Backgrounder

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Moving Forward After Hong Kong Trade Talks

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Freeing trade stimulates economic growth, creates better jobs, encourages innovation, and improves living standards. Numerous studies from a variety of sources, and using a variety of methodologies, consistently show that real economic gains flow from liberalizing trade.

For example, the *Index of Economic Freedom*, published annually by The Heritage Foundation and *The Wall Street Journal*, reports that global per capita GDP increased from $2,414 to $5,501 in 2004 (in constant 2000 U.S. dollars) as a result of freer trade. A University of Michigan study concludes that reducing agriculture, manufacturing, and services trade barriers by just one-third would add $164 billion, or about $1,477 per American household, annually to U.S. economic activity.

Considering the proven benefits of liberalizing trade, especially to developing countries, the modest progress made at the December 2005 ministerial meeting of the World Trade Organization's Doha Round of negotiations is disappointing. Although the United States introduced a strong proposal to liberalize trade at the Hong Kong meeting, other countries held back too much on making serious counterproposals, preventing the momentum needed to carry the meeting forward to a substantive conclusion. Regrettably, the meeting degenerated into an attempt by negotiators to seek guaranteed market access in foreign markets without offering any meaningful opening in their home economies.

Negotiators, however, did agree to an agenda and a stiff timeline to conclude the Doha Round by the end

Talking Points

- Failure to conclude the Doha agenda successfully means significant lost opportunities for countries around the world to make economic gains.
- The World Bank estimates that the continued reduction of tariffs on manufactured goods, elimination of subsidies and non-tariff barriers, and a modest 10 percent to 15 percent reduction in global agricultural tariffs would allow developing countries to gain nearly $350 billion in additional income by 2015. Developed countries would stand to gain roughly $170 billion.
- For further progress to be made toward successfully concluding the Doha Round in 2006, countries will need to remember that gaining market access for one's exports is just as important as gaining access to a wider variety of cheaper imports.
- In a multilateral forum, the U.S. cannot dictate new international trade norms. Other nations must share the responsibility of promoting the benefits of free trade to all.

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of 2006. WTO members understand that the U.S. President's trade promotion authority (TPA), which allows him to submit agreements to Congress for an up-or-down vote, expires in June 2007. After that time, any trade agreement will be subject not only to the vagaries of international pressure, but to U.S. congressional pressure as well. No one wants to risk that sort of difficulty with the world's largest trading partner.

The next ministerial meeting is in April. At this session, negotiators should push aggressively for trade liberalization in order to promote a conclusion to the Doha Round that advances economic prosperity around the world.

The Focus of Negotiations in 2006

The current round of trade negotiations, which began in Doha, Qatar, in 2001 with the so-called Doha Development Agenda (DDA), is possibly the toughest to date. The agenda includes some of the member countries' most politically sensitive and difficult trade issues. Among the most important issues faced by WTO negotiators were reform in agriculture; further reductions in non-agriculture tariffs; the expansion of market access in trade in services; WTO institutional rules and procedures; and developing-country concerns, including the need to reconcile the protection of intellectual property rights while ensuring access to necessary medicines.

After WTO member countries failed to reach agreement on these key issues, especially agriculture trade liberalization, at the Fifth Ministerial meeting in Cancun, Mexico, in September 2003, a Sixth Ministerial Conference was scheduled for December 2005 in Hong Kong. Because negotiators failed to reach agreements in past meetings, significant uncertainty surrounded the Hong Kong conference and its potential for concluding the DDA. The very viability of the WTO for negotiating trade liberalization was in question.

In the end, the results from Hong Kong were slightly positive. Member countries finally pulled together and made some progress on advancing the agenda. The European Union (EU) agreed to phase out its export subsidies for agricultural products by 2013, the U.S. agreed to end its export subsidies on cotton, and all developed countries made a political commitment to allow the 32 poorest WTO member countries duty-free access to at least 97 percent of their markets.[1]

While this is an improvement, however, the U.S. already grants these and other developing countries tariff-free access to 83 percent–91 percent of the U.S. market through various development programs.[2] The U.S. and Japan held out against allowing 100 percent access in fear that U.S. textile workers and Japan's rice farmers would protest the elimination of trade protection in these sectors.

In addition, trade negotiators agreed to continue to work toward concluding a more meaningful pact by the end of 2006—just in time to send the agreement through Congress before TPA expires in June 2007. Over the coming months, negotiations over eliminating non-tariff barriers to trade and opening the more politically sensitive services, industrial products, and consumer goods sectors will likely intensify. As for agriculture, the negotiations ideally will move forward, using the current, aggressive U.S. trade proposal as a starting point on which to base the final agreement.

Trade in Agriculture

The largest stumbling block for the WTO Doha Round is the agricultural trade issue. While tariffs, quotas, subsidies, and other trade distortions in manufactured goods have been reduced or eliminated since the end of World War II, protectionist agricultural policies were allowed to remain until the Uruguay Round (1986–1994).

The process of eliminating agricultural trade barriers was defined initially in the Agreement on Agriculture, which called for trade liberalization on three fronts: market access, domestic support, and export subsidies. "Market access" refers to the reg-

1. World Trade Organization, "Doha Work Programme: Draft Ministerial Declaration," WT/MIN(05)/W/3/rev.2, December 2005.
2. Office of the U.S. Trade Representative, "Update from Hong Kong: Duty-Free Quota Free," Fact Sheet, December 18, 2005, at *www.ustr.gov/Document_Library/Fact_Sheets/2005* (January 5, 2006).

ulation of imports through various policies such as tariffs and quotas. "Domestic support" is aimed at protecting domestic agriculture producers through the implementation of production subsidies and price support programs. "Export subsidies" are the various policies that directly promote agricultural exports.

While the Uruguay Round did reduce agricultural tariffs, market access for agricultural products today remains much more restricted than market access for manufactured goods. Globally, the trade-weighted average agricultural tariff in 2001 was more than three times the average for merchandise trade. In the U.S., agricultural products face a level of protection that is 1.3 times the rate of manufactured items.[3] On the basis of trade-weighted averages, the U.S., with an average ad valorem rate of 9.5 percent, has low restrictions on foreign agriculture. However, when extreme tariffs and tariff-rate quotas (such as those on sugar and milk) are included, U.S. tariff rates can be as high as 350 percent. Both tariffs and tariff-rate quotas are set to be reduced under the ongoing Doha Development Round.

Subsidies supporting agriculture producers are significant and widespread around the world. WTO members report average subsidies totaling more than $221 billion per year,[4] a little more than 18 percent of global agricultural value added.[5] Based on World Bank and WTO data, the EU and the U.S. each contributed a little more than a third of the total subsidies in 2001. A 2005 Cato Institute study indicates that farmers in Organisation for Economic Co-operation and Development (OECD) countries received $279 billion in some form of production support, or 30 percent of total farm income. U.S. farmers received $46.5 billion from the American government, or 18 percent of total U.S. farm income.[6]

Export subsidies are the most distorting of trade barriers, but they are also the least widespread. Because these policies are so disruptive, WTO member countries have committed to fully reducing and eliminating export subsidies, with the temporary exception of some developing nations. The European Union dominates the world in the use of export subsidies, providing almost 90 percent of all export subsidies to the WTO by countries with reduction commitments.[7] The U.S. ranks a distant fourth place with less than 2 percent of all export subsidies.

The U.S. proposal achieves agricultural trade reform in two five-year stages and addresses each element of agricultural trade protection: market access, domestic support, and export subsidies. Specifically, the details for increasing market access in agricultural products are as follows:

- Tariff reduction: The U.S. recommends cutting tariffs by 55 percent–90 percent. The lowest tariffs are cut by 55 percent; the highest are cut by up to 90 percent.
- Tariff-rate caps: The U.S. recommends establishing a maximum tariff rate of 75 percent for any tariff line.
- Sensitive products: The U.S. recommends limiting the number of tariff lines subject to "sensitive product" treatment to 1 percent of total dutiable tariff lines. It recommends expanding tariff-rate quotas on sensitive products.
- Special and differential treatment: The U.S. recommends smaller cuts and longer phase-in periods for the trade reforms that affect developing countries.[8]

Export competition is to be phased in by 2010 and promoted according to the following proposed reform plan:

3. Congressional Budget Office, *Policies That Distort World Agricultural Trade: Prevalence and Magnitude*, August 2005.
4. *Ibid.*, Table 12, p. 22.
5. Based on calculations using data from World Bank, World Development Indicators database, at *http://devdata.worldbank.org/data-query/* (October 3, 2005).
6. Daniel Griswold, Stephen Slivinski, and Christopher Preble, "Ripe for Reform: Six Good Reasons to Reduce U.S. Farm Subsidies and Trade Barriers," Cato Institute, Center for Trade Policy Studies *Trade Policy Analysis* No. 30, September 14, 2005.
7. Congressional Budget Office, *Policies That Distort World Agricultural Trade: Prevalence and Magnitude*.

- Export subsidies: Eliminate all export subsidies.
- Export credit programs: Eliminate trade-distorting elements of credit programs.
- State trading enterprises: Expand transparency requirements and end monopoly export privileges and export subsidies.
- Export taxes: End discriminatory tax provisions.[9]

Finally, domestic support is to be reduced substantially, with the deepest cuts made by countries with the highest levels of subsidies. These provisions primarily affect the U.S. and Europe. The following elements are to be implemented by 2010:

- Amber box (most trade-distorting programs): Cut the aggregate measure of support by 60 percent for the U.S. and 83 percent for the EU.
- Blue box (less trade-distorting programs): Reduce the cap from 5 percent to 2.5 percent of the value of production.
- *De minimis*: Cut allowances for trade-distorting programs in this category from 5 percent to 2.5 percent.
- Overall trade-distorting support: Reduce overall levels of support by 53 percent for the U.S. and 75 percent for the EU.
- Litigation protection: Protection against WTO challenges if a member keeps trade-distorting support below new, lower levels.[10]

While there are elements within the proposal that could go farther to promote trade liberalization, the plan offers countries an opportunity to make a significant first step in reducing agricultural trade barriers. The proposal allows for continued protection for a country's most politically sensitive goods while expanding market access to both developed and developing-country agriculture exporters. The benefits of making a meaningful commitment to reducing protectionist policies in agriculture markets are significant.

Global barriers to trade in agricultural products artificially prop up domestic prices for food and food products. They raise the cost of living for families forced to buy food products that are made overly expensive in these distorted markets. According to a 2004 OECD study, U.S. farm programs resulted in higher food prices and had the effect of transferring more than $16 billion from American households to domestic farmers over and above the amount that farmers received from direct government assistance.[11] The Office of Management and Budget forecasts that American taxpayers will pay $26 billion in direct agricultural subsidies in 2005.[12]

Barriers to agricultural trade are not only a burden on American households. They also depress world prices of agricultural products, negatively affecting farmers in developing countries and preventing their attempt to rise from poverty and improve their living standards. The U.S. argues for free trade and economic liberalization, yet it refuses to eliminate the very policies that would truly allow developing countries to pursue and achieve economic prosperity. William Cline of the Institute for International Economics has estimated that by removing trade barriers, developed countries could convey economic benefits to developing countries that are worth about twice the amount of their annual aid transfers.[13]

For all the benefit that would accrue to the U.S. economy, the U.S. proposal for agriculture reform

8. Office of the U.S. Trade Representative, "U.S. Proposal for Bold Reform in Global Agricultural Trade," Fact Sheet, at *www.ustr.gov/* (January 3, 2006).
9. *Ibid.*
10. Office of the U.S. Trade Representative, "Implications of the U.S. WTO Agriculture Proposal on Trade-Distorting Domestic Support," Fact Sheet, at *www.ustr.gov/* (January 3, 2006).
11. Organisation for Economic Co-operation and Development, "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005," June 2005.
12. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2006*, p. 58.
13. William R. Cline, "Effective Economic Growth for People: The Role of the United States," Center for Global Development, December 2004.

is not being offered as a unilateral action toward trade liberalization. The reform proposal is conditional on other WTO members' offering reciprocal trade concessions in agriculture products, services, and manufactured goods.

Trade in Services

Liberalizing trade in services, like trade in agriculture, is relatively new to the WTO agenda. It was not until the Uruguay Round of trade negotiations that services were formally included on the liberalization agenda. During the Uruguay Round, WTO members implemented a set of rules called the General Agreement on Trade in Services (GATS). Negotiations on the GATS were not completed by the end of the Uruguay Round in 1994, leaving many issues on the table for the latest round of trade talks. Analogous to trade talks in agriculture, services negotiations have been, and remain, problematic.

Industrialized countries, to include the U.S., are aggressively pursuing greater market access to world services markets. Developing countries with nascent services sectors are reluctant to open their markets and expose domestic firms to the rigor of global competition. A host of other issues, including regulations, immigration policy, and transparency, cloud the subject of liberalizing trade for both developed and developing countries. Advancing the goal of freer trade in services has also been held hostage to progress on agriculture negotiations.

According to the World Bank, services account for between 60 percent and 70 percent of production and employment in developed countries and roughly 50 percent of production and employment in developing and least developed countries.[14] From India to Brazil, the share of services in world trade and investment has been increasing and has been among the fastest-growing components of world trade over the past 15 years. Trade in services, as estimated from balance of payments statistics, was greater than $1.3 trillion in 1999, representing over one-fifth of world trade in goods and services.[15]

In the U.S., the services sector accounts for roughly 75 percent of GDP and 30 percent of the value of American exports.[16] Service industries account for eight out of every 10 jobs in the U.S. and provide more jobs than the rest of the economy combined. Over the past 20 years, the service industries have contributed about 40 million new jobs across America.[17] A University of Michigan study has estimated that removing services barriers would result in a $1.4 trillion gain in global income.[18]

Given the importance of services in the U.S. and world economies, the U.S. has proposed expanded commitments to market access across a host of services industries, including telecommunications; express delivery; energy exploration, transmission, distribution, marketing, conservation, and anti-pollution services; environmental and water services; distribution services; professional services; computer services; and audiovisual and advertising services. In return, countries have requested that the U.S. consider increased transparency in services regulation and more open debate about provisions allowing the temporary residence of foreign workers in a given economy.

Trade in Industrial and Consumer Goods

Even with all of the advances in trade liberalization over the past five decades, tariffs and non-tariff barriers against manufactured goods remain in effect. Negotiations to improve non-agricultural

14. World Bank, "Trade in Services in the World Economy," at *http://web.worldbank.org/* (January 6, 2006).

15. *Ibid.*

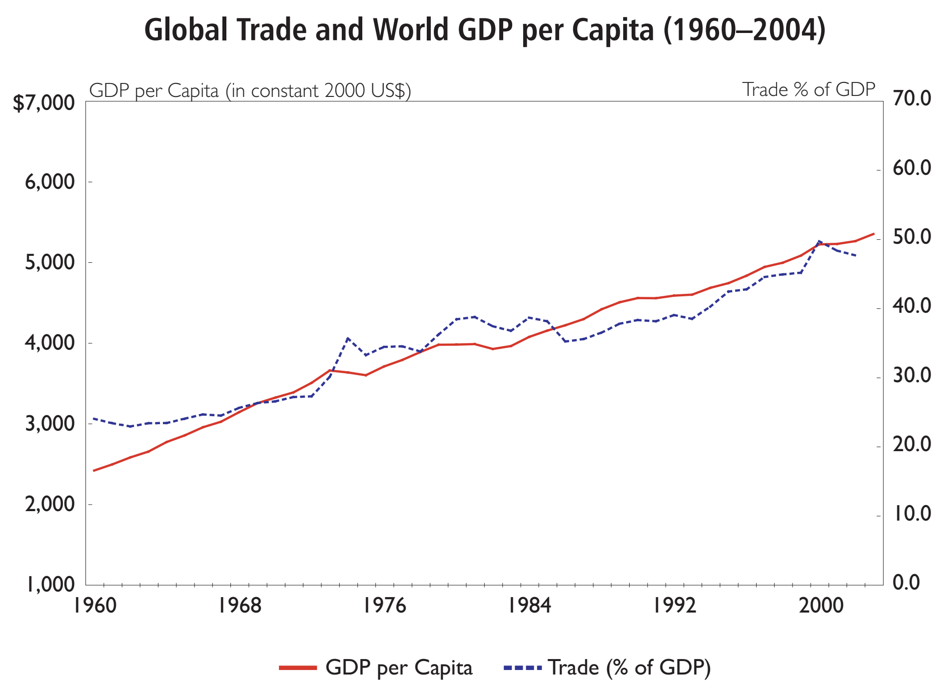
16. U.S. Department of Commerce, Bureau of Economic Analysis, "International Economic Accounts," at *www.bea.gov/bea/di1.htm* (January 6, 2006).

17. Office of the U.S. Trade Representative, "Free Trade in Services: Opening Dynamic New Markets, Supporting Good Jobs," Fact Sheet, May 2005.

18. Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "Computational Analysis of Multilateral Trade Liberalization in the Uruguay Round and Doha Development Round," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 489, December 2002.

market access therefore continue in the current Doha Round. Like negotiations in services liberalization, trade discussions surrounding these manufactured goods are beholden to progress in agriculture negotiations, with developed countries seeking greater access and developing countries reluctant to drop significant barriers to trade.

Chart 1 B 1915



Source: World Bank, *World Development Indicators Online*, available by subscription at *www.worldbank.org/data*

World exports of manufactured goods totaled more than \$8.5 trillion in 2004, accounting for over 90 percent of world merchandise exports. Global trade in merchandise has grown more than 45 percent since the Doha Round began in 2001. In 2004, developing countries' share of world merchandise trade was 31 percent, the highest level since 1950.[19] Given the value of merchandise trade and the continued importance of manufacturing in economies around the world, further trade liberalization is an important element of the ongoing Doha Round.

The U.S. proposal for further freeing merchandise trade would result in zero tariffs on all consumer and industrial products in all WTO members by 2015.[20] Non-tariff barriers would also be significantly reduced. As a result of the December ministerial meeting in Hong Kong, members reaffirmed the goal of reducing or eliminating tariffs, tariff peaks, and tariff escalation.

The Price of Failure

Countries that implement freer trade policies experience higher per capita GDP growth than countries maintaining barriers to protect themselves from global trade, as the *Index of Economic Freedom* has clearly shown in its illustrations of the gains from free trade. Between 1960 and 2004, total world trade as a percentage of global GDP has more than doubled. Concomitantly, global per capita GDP increased from \$2,414 to \$5,501 in 2004 (in constant 2000 U.S. dollars). (See Chart 1.)

The relationship between trade liberalization and economic growth is also demonstrated by the changes in the *Index* scores for trade policy. Countries that adopted more open trade policies between 1997 and 2006 enjoyed an average compound growth of 2.5 percent in per capita GDP. Countries maintaining an unchanged trade policy stance experienced an average compound growth of 2.1 percent in per capita GDP. Countries that

19. Office of the U.S. Trade Representative, "Update from Hong Kong: Non-Agricultural Market Access (NAMA)," Fact Sheet, December 2005.

20. Office of the U.S. Trade Representative, "United States Proposes a Tariff-Free World," Trade Facts, at *www.tcc.mac.doc.gov/wto_tariff_explained.doc*.

raised trade barriers managed to grow at only 1.8 percent on average. (See Table 1.)

Table 1 B 1915

Freer Trade Policy Associated with Higher GDP per Capita Growth

Trade Policy Score Change* (1997 Index–2006 Index)	Compound GDP per Capita Growth (1995–2004)
Improved	2.5 %
No Change	2.1 %
Declined	1.8 %

Note: * Among 142 countries observed, 79 countries improved, 36 had no change, and 27 declined in their trade policy scores.

Sources: World Bank, *World Development Indicators Online*, available by subscription at *www.worldbank.org/data*; Marc A. Miles, Kim R. Holmes, and Mary Anastasia O'Grady, *2006 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2006), at *www.heritage.org/index*.

Failure to conclude the Doha agenda successfully means significant lost opportunities for countries around the world to make economic gains. Numerous studies have attempted to measure these gains under various trade-liberalization scenarios. While the results and methodologies differ, the studies consistently show real economic gains associated with further trade liberalization.

- The Institute for International Economics has calculated that moving from today's trade environment to one characterized by perfectly free trade and investment would generate an additional $500 billion in annual income for the U.S., or about $5,000 per household each year.[21]
- A University of Michigan study concludes that reducing agriculture, manufacturing, and services trade barriers by just one-third would add $164 billion, or about $1,477 per American household, annually to U.S. economic activity. Completely eliminating trade barriers would boost U.S. annual income by $497 billion.[22]

In short, freeing trade stimulates economic growth, creates better jobs, encourages innovation, and improves living standards for millions of Americans.

The World Bank estimates that the continued reduction of tariffs on manufactured goods, elimination of subsidies and non-tariff barriers, and a modest 10 percent to 15 percent reduction in global agricultural tariffs would allow developing countries to gain nearly $350 billion in additional income by 2015. Developed countries would stand to gain roughly $170 billion.[23]

These gains to developing countries from freeing trade result both from export expansion and from reducing their own high tariff and non-tariff barriers. Unfortunately, developing countries generally believe that reducing protectionist policies at home will lead to economic catastrophe. As a consequence, many of these countries have thwarted progress in WTO trade negotiations by demanding preferential access to world markets without embracing trade liberalization in their domestic economies.

A recent Cato Institute report examines a number of studies on trade and economic performance in sub-Saharan Africa, concluding that the region's poor growth rates and low measure of economic freedom are, in part, a function of pur-

21. William R. Cline, *Trade Policy and Global Poverty*, Center for Global Development, 2004.
22. Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "Multilateral, Regional, and Bilateral Trade-Policy Options for the United States and Japan," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 490, December 2002, and "Computational Analysis of Multilateral Trade Liberalization in the Uruguay Round and Doha Development Round," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 489, December 2002.
23. World Bank, *Global Economic Prospects 2004: Realizing the Development Promise of the Doha Agenda*, at http://econ.worldbank.org (January 2, 2006).

suing a high degree of trade protectionism.[24] Should these countries embrace more open trade policies and initiate other economic reforms, they would reduce poverty and experience greater economic opportunity.

Conclusion

For further progress to be made toward successfully concluding the Doha Round in 2006, countries will need to remember that trade is not a zero-sum game: that gaining market access for one's exports is just as important as gaining access to a wider variety of cheaper imports. The U.S. has made a bold proposal to move beyond the impasse on agriculture and address issues of importance to all, including those regarding trade in services and manufactures.

In a multilateral forum, however, the U.S. cannot dictate new international trade norms. Other nations must step up to the plate and share the responsibility of promoting the benefits of free trade to all. The data reflect the world's dependence on international trade and the promise free trade brings to promoting economic growth. Successful conclusion of the current WTO round of negotiations will bring economic opportunity, expand economic freedom, and promote prosperity for all involved.

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24. Marian Tupy, "Trade Liberalization and Poverty Reduction in Sub-Saharan Africa," Cato Institute *Policy Analysis* No. 557, December 6, 2005.