the WTO now has 148 members including many developing and least developed countries (LDCs)<sup>5</sup>. It is now three-quarters the size of the United Nations. The scope of rounds has also expanded. The first five rounds were narrowly focused on reducing manufacturing tariffs. During the 1960s and 1970s, their coverage expanded to encompass anti-dumping, development issues and non-tariff barriers. Agriculture, services, intellectual property and dispute settlement issues became important components of the agenda for the Uruguay Round, which commenced in 1986. Although three of the

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4 These issues were first raised in the WTO at the 1996 Singapore Ministerial Conference.

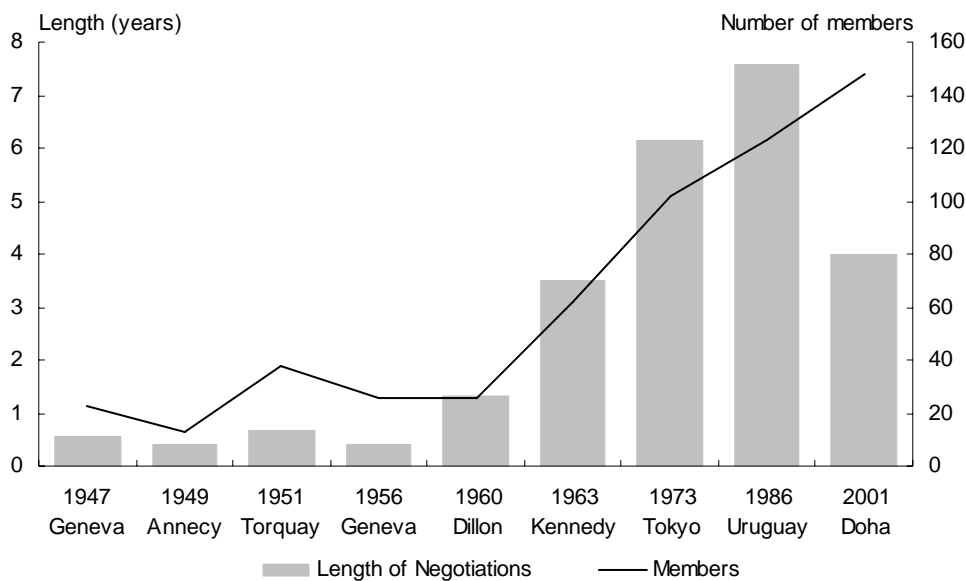
5 Saudi Arabia is expected to become the WTO's 149<sup>th</sup> member by the time of the Hong Kong meeting.

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four 'Singapore issues' were excluded in 2004, the agenda for the Doha Round is no less broad and ambitious than that of any of its predecessors.

Reflecting these developments, the duration of rounds has been gradually increasing (Chart 1). Against this backdrop, the Doha Round's initial deadline of 1 January 2005, appears to have been particularly optimistic. It is now hoped that the current round of negotiations can be completed by the end of 2006.

**Chart 1: Participation and duration of rounds**



## The economic significance of the Doha Round

The economic significance of the Doha Round derives from the efficiency benefits that can be achieved by liberalising global trade flows. There have been many attempts to estimate these potential benefits. However, results have varied widely, reflecting the use of different data, methodologies and assumptions.

The World Bank has estimated the potential economic gains of the Doha Round at between US\$59 billion and US\$269 billion, depending on whether it achieves a 'low' or a 'high' ambition outcome (2005a, pp. 134-5). These gains are attributable solely to the liberalisation of global merchandise trade and do not include the potential benefits of liberalising international trade in services. Around 40 per cent of gains are estimated to go to developing countries, especially in Asia. Some LDCs are forecast to suffer small losses as a result of losing preferential access to protected developed country markets. As a result, the World Bank acknowledges that additional aid flows will be required to cushion their adjustment to a more liberal trading regime (see Wolfowitz 2005).

## Significance of the Hong Kong Ministerial Conference

Ministerial conferences are the WTO's peak decision-making body. They must be held at least every two years. The Doha Round was launched in November 2001 by the Doha Ministerial Conference. The next Ministerial Conference was held at Cancún in September 2003. The purpose of this meeting was to agree on priorities for ongoing negotiations in the round. However the meeting ended in disarray because of disagreement over whether the Doha Round should include discussion of the four 'Singapore issues', dissatisfaction amongst developing countries over the lack of progress of negotiations on agriculture and the emergence of a deal between the European Union (EU) and the United States (US) that appeared to preclude further progress on this issue. After the breakdown of the Cancún meeting, momentum in the Doha Round was only restored in July 2004, when members endorsed a package of frameworks and other agreements negotiated by senior trade officials (the 'July 2004 package').

The Hong Kong meeting needs to secure sufficient consensus on the key features of a reform package to enable detailed provisions to be finalised by the end of 2006. As the Director-General of the WTO, Pascal Lamy, recently stated, the Hong Kong Ministerial is 'the last and best chance to conclude the Round by next year' (Lamy 2005). The 2006 deadline is significant because the US President's current Trade Promotion Authority (TPA) expires in mid-2007. It is widely believed that it would be very difficult for the US Administration to obtain congressional approval to extend the TPA. The TPA restricts Congress to either wholly accepting or rejecting a trade agreement negotiated by the President rather than 'cherry picking' particular elements.<sup>6</sup>

## Key issues on the Hong Kong agenda

### Agricultural goods: a focus of the Doha Mandate

The most important task for participants at the Hong Kong meeting is to agree on the details of how to lower tariffs, reduce trade-distorting domestic support and eliminate export subsidies. This objective is fundamental to the outcome of the entire Doha Round. The 2003 Cancún Ministerial Conference broke down because of inadequate progress on reform of trade in agricultural goods. Many developing countries will not agree to liberalise NAMA or services in the absence of substantial progress in agricultural trade.

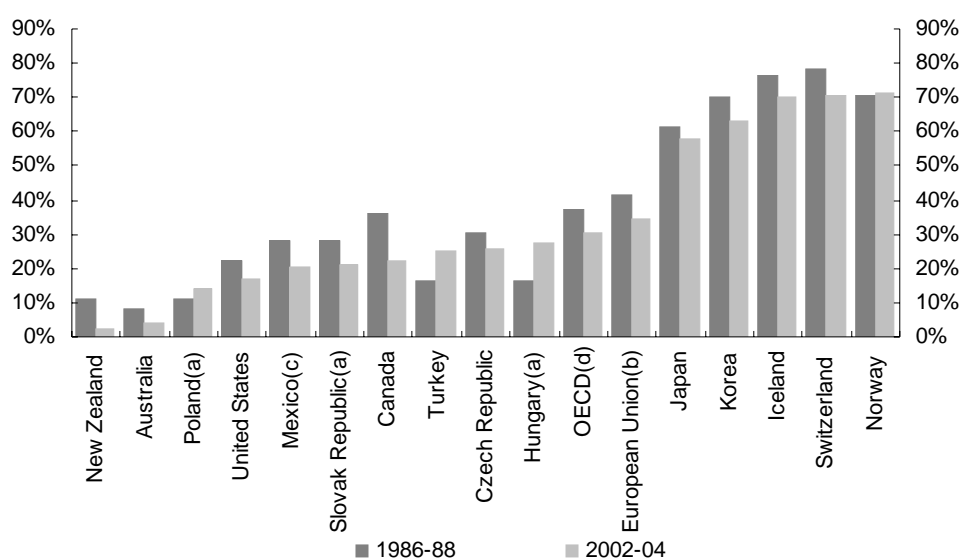
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<sup>6</sup> The TPA was 'purchased' by the US Administration with protectionist side deals, including significant increases in domestic subsidies for agriculture and duties on steel imports.

### Distortions in agricultural trade

Although agriculture accounts for only 4 per cent of global GDP and 10 per cent of trade flows, 60 per cent of the estimated gains from liberalising global merchandise trade are expected to come from freeing up trade in agricultural goods (World Bank 2005, pp. 133-4). This reflects the wide-ranging distortions that currently exist in global agricultural trade. According to the WTO, 'the agricultural sector is characterised by the highest tariffs in the trading system'. A 2001 study cited by the WTO estimated the level of the world's average bound agricultural tariffs at around 62 per cent (more than twice the estimate for manufactured products). This study also estimated the average applied tariff for agricultural goods at 17 per cent (compared with 9 per cent for manufactured goods) (WTO 2003a, p. 127). The OECD estimated that government support to agricultural producers across the OECD in 2004 was US\$279 billion (around 30 per cent of farm receipts in these countries) (2005a, p. 36). As Chart 2 illustrates, producer support as a proportion of farm receipts varied from less than 5 per cent in New Zealand and Australia to over 60 per cent in Japan and Korea, and around 70 per cent in four European Free Trade Association countries.<sup>7</sup>

**Chart 2: OECD percentage producer support estimates**



(a) For the Czech Republic, Hungary, Poland and the Slovak Republic, 1986-88 is replaced by 1991-93 and 2002-04 by 2001-03.

(b) EU-12 for 1986-94 including ex-GDR from 1990; EU-15 for 1995-2003; EU-25 from 2004.

(c) For Mexico, 1986-88 is replaced by 1991-93.

(d) Austria, Finland and Sweden are included in the OECD total for all years and in the EU from 1995. The OECD total does not include the six non-OECD EU member states.

Source: OECD (2005a).

<sup>7</sup> Iceland, Liechtenstein, Norway and Switzerland.

### Interests and objectives of WTO members

WTO members have different interests and objectives in relation to agricultural trade reform. The most ardent proponents of liberalisation are efficient producers likely to benefit from increased production and higher world food prices as a result of lower tariffs and trade-distorting subsidies. These include the US (although it is also a major subsidiser of agricultural production), members of the Cairns Group<sup>8</sup> and members of the G-20 group of developing countries with an interest in agriculture.<sup>9</sup>

While many developing countries are expected to benefit from liberalising agricultural trade, it will not assist food-importing countries that are unable to increase production. In addition it may pose issues, particularly in the short term, for LDCs that would lose preferential access to protected developed country markets.<sup>10</sup>

Greatest resistance to liberalisation of trade in agriculture has come from the EU and members of the G-10 group (which includes Japan, Korea, Norway and Switzerland).<sup>11</sup> Although liberalisation of trade in agricultural goods is expected to provide these countries with large net benefits in the form of lower consumer prices, it would disadvantage producers that benefit from subsidies and artificially high domestic prices. Taxpayers in these countries are also likely to benefit from the reduction or elimination of support payments.

From the perspective of protectionist developed countries and LDCs that currently rely heavily on preferential access to developed country markets, success in agricultural trade negotiations involves minimising liberalisation (or, in the case of LDCs, securing compensation for the impact of preference erosion).

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8 Established in August 1986, the Cairns Group is a coalition of 17 agricultural-exporting countries that account for around 23 per cent of the world's agricultural exports. Convened by Australia, its membership also consists of Argentina, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, South Africa, Thailand and Uruguay. The Cairns Group played an important role in the early stages of the Uruguay Round in moving agriculture to the forefront of the multilateral trade agenda.

9 The G-20 was created in August 2003 in the lead-up to the Cancún Ministerial Conference. Convened by Brazil, it currently has 18 other members: Argentina, Bolivia, Chile, China, Cuba, Egypt, India, Indonesia, Mexico, Nigeria, Pakistan, Paraguay, the Philippines, South Africa, Tanzania, Thailand, Venezuela and Zimbabwe. Nine of its members are also members of the Cairns Group.

10 Agricultural preference erosion is a key issue for the G-90, a group of poor (mostly African) countries that are highly dependent on preferential access to developed country markets (although the United Nations Conference on Trade and Development recently concluded that many LDCs do not rely heavily on preferences and that any negative impact from their removal would be limited to a few countries (UNCTAD 2005)).

11 The G-10 grouping currently has nine members: Iceland, Israel, Japan, Korea, Liechtenstein, Mauritius, Norway, Switzerland, and Chinese Taipei.

### Market access

Barriers to market access, in the form of tariffs, tariff rate quotas (TRQs) and other import restrictions, are the major source of distortion in the global agricultural market.<sup>12</sup> According to a recent study, elimination of barriers to market access would contribute 93 per cent of the potential economic gains that could be achieved from removing all agricultural trade distortions (Anderson and Martin 2005, p. 1312).

It was agreed as part of the July 2004 package that maximum bound agricultural tariffs would be divided into bands and that tariffs within each band would be reduced in accordance with an agreed formula. To narrow tariff differentials, it was also agreed that tariffs in higher bands would be subject to deeper cuts than those in lower bands. The task of the Hong Kong meeting is to agree on the details of this tariff reduction formula, including the following key issues:

- the number of bands into which tariffs should be divided and the width of each band;
- the size of the cuts that should be applied to tariffs within each band (including the extent of progressivity across bands);
- whether there should be an upper limit or cap on all agricultural tariffs; and
- the extent to which developing countries should be able to make lesser cuts to tariffs in accordance with the principle of 'special and different treatment'.

It must also agree on rules for dealing with 'sensitive products'. The July 2004 package provided that certain goods could be treated as sensitive and be subject to lower tariff reductions in return for concessions such as an increase in relevant TRQs. Therefore, the Hong Kong meeting must also agree on:

- the maximum number of products that should be able to designated as sensitive;
- the extent of tariff reductions required for sensitive products; and
- the amount that TRQs should be expanded to offset lower tariff reductions.

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<sup>12</sup> In addition, many agricultural products are also subject to tariff escalation, under which much higher tariffs are imposed on imports of processed goods than on imports of raw materials (World Bank, 2004, pp. 123-5).



### Domestic support

Domestic support consists of financial assistance provided to agricultural producers.<sup>13</sup> Under WTO rules, support measures are categorised according to the extent to which they are likely to stimulate over-production and therefore distort trade. Subsidies that are considered least trade-distorting are categorised as 'green box' measures. These are not currently subject to any restrictions. WTO restrictions apply to trade-distorting subsidies. Three categories of trade-distorting subsidies are currently permitted: 'amber box' measures (which are the most trade-distorting), 'blue box' measures (which are 'partially de-coupled' from production and therefore less trade-distorting) and '*de minimis*' support (under which members are permitted to make distorting payments that do not exceed a fixed proportion of the value of domestic production).

The Doha mandate included the objective of reducing expenditure on trade-distorting subsidies. The July 2004 package contained an agreement that the largest subsidisers (the EU, US and Japan) would make the largest cuts. The Hong Kong meeting must try to agree on lower overall spending limits as well as on whether reductions or caps should apply to particular categories of expenditure (that is, amber box, blue box or *de minimis*).

### Export subsidies

Export subsidies are payments made by governments to producers to increase their competitiveness in export markets by allowing them to sell at prices below the cost of production. They are often used as a means of clearing surpluses created as a result of domestic production incentives. Export subsidies have a negative impact on large food exporters because they depress prices in targeted export markets and reduce domestic adjustment pressures that might arise in countries with high domestic tariffs.

The mandate for the Doha Round called for reductions in, with a view to phasing out, all forms of agricultural export subsidies. In an important breakthrough, it was agreed as part of the July 2004 package that all forms of export subsidies would be eliminated by a 'credible' date through a process of phased annual reductions. The Hong Kong meeting is to consider the date for ending export subsidies as well as rules relating to export credits, food aid and state trading enterprises.

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13 In 2003, the WTO stated that the value of domestic support measures notified to it totalled US\$104 billion. The EU, US, Canada and Japan accounted for 84 per cent of this expenditure. Developing countries accounted for 12 per cent, with the remaining 4 per cent spent by other industrialised countries (WTO 2003a, p. 136).

### Negotiations on agriculture in the lead-up to Hong Kong

Intensive high-level negotiations on agriculture have been taking place in October in the lead-up to the Hong Kong meeting. The main participants in these talks have been the 'Five Interested Parties' (FIP): the US, the EU, Australia, Brazil and India. An important development in these negotiations was the release by the US on 10 October of a major new proposal to reform agricultural trade (USTR 2005). This proposal immediately prompted revised proposals from both the EU and the G-20 (Mandelson 2005, G-20 2005). A further EU offer was released on 28 October. Their respective negotiating positions as at the end of October 2005 are set out in Table 1.

During the October negotiations, the US and the EU have each proposed substantial reductions in maximum levels of expenditure on trade-distorting domestic support. In particular, the US has moved away from its previous position of refusing to move in the absence of any EU offer of major tariff reductions. Importantly, the US has also proposed 2010 as an end date for the elimination of export subsidies.

The issue of market access remains a key area of deadlock. The US has proposed that developed countries make major reductions in their agricultural tariffs with limited flexibility for sensitive products. Substantial improvements in market access for US producers are seen as necessary to gain congressional support for any proposal to reduce support payments to US producers. The US position on market access has been supported by Australia (Vaile 2005) and the G-20 (although the G-20 itself has not requested such large cuts by developed countries). By contrast, the EU has proposed lower tariff cuts combined with extensive flexibility for sensitive products. As this position is not regarded as acceptable by the four other members of the FIP, the EU will have to make a more ambitious offer if there is to be agreement in Hong Kong. However, the capacity of EU negotiators to make an improved offer is limited by the opposition of some members, especially France, to any reform proposal that goes beyond the tariff cuts agreed in the Uruguay Round or the reductions in domestic support agreed as part of the EU's 2003 reforms to its Common Agricultural Policy.

The other significant area of disagreement concerns the amount of liberalisation that should be expected of major developing countries. The G-20 has proposed that its own members make much smaller tariff cuts and that their reductions be implemented over a longer period. By contrast, the US and the EU are likely to press for greater reciprocity from major developing countries on agricultural reform, as well as in relation to NAMA and services.

**Table 1: Negotiating positions of US, EU and G-20 on agriculture (October 2005)**

	<b>United States</b>	<b>European Union</b>	<b>G-20</b>
<b>Market access</b>	<p>Tariff cuts of 55 to 90 per cent (with maximum cuts where bound tariffs are over 60 per cent).</p> <p>Tariffs capped at 75 per cent.</p> <p>No flexibility in basic formula.</p> <p>Sensitive products limited to 1 per cent of tariff lines.</p>	<p>Tariff cuts of 20 to 60 per cent (with maximum cuts where bound tariffs are over 90 per cent). Tariff cuts between 20 and 45 per cent in lowest band.</p> <p>Tariffs capped at 100 per cent.</p> <p>Up to 8 per cent of tariff lines can be designated sensitive (partially offset by larger TRQs).</p> <p>Special safeguards to be retained.</p>	<p>Tariff cuts of 45 to 75 per cent (with maximum cuts where bound tariffs are over 75 per cent).</p> <p>Minimum average cut of 54 per cent across all tariff lines.</p> <p>Tariffs capped at 100 per cent.</p> <p>Sensitive products limited to 1 per cent of tariff lines (1.5 per cent for developing countries).</p>
<b>Domestic support</b>	<p>Overall ceiling reduction of 53 per cent (in return for 75 per cent from EU and 53 per cent from Japan).</p> <p>Amber box ceiling reduction of 60 per cent (in return for reductions of 83 per cent by EU and Japan).</p> <p>Cap blue box ceiling at 2.5 per cent of value of agricultural production.</p> <p>Cap <i>de minimis</i> support ceiling at 2.5 per cent of value of agricultural production.</p>	<p>Overall ceiling reduction of 70 per cent (in return for 60 per cent from US, at least 60 per cent from Japan and 50 per cent by other large users).</p> <p>Cap blue box ceiling at 5 per cent of value of agricultural production with new disciplines to ensure minimal trade distortion.</p> <p>Reduction of at least 80 per cent in maximum levels of <i>de minimis</i> support by developed countries.</p>	<p>Overall ceiling reduction of 80 per cent by EU and 75 per cent by US. Japan either 75 or 80 per cent. Other developed countries 70 per cent.</p> <p>Reduction in <i>de minimis</i> support ceiling related to overall level of cuts.</p>
<b>Export subsidies</b>	<p>Elimination by 2010.</p>	<p>No date for elimination suggested. Contingent on disciplines covering other export promoting policies.</p>	<p>Elimination in 5 years.</p>
<b>Special and different treatment</b>	<p>Slightly lesser tariff cuts and longer phase-in periods to ensure real improvements in access while ensuring import-sensitive sectors in those countries are afforded adequate protection.</p>	<p>Tariff cuts two-thirds of developed countries applying to bands with higher thresholds.</p> <p>Tariffs capped at 150 per cent.</p>	<p>Tariff cuts of 25 to 40 per cent for developing countries (with highest reductions over 130 per cent).</p> <p>Maximum average cut of 36 per cent.</p> <p>Tariffs capped at 150 per cent.</p>

### Non-agricultural market access: progress must continue

While agricultural reform has become the focus of the round, further liberalisation of trade in manufactured goods is a key element of the Doha agenda.

### Distortions in trade in manufactured goods

Because it has been a central component of all previous rounds of multilateral trade negotiations, trade in manufactured goods is generally subject to far fewer distortions than agricultural trade.<sup>14</sup> Developed countries generally have low bound and applied tariffs.<sup>15</sup> However, some goods are subject to major market access restrictions or tariff peaks.<sup>16</sup> These market access barriers often apply to manufactured goods that are of particular interest to exporters in developing countries, such as textiles, clothing and footwear.<sup>17</sup>

In addition, developing countries themselves frequently impose high tariffs on imports of manufactured goods (much higher than those of developed countries) and these are largely unconstrained as their bound tariffs are higher still. Developing countries have only recently begun to participate in multilateral trade negotiations and, under the special and differential treatment principle, they often made much shallower tariff cuts than their developed counterparts. As a consequence, substantial efficiency gains could be achieved by further liberalising trade in manufactured goods.

### Interests and objectives of WTO members

Developed countries have expressed an interest in an approach that would give them better access to markets in large developing countries (for example, Brazil, China and India). Many of these markets are characterised by high bound tariffs, although applied tariffs have fallen in recent years. While they may disagree with one another on the issue of agricultural market access, the US and the EU have both called for a NAMA outcome that leads to further reductions in applied tariffs on imports of manufactured goods in large developing countries.

Developing countries have argued for better access to developed country markets for products that they can produce efficiently and that are currently subject to tariff peaks (especially in the key TCF sector). As with agriculture, LDCs that currently have

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14 The original GATT applied to both agricultural and manufactured goods. However, at the insistence of the US and European countries, successive GATT negotiations focused on liberalising trade in manufactured goods, allowing more protectionist policies to persist in the agricultural sector (FAO 2000).

15 As Trade Minister Vaile has noted, average applied manufacturing tariffs have fallen from 40 per cent in 1948 to under 4 per cent today. The two rounds prior to Doha, the Toyko and Uruguay rounds, delivered cuts in developed country tariffs of 33 per cent and 40 per cent respectively (Vaile 2004).

16 For developed countries, tariffs higher than 15 per cent are generally regarded as tariff peaks.

17 According to Anderson and Martin (2005, p. 1304), average applied tariffs on imports of manufactured goods (other than textiles and wearing apparel) in 2001 were 1 per cent in developed countries and 8 per cent in developing countries. By contrast, average applied tariffs on imports of textiles and apparel were 8 per cent in developed countries and 17 per cent in developing countries.

preferential access to these markets are concerned that they will lose market share as a result of preference erosion if others obtain equal market access.

### Negotiations on NAMA in the lead-up to Hong Kong

The July 2004 package incorporated an agreement on the key features of an approach to improving market access for trade in manufactured goods. Most importantly, it was agreed to work on reducing tariffs using a non-linear formula approach (such as a 'Swiss formula'<sup>18</sup>), with some flexibility for developing countries. The task of the Hong Kong meeting is to agree on the details of how this should be implemented.

Negotiations on NAMA have made slower progress than those on agricultural trade. This is because a number of major developing countries (especially Brazil and India) have been unwilling to participate fully in the absence of clear progress towards what they would regard as a satisfactory agreement on other issues – mainly agriculture but also, in the case of India, services. A key issue for Hong Kong is whether a trade-off will emerge under which developed countries could agree to substantial agricultural liberalisation while major developing countries agree to lower their own manufacturing tariffs significantly.

### Services: differing interests drive different priorities

Market access commitments governing services are the third key topic for discussion at the Hong Kong meeting. Services negotiations operate differently from those covering agriculture and NAMA. The rules are based on a positive list of commitments by each WTO member to provide market access according to four modes of delivery.<sup>19</sup> These commitments can be 'horizontal' (so that they apply to all sectors) or sectoral (so that they are confined to particular industries such as banking or telecommunications). Commitments can also be subject to restrictions that limit their application in terms of market access and national treatment.

In contrast to agriculture and NAMA, services negotiations are still based on a process of bilateral requests and offers. WTO members make requests of one another for

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18 The Swiss formula is an approach to cutting tariffs that is designed to maximise harmonisation by minimising the difference between high and low tariffs. According to the WTO, it uses a single mathematical formula to produce a narrow range of final rates from a broad range of initial rates. The formula is  $Z = AX/(A+X)$  (where X is the initial tariff rate, A is the coefficient, and Z is the final tariff rate). The lower the coefficient, the faster tariffs are reduced, and the lower the maximum rate is at the end of the process. It is known as the Swiss formula because it was proposed by Switzerland during the Tokyo Round of multilateral trade negotiations (WTO 2003b).

19 The GATS defines these four modes as Mode 1: cross-border supply; Mode 2: consumption abroad; Mode 3: supply through commercial presence abroad; and Mode 4: supply through movement of natural persons.

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further market access in particular areas. At the completion of this process, each country decides an appropriate offer of additional market access that will be made available to other WTO members. This can be followed by another round of requests and offers. In general, members are able to proceed at their own pace, and are not required to consent to any particular request for additional market access.

### Distortions in services trade

Distortions in services trade derive from restrictions in domestic legislation that limit market access and competition. Australia's Department of Foreign Affairs and Trade has estimated that a 50 per cent liberalisation of the global services market would boost global GDP by US\$250 billion (DFAT 2004). The OECD argues that 'gains from more open services trade are substantially greater than those from liberalising trade in goods'. This reflects the size of service sectors around the world, the extent of current restrictions on cross-border supply and the flow-on benefits of efficiency gains for the agriculture and manufacturing sectors (OECD 2005b).

### Interests and objectives of WTO members

In common with NAMA, negotiations on market access in services have highlighted differences in the priorities of developed and developing countries. Many developed countries are exporters of services and have a strong interest in lowering barriers to market access (both in other developed countries and in large developing countries).

However, most developing countries (India being an important exception) are not major exporters of services and do not have similar interests in this area. They generally perceive requests to liberalise key services markets as a threat to domestic producers and sometimes also to government control. Their main focus is on securing greater flexibility to supply unskilled or semi-skilled workers to developed countries, reflecting the importance of overseas remittances to their economies (see World Bank 2004, pp. 148-9).

### Negotiations in the lead-up to Hong Kong

The July 2004 package called for more progress in services negotiations and the tabling of revised offers by May 2005. To date, there has been one full round of requests and offers. A number of WTO members, including Australia, have submitted revised offers. A total of 69 initial offers (covering 94 members) have now been tabled, as well as 28 revised offers covering 53 members (including the 25 EU members) (DFAT 2005).

In the lead-up to the Hong Kong Ministerial Conference, WTO members that aspire to a more ambitious outcome on services than currently appears likely are searching for ways to encourage other members to make broader and deeper market access offers as part of a new round of revised offers in 2006. Australia is part of a newly formed

group on services whose objective is to secure the support of the Hong Kong meeting to raise the WTO's overall level of ambition in this area and set a new date for a further round of revised offers in 2006.

The Hong Kong meeting will also consider whether to complement the request-offer process with measures that could include:

- identifying a target for WTO members to aim at when preparing their offers (which could include specific and detailed targets or objectives relating to both sectoral coverage and depth of offers);
- using plurilateral and sectoral approaches to identify restrictions on market access to be eliminated (such as nationality and residency requirements);
- common requests in high-priority services sectors; and
- greater focus of measuring the extent of progress by WTO members towards agreed benchmarks for liberalisation.

These approaches aim to encourage major developing countries to agree to more rapid liberalisation of their services markets than is currently contemplated.

## Challenges for Hong Kong

It is generally believed that the Hong Kong Ministerial Conference has to agree on a specific package of reforms covering agriculture and NAMA if a worthwhile outcome to the Doha Round is to be achieved by the end of 2006. In relation to services, it is simply hoped that participants will agree to pursue more ambitious outcomes in 2006 and support the use of complementary approaches to the existing process of requests and offers.

It is not possible to know whether participants at Hong Kong will reach agreement on agriculture and NAMA. However it is possible to identify three issues that need to be considered in assessing the potential economic benefits of any agreements that are reached.

The first is the potential impact of any agreement on current applied tariff levels and, in the case of agriculture, current levels of expenditure on trade-distorting domestic support measures. This is important because agreements will involve reductions to bound tariff levels and baseline levels of domestic support and these are often much

higher than applied tariffs and current levels of spending.<sup>20</sup> The difference between bound and applied tariff levels is sometimes termed the 'water in the tariff' (Stoeckel and Reeves 2004, p. 29). The same term is also applied in the context of domestic support to the difference between commitment levels and actual spending.

If there is substantial 'water' in a country's tariffs, very large reductions in bound tariffs may be necessary before applied tariffs begin to be lowered. The same applies in relation to expenditure on domestic support. The potential economic efficiency gains from the Doha Round that were identified earlier in this article will only be realised if current distortions are reduced. If this is not achieved, the contribution of the Doha Round in relation to agriculture and NAMA will be limited to lowering ceilings on future increases in protection.<sup>21</sup>

The second issue relates to agriculture and concerns about the extent to which members will be permitted to designate 'sensitive' products that will be subject to lower tariff cuts. This is a key area of disagreement between the US (along with members of the Cairns and G-20 groups) and the EU (and G-10 countries). Because the products likely to be designated sensitive are presently characterised by high market access barriers (including TRQs), their exclusion in large numbers from the overall tariff reduction formula for agricultural goods would quickly reduce potential gains from agricultural liberalisation (although some benefits could still be realised if significant compensatory increases in the size of TRQs are able to be negotiated).<sup>22</sup>

The third issue, which applies in relation to both agriculture and NAMA, concerns the extent to which agreements require major developing countries to reduce their own

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20 According to one estimate, bound weighted average agricultural tariffs exceed actual applied weighted average agricultural tariffs by 93 per cent (developed countries), 129 per cent (developing countries) and 500 per cent (LDCs). To reduce the global actual average tariff by one third, it would be necessary to reduce bound rates for developed countries by at least 45 per cent, and up to 75 per cent for the highest tariffs (Anderson and Martin, 2005, pp. 1305 and 1313).

21 On the basis of 2001 subsidy levels, Anderson and Martin have estimated that a 75 per cent reduction in ceilings for 'amber box' support would only require the US to cut actual expenditure by 28 per cent and the EU to do so by only 18 per cent (2005, pp. 1313-4). In announcing a proposal for a 70 per cent reduction in 'amber box' support, EU Trade Commissioner Peter Mandelson stated that the proposal would 'in effect, bind in Geneva, internal reform already undertaken as part of the current CAP reform'.

22 Anderson and Martin (2005, p. 1314) state that many of the potential gains from Doha are likely to 'evaporate' if large numbers of sensitive farm products are quarantined from substantial tariff cuts. They estimate that welfare gains from agricultural reform would shrink by three-quarters if only 2 per cent of agricultural tariff lines in developed countries and 4 per cent of agricultural tariff lines in developing countries were subject to just a 15 per cent tariff cut.



levels of protection.<sup>23</sup> The growing importance of trade between developing countries (so-called 'South-South trade') means that they can make large gains by cutting their own agricultural and industrial tariffs. By the same token, an unwillingness to reduce their own tariffs will reduce their potential economic gains from the Doha Round. In addition, by agreeing to make their own substantial reductions in protection, major developing countries may be able to exert more pressure on developed countries to offer genuine improvements in market access, especially in relation to agricultural trade.

## Conclusion

The outcome of the Hong Kong meeting will determine whether the Doha Round is able to be completed by the end of 2006 and whether it will deliver an agreement that will expand global trade. If the meeting is unable to agree on specific reforms to agriculture and NAMA, the Doha Round is likely either to collapse or proceed on a 'low road' towards an agreement involving only modest reductions in protection.

While it is to be hoped that the Hong Kong meeting can reach an agreement that boosts prospects for a successful conclusion to the Doha Round, a failure to achieve further significant liberalisation does not mean that the world will not continue to benefit from the existence of a rules-based trading system that limits protectionism and provides a mechanism to settle international trade disputes.

Countries can continue to pursue liberalisation within the overall WTO framework through reciprocal agreements with major trading partners.<sup>24</sup> These agreements have proliferated over the past decade (World Bank 2005b, p. 27). They are likely to become even more widespread if the Doha Round collapses or fails to deliver an ambitious outcome. Preferential trade agreements have the potential to deliver 'WTO plus' outcomes by reducing or eliminating tariffs and other obstacles to trade. They can also address issues such as investment and competition policy that have implications for trade but are not part of the Doha agenda. However, the potential benefits that may be derived from individual agreements must be weighed against their potential to divert international trade flows away from efficient producers and, on an aggregate basis, their potential to fragment the world trading system by creating a complex web of overlapping preferences. The principle of non-discrimination, under which tariff cuts

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23 In the words of the World Bank (2004, p. 220), 'the overuse of non-reciprocity in previous market access negotiations has excluded developing countries from the major source of gain from trade liberalization – namely the reform of their *own* policies ... a willingness to pursue liberalisation at home is critical to increase developing countries' participation in global trade, particularly South-South trade, which is subject to significant barriers', (emphasis in original).

24 These are permitted under Article XXIV of the GATT and Article V of the GATS.

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negotiated in a round are extended to all participants, was intended to overcome the problems caused by the extensive use of preferential trade arrangements in the period prior to World War II.

Finally, while the principle of reciprocity, as reflected in both multilateral and bilateral trade agreements, plays a valuable role in allowing countries to trade off 'concessions' with one another, it is widely acknowledged that significant economic benefits can be achieved by a country going it alone and lowering trade barriers without seeking immediate reciprocal concessions from others (Bhagwati 2002). As the World Bank notes, in the past 20 years unilateral tariff reductions by developing countries have been larger than reductions under the Uruguay Round and preferential agreements combined (World Bank 2005b, p. 27). It is therefore, just possible that in the absence of a multilateral trade negotiation round, all countries may be more willing to liberalise access to their own markets on a unilateral basis rather than maintaining current barriers as 'negotiating coin' for trade talks. However, it is also possible that a failure of the Doha Round to deliver an ambitious trade outcome could entrench protectionist attitudes in the years to come.

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