

PERSPECTIVES

**THE TROUBLE WITH TRADE:
THE INTERNATIONAL TRADING SYSTEM
AFTER HONG KONG**

MARK P THIRLWELL

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**The trouble with trade:
The international trading system after Hong Kong¹**

Mark P. Thirlwell

After Hong Kong

In December of last year, Hong Kong hosted the sixth World Trade Organization (WTO) ministerial meeting. After the failure of the Cancun ministerial in September 2003, when members proved unable to reach agreement even on a broad negotiating framework, the Hong Kong meeting was to be *the* landmark meeting for the current Doha Round of international trade talks. It was to be the trade summit that would finalise all the details needed to pave the way for the completion of the first successful multilateral trade round since the Uruguay Round was concluded in 1994. It would be a Big Deal. Yet, as the date for the meeting drew closer, trade officials set about scaling down expectations for the summit, and by the time the week-long ministerial came to a close on 18 December, the best that many observers could say of it was that Hong Kong had kept the negotiating process alive.²

Why was it so difficult to secure a substantive agreement at Hong Kong? And what – if anything – does this tell us about the health of the international trading system?

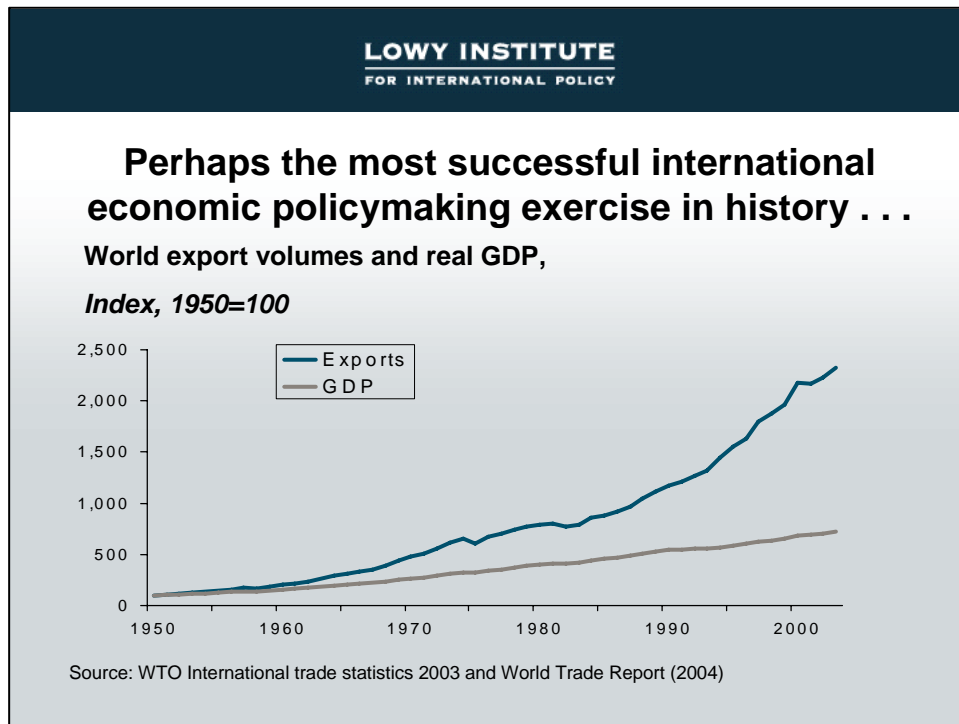
The most successful international policymaking exercise in history . . .

Globalisation, or international economic integration, is one of the defining features of the age. One of the foundations of this integration process has been cross-border trade in goods and services. Indeed, since the end of the Second World War, the rate of growth of international trade has significantly outpaced the growth of output, reflecting a steady rise in the economic importance of trade (chart). True, some of this trend can be explained by technologically

¹ This *Perspectives* is based on a presentation delivered as part of the Lowy Institute's regular lunchtime seminar series, held at the Lowy Institute in Sydney on 15 February 2006. It also draws on chapter 2 of my recent Lowy Institute Paper. Mark P Thirlwell, *The new terms of trade*. Lowy Institute Paper 07. Sydney, Lowy Institute for International Policy, 2005. The Paper is available for download at: <http://www.lowyinstitute.org/Publication.asp?pid=317>.

² A feeling for the prevailing sentiment after the talks were concluded can be picked up from media reports at the time. For example, see: Guy de Jonquieres and Frances Williams, WTO deal fails to heal rifts. *Financial Times*, 17 December 2005. John Chalmers and Kim Coghill, World trade deal survives stormy Hong Kong talks. *Reuters*, 18 December 2005. Guy de Jonquieres, Tentative steps forward seen as better than none. *Financial Times*, 18 December 2005. Scott Miller and Greg Hitt, Farm-aid pact averts failure in global trade talks. *The Wall Street Journal*, 19 December 2005.

induced falls in the price of transport and communications. But most economists would award trade policy a starring role in the story, and in particular, would highlight the part played by the multilateral trading system – based around first the General Agreement on Tariffs and Trade (GATT) and then its successor, the WTO – in reducing policy barriers to trade and minimising international trade disputes.³



In other words, the multilateral trading system can be credited with helping shape today's international economy. It is not too great a leap from here to suggest that it deserves the accolade of being perhaps the most successful international (economic) policy initiative yet attempted.

. . . is in trouble

Despite this impressive achievement, however, the system is in trouble. Before December's Hong Kong ministerial, two of the previous three WTO meetings had ended in abject failure. The most notorious of these came in Seattle, in 1999, when the world's leaders tried and failed to start a new trade round against a backdrop of dramatic anti-globalisation protests. Then, after the Doha Round finally did get under way, there came the collapse in Cancun.

³ For a sceptical take on the evidence of the role of the multilateral system in boosting trade see Andrew K Rose, Do we really know that the WTO increases trade? *MAS Occasional Paper No. 24* Economic Policy Department, Monetary Authority of Singapore 2002. For a response to this, see Arvind Subramanian and Shang-Jin Wei, *The WTO promotes trade, strongly but unevenly*. IMF working paper. Washington DC, International Monetary Fund, 2003.

Ministerial meltdowns aside, achieving progress in the current Doha round has proved to be ‘painfully difficult and has raised questions about the process itself’, according to a report to the WTO’s director-general by a consultative board of ‘wise men.’⁴ One doesn’t necessarily have to be an advocate of the bicycle theory of international trade policy — the theory which asserts that momentum is all, with the world either moving forward towards freer trade or sliding backwards into more protectionism — to view this lack of progress as a source of real concern for the future of the system. As the WTO’s wise men pointed out, since the WTO is basically a negotiating machine, to the extent it becomes unable to negotiate effectively, or even is perceived to be unable to do so, its position becomes precarious.⁵

This background helps explain the sharp focus on the Hong Kong meeting. The fear was that failure – in the form of another collapse like Cancun – could sound the death knell for both the Doha Round and the multilateral system. Such fears may have been overdone. Certainly, trade rounds have been in trouble before and still reached a successful conclusion: the Uruguay Round, for example, suffered collapses in Montreal (1988) and Brussels (1990). That said, however, a complete failure at Hong Kong would almost certainly have inflicted severe long-term damage on the system’s credibility. Given this context, therefore, the absolute minimum requirement for the Hong Kong ministerial was to avoid another breakdown in negotiations. The good news is that this requirement was met – Hong Kong did do enough to keep the show on the road. But did it deliver anything beyond this minimalist outcome?

Question: what did Hong Kong deliver?

Boosters of the ministerial have emphasised several policy announcements:⁶

- Perhaps the most trumpeted of these commitments was an agreement to phase out agricultural export subsidies by 2013. There was also a commitment to front-load the reductions. These pledges were made conditional on reaching agreements on the treatment of in-kind food aid, export credit programs, and state trading enterprises.

⁴ Peter Sutherland, Jagdish Bhagwati, Kwesi Botchwey, Niall Fitzgerald, Koichi Hamada, John H. Jackson, Celso Lafer and Thierry de Montbrial, *The future of the WTO: addressing institutional challenges in the new millennium. Report by the Consultative Board to the Director-General Supachai Panitchpakdi*. Geneva, World Trade Organization, 2005, p.61.

⁵ Ibid.

⁶ For an upbeat assessment of Hong Kong’s achievements, see Jagdish Bhagwati, A blend of strong measures puts trade talks back together. *Financial Times*, 20 December 2005. A more pessimistic view can be seen in Jeffrey Schott’s response to Bhagwati. Jeffrey Schott. *A political jolt needed to break WTO 'Alphonse and Gaston' routine*. Institute for International Economics 2005: <http://www.iie.com/publications/opeds/oped.cfm?ResearchID=591>.

- The rich countries (the US, EU and Japan) agreed to award duty- and quota-free access to their markets to the world's least developed countries.
- The Hong Kong declaration included an endorsement of 'aid for trade'. That is, it supported the idea that rich countries should give aid to poorer countries to enable their more effective participation in international trade. Some rich countries also announced increases in their aid for trade programs.
- The meeting produced a pledge to end (US) subsidies to cotton exports in 2006.

In addition, Hong Kong concluded by setting a new deadline of 30 April 2006 for WTO members to reach agreement on the full details of reductions in barriers to agricultural and non-agricultural trade (something that was originally the aim for Hong Kong itself). The plan would then be to produce comprehensive draft schedules of the commitments based on these agreements by the end of July 2006.

Answer: not very much

A closer look at some of these policy announcements makes them appear less impressive than at first glance.⁷ For example, the 2013 date to remove agricultural export subsidies was basically determined by internal EU reforms to the Common Agricultural Policy (CAP) that had been agreed back in 2003. Other WTO members had sought an earlier date (2010) for their abolition. More importantly, export subsidies are only a small part of the distortions afflicting agricultural trade, comprising less than 5% of overall OECD support to agriculture. Instead, worldwide welfare costs from agricultural protection are overwhelmingly the result of market price support measures (basically tariffs and other market access measures). Back-of-the-envelope calculations by economists at the World Bank estimate a total cost to world welfare from agricultural protection of US\$129 billion, of which 6% is attributable to domestic support measures, 8% to export subsidies, and 86% to market price support.⁸ Moreover, the Bank economists note that such calculations tend to overestimate the

⁷ Critical assessments of the Hong Kong meeting include Ken Heydon, *After the WTO Hong Kong ministerial meeting: what is at stake?* OECD Trade Policy Working Paper No.27. Paris, OECD, 2005, Joseph Stiglitz and Andrew Charlton, *The Doha Round after Hong Kong* (paper presented at the conference: An assessment of the Doha Round after Hong Kong, Manchester University, 2-3 February 2006).

⁸ Table 3 in Kym Anderson, Will Martin and Ernesto Valenzuela, *Why market access is the most important of agriculture's 'three pillars' in the Doha negotiations*. Trade Note 26. Washington DC, World Bank, 2005.

importance of export subsidies: more sophisticated, model-based estimates tend to find export subsidies are closer to the source of just 1-2% of total welfare costs.⁹

The commitment to grant better access to the least developed economies is also a heavily qualified one – even after taking into account the mixed benefits of such preferential access. This is because the agreement restricts access to ‘only’ 97% of tariff lines. While this might sound generous, it still leaves about 330 product lines for potential exclusion from the agreement. This is problematic in terms of market access, since many of the poorest developing countries have their exports concentrated in a relatively small number of product lines. In the case of Bangladesh, for example, it’s been estimated that roughly 20-25 tariff lines account for around two-thirds of the country’s total exports.¹⁰

Again, the plan to remove export subsidies to cotton was more hype than substance. It is US *domestic* subsidies that make up 80-90% of total US support for cotton, and the US was anyway likely to have to eliminate its cotton export subsidies after losing a WTO case to Brazil.¹¹

More important than these qualifications, however, is the fact that Hong Kong failed to deliver significant progress in most of the areas that really mattered. Agricultural market access is the issue that has been at the centre of the Doha Round, reflecting the fact that this is where many of the biggest tariff barriers still remain. On one estimate, for example, roughly two-thirds of the gains that would come from dismantling *all* merchandise trade barriers and farm subsidies would derive from agriculture.¹² Yet progress in this area – in the form of agreement on actual cuts in tariffs – was deferred at Hong Kong, as were other tough issues such as the treatment of so-called ‘sensitive products,’ and the relative treatment afforded to developed and developing countries. The progress made in the NAMA negotiations (NAMA is WTO-speak for non-agricultural market access, basically trade in industrial products, which accounts for the majority of world trade flows) was even more negligible, while at best services negotiations went nowhere and at worst went backwards.¹³

⁹ Table 4 in Ibid.

¹⁰ The distribution of protection is important. Heydon points out that in 2002 Bangladesh was charged the same amount of tariffs (about US\$330m) on its US\$2.5b of exports to the United States as France was charged on its US\$30b exports to the same destination, p. 8

¹¹ Stiglitz and Charlton, *The Doha Round after Hong Kong.*, p. 3

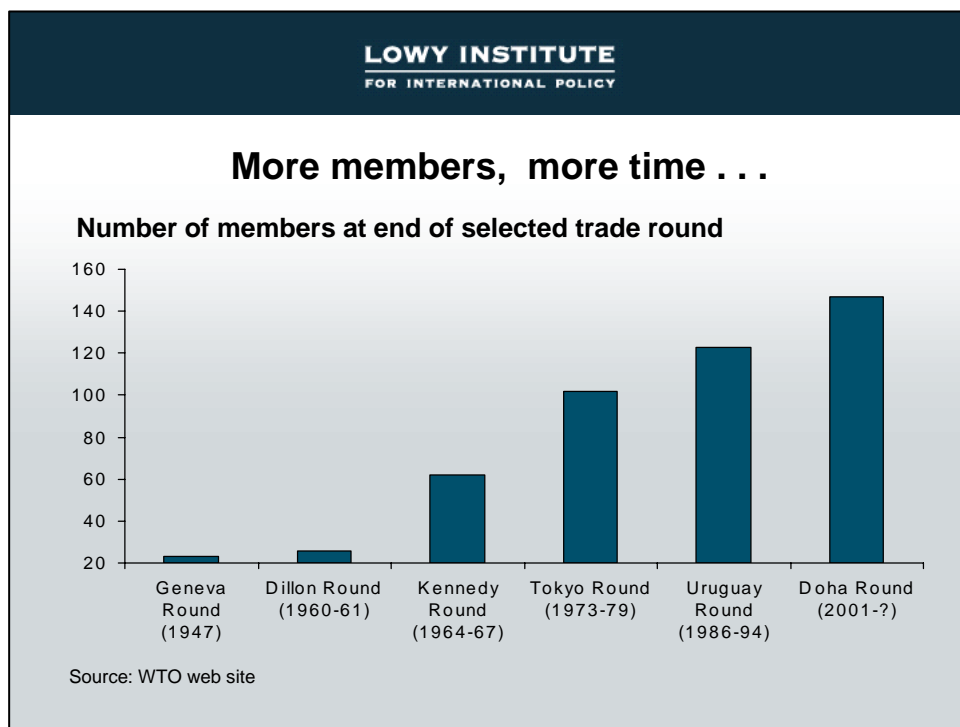
¹² Kym Anderson and Will Martin, *Agricultural market access: the key to Doha success.* Trade Note 23. Washington DC, World Bank, 2005.

¹³ For an example of the latter view see Heydon, *After the WTO Hong Kong ministerial meeting: what is at stake?* p. 4

In other words, once the announced achievements have been appropriately discounted, what Hong Kong did was little more than keep the Doha Round alive. Sure, avoiding the disastrous image of another Cancun-style collapse *was* an important policy achievement. But it was an achievement secured by postponing all the difficult decisions. In the words of the chairman of the US senate finance committee, on the tough issues the ministerial just ‘kicks the can down the road’.¹⁴

The perils of success

Why has reaching agreement proved to be so difficult? Given the recent history of trade negotiations, the fact that the Doha Round is dragging on should probably not come as a great surprise. This is how multilateral trade negotiations now seem to work. In the case of the Uruguay Round, for example, negotiations took seven and a half years, or almost double the original schedule.

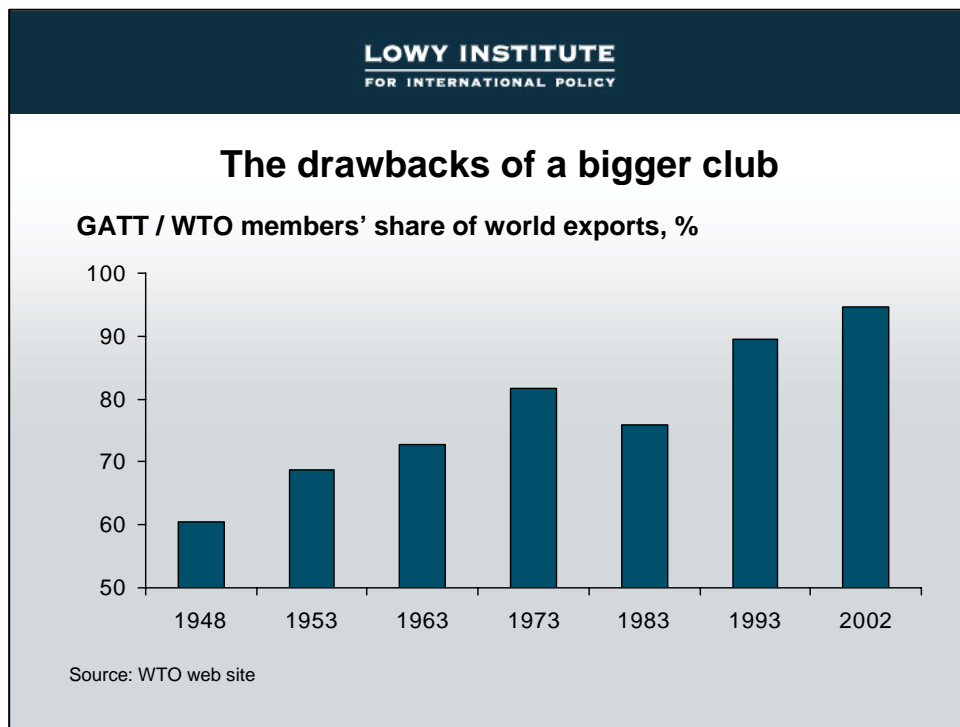


Arguably, part of the problem is that the multilateral system is a victim of its own success. Membership of the WTO is now at an all time high (chart). From the original 23 signatories to the GATT in 1947, the number of member economies has risen to 149 (with Saudi Arabia becoming the most recent WTO member in December 2005). More members are on their way, and the WTO is heading towards something approaching universal membership. All

¹⁴ Cited in Jonquieres and Williams, WTO deal fails to heal rifts.

else equal, a greater number of members makes achieving consensus a more difficult and time-consuming task. This is even more the case when the increase in size has been accompanied by an increase in diversity: originally the GATT was basically a rich countries' club that focused on liberalising trade in industrial products. The expansion of membership to emerging markets and developing countries brings new interests and new constituencies into the negotiations.

The growth in membership means that the share of world trade accounted for by WTO members has also expanded, rising from around 60% in 1948 to more than 95% in recent years (chart). WTO negotiations therefore now cover more trade than ever before. Moreover, they also cover different *kinds* of trade, as the multilateral system has extended its reach into new areas such as services and intellectual property rights. This in turn has made the outcome of negotiations more sensitive, and hence increased the degree of difficulty.



Success – more members, more trade, more issues – has therefore come at a cost: trade negotiations are tougher and take longer. And time matters. For example, the longer the time required to reach a successful result at the multilateral level, then the more likely trade ministers will end up looking elsewhere for politically visible ‘deliverables’. Questions of time might also explain what appears to be the fading interest of the business community in international trade rounds. There is now a marked contrast between the accelerating pace of the international product cycle – thanks to the forces of globalisation – and the glacial pace of

trade negotiations.¹⁵ Again, from the point of view of a corporate lobbyist, the cost-benefit equation from multilateral negotiations may as a result be looking less attractive than some of the alternatives on offer.¹⁶

Time is also an important consideration in the context of the current negotiations. US Trade Promotion Authority (TPA) is due to expire in July 2007. Under TPA, the US Congress agrees to consider trade agreements on a 'fast track' basis, voting them up or down without amendment and with only limited debate. The theory is that this means trading partners can be more confident that concessions accepted by US negotiators as the price of an agreement won't subsequently be changed when Congress votes on the implementing legislation. To beat the expiration of TPA, the general consensus is that all of the hard work on the Doha round must be completed by year end.

New trading powers and new challenges . . .

If the perils of success are one important explanation of the difficulties facing the Doha Round, another is what appears to be the declining enthusiasm for an agreement on the part of the major country players.

In part, this might just reflect negotiating positions. For example, the growing economic strength of emerging markets has quite naturally seen them become more assertive negotiating partners, and hence less willing to accept a deal effectively imposed by the developed economies. For their part, the major developed economies are reluctant to afford generous concessions to what they see as increasingly potent competitors in global markets. The reciprocal bargaining framework of WTO negotiations – concessions are 'purchased' by other concessions – means that stalemate is always a potential risk.¹⁷ For example, while some of the big emerging market economies feel that they are overdue rich country concessions on agriculture after the disappointments of the Uruguay Round, their counterparts in the EU are reluctant to offer a substantive deal on agriculture in the absence of significant progress in areas of interest to *their* constituents, such as services or investment.

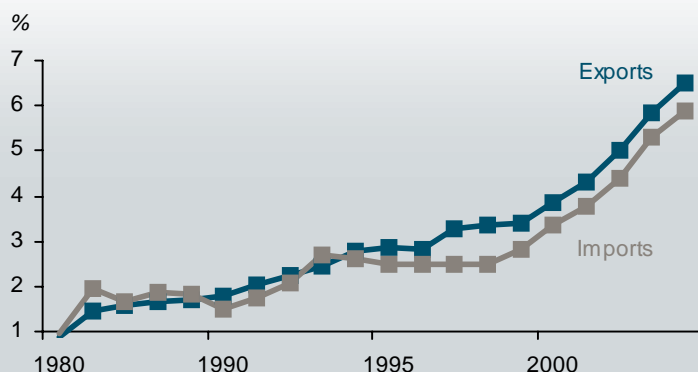
¹⁵ This point is made by Aaditya Mattoo and Arvind Subramanian, Why prospects for trade talks are not bright. *Finance and Development* 2005.

¹⁶ Also, it is possible that the dearth of corporate interest reflects past successes: trade barriers today are now relatively low across many products, and several key markets have anyway been pursuing unilateral liberalisation in recent years.

¹⁷ Most economists would argue that the idea that reducing trade barriers is seen as a 'concession' in the context of the WTO – rather than as an action that should be taken anyway to reap the benefits of trade liberalisation – is part of the problem.

New trading powers: China

China's share of world merchandise trade



Source: WTO international trade statistics database

But it is also possible that there is something more at work here. In particular, some observers have pointed to what they see as a more general decline in enthusiasm for free trade in the advanced economies.¹⁸ Increasing numbers of commentators are questioning whether the adjustment costs associated with international economic integration should lead to a reassessment of the benefits from free and open trade.¹⁹ To take just one example, Paul Krugman wrote last year that as corporations made their case for squeezing the wages and benefits going to their employees, citing foreign competition in justification, this made ‘free trade liberals’ like him very nervous, since when ‘corporate executives say that they have to cut wages to meet foreign competition, workers have every right to ask why we don’t cut the foreign competition instead.’²⁰

Two potential explanations for this latest rethink on the benefits of an open trading system have been advanced. One relates to the rise of new trading powers, the other to the spread of trade into new – and more sensitive – areas of national economies.

¹⁸ The fact that in December 2001 TPA passed by a majority of just one vote in the US House of Representatives, and that in 2004 the Central America Free Trade Agreement (CAFTA) managed to scrape only a two-vote majority are a couple of pieces of evidence frequently cited in defence of this proposition. (The Australia-US Free Trade Agreement (AUSFTA) went through the House on a comfortable 314-109 vote.)

¹⁹ Of course, their predecessors have been doing this for a long time. As Douglas Irwin points out, the case for free trade has ‘survived repeated scrutiny from economists ever since Adam Smith made his celebrated case for free trade in the *Wealth of Nations*’. Douglas A Irwin, *Against the tide: an intellectual history of free trade*. Princeton, Princeton University Press, 1996., p. 3

²⁰ Paul R Krugman, The big squeeze. *The New York Times*, 17 October 2005.

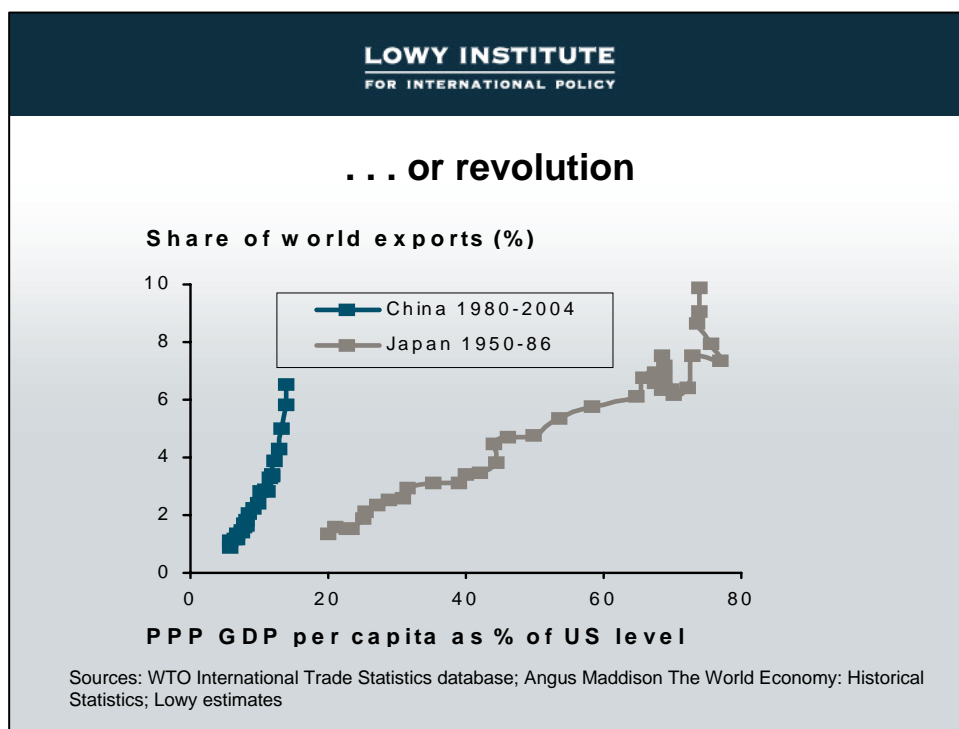
There is no doubt that the perceived competitive challenge posed by the rise of new trading powers in general, and the emergence of China as a major trading nation in particular, has been the subject of a great deal of attention and more than a little concern (chart). By 2004 China had become the third largest trading nation in the world, accounting for about 6½% of world merchandise exports, 6% of world imports, 8% of world manufactures exports, 15% of office and telecommunications exports, 17% of textile exports, and 24% of clothing exports. On the import side of the equation, in the same year China was the source of one-third of growth in world demand for oil and one-half of growth in world demand for metals. Since the start of the current millennium, China has also been the single most important contributor to the growth in world trade.



Yet in many ways there is nothing particularly new here. The economic rise of Japan in the 1970s and 1980s prompted an increase in trade tensions between Japan on the one hand and the US and Europeans on the other. To some extent, China looks like a rerun of the Japan story. For example, for much of the past two decades China's share of world exports has been below that achieved by Japan during its integration process, and is only now catching up (chart).²¹ Indeed, to date, US-China trade tensions have tended to be less pronounced than earlier US-Japanese disputes, at least insofar as actual trade measures are concerned.

²¹ This section draws on the discussion in Mark P Thirlwell, *Shaking the world? China and the world economy*. Lowy Institute Perspectives. Sydney, Lowy Institute for International Policy, 2005.

However, one important caveat to this optimistic take on the issue is that China's international integration experience could yet turn out to be more revolutionary than a simple replay of the Japanese story. An obvious difference between these two integration experiences, for example, is the relative income level at which they have taken place. Thus Japan started its post-World War Two integration process with a level of GDP per capita roughly 20% that of the United States (chart). Then, by the time Japan's share of world exports had reached the 6-7% range, Japan's GDP per capita had climbed to roughly two-thirds that of the US level. In contrast, China began its integration process with a GDP per capita of around 5% of the US level, and was still at less than 15% (below Japan's *starting* point) when it reached the same 6-7% range in 2004. This much bigger gap between leader and follower implies that the scope for further 'catch-up' growth remains very large.²²

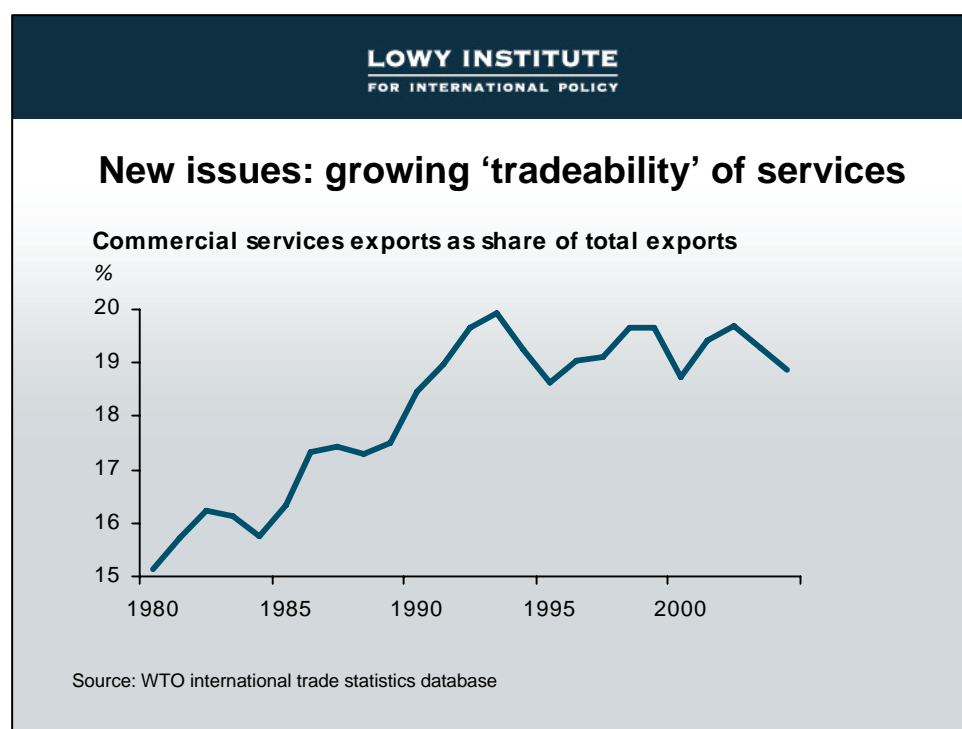


A further difference is scale. China's share of world population today is far higher than Japan's was in the 1970s and 1980s, so the scale of the resulting global supply shock is likely to turn out to be much larger. For example, China's population is almost four and half times larger than that of the United States, while its labour force is roughly five times bigger. At a comparable stage in Japan's penetration of world export markets, Japan's population and labour force were closer to half US levels.

²² GDP per capita measured on a purchasing power parity (PPP) basis.

Taking these two differences into account, it is therefore quite possible that the adjustment effects of China's economic rise will *eventually* prove to be much greater than those associated with Japan's.²³

Along with new trading powers, a second challenge to the current international trading order stems from the expansion of trade into new areas of the economy, specifically the growing 'tradeability' of services, increasingly as a product of offshore outsourcing. The outsourcing of some relatively low-skilled service sector jobs (call centres, for example) started in the early 1990s. But that has now been joined by more skilled white collar jobs in, for example, the IT and financial sectors, and now the claim is that anything that can be done remotely can be 'offshored', ranging from financial market analysis to virtual classrooms and medical examinations.



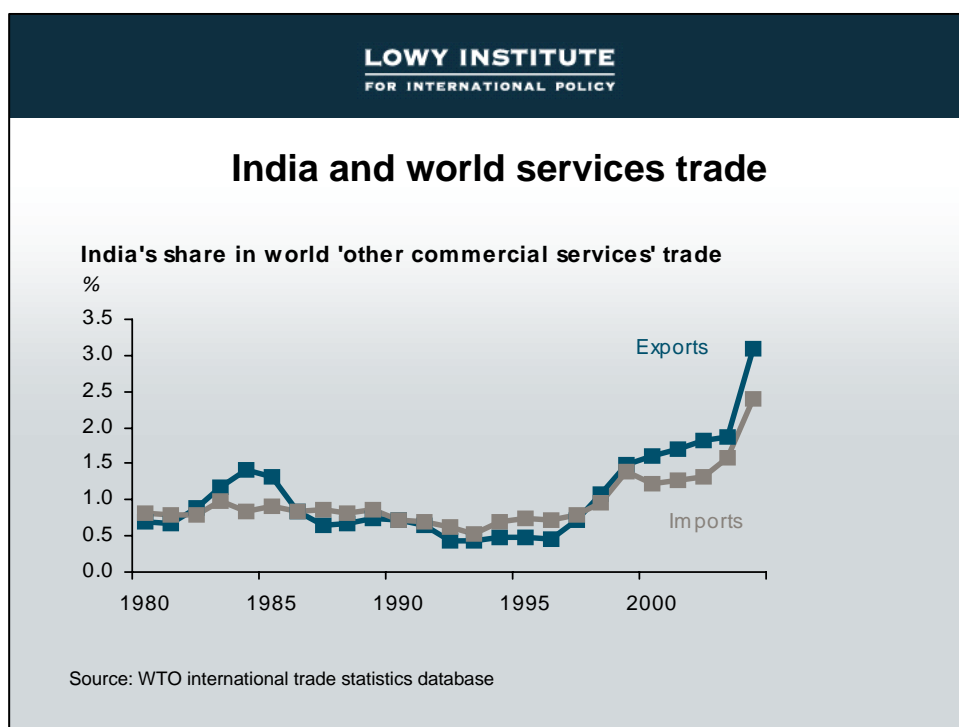
There are significant limitations with the data on services trade, so an accurate picture of the growing tradeability of services is not readily available. Still, the data we do have show that in recent years, exports of commercial services have accounted for roughly one in every five dollars of total export sales (chart) – a figure that is likely to be an underestimate.

Moreover, the rising tradability of services is also linked to the emergence of new trading powers - in particular, India.²⁴ While India's integration into the international economy to

²³ Given China's current export mix, arguably it is middle income economies that are facing the greatest economic competition from Chinese producers, rather than the rich developed nations.

date has *quantitatively* been much more modest than that of China, the *qualitative* nature of the Indian push into global markets has been important. Here the ‘new’ feature is that the striking aspect of the current Indian development model has been the central role played by services.

India has seen its share of world services exports triple in the space of about a decade (chart), and many of these gains have come in so-called new economy sectors like software, where India’s share of the global market is around 17%, and where the growth of its exports has been double the world average. This has allowed Indian firms to compete in areas once thought to be the preserve of the developed world and to become a major force in the international outsourcing phenomenon: McKinsey estimates that Indian firms control over half the global IT and back office outsourcing markets.



Given the central importance of services in developed economies, in the longer term the Indian model has at least the potential to generate an even more fundamental shift in the international division of labour than the rise of China.²⁵

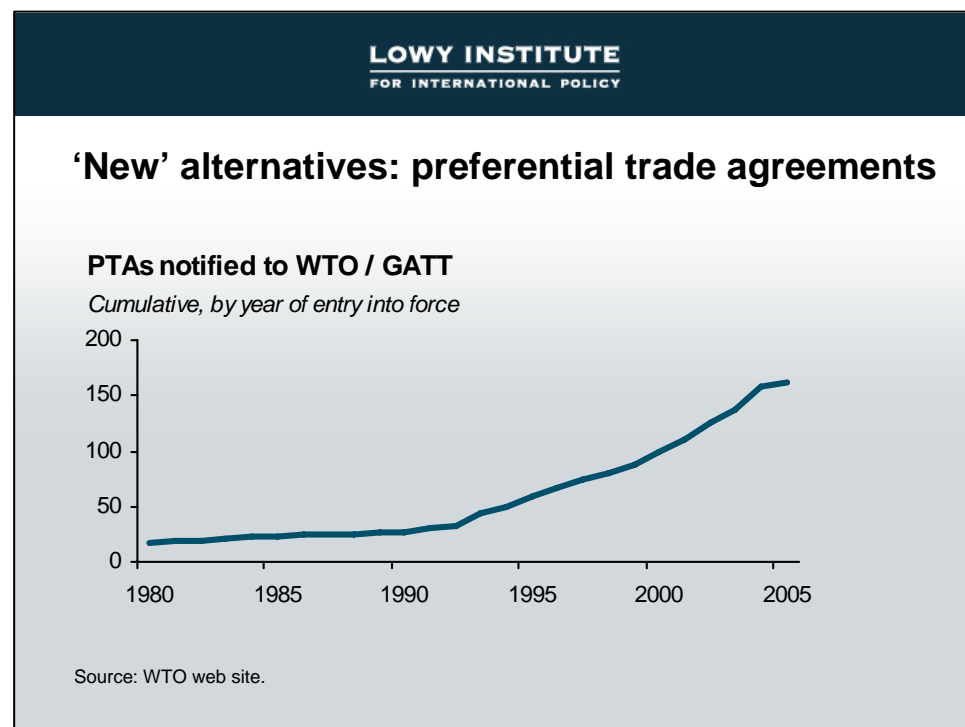
²⁴ Mark P Thirlwell, *India: the next economic giant*. Lowy Institute Paper 01. Sydney, Lowy Institute for International Policy, 2004.

²⁵ See for example Stephen S Cohen and J. Bradford DeLong, Shaken and stirred. *The Atlantic Monthly* 295 (1) 2005.

In fact, the data we have so far suggests that this story isn't (yet?) that important in terms of job numbers, even in the United States which is at the forefront of the trend. But the *idea* is a powerful one, in that it serves to undermine the old, comforting story whereby increased participation by emerging markets in the manufacturing sector would see developed economies shift their workforces into more highly paid and more highly skilled jobs in a service sector that was relatively sheltered from the bracing winds of international competition.

... and not so 'new' alternatives

Whether the problems facing the multilateral system are a product of its own past successes or of new trends in international trade, or reflect some combination of the two, one consequence of the resulting slow progress at the multilateral level has been that policymakers have been looking elsewhere for trade policy action. In particular, they have turned their attention to preferential trade agreements (PTAs), typically in the form of bilateral free trade agreements (FTAs) and regional trade agreements (RTAs).²⁶

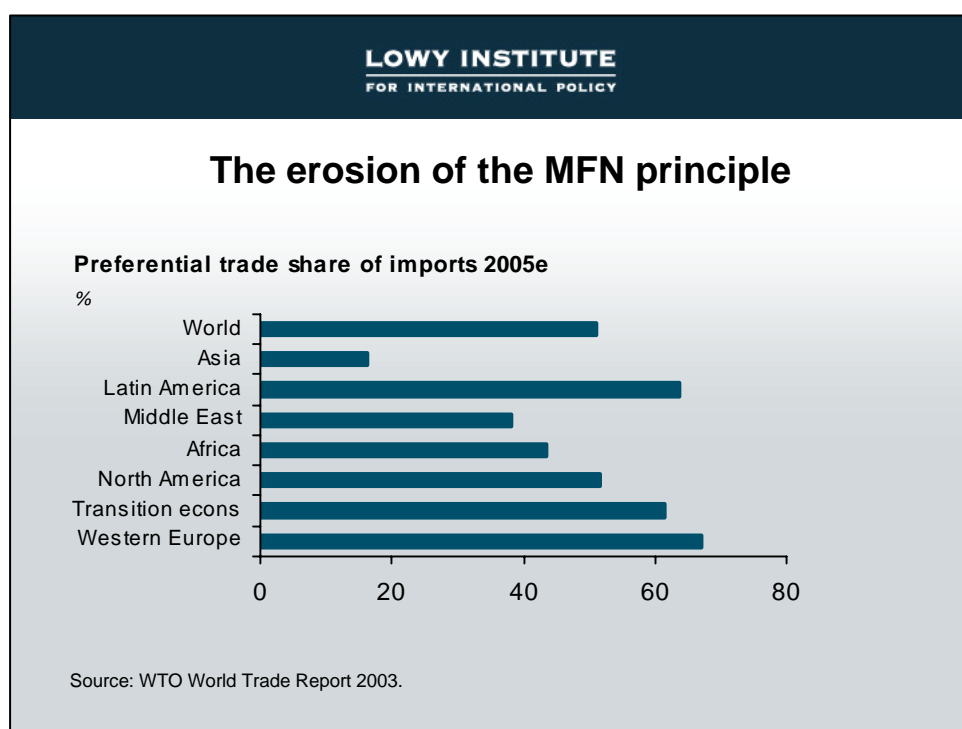


Such agreements have been around for a while – they are not strictly speaking a 'new' alternative – but the number of PTAs being signed has increased markedly since the mid-1990s (chart). By 2004, nearly every significant economy in the world and virtually every

²⁶ It is also possible that the causality runs in both directions, so that more focus on PTAs has taken attention – and negotiating resources – away from the multilateral system.

WTO member were involved in some form of PTA: the World Bank could find only 12 countries that did not belong to at least one such agreement, and almost all of these were either islands or microstates. Indeed, on average, the Bank estimates that each country now belongs to six PTAs (although this hides substantial variations across regions and development levels).²⁷

The WTO has estimated that, by 2000, around 43% of world merchandise trade was taking place within PTAs (chart).²⁸ By last year, the WTO expected that more than half of all world trade would take place on a preferential basis, representing a fundamental challenge to the philosophy underpinning the multilateral system. The concept at the heart of the latter is that of non-discrimination, an ideal embodied in two guiding principles: most favoured nation (MFN) which says that a WTO member must treat all other members equally, and national treatment, which says that a member should not discriminate between its own and foreign products, once the latter have entered the national market. The spread of PTAs has been such as to lead observers to worry that the MFN principle, one of the anchors of the multilateral system, is becoming the exception, rather than the rule for world trade.



²⁷ Chapter 2 in World Bank, *Global economic prospects 2005: trade, regionalism and development*. Washington DC, World Bank, 2004.

²⁸ This estimate may be too high, since the value of total trade flows between PTA partners will tend to overstate the actual trade that takes place on a preferential basis (as the tariff schedules of many PTA members include MFN duty-free rates of zero).

Conclusion

The multilateral system is in trouble, and the difficulty in reaching a substantive agreement in Hong Kong is a symptom of this.

There is some good news. Hong Kong did just enough to keep the Doha Round alive, and did succeed in avoiding a Cancun-style collapse. But the bad news is that it did little else. That leaves a formidable agenda for trade negotiators, and an increasingly tight timeline. Given what now appears to be a declining appetite for substantive multilateral liberalisation, the odds on a successful conclusion to the Doha Round within the currently envisioned timetable continue to worsen. Partly as a result, policymakers seem set to continue with their focus on PTAs. In the aftermath of Hong Kong, for example, the US and South Korea announced that they planned to start negotiations on a bilateral trade agreement on 3 May 2006.

What does all of this mean for Australia? It suggests that the likelihood of a substantive deal on agriculture – for which we still need the multilateral system – remains disappointingly low. It also suggests that the action on trade liberalisation, such as it is, will continue to be found at the bilateral and regional level. This is problematic, since the multilateral system is by the far superior route to freer world trade, in contrast to the winding, and sometimes uncertain, path offered by preferential arrangements.

Given that PTAs have a number of potential costs and drawbacks, the pressing challenge for policy therefore is to continue to work to ensure that we maximise the net gains and minimise the associated risks from such agreements. To this end, a useful step would be to submit both existing and proposed Australian PTAs to a regular process of rigorous and independent review, with the Productivity Commission an obvious candidate for the role. A tough review process would facilitate the development of best practice agreements and minimise the dangers of falling victim to some of the pitfalls associated with the worldwide rush into preferential trade.

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ABOUT THE AUTHOR

Mark Thirlwell is Program Director, International Economy at the Lowy Institute for International Policy. Mark is a graduate of Cambridge University and has an MPhil degree in economics from Oxford University. Before joining the Institute, Mark worked as an economist for the Bank of England, JP Morgan and the Australian Export Finance and Insurance Corporation.

He is the author of the Lowy Institute Papers *India: the next economic giant* and *The new terms of trade*.

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