CGD/IIE Brief

Achieving a Grand Bargain in the Doha Round[1]

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The Challenge

Time is running out for the Doha "Development Round" of global trade negotiations. US negotiating authority expires in mid-2007. Ideally, the outlines of a deal would have been in place by the December 2005 meeting of trade ministers in Hong Kong, although it now appears that an additional high-level meeting in early 2006 may be necessary for this purpose. The collapse of the ministerial meeting in Cancun in September 2003 showed that developing countries will not settle for a face-saving minimalist agreement, nor should they. The July 2004 Geneva "framework" agreement set the stage for more meaningful liberalization, particularly in agriculture. But the major negotiating countries have not yet made commitments to the deep liberalization necessary to realize the potential of the framework.

The best approach is a "grand bargain" that would include deep cuts in agricultural tariffs and subsidies in industrial countries; major cuts in their tariffs in manufactures including textiles and apparel; a ceiling of 10 percent on all tariffs on manufactures in industrial countries; major cuts in agricultural tariffs of developing countries; major cuts in their tariffs on manufactures albeit using a formula differentiated from that for industrial countries; liberalization of key service sectors in developing countries; and the granting of free or preferential entry to imports from Least Developed Countries (LDCs) into middle-income country markets and complete free entry for these imports into industrial country markets.

The stakes are high. Global free trade in goods could lift 500 million people out of poverty (at the $2 per day level) over 15 years, and convey economic benefits worth $200 billion annually to developing countries.[2] The gains would be even larger including free trade in services, especially if this involved substantial opening to cross-border movement of temporary labor. Half of the developing countries' gain in goods would arise from elimination of barriers in industrial country markets. This means that through opening their markets to free merchandise trade, industrial countries could provide about twice as much in annual benefits to developing countries as they currently give in development assistance. Moreover, they could do so while granting the benefit of lower consumer prices to domestic households rather than imposing higher tax burdens on them.

No one expects the Doha Round to deliver global free trade. However, everyone has a right to expect the negotiations to achieve a major step in that direction, for example by cutting overall protection by half or more. The developing countries in particular have every right to expect meaningful gains in this Round. In the Uruguay Round concluded in 1995, they did achieve a back-loaded elimination of textile quotas; but textile tariffs remain fairly high, and that round essentially left protection levels unchanged in agriculture, which is the most important export sector for many developing countries.

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Moreover, in the declaration launching the current round in Doha, Qatar in late 2001, the industrial countries joined in the pledge to place developing countries' "needs and interests at the heart" of the new round. A collapse of the round would be a severe setback to the momentum for global development that has begun to take shape through such initiatives as the UN Millennium Development Goals, the increase in international aid levels, and the cancellation of debt for heavily indebted poor countries.

Outlines of a Bargain

It is important to recognize that a successful "Development Round" does not mean that industrial countries should eliminate their protection while developing countries maintain theirs. There are two core reasons. The first is that regardless of political motivations on behalf of advancing global development, the reality is that industrial country interest groups simply will not endorse unilateral trade liberalization, but instead will expect to see some quid pro quo in terms of increased export opportunities in at least the large middle-income countries. Some substantial element of prospective reciprocity will be needed to mobilize export interests in industrial countries sufficiently that they will be prepared to provide the political support necessary to overcome the inevitable resistance of interest groups currently benefiting from import protection. The second reason is that to a large degree, it would be beneficial for most developing countries to reduce their own protection as well. Many developing countries continue to maintain excessive protection that curbs rather than spurs their economic growth. However, they too face domestic interest group obstacles to import liberalization that will be easier to overcome within the context of a multilateral negotiation holding out the prospect for increased market access abroad.

Considering that the WTO negotiations require consensus, another dynamic that must be taken into account in the Doha Round is the potential blocking leverage of some of the Least Developed Countries (LDCs). Many of them are concerned that broad international trade liberalization will erode the advantages they currently have from preferential entry. There also are concerns that higher world food prices resulting from elimination of industrial country subsidies and protection would adversely affect food-importing LDCs. As discussed below, both of these concerns are exaggerated. However, there will nonetheless be a need to ensure that the LDCs perceive benefits rather than losses from the Doha outcome.

For this purpose, the industrial countries should deepen existing preferential entry for LDCs, and the middle-income developing countries should offer them preferential entry that presently does not exist.

The key elements of a "grand bargain" package would thus be as follows:

- Industrial countries would make deep cuts in their protection, especially in agriculture and in peak tariffs in other sectors, and would also reduce tariff protection in textiles and apparel. Industrial countries would set a ceiling of 10 percent on all tariffs on manufactured goods, including textiles and apparel.
- In agriculture, industrial countries would agree to eliminate export subsidies within five years of completion of the round. They would commit to the complete elimination, over a reasonable timetable such as a decade, of all domestic subsidies that provide a production incentive ("coupled" subsidies). They would commit to retain only subsidies "decoupled" from production.[3] They would commit that within five years they would curb all narrowly-defined trade- and output-distorting domestic subsidies (as discussed below) to no more than 5 percent of agricultural output value. They would sharply reduce high tariffs, especially the tariffs applied in tariff-rate-quota protection. They would commit to a timetable for escalating the volume bases for all tariff-rate quotas.
- The WTO would implement robust monitoring of agricultural subsidies to ensure those reported as decoupled from output are in fact decoupled. Country "notifications" of subsidies would be required within six months rather than the present typical delay of four years to make monitoring meaningful.
- Middle-income developing countries would cut high tariffs, by enough to ensure significant reduction in actually applied tariffs (where, as is often the case, "bound" tariff levels are much higher). They would do so in both agriculture and industrial goods.
- Middle-income developing countries would apply a Special and Differential (S&D) parameter that would make their liberalization a substantial fraction (e.g. one-half to two-thirds) of that required under the formula adopted for industrial countries. They would set a ceiling of 15 to 20 percent on all tariffs on manufactures.
- Industrial countries would extend existing preferences to Least Developed Countries (LDCs) by making product coverage complete and entry duty- and quota-free.[4]
- Middle-income developing countries would introduce preferential entry for imports from LDCs.

- Developing countries would make forthcoming offers in financial, construction, and infrastructure services. Industrial countries would bind existing free entry of electronic delivery of cross-border services. However, temporary movement of labor would not constitute a major part of the Doha Round agreement, but would be left for future bilateral agreements between industrial and partner developing countries.
- LDCs and other low-income developing countries would reduce high tariffs to intermediate levels (e.g. no higher than 15-25 percent).[5]

Actors and Reciprocal Interests

The principal actors in the Doha Round are the European Union; the United States; the Group of 20 developing countries led by Brazil, China, and India; the Least Developed Countries (LDCs); and the non-LDC ("Other") Group of 90 Africa-Caribbean-Pacific developing countries. Other important groups include the Cairns Group of agricultural exporters (which includes among others Argentina, Australia, Brazil, Canada, New Zealand, and South Africa), and the G-10 group of advanced countries with relatively high agricultural protection (which includes among others Japan, Korea, Norway, and Switzerland).

If we designate the countries seeking liberalization in a given area as being on the "demand" side of liberalization, and the countries whose markets are relatively more protected as being on the "supply" side, then the liberalization "transactions" in the Doha Round can be outlined as follows. In agriculture, the United States, the Cairns Group, most of the G-20, and Other G-90 are on the demand side. (Some LDCs are also on the demand side for products and markets where they do not enjoy preferential access, such as West African states' demand for liberalization in cotton.) The European Union and the G-10 are on the supply side. To an important degree, however, the United States is also on the supply side with respect to its agricultural subsidies; members of the G-20 are as well, especially regarding high bound agricultural tariffs.

In manufactures, it is the industrial countries (EU, US, G-10) that are on the demand side, and the G-20 and other developing countries that are on the liberalization supply side because of their still relatively high tariffs. The exception is in textiles and apparel, where tariffs remain high enough that it is primarily the industrial countries that are on the liberalization supply side, and the G-20, Other G-90, and even LDCs (again where preferences are incomplete) that are on the demand side.

Table 1. Doha Grand Bargain Liberalization by Major Party (row) and Prospective Benefiting Partner (column)

	US	EU	Japan	G20	LDCs	OthG90
US		↓AS		↓AS, TRQ tTA, tPK	↑FE	↓AS, TRQ tTA, tPK
EU	↓AXS, tA			↓AXS, tA TRQ, tTA	↑FE	↓AXS, tA TRQ, tTA
Japan	↓tA, TRQ			↓tA, TRQ	↑FE	↓tA, TRQ
G20	↓tM, tA	↓tM	↓tM	↓tM, tA	↑PE	↓tM, tA
LDCs	(↓t)	(↓t)	(↓t)	(↓t)	(↓t)	(↓t)
OthG90	↓t	↓t	↓t	↓tM	↓t	↓t

G20: group of 20
LDCs: Least Developed Countries
OthG90: Other G90 countries
A: agriculture M: manufactures AS: agricultural subsidies linked to output TRQ: tariff rate quotas t: tariff
TA: textiles and apparel PK: peak FE: free entry AXS: agricultural export subsidies PE: preferential entry

In services liberalization, for financial, construction, and infra-structure services the EU, US, and G-10 are on the demand side and the G-20 and some in the Other G-90 are on the supply side. Cross-border electronic delivery of services is potentially important as an area of liberalization "supply" in the form of binding existing free access in the industrial countries. Although the G-20 and Other G-90 are on the demand side in temporary movement of labor (market access for guest workers), not much can be expected in this round on this issue.

The challenge of any round of multilateral trade negotiations is to achieve an overall balance of offers that makes it attractive for all countries to participate (and for none to exercise potential blocking power under the consensus tradition). Table 1 summarizes the pattern of liberalization supply and demand for the main groupings of actors, with offers by country or region in the rows and principal beneficiary partners in the columns.

The July 2004 Framework

The mid-2004 Geneva agreement that got the Round back on track after the Cancun breakdown provided that agricultural export subsidies would be eliminated, including below-market rates on export credit. It stipulated that industrial countries would cut the bound level of their "aggregate measure of support" (AMS) in subsidies linked to output ("amber box" subsidies) by at least 20 percent in the first year after the Doha Round is concluded. The agreement called for deeper cuts in higher agricultural tariffs. It also called for nonlinear tariff cuts and the elimination of tariff peaks in manufactures, and allowed for longer phase-in periods and lesser cuts for developing countries.

The elimination of agricultural export subsidies agreed in Geneva is a significant achievement, but modest. It mainly affects the European Union, and amounts to only a small portion of total EU subsidies. It is much more important to decouple US subsidies from output; to ensure that the EU pledges that it is decoupling are valid; to cut sharply the high agricultural tariffs (especially tariffs applicable in tariff-rate-quota regimes) in the EU and especially Japan; and to substantially increase, and eventually fully liberalize, the quota levels at which the tariff-rate quota penalty tariffs are triggered.

Overall, the framework left a wide range of latitude for either a maximal or minimal outcome to the negotiations. As one illustration, as discussed below the existing unused spare capacity in the AMS for the United States and the EU

means that they could meet the required 20 percent cuts without any reduction in actual subsidies, so the true cuts would remain to be established beyond this minimum.

Agriculture[6]

Liberalizing global trade in agriculture is crucial to achieving a major overall outcome in the Doha Round. Agriculture accounts for about half of the total potential benefits from global free trade for both industrial and developing countries. This sector is especially important for reducing global poverty, because about three-fourths of the world's poor are in the rural sector and would stand to benefit from increased export opportunities.

Developing countries have tended to stress the need to reduce agricultural subsidies in the Doha negotiations. In part, this reflects the fact that few developing countries can afford to provide subsidies to their own farmers. In part, however, it may reflect their reluctance to place their own agricultural tariffs on the table. As it turns out, industrial country farm subsidies are generally less important than their tariffs and tariff-rate quotas in their total protection against developing countries. If the amount of output-distorting subsidies is converted into a measure of a tariff with the equivalent import-suppressing effect, it turns out that subsidies have been less important than tariffs in the EU (10 percent tariff-equivalent of subsidies versus 33 percent average for tariffs) and especially Japan (3 percent versus 76 percent). The United States, with its low tariffs, is the exception, as its agricultural subsidies had a tariff-equivalent of 10 percent, versus its 9 percent average tariff.[7]

Tariffs

Tariff protection, and especially beyond-quota tariff rate quota protection, remains far higher in agriculture than in manufac-tures.[8] Post-Uruguay Round most-favored-nation (MFN) tariffs in agriculture are a weighted average of 36 percent in industrial countries, compared with 12 percent in textiles and apparel and only 3 percent in other manufactures. The corresponding averages for developing countries are 30, 18, and 12 percent, respectively (Figure 1).[9]

Recent negotiations on agricultural tariffs have built on a proposal by the Group of 20 developing countries to separate tariffs into "tiers" and apply deeper cuts for the higher tiers. US negotiators have reportedly sought deeper tariff cuts and increased market access, whereas EU negotiators have sought

Figure 1

Average Applied MFN Agricultural Tariffs, 1998 (percent)

DC: developed countries
DgC: developing countries
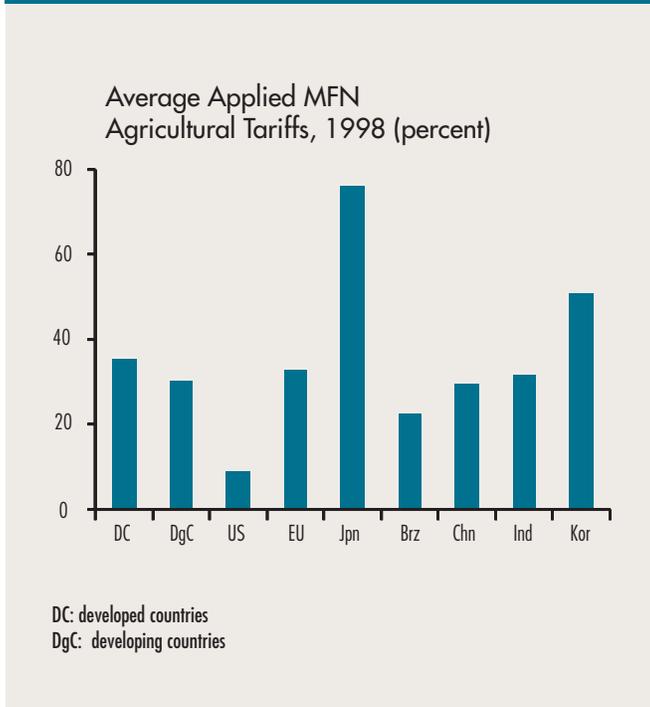
assurances of reduction in US agricultural subsidies prior to committing to tariff reductions.[10] The different emphases reflect the fact that US agricultural tariffs are relatively low whereas those of the EU are relatively high.

In October, 2005, the United States tabled a proposal for deep cuts in agricultural tariffs. Building on the G-20 proposal for graduated cuts by tiers, the proposal called for tariffs under 20 percent to be cut by about 50 percent, with the cuts rising to 85-90 percent for tariffs above 60 percent. There would additionally be a post-reform ceiling of 75 percent on all agricultural tariffs. This proposal involves extremely large cuts, for example reducing a 60 percent tariff to 9 percent. The US emphasis on tariff cuts reflects its own relatively low agricultural tariffs, which average about 9 percent weighting sectors by global output. By implication, the post-cut US average would be only about 4 percent.

The European Union, which relies much more heavily on tariff protection, responded with a proposal to cut tariffs by a maximum of 60 percent for the highest tariffs, and by an overall average of 46 percent. Considering that the average EU agricultural tariff is about 33 percent, this implies a post-reform average of about 18 percent. The difference between the US and EU proposals is even greater for above-quota tariffs in tariff-quota categories, which average 35 percent for the United States and 79 percent for the EU.[11] The latter would be cut to 36 percent under the EU formula but to 13 percent under the US formula. Importantly, the US proposal would allow departures from the tariff-cutting formula in only 1 percent of tariff lines for sensitive products. In contrast, the EU proposal would allow cuts by one-third to two-thirds less than the standard formula for up to 8 percent of tariff lines, which by some accounts would represent the great bulk of agricultural imports.[12]

In reaching agreement, it would help greatly if key developing countries such as Brazil and India were prepared to adopt deep cuts of their sometimes inordinately high agricultural tariffs. Although as noted actual applied tariffs in agriculture for developing countries are an average of about 30 percent, in some products the "bound" rates can be in the range of 100 percent in some important countries. US farm interests, for example, would be far more interested in committing to the dismantling of production-linked subsidies at home if they saw an opportunity to lock in reform of such potential protection abroad; and the bound rates are often so high that their actual application would be damaging to the country in question in any event.

Many developing countries appear to be concerned that in the face of subsidized agricultural production in industrial countries, they cannot commit to elimination of the high bound rates, because they may find they need to apply them in the face of a sudden onslaught of low-cost agricultural imports. But there are two straightforward solutions that are better than keeping the high bound rates. The first is to ensure that industrial countries live up to pledges to decouple subsidies from production. The second part of the solution would be to *shift toward a reliance on "safeguard" protection in agriculture when necessary*, rather than maintaining extremely high bound tariff levels. This type of protection is the main source of temporary import relief allowed under WTO rules in industrial goods. When a surge of imports occurs, and if a test of "injury" to domestic producers is met, a country can impose temporary special tariffs that phase out over a relatively short period such as three years. It would be better to apply this concept in agriculture than to allow permanent exemption of "sensitive" products from the deep cuts otherwise applicable.[13]

Subsidies

The Uruguay Round of multilateral trade negotiations completed in 1994 established the framework for discipline on agricultural subsidies. It placed output-distorting subsidies in an "amber box" with negotiated ceiling subsidy totals (Aggregate Measure of Support, AMS). "Decoupled" subsidies not affecting output, such as direct income payments unrelated to production, were placed in a "green box" not subject to limits. Subsidies potentially affecting output but contingent on output limiting measures such as land set-asides were placed in a "blue box," also unconstrained. The agreement also exempted as de-minimis two tranches of subsidies of up to 5 percent of output (crop-specific and general). The central challenge of the Doha Round in subsidies is to achieve a strong commitment to the phase-out (or at least sharp phase-down) of amber- and blue-box subsidies that boost output (or keep it from falling); and to close or at least narrow the de-minimis loophole.

In 2003 the EU adopted a major reform set to decouple a substantial portion of its subsidies from output, to be implemented in the period 2005-07.[14] The bulk of these changes represented shifts of subsidies from the blue box, where they were related to output but nonetheless subject to production constraints, to the green box. In this shift, payments previously linked to output were replaced by a "Single Farm Payment" (SFP), based solely on producers' historical payments in 2000-02. Unfortunately, in the United States the farm bill of 2002 took a step backwards. It raised "loan rates" on grains, reestablished a target-price system, created new counter-cyclical payments, and, crucially, allowed farmers to update historical bases—so that payments were no longer decoupled from production decisions.[15]

The framework agreement of July 2004 uses the total of amber box, blue box, and de-minimis subsidies as the overall measure of trade-distorting subsidies to be cut. An important problem is the large amount of "water" in the bound levels of the Aggregate Measure of Support (AMS). The EU AMS bound ceiling for 2001 (the most recent available year) was €67.2 billion ($60 billion) annually, but the actual amounted was only €39.3 billion ($35.1 billion).[16] Similarly, the US bound AMS ceiling for 2001 was $19.1 billon, but the actual amount was only $14.4 billion.[17] The large gap between bound and actual rates means that a large "cut" in the bound rate would be compatible with no reduction at all in actual subsidies.

A second central problem is that a major component of the AMS is fictitious: market price support (MPS). This measure is an accounting concept, equal to the difference between the domestic administered support price and the average world price in 1986-88. The use of an outdated benchmark is already a clue to the fiction of this concept. More fundamentally, however, it would be flawed even if current world prices were used. The reason is that it is a measure of protection that is redundant with protection provided by tariffs and tariff-rate quotas. As such, its inclusion in the AMS overstates the additional protective effect of "subsidies" beyond that already provided by tariffs.

Conceptually the MPS is not a subsidy. Typically it does not involve budgetary outlay.[18] For example, in 2001, the United States had $5.8 billion in MPS from its administered price supports ($4.5 billion for dairy, $1.0 billion for sugar, and $0.3 billion for peanuts), yet the corresponding budgetary outlays were close to zero.[19] Similarly, the European Union no longer builds up "butter mountains" of costly stockpiles, so it is likely that its accounting MPS too does not represent budgetary outlays. Japan has already shown that including the MPS in the subsidy base can be mischievous. By eliminating administered prices in the late 1990s while keeping tariff and tariff-rate quota protection intact, it sharply cut its reported MPS and amber box subsidies without changing de-facto protection.[20] Skeptics similarly fear that US and EU commitments to cut amber box "subsidies" in the Doha Round will be accomplished by removing administered prices and getting credit for reducing subsidies that do not exist.[21]

The clean solution to this problem would be to strip out market price support from the measure of amber-box AMS, on grounds that its protective effect is already incorporated in tariffs and tariff-rate quotas, which are being liberalized separately.[22] Then the proposed cuts in subsidies would be from a smaller but more meaningful base. If the MPS is kept in the base, then at the least the negotiators should agree that when a country cuts its MPS in the future, its total amount of allowable AMS should be cut by the same amount. Otherwise fictitious subsidies could be replaced by real subsidies without penalty.

If the MPS is stripped out of the AMS, actual trade-distorting subsidies (not bound levels) in the most recent reported year were as follows. In 2001, the European Union had $10.6 billion in narrow AMS subsidies (total €39.3 billion less €27.5 billion MPS), plus $0.7 billion de-minimis support, plus $21.2 billion in blue box support, for a total of $32.5 billion.[23]

The United States in 2001 had $8.6 billion in narrow AMS support ($14.4 billion less $5.8 billion MPS), $7.1 billion in de-minimis support, and zero in blue box subsidies, for a total of $15.7 billion narrow trade-distorting support. A 50 percent cut in actual, narrowly-defined trade-distorting subsidies would thus reduce the EU level to $16.2 billion, or 5.4 percent of agricultural output value, and the US level to $7.9 billion, or 4 percent of agricultural output.

So the Doha Round negotiators could reasonably be asked to cut through all the opacity of domestic subsidies by committing to the following goal: *total narrowly-defined trade-distorting subsidies (AMS excluding MPS; plus blue box and de-minimis) should be cut to no more than 5 percent of agricultural output value.*

In contrast, the offers so far leave far more room for large post-reform subsidies. In October, 2005, the United States offered to cut the AMS bound level by 60 percent, or from $19.1 billion to $7.6 billion.[24] The US would place the counter-cyclical subsidies in the blue box, but limit the blue box to 2.5 percent of GDP, amounting to $5 billion. It would cut the de-minimis allowance to a total of 5 percent of GDP (2.5 percent specific, 2.5 percent general). This total potential would amount to $22.6 billion, of which $5.8 billion would be fictitious MPS (at the 2001 rate), leaving the potential true (narrow) trade-distorting total at $16.8 billion. This is actually higher than the narrow 2001 level ($15.7 billion as just indicated).

Similarly, the EU has proposed a 70 percent cut in the bound AMS, to $24 billion.[25] It has suggested an 80 percent cut in de-minimis protection, to 2 percent of agricultural GDP or $6 billion for itself. Together with the framework 5 percent ceiling for blue box subsidies ($15 billion), this would amount to $45 billion. If the MPS maintained its 70 percent share of the AMS, post-reform MPS would be $16.8 billion, and narrow AMS, $7.2 billion. Total narrowly-defined trade distorting subsidies would be $28.2 billion (7.2 + 6 + 15), only 13 percent lower than the same concept in 2001 ($32.5 billion). Even worse: if both the United States and the European Union decided to follow the Japan tactic and eliminate adminis-tered prices (while keeping tariff protection), this would allow room for a major increase in trade-distorting subsidies unless the new AMS ceiling explicitly provided that in such cases the bound ceiling would be reduced by the amount of the previous MPS.

The developing countries should continue to press the United States and the European Union to achieve cuts much closer to 50 percent in the actual level of narrowly-defined amber box, blue box, and de-minimis subsidies. They and other negotiators should also call for aggressive WTO monitoring of subsidies to ensure that they are actually fully decoupled (green box) if they are treated as such. To make this possible, the negotiators should agree that notification of subsidy amounts to the WTO will be made within no later than six months of the completion of the crop year. The present lag of typically four years in the notifications makes serious monitoring impossible.

Manufactures

The July 2004 framework agreement calls for major cuts in protection of manufactures while preserving some degree of flexibility for developing countries, including less than full reci-procity. Both industrial and developing countries still have relatively high tariffs in textiles and apparel (figure 2). Although the Uruguay Round eliminated textile and apparel quotas (after a lengthy timetable that just ended in January 2005), it did little to cut tariffs in these traditionally sensitive sectors.

In all other manufactures as a group, industrial country tariffs tend to be low, at a weighted average of about 3 percent, whereas developing country tariffs as actually applied are considerably higher at a weighted average of 11.5 percent (Figure 3).[26] Bound tariff levels in developing countries are

Figure 2

Average Tariffs in Textiles and Apparel (percent)

Figure 3

Average Tariffs in All Other Manufactures (percent)

Figure 4

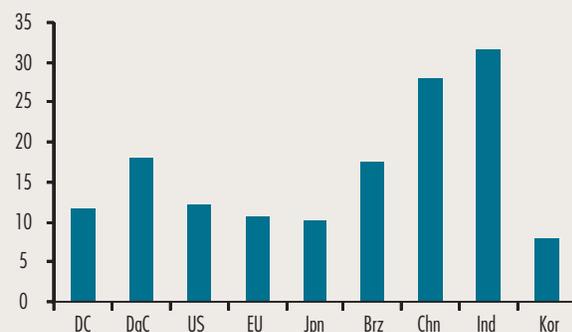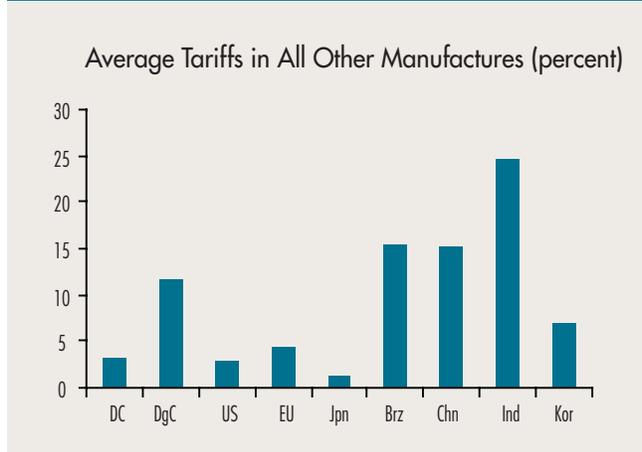### Tariffs Under Alternative Swiss Formula Coefficients (percent)

even higher. A key objective of industrial country negotiators is to obtain reductions in developing country protection in manufactures, and to do so in a meaningful way that cuts applied tariffs, rather than just squeezing the "water" out of bound tariffs.

The negotiations have centered on a tariff-cutting (Swiss) formula that reduces higher tariffs by a larger proportion than lower tariffs.[27] Industrial countries have called for a formula "coefficient" that generates deep cuts for high tariffs; developing countries have tended to favor either a coefficient that leads to shallower cuts, or a coefficient for cuts by industrial countries that is different from (more aggressive than) that used for developing country cuts.[28]

The fundamental point that developing country negotiators should keep in mind is that extremely high tariffs maintained by a country are injurious to the country's own economy. They impose high costs on consumers, lead to monopoly power and lethargic technological change for domestic firms, and indirectly act as a penalty to exports (by causing the exchange rate to settle at an overly strong level as a consequence of suppressing demand for imports). Developing countries should be prepared to accept a tariff formula that would cut even very high tariffs down to a range of no more than, say, 15-20 percent, in exchange for a deep liberalization of industrial country agricultural markets and textile and apparel tariffs. In the Swiss formula, a coefficient of $C = 20$ would accomplish cuts of this magnitude. Developing countries could reasonably call for a more aggressive coefficient (such as $C = 10$; see figure 4) for industrial countries.
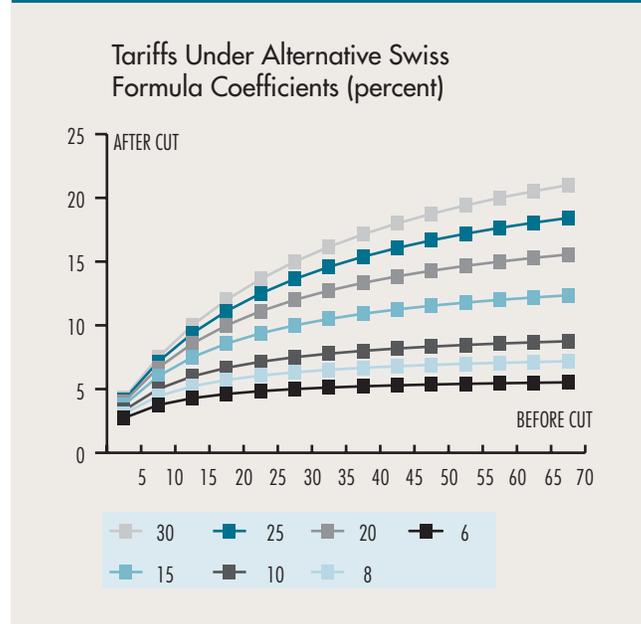
More generally, it would seem useful to think of special and differential treatment for developing countries as involving a specific "S&D parameter" modifying what is expected of industrial countries. For example, if this parameter were 2.0, then a Swiss formula that generated a 60 percent proportionate cut in a given tariff would translate to a 30 percent (= 60/2) proportionate cut for a developing country. It would be straight-forward to develop a set of S&D coefficients for any given Swiss formula that would cut tariffs by half as much for developing countries as for industrial countries (for an S&D parameter of 2.0), or by any other specified fraction.[29]

Similarly, in another dimension of flexibility for developing countries—length of phase-in period—an S&D parameter of 1.5 to 2 would translate a 5 year implementation period for industrial countries into a 7.5 to 10 year period for developing countries.

Finally, tariff peaks should be eliminated by specifying post-reform tariff ceilings. For industrial countries, peak tariffs are typically defined as those above 15 percent. A reasonable target is that after the Doha Round is fully implemented, *no industrial country tariff in manufactures should exceed 10 percent*, as proposed in early October by the European Union. Once again, a differential-treatment parameter could

be applied. Thus, with the industrial country ceiling for tariffs on manufactures set at 10 percent, no developing country tariff in manufactures would exceed 15 percent if the differential-treatment parameter were 1.5, or 20 percent if it were 2.

As for the LDCs, it would also be in their own interests to set the ceiling on tariffs for manufactures at moderate levels. Arguably they might keep flexibility to have tariffs as high as 25 percent, if middle-income countries agreed to ceilings of 20 percent. Tariffs much higher than this, however, would almost certainly be to the detriment of sustainable growth in the LDCs.

A crucial feature of tariff liberalization in manufactures is that the WTO set of "safeguard" options would be available to buffer the adjustment to lower protection. When there is a surge in imports, and when the country can show that "injury" has occurred, then time-limited safeguard tariffs can be imposed. These are phased out over three years. As part of the negotiations in manufactures tariffs, differential treatment could again be allowed to provide developing countries greater (but still constrained) latitude for applying safeguard protection.

Services[30]

The Doha Round negotiations have gone further in agriculture and manufactures than in services. Many economic analyses tend to show that the gains from liberalization could be even greater in services than in goods, especially if temporary labor services are included.[31]

Industrial country objectives in this area tend to be to expand substantially access of their multinational firms to right of establishment in developing countries in such areas as financial services, construction, and infrastructure. Developing countries have tended to be cautious on opening these areas. Instead, they have tended to seek opening of temporary labor services. The negotiations consist of country by country "offers" and "requests," rather than a uniform and transparent mechanism such as a formula for cutting tariffs. In part, this is because services protection is mainly by regulation, analogous to a quantitative restriction, rather than by a price mechanism analogous to a tariff.

As part of a grand bargain, it would seem desirable for both industrial and developing countries to adopt at least the easier parts of services liberalization. Most developing countries that have opened their banking sectors to foreign firms have found

that there are benefits to stability of the domestic banking system, for example, and expansion of market access in financial services would seem a reasonable area in which many developing countries could both benefit their own economies and help sweeten the deal for an overall agreement that involves true liberalization of industrial country agricultural protection and reduction of high textile-apparel tariffs. For their part, the industrial countries could usefully offer to lock in the current open-market treatment of cross-border "offshoring" services such as call centers and software development. This is an area that has ignited great concern about loss of jobs abroad, and clearer industrial country commitments to keep these markets open would be insurance that developing countries might be well advised to purchase.

The largest potential offer that industrial countries could make in services would be in liberalization of cross-border movement of temporary labor. However, this area is so politically and culturally sensitive that it seems unlikely that a major new agreement can be achieved within the timetable of the Doha Round, yet it would be a serious mistake to derail Doha because the absence of such an agreement. One question is whether this issue belongs in the WTO, or is more appropriately an issue of bilateral arrangements between geographically and historically linked countries.[32]

Preference Erosion?

An issue of considerable recent debate has been whether global trade liberalization would actually hurt rather than help the LDCs because it would reduce their special advantages from tariff preferences. This concern tends not to take the full picture into account. If there were global free trade, the LDCs would gain new markets in the many countries where they do not have preferential entry, including middle-income developing countries. Moreover, LDCs should gain from liberalizing their own markets, and politically that is much more difficult for most of them to do, given domestic interest group opposition, in the absence of a global trade agreement.

In model estimates of the effects of preference erosion, it turns out that the LDCs still gain from global free trade, although not by as much as calculated if preferences are not taken into account.[33] This net favorable outcome does depend on liberalization of the markets where they do not currently have free entry.

The issue of preference erosion must be dealt with or else there is some risk that the Doha Round could stall because

of squabbles between the LDCs and the middle-income countries. As suggested above, my solution to this potential problem is that the middle-income countries should join with the industrial countries in extending preferential, and ideally free, entry to imports from the LDCs, thereby sweetening the deal and alleviating any concerns about adverse effects of lowering the preferential advantage.

LDC Food Deficits?

It is broadly recognized that because the bulk of the world's poor are in the rural sector, improved agricultural export prospects for developing countries would help reduce global poverty. However, some have argued that the Least Developed Countries would instead be hurt by liberalization of global agricultural trade, because they are food importers and agricultural free trade would boost world food prices. This concern is broadly misplaced. Although it is true that the LDCs have a trade deficit in food, they have even larger deficits in manufactures. They have large trade deficits in everything, financed by aid inflows. It turns out that they have comparative advantage in food and agriculture, just like most other developing countries.[34] The ratios of their exports to imports of food are considerably higher than their corresponding ratios for manufactures. So a complete (rather than partial) analysis will show that the LDCs benefit from global agricultural liberalization rather than lose from it, even though they are food importers and even though food prices will rise. They will experience terms of trade gains that should more than offset any direct losses from higher food prices. An increase in global productivity as a consequence of more efficient international allocation of resources should lower, not raise, overall world prices. This means that the savings the LDCs should experience from lower prices on manufactured imports should comfortably exceed the additional costs they will pay on higher agricultural prices.

Conclusion

The grand bargain that needs to be struck in the Doha Round involves deep cuts in tariffs and tariff-rate quotas in agriculture by industrial countries; and deep reductions in their output-distorting farm subsidies, together with a new mechanism for aggressive WTO monitoring to ensure that any "green" or "blue box" subsidies in fact do not induce extra output. There

should be a timetable for the complete elimination of output-distorting farm subsidies. There should be cuts in middle-income countries' agricultural tariffs as well. Developing countries concerned about vulnerability to surges in agricultural imports should instead apply temporary safeguard protection if needed.

In manufactures, a tariff cutting formula should be chosen that requires relatively deep cuts for high tariffs. Developing countries can reasonably seek a "differential-treatment parameter" of say 1.5 to 2, meaning that for example the depth of their tariff cut would be only two-thirds to one-half as large as indicated by the tariff-cutting formula applied to industrial country tariffs. Tariff peaks should be chopped off by applying a ceiling of no more than 10 percent for any industrial country tariff, again with a differentiated (higher) ceiling for middle-income countries. Cutting developing country tariffs below "applied" levels, not just making phantom cuts from high "bound" levels that leave post-reform tariffs still at or above presently applied levels, will be an important part of the quid pro quo needed to motivate industrial country interest groups to press for farm trade liberalization as the industrial-country part of the bargain. Tariff cuts in manufactured goods should be implemented in textiles and apparel as well as other sectors, and carve-outs for "sensitive" sectors should be kept to a minimum.

For the LDCs, industrial countries should grant full and immediate free access, and middle-income countries should adopt preferential (and ideally free) entry, in order to assure LDCs that they too will benefit from the Grand Bargain rather than lose ground because of tariff preference erosion from general liberalization.[35] It will also be important that LDCs recognize that because they have comparative advantage in agriculture, they too will gain, certainly in the long run but also in the near term, from global agricultural liberalization despite (and ultimately because of) the likely resulting rise in world food prices.

It will require political leadership on all sides, and in particular a willingness to confront powerful domestic special interests, for this bargain to be achieved. The domestic political calculus may be helped in this direction by the fiscal pressures in especially the United States, where it should be increasingly obvious that farm subsidies directed heavily toward large recipients may be an area more politically attractive for budget cuts than cutbacks in the social safety net.

Endnotes

1 For comments on an earlier draft or discussion on specific issues, I thank Kimberly Elliott, Gary C. Hufbauer, Will Martin, John Nash, David Orden, and Jeffrey Schott.

2 William R. Cline, *Trade Policy and Global Poverty* (Washington: Center for Global Development and Institute for International Economics, 2004). Note that in 2002 the World Bank estimated 320 million persons lifted out of poverty for the same concept ($2 per day, dynamic model), because of lesser inclusion of induced investment effects. In November 2005, however, new World Bank results cut this estimate to 95 million. It is likely that the new estimate is a substantial understatement, but evaluation of the new results is beyond the scope of this Brief. See Cline, 2004, pp. 143, 282-84; and Kym Anderson, William J. Martin and Dominique van der Mensbrugghe, "Global Impacts of the Doha Scenarios on Poverty," chapter 17 in Thomas W. Hertel and L. Alan Winters, eds., Putting Development Back into the Doha Agenda: Poverty Impacts of a WTO Agreement (Washington: World Bank, 2005).

3 In effect this would leave as permissible only "green box" subsidies decoupled from output, thereby making irrelevant the current opaque and ambiguous system of reporting subsidies as in a controlled "amber box," an uncontrolled but not fully decoupled "blue box," or exempt as "de minimis," as discussed below.

4 The United Nations' list of Least Developed Countries includes 49 nations with total population of about 650 million. These include such relatively large countries as Bangladesh, Ethiopia, Democratic Republic of Congo, Myanmar, Sudan, Tanzania, Afghanistan, Nepal, and Uganda, as well as numerous smaller countries. Approximately three-fourths of the Sub-Saharan African countries are designated as LDCs. (See Cline 2004, pp. 48-51).

5 For this purpose, an appropriate cut-off income level would be the $735 per capita used by the World Bank in its classification of Low Income Countries. See World Bank, *World Development Indicators*, 2004.

6 For a more detailed analysis, see Kimberly Elliott, *Delivering on the Doha Agenda: Agriculture in Rich and Poor Countries*, Center for Global Development and Institute for International Economics, forthcoming.

7 Cline, 2004, p. 123.

8 Tariff-rate quotas apply a lower tariff on imports up to a total quota volume, and a higher tariff once this threshold is exceeded.

9 See Cline, 2004, p. 198. The rates include the effect of tariff-rate quotas.

10 In the October 2005 US proposal discussed below, the United States called for 90 percent cuts in the highest agricultural tariffs. The European Union responded with a call for more substantial US cuts in farm subsidies, and a cut of only 50 percent in the highest agricultural tariffs. Alan Beattie, "EU Offers Counter-bid on Farm Trade," *Financial Times*, October 10, 2005.

11 Economic Research Service (ERS), *WTO Agricultural Trade Policy Commitments Database*. (Washington: US Department of Agriculture). www.ers.usda.gov/db/wto.

12 Frances Williams, "Crunch Week for Draft Trade Declaration," *Financial Times*, Nov. 7, 2005; and "EU Offer of Deeper Farm Tariff Cuts Fails to Restart Talks," *Bridges*, vol. 9, no. 37, Nov. 2, 2005 (Geneva: International Centre for Trade and Sustainable Development).

13 Note that in the Uruguay Round, those (mainly industrial) countries that converted agricultural quotas into tariffs were given the right to impose Special Safeguards on these goods, triggered by imports above specified volumes and not requiring the demonstration of serious injury necessary for safeguard protection in manufactures. This authority will lapse if not renewed in the Doha Round. Although some developing countries have proposed that Special Safeguards in agriculture be extended to developing countries, a better outcome would be to abolish them and instead require the same discipline for safeguard protection in agriculture as in manufactures.

14 "In future, the vast majority of aid will be paid independently of the volume of production." European Commission, "The Common Agricultural Policy—A Policy Evolving with the Times." (http://europa/eu.int/comm./agriculture/public/capleaflet/cap_en.htm.) Also see David Kelch and Mary Anne Normile, "European Union Adopts Significant Farm Reform," *Amber Waves*, September 2004, US Department of Agriculture.

15 See Robert L. Thompson, "Essentials for the 2007 Farm Bill in a Global Context." *Trade Policy Analysis*, vol. 7, no. 6, July 2005. Cordell Hull Insitute. Note that "loan rates" are commodity price benchmarks for collateral on government agricultural loans. If the actual price falls below the loan rate, the government makes a payment to the farmer to cover the difference upon repayment. This is candidly called "marketing loan gains." The farmer can elect not to obtain the loan at all, in which case the government makes a "deficiency payment" based on the difference between the market price and the loan rate. See US Department of Agriculture, Economic Research Service, "Farm and Commodity Policy: Questions and Answers" (www.ers.usda.gov/briefing/farmpolicy/questions/).

16 World Trade Organization, "Notification," G/AG/N/EEC/51, November 4, 2004.

17 ERS, *WTO Agricultural Trade Policy Commitments Database*.

18 Indeed, the WTO rules explicitly exclude adding such outlays, as double-counting. WTO, Agreement on Agriculture, Annex 3: Domestic Support: Calculation of Aggregate Measure of Support, paragraph 8.

19 ERS, *WTO Agricultural Trade Policy Commitments Database*.

20 Japan's reported AMS fell from $25.8 billion in 1997 to $5.9 billion in 1998. ERS, *WTO Commitments Database*.

21 The European Union no longer spends heavily to build up butter mountains, so it is likely that its MPS too is almost fully book-keeping rather than budgetary outlays.

22 De Gorter and Cook also arrive at this conclusion. Harry de Gorter and J. Daniel Cook, "Domestic Support in Agriculture: A Struggle for Meaningful Definitions." (Ithaca, NY: Cornell University, 2005, processed.)

23 WTO, G/AG/N/EEC/51; and, for de-minimis, ERS, *WTO Commitments Database* (for 2000).

24 Office of the US Trade Representative, "US Proposal for Bold Reform on Global Agriculture Trade." Doha Development Agenda Policy Brief, October 10, 2005.

25 See European Commission, "EU Trade Commissioner Mandelson on WTO Negotiating Proposals," October 10, 2005. (http://europa-en-un.org/articles/en/article_5114_en.htm.) Note that the decline of the dollar has boosted the bound ceiling, which is expressed in euros, to about $80 billion.

26 At the country level, the averages are obtained by weighting products by world output shares. For the industrial country (DC) and developing country (DgC) averages, weights are based on shares in group GDP and trade turnover. Tariff rates are most-favored-nation rates for 1997-98. The rates may be modestly overstated because the cuts agreed in the Uruguay Round were not yet fully completed. See Cline, 2004, pp. 175-78 and p. 198.

27 The formula is: $t_1 = [t_0 \times C] / [t_0 + C]$, where t_0 is the tariff before the cut (in percent), t_1 is the tariff after the cut, and C is the "coefficient" chosen. A lower value of C leads to larger proportional cuts for higher tariffs.

28 A proposal by Pakistan, for example, calls for the formula to apply a coefficient of $C = 6$ for industrial countries and $C = 30$ for developing countries. (World Trade Organization, "Market Access for Non-Agricultural Products: The Way Forward, Communication from Pakistan." TN/MA/W/60, July 20, 2005.) As shown in figure 4, this would cut a 30 percent tariff to 15 percent in a developing country but to 5 percent in an industrial country.

29 For example, if the industrial country Swiss formula coefficient is set at $C = 10$, then the proportionate cut in the tariff will be half as much for developing countries along the following schedule. For initial tariffs of 5, 10, 20, and 30 percent, the standard Swiss formula would cut tariffs to 3.33, 5, 6.67, and 7.5 percent, yielding proportionate tariff cuts of 33.3%, 50%, 66.7%, and 75%, respectively. To obtain proportionate cuts only half as large, the adjusted coefficients for developing countries would need to be $C = 25$, 30, 40, and 50, respectively. For a more moderate S&D parameter of 1.5, any given proportionate tariff cut of x would translate to $x/1.5$ for developing countries. This would generate an alternative set of Swiss formula C coefficients corresponding to the industrial country $C = 10$, depending on the level of the initial tariff.

30 This section is from my article "Doha and Development," *Foreign Affairs*, forthcoming.

31 Brown, Deardorff, and Stern (p. 40) estimate that services would account for about two-thirds of potential static gains for developing countries from global free trade. (Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "CGE Modeling and Analysis of Multilateral and Regional Trade Negotiating Options." Research Seminar in International Economics Discussion Paper 468. Ann Arbor, MI: University of Michigan, 2001.) The World Bank (p. 172) suggests that developing country gains from global free trade in services (excluding temporary labor) could be four times as large as those from free trade in goods. (World Bank, *Global Economic Prospects and the Developing Countries 2002: Making Trade Work for the World's Poor*. Washington: World Bank, 2002). Note, however, that the assumption typically used in such estimates—that free trade would reduce the price of such services as public utilities, construction, and transport to the lowest rate currently identified among reference countries—is likely to give an upward bias to estimated welfare gains because of country-specific factors not included.

32 The case for a bilateral approach is set forth by Lant Pritchett, *The Future of Labor Mobility: Irresistible Forces Meet Immovable Ideas*, forthcoming, Center for Global Development.

33 See Cline, 2004, pp. 217-20.

34 Excluding Bangladesh, three-fourths of the population of LDCs is in countries that have comparative advantage in food production. And although Bangladesh instead has comparative advantage in manufactures, it stands to gain from the Doha Round from liberalization of markets for manufactured goods.

35 This approach would seem far more compelling than the current international strategy, which is to offer "aid for trade." Such aid would seem unlikely to be truly additional and would thus come at the expense of other aid; and the magnitudes suggested, some $200–$400 million over five years, have been characterized by some LDC spokespersons as too small to be meaningful at about $2 million per country per year. See International Monetary Fund and World Bank, "Doha Development Agenda and Aid for Trade," September 19, 2005.

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Achieving a Grand Bargain in the Doha Round

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