SAIIA

OCCASIONAL PAPER NO 64

Development Through Trade Programme

July 2010

# Whither the Multilateral Trading System? Implications for (South) Africa

Peter Draper

South African Institute of International Affairs

African perspectives. Global insights.

## ABOUT SAIIA

The South African Institute of International Affairs (SAIIA) has a long and proud record as South Africa's premier research institute on international issues. It is an independent, non-government think-tank whose key strategic objectives are to make effective input into public policy, and to encourage wider and more informed debate on international affairs with particular emphasis on African issues and concerns. It is both a centre for research excellence and a home for stimulating public engagement. SAIIA's occasional papers present topical, incisive analyses, offering a variety of perspectives on key policy issues in Africa and beyond. Core public policy research themes covered by SAIIA include good governance and democracy; economic policymaking; international security and peace; and new global challenges such as food security, global governance reform and the environment. Please consult our website www.saiia.org.za for further information about SAIIA's work.

## ABOUT THE DEVELOPMENT THROUGH TRADE PROGRAMME

Established in March 2003, SAIIA's Development through Trade (DtT) Programme is based on the view that properly managed trade and investment liberalisation is vital for addressing Southern Africa's enormous development challenges.

Its work is broadly divided into two streams. (1) Area studies analyse various free trade area negotiations, either under way or envisaged, in order to understand their broader impact on the region and identify negotiating options. (2) Issues analysis unpacks key multilateral (WTO) and regional issues with a view to formulating recommendations on policy and/or negotiating options. It also considers unilateral trade policy issues lying outside of the reciprocal trade negotiations arena.

This process takes place through publications; events, including roundtables, workshops and conferences; interaction with the media and governments; a growing network of regional and international partners; and participation in Business Unity South Africa's trade committee.

SAIIA gratefully acknowledges the Australian Agency for International Development (AusAID) and the Swedish International Development Agency (SIDA), which has generously supported the DtT Programme.

**Programme head:** Peter Draper peter.draper@saiia.org.za



Please note that all currencies are in US$ unless otherwise indicated.

## ABSTRACT

So far the World Trade Organisation (WTO) has acted as a constraint on the worst protectionist pressures building in the global trading system following the 2008–10 global financial crisis, which is a testament to the system's constraining power. But the combination of these pressures with fundamental changes in global economic power has implications for what countries will be prepared to concede in the context of multilateral negotiations in the future, and therefore for the shape of the multilateral trading system. Overall, it appears that the current world of multilateral impasse on the trading front is likely to endure and potentially deepen if the US does not provide the necessary leadership, which seems unlikely, as the US is increasingly unwilling to underwrite the costs of maintaining the global trading system, whereas China is unwilling to step up to the plate in the short to medium term. Therefore, the future of the WTO's negotiating mechanism lies in plurilateral agreements negotiated under its auspices and subject to a 'code of conduct' agreed to by the broader membership. These and the proliferation of trade-related discussions in other multilateral forums mean that the negotiating capacities of all countries will be increasingly stretched. Since South Africa in particular is viewed, and to some extent sees itself, as 'representing' African interests, the degree of negotiating stretch will extend further than narrow national self-interest, since the majority of poor (African) countries cannot engage across this widening front. Consequently, the South African government needs to identify its core priorities in this connected set of trade-related negotiations and organise its negotiating resources accordingly.

## ABOUT THE AUTHOR

Peter Draper is a research fellow and head of the Development through Trade programme at the South African Institute of International Affairs. His areas of expertise are trade and investment policy, and trade negotiations, with particular reference to the World Trade Organisation, the Southern African region and South Africa's bilateral ties with key trading partners.

He is a member of Business Unity South Africa's trade committee; lectures International Business Regulation at Wits Business School, where he is also a visiting adjunct professor; and is a research associate of the Department of Political Science at the University of Pretoria. He is a board member and non-resident senior fellow of the Brussels-based European Centre for International Political Economy; a non-resident fellow of the Organisation for Economic Co-operation and Development's Centre; a member of the IMD-Lausanne's Evian group; a board member of the Botswana Institute for Development Policy Analysis; and a member of the World Economic Forum's Global Agenda Council on Trade.

## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| BI | Brazil–India |
| BRIC | Brazil–Russia–India–China |
| EU | European Union |
| FDI | foreign direct investment |
| IMF | International Monetary Fund |
| UN | United Nations |
| US | United States |
| WTO | World Trade Organisation |

## BACKGROUND

Most analysts of the World Trade Organisation (WTO) and (discretely) many senior trade negotiators agree that the Doha Round is not likely to conclude soon. This has serious implications, should the round collapse. Nonetheless, this occasional paper assumes a 'Doha Lite' outcome[1] at some point in the future and speculates about what that would mean for the WTO and the multilateral trading system. Specifically, what are the likely contours of the WTO beyond the Doha Round; and what implications does this hold for developing countries – especially 'emerging middle powers'[2] like South Africa?

## ECONOMIC DRIVERS

The WTO's underlying difficulties have economic roots in the ongoing and far-reaching structural adjustment of the global economic geography, and more specifically in the shift of economic power from the West to the East. China's rapid export-oriented manufacturing ascent is central to this; compared with its 'BRIC'[3] (Brazil–Russia–India–China) counterparts, China is in a league of its own. Nonetheless, the 'BI' (Brazil–India) component has major upside potential, with India starting to have significant impact on some global markets, especially in the area of information technology, and Brazil in agriculture; beyond Russia's resource wealth, its future presence in value-added activities is not obvious. These countries' emergence is transforming global power relations and causing considerable anxiety mixed with anxious optimism both in the West and the developing world.

The 2008–10 global economic crisis has sharpened these tensions and in some parts of the world has strengthened the backlash against unilateral economic liberalisation à la the 'Washington Consensus'.[4] The crisis has also prompted calls for the re-regulation of key economic sectors, notably finance, and has been accompanied by huge financial bailouts of some manufacturing sectors, especially the automotive sector. These policy measures closely followed the food crisis of 2006–08, which saw many countries resort to export taxes in order to retain domestic food supplies. The overall picture is an escalating pattern of protectionism[5] that is by no means confined to the developed world, and encompasses, among other things, 'buy local' government stimulus packages, tariff increases and increased resort to trade remedies.

Underpinning the protectionist impulse is the accumulation of huge global economic imbalances between chronic deficit and surplus countries and associated currency alignments. In a world of differing exchange rate regimes and potential financial deleveraging in the wake of the financial crisis, the future of these imbalances is uncertain. While the WTO cannot solve this problem – if any multilateral institution can, it belongs squarely within the purview of the rejuvenated International Monetary Fund (IMF) – the tensions it generates manifest in the trading system and raise sharp questions, particularly around exchange rate management and its impact on trade.

Global climate negotiations sharpen these underlying distributional conflicts. With growth and development imperatives occupying centre stage in the growing global climate change crisis, many in developed and developing countries alike are asking: Who will pay the costs of mitigation? Will the developed world lead by example? What burden will major developing countries take on? These questions are underpinned by a 'competitiveness' agenda rooted in the underlying economic geography shift, which permeates the climate talks. Whatever is agreed in Mexico and beyond will feed back into the WTO and the multilateral trading system.[6]

So far, the WTO has acted as a constraint on the worst protectionist pressures building in the system, but the combination of these pressures has implications for what countries will be prepared to concede in the context of multilateral negotiations in the future, and therefore for the shape of the multilateral trading system.

## POLITICS

Political leadership will be essential to manage the underlying economic adjustments. The first port of call still, and for the foreseeable future, is the US. However, the Obama administration is confronted by a plethora of challenges, ranging from potential war(s) in the Middle East, through managing the economic crisis and financial regulation reform, to transforming domestic health care. The US administration thus faces capacity constraints of its own as its 'policy bandwidth' is severely stretched into the foreseeable future. Trade policy and negotiations are low on the radar screen. If and when the administration does get around to trade policy, it will encounter a hostile Congress exercised by a recent history of large current account deficits and a domestic manufacturing sector in relative decline. Furthermore, the willingness of the US elite to underwrite the costs of maintaining the post-Second World War multilateral trading system is arguably diminishing in proportion to rising competitiveness concerns and diminishing corporate interest[7] in WTO negotiations. Therefore, it is difficult to foresee the US providing much leadership to the multilateral trading system in the absence of securing US preferences on a range of regulatory issues that may be anathema to many developing countries.

The European Union (EU) is no better placed to provide the necessary leadership. While trade is a European Commission competency, the EU lacks the US's geopolitical clout. Like the US, but more so, it is hamstrung in the WTO by its unwillingness to free up its agricultural markets substantially, and by the relative lethargy on the part of corporate interests that stand to gain through opening up export markets for trade and investment. Unsurprisingly, the EU is looking to free trade agreements to buttress its commercial objectives.

The 'BICs' (with Russia not being a WTO member and looking unlikely to join for some time) face major domestic development challenges of their own. As such, they are not yet ready to play the kind of global leadership role the US traditionally has; at the same time, they have a number of defensive concerns that mirror US and EU offensive interests. These defensive concerns are echoed by a host of developing countries concerned with maintaining domestic 'policy space', especially in terms of behind-the-border regulations.

Overall, it appears that the current world of multilateral impasse on the trading front is likely to endure and potentially deepen if the US is unable to provide the necessary leadership.

## IMPLICATIONS FOR THE WTO

Taken together, these developments imply convergence towards less ambition in WTO negotiations, paralleled by an acceleration of regional and bilateral talks. This is likely to be accompanied by growing recourse to the WTO dispute settlement mechanism to settle a probable escalation in disputes, particularly if the negotiating mechanism remains stalled. Hence, multilateral forums outside of the WTO may gain in relative importance as negotiating forums. Therefore, the WTO may be headed for a period of consolidation, with the attendant risk of being increasingly bypassed by the major trading powers. This sharpens the gathering debate around how the WTO's membership arrives at decisions both now and in the future.

The WTO negotiating mechanism's prospects lie substantially in plurilateral agreements negotiated by like-minded subsets of WTO members.[8] This would be consistent with the current WTO practice of allowing multiple distinctions among members, including several extant plurilateral codes, and would have the added benefit of allowing the major trading powers – developed and emerging – to deepen rules on issues of core interest to them and avoiding the blocking power of the broader membership. This offers the prospect of reviving the WTO's negotiating mechanism, but for this approach to work it has to be contingent on not harming the interests of the broader membership.

Therefore, it would be necessary to negotiate a 'code of principles' that would govern plurilateral accords. Such a code could reassure the many developing countries that are nervous of having plurilateral agreements foisted on them and could include, among other things, the underlying principles that:[9]

1 membership is voluntary;
2 the subject of the plurilateral is a core trade-related issue;
3 those participating in plurilateral negotiations should have the means, or be provided with the means as part of the agreement, to implement the outcomes;
4 the issue under negotiation should enjoy substantial support from the WTO's membership; and
5 the 'subsidiarity' principle should apply in order to minimise the intrusion of 'club rules' on national autonomy.

Flowing from these principles, plurilateral codes should also be governed by a set of rules. These could include, among others, the following:

1 only parties to the agreement could participate in WTO dispute settlement and, consequently, cross-agreement retaliation should not be allowed, since it would reduce the incentives to join the agreement;
2 any WTO member could participate in the negotiations on a voluntary basis, subject to demonstrating sufficient capacity to implement the outcomes; and
3 the provision of benefits to non-members should not be required, since that would reduce the incentives to negotiate the plurilateral, but could be allowed.

Two obvious and linked dangers are that a small group of developed country members negotiates an agreement that sets the bar so high that poorer WTO members are unable to join; and that the plurilateral(s) – as happened to the Tokyo codes in the Uruguay Round – are subsequently multilateralised in later negotiating rounds via the single undertaking. These are powerful objections, and developing countries in particular need to take them seriously.

The first problem would be minimised through the active participation of developing countries in negotiating the codes, especially emerging middle powers. Since they are active participants in economic globalisation, they also have a strong interest in defining the rules that govern it, and therefore are likely to participate. Furthermore, they have learned from the Uruguay Round experience and are unlikely to simply accept agreements being foisted on them in the context of a single undertaking – nor, indeed, would the majority of developing countries – as they demonstrated during the Cancun ministerial. Nevertheless, the price of policy space is eternal vigilance.

A third potential problem is that the codes would reduce the need for a single undertaking, with a consequent reduction of possibilities for cross-issue trade-offs. To take one practical potential consequence, developed countries could simply ignore demands for agriculture policy reform, while forging ahead with a code on competition policy. In this scenario, the reforms to developed country agricultural policy regimes that many developing countries are pushing for may simply never make it onto the agenda.

The obvious riposte is that cross-issue trade-offs can still occur in the absence of a single undertaking. Emerging middle powers with substantial markets could withhold participation in plurilaterals in return for developed country participation in agriculture negotiations, for example. Emerging middle powers could also contemplate launching their own plurilateral negotiations, impelling developed countries to participate. This logic could even propel the membership towards the single-undertaking approach, thus obviating the need for plurilaterals altogether. In this scenario, initiating plurilaterals provides the spark to reignite the WTO's negotiating mechanism.

So what issues could form the basis for an emerging set of plurilateral agreements? Two seem particularly obvious and are underpinned by dynamics emerging from the financial crisis: transparency in government procurement, and financial services. The former is already covered by a plurilateral code, so the key issue is to expand the agreement to major non-signatory trading powers, especially emerging markets (including South Africa), and deepen it, on terms agreeable to potential signatories. Financial services are covered by the General Agreement on Trade in Services and its ensuing market access commitments are extended unilaterally on a country-specific basis. In the wake of the financial crisis and the many regulatory interventions agreed by G20 leaders, it may be sensible to build a WTO agenda around the work of the Financial Stability Board and the IMF.

A third plurilateral agreement seems theoretically plausible, if politically fraught: investment. Since a core group of emerging market countries are now actively engaging in outward foreign direct investment (FDI) as well as being recipients of FDI, their interest in multilateral investment rules may be converging with established investors in the developed world. Underpinning this is the escalation in investment nationalism in recent years, associated with national security considerations and resource – especially food and energy – security. Even poor developing countries in Africa have an interest in enforceable multilateral disciplines, provided the right balance is struck between investor obligations and rights, and host nation policy space. Whether this could be translated into a plurilateral investment code is an entirely different matter, as would be its relationship to the 1 500 or so bilateral investment treaties, but one that should not be lightly dismissed.

Beyond plurilaterals, at least two other issues will require attention, although it is likely these would have to ultimately be negotiated across the entire membership: the environment and exchange rates. The former is managed through a host of multilateral environmental agreements, some of which have trade implications. The big picture item is the UN Framework Convention on Climate Change process and the competitiveness agenda cited above. But the Doha Round also has a process under way to liberalise trade in environmental goods and services, which could be harnessed into a plurilateral agreement as an 'early harvest' of the Doha Round.

Exchange rates are much trickier, and fall under the purview of the IMF. The main protagonists are those large economies practising flexible exchange rate regimes, particularly the US, the EU, Brazil and India; and those pegging or closely managing their exchange rate regimes – principally East Asian countries and especially China. The IMF lacks an enforcement mechanism and must rely on the consent of its powerful members, who lie at the centre of the issue. Hence, the WTO, with its dispute settlement mechanism, is regarded as attractive by some within the flexible exchange rate regimes 'zone'. The danger with introducing such a matter into the WTO is that it could overload the system, since a case would essentially revolve around currency management and monetary policies – not exactly traditional territory for the WTO.

## IMPLICATIONS FOR DEVELOPING COUNTRIES AND SOUTH AFRICA

To summarise, a number of core issues concerning global trade should move into plurilateral negotiations within the WTO, or they will move to similar groupings in forums outside the WTO. It is likely that the negotiating capacities of all countries will be increasingly stretched, but particularly, for our purposes, those emerging middle powers like South Africa that potentially will be invited to the high table. Since South Africa in particular is viewed, and to some extent sees itself, as 'representing' African interests, the degree of negotiating stretch will extend further than narrow national self-interest, since the majority of poor (African) countries cannot engage across this widening front.

Furthermore, as recent dynamics in the G20 leaders' forum attest, South Africa is increasingly likely to find that the BRICs share more in common with each other in the geopolitical sense than they do with South Africa (which is patently not a BRIC).[10] Therefore, coalitional possibilities will become increasingly important, particularly those with other 'middle powers' and 'emerging middle powers' on specific issues. The nature of these coalitional possibilities will be grounded in South African economic policy realities and trajectories, which to some extent still have to be defined in the Zuma administration.

Consequently, the South African government needs to identify its core priorities in this connected set of trade-related negotiations and organise its negotiating resources accordingly. The first step should be to settle the issues concerning who is in overall charge of economic policy within government and on that basis build appropriate intra-government forums to co-ordinate negotiating positions and then allocate responsibilities among departments accordingly. The next step should be to stake out negotiating positions on each of the potential plurilateral negotiating issues identified above and to secure agreement on such issues within the intra-government structures established to co-ordinate positions. On this basis, dialogue with other African states on this agenda would be more focused and should be the next step. Finally, alliances with like-minded middle powers and emerging middle powers should be pursued on the basis of this set of consultations, while not ruling out potential alliances with the BRICs – and, indeed, with the developed world, should their negotiating positions converge with ours. In short, South Africa needs to move towards a proactive mode of anticipating future negotiating issues.

## ENDNOTES

1 For the implications of such an outcome for South Africa, see Draper P, 'Towards Doha Lite? Consequences for South Africa', an electronic briefing to SAIIA members, 19 June 2007.

2 Schoeman distinguishes traditional (developed country) 'middle powers' from 'emerging middle powers'. The former are not regional hegemons, are developed, and historically have played bridging roles between/among the great powers in international negotiations (Canada and Australia are good examples). The latter are major emerging markets that exert regional dominance, if not hegemony; see Schoeman M, 'South Africa as an emerging middle power', in Daniel J, Habib A & R Southall (eds), *State of the Nation: South Africa 2003–2004*. Cape Town: HSRC Press, 2003.

3 The famous acronym coined by Goldman Sachs.

4 Sally R, 'The Political Economy of Trade Liberalisation: What Lessons for Reforms Today?', Trade Policy Report, 18. Johannesburg: SAIIA, 2007.

5 See the collection of essays in Baldwin R & S Evenett (eds), *What World Leaders Must Do to Halt the Spread of Protectionism*. London, VoxEU.org & CEPR, 2008.

6 The UN Framework Convention on Climate Change process also has implications for other multilateral institutions connected to global finance, particularly the IMF, multilateral development banks and the G20 leaders' forum.

7 Mattoo A & A Subramanian, 'Multilateralism beyond Doha', Peterson Institute for International Economics, Working Paper Series, 8. Washington, DC: PIEE, 2008. There are divergent views on the extent of corporate interest in the Doha Round; from the standpoint of many developing countries, certain US corporate interests remain strongly connected to the negotiating process and broadly determinative of US government positions.

8 Khumalo N, 'Looking Beyond the Doha Round: Reforming the WTO Negotiating Process', Policy Briefing, 4. Johannesburg: SAIIA, 2009.

9 This discussion is based on the paper developed by the World Economic Forum's Global Agenda Council on Trade, in which the author participated. Global Agenda Council on Trade 'A plurilateral "club-of-clubs" approach to World Trade Organisation reform and new issues', World Economic Forum, mimeo, 2010.

10 Draper P, 'SA must push G20 to carry out its broader reform agenda', *Business Report*, 22 September 2009.

## SAIIA'S FUNDING PROFILE

SAIIA raises funds from governments, charitable foundations, companies and individual donors. Our work is currently being co-funded by AusAid, the Bradlow Foundation, the United Kingdom Department for International Development, the European Commission, the Foreign and Commonwealth Office, the Finnish Ministry for Foreign Affairs, the International Institute for Sustainable Development, INWENT, the Konrad Adenauer Foundation, the Royal Norwegian Ministry of Foreign Affairs, the Royal Danish Ministry of Foreign Affairs, the Royal Netherlands Ministry of Foreign Affairs, the Swedish International Development Cooperation Agency, the Canadian International Development Agency, the Organisation for Economic Co-operation and Development, the United Nations Conference on Trade and Development, the United Nations Economic Commission for Africa, and the African Development Bank.

SAIIA's corporate membership is drawn from the South African private sector and international businesses with an interest in Africa. In addition, SAIIA has a substantial number of international diplomatic and mainly South African institutional members.

South African Institute of International Affairs
Jan Smuts House, East Campus, University of the Witwatersrand
PO Box 31596, Braamfontein 2017, Johannesburg, South Africa
Tel +27 (0)11 339-2021 • Fax +27 (0)11 339-2154
www.saiia.org.za • info@saiia.org.za

South African Institute of International Affairs

African perspectives. Global insights.