From Doha to the Next Bretton Woods

A New Multilateral Trade Agenda

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When the Doha Round of multilateral trade negotiations was launched, in 2001, the price of oil was $25 a barrel, a ton of rice cost $170, China's current account surplus was two percent of the country's GDP, U.S. financial institutions were at the vanguard of globalization, and the term "sovereign wealth fund" could have been mistakenly thought to refer to the retirement kitty of an aging monarch.

As of November 10, 2008, oil was going for $65 a barrel, and rice for $515 a ton. China and the oil-producing states have trillions of dollars at their disposal. The U.S. financial system, in the midst of the worst financial crisis since the Great Depression, is teetering between socialization and oblivion. As all these changes have unfolded, the governments involved in the Doha talks have, Nero-like, spent too much time dwelling on minor issues while ignoring the burning questions. After the failure of the recent round of negotiations this past July in Geneva, the international community will be tempted to resuscitate the Doha process. Indeed, as part of calls to reshape the international financial system—under a proposed Bretton Woods II—British Prime Minister Gordon Brown has pushed for the completion of the Doha Round.

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But this effort to revive Doha seems inadequate because the existing Doha agenda does not respond to the challenges posed by increasing global integration. Fluctuating commodity prices, threats to the economic security of middle-class workers, financial instability, and environmental insecurity have significant global implications that demand a multilateral response. Going forward, a new round of Bretton Woods talks is needed to develop a more ambitious agenda than Doha has and to involve a broader set of institutions than just the World Trade Organization (WTO).

A STALLED CONVERSATION

SINCE THE mid-1990s, world trade has grown rapidly, at a pace of approximately six percent a year—twice as fast as global economic output. During that time, however, WTO members have not adjusted the maximum levels of tariffs and other barriers that they can maintain on goods and services. In other words, overall trade has flourished, but the multilateral process that governs trade has languished.

Trade has grown throughout the world because many governments have increasingly come to believe that openness promotes long-term development. Many unilaterally liberalized their regulations on goods and services. Tariffs on goods have declined from a worldwide average of over 25 percent in 1980 to less than ten percent today. Many states have drastically reduced barriers to foreign investment and international trade in various service sectors, including finance, telecommunications, transport, and retail. Much of this liberalization has taken place in the context of regional trade agreements, such as the North American Free Trade Agreement (NAFTA) and a series of agreements between the European Union and its eastern neighbors. Since the early 1990s, the number of such pacts has risen from under 90 to nearly 400.

These parallel unilateral and regional efforts at liberalization ended up robbing the multilateral process of some of its raison d'être. By the time the Doha talks resumed in Geneva last summer, little of consequence was even on the table. In richer developing countries—a group that includes Brazil, China, and India—the reforms proposed would have left average tariff rates for agricultural goods unchanged,

at about 13.5 percent, and would have reduced tariff rates for manufactured goods only slightly, from 6.4 percent to 5.6 percent.

Supporters of the Doha process concede that its goals when it comes to lowering trade barriers are modest but argue that its real purpose is to provide security for trading partners: legal commitments offer mutual assurances that trade policies will not be reversed. This argument would be compelling if the Doha talks actually contemplated guarantees against states suddenly resorting to punitively high import tariffs, such as those imposed by the Smoot-Hawley Tariff Act of 1930. In fact, the Doha proposals did not offer any meaningful guarantees of this kind. For example, under the proposals, the richer developing countries would still have had the leeway to adjust their agricultural tariffs by a margin of about 30 percentage points—and this is when their actual such tariffs are, on average, already 13.5 percent.

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One sign of Doha's limited relevance is that the groups traditionally at the forefront of multilateral liberalization—private corporations in the intellectual-property, manufacturing, and service sectors—are now notable by their absence from the process. So modest were Doha's aims this past summer, that even the usual antiglobalization protesters did not bother to show up in Geneva.

UNCERTAIN SUPPLY, UNCERTAIN MARKETS

Fueled by increasing productivity and low inflation, the world economy enjoyed its most pronounced growth spurt ever between 2002 and 2007. But in the last year, abundant supplies have given way to widespread shortages. Rising commodity prices have endangered food and energy security. Over the last three years, the increase in food prices has threatened to push as many as 100 million people into poverty. The current recession has led to a sharp decline in agricultural prices, but food prices are likely to remain high in the medium to long term because many of the underlying factors that have pushed them up—greater demand in the developing world, high fuel prices, stagnant agricultural productivity, and pressure on agricultural supplies brought about by climate change—will last.

The pressure on food prices has been exacerbated by restrictions on agricultural exports in a number of developing countries and by biofuel policies in industrial countries. Eighteen developing countries have imposed limitations on exports in order to maintain their domestic supplies. But as a result of such export controls, global food supplies have contracted and prices have risen, further aggravating global food insecurity.

The WTO has been of little help as the crisis has unfolded, because it permits taxes and quotas on agricultural exports. Under normal conditions, subsidies to farmers introduce huge distortions that encourage domestic production and exports. But under abnormal conditions, such as those prevailing now, the opposite occurs: countries tend to prevent exports and liberalize import regulations. If importers face such restrictions from producing countries during bad times, they are unlikely to think of international trade as a reliable means of maintaining food security and instead will be tempted to move toward more self-reliance. A vicious cycle results.

The second threat to food security has come from biofuel policies in the industrialized world. In the United States, the combination of ethanol mandates, tax credits for ethanol producers, and tariffs on imported Brazilian ethanol has meant that more land is being used to produce corn for biofuel and less is being devoted to wheat and soybean production. Other industrial countries have enacted similar policies, which, together with the United States' policies, account for as much as 70 percent of the increase in food prices worldwide, according to research conducted at the World Bank. And yet even as food prices soared and import barriers declined, the Doha talks continued to focus on traditional forms of agricultural protection, such as production subsidies, which have become less relevant. The trade agenda needs to be enlarged to include a discussion of all trade barriers—on imports and exports—and biofuel policies, including tariffs on imports.

FUELING GROWTH

The new trade agenda must also include a serious conversation about energy. There has been a dramatic rise in the price of oil since 2002, even though prices have declined from the peaks they reached last summer. Uncertainty about available supplies and increased demand

from emerging countries such as China and India have resuscitated fears about energy security and pushed prices up. But another factor is the cartelization of oil markets by oil exporters. The power wielded by the Organization of the Petroleum Exporting Countries (OPEC) tends to be high when demand is high, as it is now. Oil is the world's most important traded commodity, yet a striking gap in the global trading system is the absence of any formal rules to prevent collusion by oil-producing states.

Rising oil prices have prompted a number of unilateral responses. Many oil-importing states have attempted to cushion consumers against price increases by subsidizing gasoline and heating fuel, especially for poorer households. In the process, they have sustained high world prices by dampening incentives to reduce consumption. For example, because of government subsidies, consumer prices for energy in India last year rose very little despite sharp increases worldwide. At the same time, states have considered taking unilateral action against OPEC. For example, the U.S. House of Representatives has approved a "NOPEC" bill that would allow the Justice Department to prosecute anticompetitive conduct by OPEC members. Legislation introduced in the U.S. Senate would require action against OPEC member states in retaliation for their collusion on export quotas. But neither U.S. antitrust law nor international trade rules currently offer protection against such collusion, even though it is against the spirit of open multilateral trade.

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New multilateral trade rules should target cartels. The best course of action, drawing on precedents set by the WTO (for example, commodity agreements), would be to bring together the world's oil producers (both OPEC members and nonmembers such as Russia) and its oil consumers (represented, for example, by an expanded International Energy Agency) to draft a new set of rules on the global energy trade. Ideally, collusion on supply quotas would be outlawed, but without impairing a state's ability to stabilize prices or conserve its natural resources.

A FAIR EXCHANGE

ANOTHER MAJOR problem has been the persistent and substantial undervaluation of major currencies, especially the yuan (by about 20–60 percent) and those of some oil-exporting countries (by more than 100 percent). Undervalued currencies are in effect both an import tax and an export subsidy, and the countries that maintain them wind up hurting the profitability of industries in states with which they trade. To escape these adverse effects, capital in the ailing countries tends to relocate elsewhere, leaving immobile, generally low-skilled labor to bear the brunt of these states' declining competitiveness.

This issue increasingly resonates in domestic politics, especially in the United States, where it has prompted calls for action. The Nobel Prize laureates Paul Samuelson and Paul Krugman, among other prominent economists in the United States, have expressed concern about the impact of trade on the living standards of U.S. workers. Some American economists and lawmakers have called for imposing a duty on imports from countries with undervalued exchange rates. But any such unilateral action would be, by definition, partial and hence ineffective. Undervalued currencies affect more than just one country: China's cheap yuan, for example, has an impact not only on the United States and the European Union but also on emerging economies and African countries, whose products compete with China's on the world market.

A multilateral approach may prove more fruitful. Under the historical division of labor between the International Monetary Fund and the WTO, the IMF has jurisdiction over questions relating to exchange rates. But its oversight has been weak at best. Whereas the IMF has been able to influence member countries that have borrowed from it, it has not been successful in affecting economic policy in countries that do not need IMF money. Moreover, the IMF lacks an effective enforcement mechanism. Compounding these problems is the IMF's eroding legitimacy. It lost its status as a trusted interlocutor in emerging markets, particularly in Asia, after the Asian financial crisis of 1997–98. There, the IMF was seen as having failed to provide enough money to countries in need and as having attached unnecessarily tough conditions to its loans, which many believe aggravated the effects of the crisis. The IMF's governance structure is also outdated; it reflects

the receding realities of the Atlantic-centered world of 1945 rather than the rise of Asia in the twenty-first century.

One possibility going forward would be for the IMF and the WTO to cooperate on exchange-rate issues. The IMF would continue to provide technical expertise to assess the valuation of currencies. But because undervalued currencies have serious consequences for global trade, it would make sense to take advantage of the WTO's enforcement mechanism, which is credible and effective. The WTO would not displace the IMF; rather, this arrangement would harness the comparative advantages of each institution.

NOUVEAUX RICHES

A GROWING CONCERN is the nationalization of finance in the hands of sovereign wealth funds (SWFs). Governments in the developing world are holding increasingly large amounts of wealth in the form of foreign exchange reserves. Estimates by Morgan Stanley suggest that SWFs hold a total of $2.5 trillion today and that this number will grow to $12 trillion by 2015. The majority of these funds will be held by oil-exporting states, as well as China and other countries in East Asia.

The growth of SWFs has provoked two major fears. The first concern, which is macroeconomic, is that state funds can too easily destabilize global currency and bond markets, by, for example, suddenly shifting their portfolios from one market or sector to another. The second concern, which is microeconomic, is that SWFs could end up controlling sensitive or strategic industries in other countries.

The United States is in the process of adopting legislation that would tighten scrutiny of investments by foreign governments that raise security concerns. Similarly, the European Commission is considering acting to prevent corporate takeovers by publicly controlled foreign investment funds. But such unilateral actions could easily be construed as defensive and protectionist, especially if they are justified in the name of national security—as was the case when the U.S. Congress scuttled the bid by the China National Offshore Oil Corporation, or CNOOC, for the U.S. oil giant UNOCAL in 2005 and blocked Dubai Ports World's efforts to acquire control of U.S. shipping facilities in 2006.

The case for a multilateral approach to regulating SWFs is clear. Exporters of capital want secure access to investment opportunities in foreign markets, and importers of capital have legitimate concerns about the motivations of state investors and the consequences of such transactions. Mutually beneficial bargains are there for the making. The WTO is an appropriate forum for such deals because it already regulates private and government investments in key service sectors, such as finance, telecommunications, and transport. One way to manage such investments would be to require countries importing capital, such as the United States and EU member states, not to impose undue restrictions on investments. In return, SWFs would commit to following certain criteria—transparency, an arms-length relationship with their national governments, and the pursuit of purely commercial objectives—modeled after the voluntary code of conduct for SWFs negotiated under the auspices of the IMF in October 2008.

WORKING OFF THAT GLUT

Seismic changes shook the U.S. financial system in 2008. Many icons of capitalism disappeared or fell under government control in a matter of weeks. Whether or not one agrees with the *Financial Times* columnist Martin Wolf that these changes herald the end of an era of overly complex and underregulated finance, the crisis will certainly lead to a reexamination of national policies and international rules.

Better management of the imbalances that rocked the system must be a priority. Lax regulation, a bubble psychology, and perverse incentives for managers and rating agencies that profited from overestimating the value of assets underlying complex financial instruments were all factors. But one key macroeconomic cause was excess liquidity, which allowed for cheap loans and poor lending standards and kept afloat an unsustainably leveraged housing market. As Federal Reserve Chair Ben Bernanke has explained, this excess liquidity was itself the result of a "global savings glut," by which he meant the large current account surpluses built up by China and the oil-producing states. Preventing the reemergence of such liquidity-fueled bubbles will require limiting such global imbalances in the future, and that calls for a multilateral approach. Cooperation on exchange rates and excessive commodity prices is a good way to start. But

multilateral cooperation will also be necessary on the regulation of the financial sector. Although finance has become global, its regulation has remained national. If financial regulation is to remain a purely national question, then individual countries should have the freedom to determine the pace of the integration of their own financial systems into global economic institutions. Negotiations at the WTO or in the context of regional agreements should be more circumspect about pushing financial-sector liberalization and, especially, greater openness to short-term capital inflows.

Another option would be to move toward global regulation of finance. After last fall's crisis, any reconfiguration of the financial systems in the United States and the United Kingdom is likely to limit the leverage of banks and other financial institutions, such as hedge funds. But if other jurisdictions do not adopt similar rules, then national regulators will become concerned about a race to the bottom, with financial institutions fleeing to countries with fewer restrictions. Hence, some form of multilateral cooperation to coordinate national regulation seems necessary and desirable compared to uncoordinated national action. These efforts will require coordination between, on the one hand, the IMF and the WTO, which help guarantee states' financial openness, and, on the other hand, the Bank for International Settlements and the Financial Stability Forum (with expanded membership), which deal with financial regulation. A cooperative approach is necessary to make sure that when countries open themselves up to financial flows, they have the regulatory capacity to manage them, or, when they lack such capacity, they are able to restrict those flows.

ENVIRONMENTAL PROTECTIONS, NOT PROTECTIONISM

CLIMATE CHANGE, increasingly recognized as the gravest danger to humanity, will be the subject of international negotiations at the United Nations Climate Change Conference in Copenhagen later this year. As the momentum for acting decisively on the issue picks up, there is growing talk of using trade as an instrument for furthering environmental objectives. In the United States, the most prominent bill under discussion in Congress is on restricting imports from countries that do not act adequately to protect the environment. The European

Union has been contemplating enacting similar rules. European and U.S. producers of energy-intensive products, such as chemicals, metals, and paper, are pushing for restrictions on imports coming from China and India, where environmental standards are especially lax.

The international community will have an opportunity to design a new regime to manage both climate change and trade at the Copenhagen summit, the most significant such meeting since the conference in Kyoto in 1997. The key objective of that regime should be to ensure the participation of all the major carbon-emitting countries, including developing nations. The negotiations should therefore exclude up-front the threat of trade sanctions as a tool to force cooperation, as these tend to alienate developing nations. Instead, as Nicholas Stern, former chief economist of the World Bank, has proposed, participation and compliance should be secured through transfers of finance and technology—particularly since most developing countries see climate change as a problem caused by emissions from the industrial world.

If all countries agree in Copenhagen to reduce carbon emissions across the board, then there will be little basis for trade restrictions in particular sectors. With economy-wide emissions targets, governments would retain the flexibility to mandate reductions across sectors of their economy as they see fit. Accordingly, they would be immune to punitive action from their trading partners in specific sectors. Of course, as under the Montreal Protocol, an international treaty that phases out substances that cause ozone depletion, whatever agreement emerges from Copenhagen could include a provision to allow for trade sanctions. But these trade sanctions should serve as enforcement mechanisms to be put in place only after cooperation is secured, not as sticks to induce cooperation in the first place.

UPDATING THE GUEST LIST

It is an old axiom of trade politics that the will of concentrated interests, typically those of producers and exporters, trumps the will of diffuse interests, usually those of consumers. The genius of the WTO's reciprocal framework was to harness exporters' interests in liberalization to overcome opposition from domestic producers fearful of foreign competition. Consumers were the incidental beneficiaries of reform.

Consumers and other actors with diffuse interests will need to play a more active role in driving the new trade agenda than they have in the past, because they now have more at stake. As evidence of their growing influence, governments in several developing countries have imposed agricultural export taxes, increased fuel subsidies, and tightened anti-inflationary policies. The natural next step is for governments to cooperate on furthering the security-minded interests of their constituents.

One challenge ahead, as the failure of the latest Doha meeting highlighted, will be to resolve differences between the world's traditional powers and its new powers, such as on the pace of liberalization. Although these states' divergent interests would seem to hinder chances for future cooperation in the WTO, the proposed new trade agenda would create more common interests and greater scope for give-and-take between existing and rising powers than have existed until now. All large oil consumers, be they traditional powers (the United States and Europe) or emerging ones (China and India) share an interest in an open energy market without artificial restrictions on supplies. If such a market were achieved, China and India would be less tempted to secure supply sources through costly bilateral deals. On exchange rates, large emerging economies, such as Brazil and South Korea, share an interest in ensuring that China and Middle Eastern states adopt less distortionary exchange-rate policies. Likewise, countries that import capital and those with SWFs all have a stake in keeping investment flowing, which means addressing the legitimate security concerns of host states.

Still, two questions remain: Which countries should participate in the negotiations, and what is the appropriate forum for the talks? It may not be necessary, or even desirable, to continue following the model of the Uruguay Round, in which all countries are invited to discuss all issues and are all bound by any resulting rules. With the failure of the Doha talks, such efforts to create rules that would apply uniformly to an increasingly diverse membership began to seem like dangerous overreaching. Some issues, such as investment by SWFs, would be best resolved by that subset of countries which are most directly involved. In some cases, the benefits of the agreements coming out of these limited talks could be extended to all of the WTO's members.

At the moment, the WTO is the lone official forum for most negotiations on trade issues. That makes it an appropriate venue for discussing trade restrictions in the agricultural sector, but not necessarily for discussing the other major economic issues of the day. Cooperation is needed between the WTO and the IMF on questions involving exchange rates and SWFs. For energy issues, both organizations that represent oil exporters, such as OPEC, and those that represent importers, such as an expanded version of the International Energy Agency, need to be involved. On the environment, and specifically climate change, the WTO should be subordinate to forums such as the upcoming Copenhagen summit.

FROM DOHA TO WASHINGTON

THE DOHA ROUND of trade negotiations was one of the more serious attempts at multilateral cooperation in recent years. It might be tempting, therefore, to exaggerate the consequences of its latest failure. But the issues now at stake in Doha are marginal, and, more important, Doha distracts attention from other matters of greater significance, such as the consequences for trade from misaligned exchange rates and environmental protection. Multilateral cooperation is needed to prevent any protectionist measures that these issues may provoke.

The outlook for multilateral cooperation has become cloudy. The United States, the world's acting hegemon, is facing economic disarray and finds itself distracted in Afghanistan and Iraq. Meanwhile, "the rise of the rest," as Fareed Zakaria, the editor of *Newsweek International*, has described what is happening to emerging powers, has dispersed power and complicated collective action. Despite these difficulties, however, it is time to start working on a new agenda that really matters, rather than trying to resuscitate an inconsequential enterprise. The interests of a more diverse group of actors are now at stake. This calls for a new approach to international cooperation and the reallocation of responsibilities among international institutions. A Bretton Woods II offers exactly this opportunity.