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Assessing the EC Trade Policy in Goods

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About Jan Tumlir: The late Jan Tumlir was a leading scholar of trade policy, with a distinctive constitutional, classical-liberal defence of free trade drawn from his reading of law and economics. A Czech by origin, Jan Tumlir emigrated to the West in the 1940s and in 1967 became the Director of Economic Research and Analysis at the General Agreement on Tariffs and Trade (GATT). He supervised the economic research of the GATT for almost two decades, and was known as the GATT's "resident philosopher". Tumlir emphasised the structural nature of protectionism as the outgrowth of overactive government at home. He strongly advocated a rule-based international economic order pillared on free trade and constitutional democracy.

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EXECUTIVE SUMMARY

• The recent shift in European trade policy to negotiate bilateral agreements with no less than 24 countries is taking Europe into dangerous waters. In contrast to bilaterals envisaged by Chile, Japan, Korea, Singapore and the U.S., the bilaterals considered by the EC are characterized by high tariffs and non-tariff barriers in goods, and by restrictive regulations in services and investment.

• Multilateral liberalization of trade should be the centre of European trade strategy. The EC trade negotiators in industrial goods (NAMA) should aim (or should have aimed) at achieving what the European business community is asking for – namely no single industrial tariff above 15 percent. Such a target makes good economic sense. It would eliminate the tariff peaks that constitute the main obstacle faced by the European exporters, and that generate most of the protection costs imposed on the consumers in the rest of the world. Furthermore, it would increase the certainty of access to emerging markets for European exporters, and should make it easier to negotiate exceptions as simple and as predictable as possible.

• Applied to nine major emerging countries, the paper gives a concrete sense of the changes in protection associated with this 15 percent target and to simple and predictable exceptions. The emerging countries would then exhibit average bound tariffs ranging from 6.7 to 14.7 percent, with a maximum bound tariff of 50 percent (but only a tiny proportion of the bound tariffs would be higher than 30 percent). Effective cuts in average applied tariffs are limited to three emerging countries, but the average tariff water would be eliminated or sharply reduced.

• The EC position in the WTO agricultural negotiations should be rebalanced by a more extensive cut in the high tariffs and a smaller cut of the low tariffs. This would deliver more *economic* gains to the European consumers than the current EC proposal, and it would leverage *political* benefits since a vast majority of EC farm and food producers (all those protected by small and moderate tariffs) would find the rebalancing of the EC tariff proposal favorable to their interests, compared to the current EC offer.

• The results of such a rebalanced position would meet the two key criteria set for the Doha Round – namely, "*less than full reciprocity in reduction commitments*", and "*comparably high level of ambition in market access for Agriculture and NAMA*".

• The EC should position itself as a WTO Member with a long term view of the world trade regime. Assuming responsibility for the future relevance of the world trading system is a sign of leadership. Europe implicitly assumes that future rounds of trade negotiations will follow after a successful Doha Round. Those future rounds will address the unfinished business left by (perhaps) a more modest but a "clean" Doha outcome much more easily than if they inherit a Doha package more ambitious for some products, but riddled with more distortive exceptions on many products. In short, the ECs long term strategy should be to promote a series of WTO Rounds of liberalization as a slow but nonetheless perennial "peeling of the protectionist onion".

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Introduction

The European Community (EC) is playing a key role in trade negotiations. But, this is due much more to its mere size in the current world economy than because of a leadership based on innovative initiatives. The Doha Round negotiations at the World Trade Organization (WTO) have repeatedly witnessed an EC out of touch with the rest of the world from dragging its feet in market access (in agriculture) to tabling schemes (such as competition policy) much too complex for most of the very heterogeneous WTO membership. And the EC safeguards or ambiguous attitude *vis-à-vis* developing countries make the self-proclaimed "multilateralist" credentials of the EC look more like a way of bickering with the US than an accurate description of the EC position.

The rapid emergence of potentially much larger economies in Asia implies that the advantage that the EC gets from its relative economic size will fade away, possibly at a rapid pace. The EC trade policy is thus at the crossroads. Should it continue on the current trend, with the risk of becoming an increasing burden in the world trade forum? Or should it recognize its long-term interests as those of a "diminishing giant", and launch appropriate innovative initiatives?

There is thus an urgent need for assessing the current EC trade policy in goods. Section 1 starts by analysing the recent Commission's proposal on bilateral trade agreements. It shows that the bilateral trade agreements contemplated by the Commission are characterized by trade preferences so substantial that they could easily create severe trade distortions costly for both European consumers and producers. By contrast, the alternative option a successful Doha Round would provide substantial benefits to the EC for two reasons. The EC is one of the world's worst offenders in agricultural protection and a highly protected services provider (as most WTO Members). As a region with (a much) lower growth than large parts of the rest of the world, the EC has a crucial interest to remain in close contact with the fastest growing economies.

The rest of the paper assesses the EC policy in the Doha Round by presenting alternatives detailed enough to give a concrete sense of the issues at stake and of the outcomes within reach. If the current negotiations fail or if there is a last minute change of opinion within the next few weeks, these alternatives could offer fresh options. If the current negotiations succeed, they offer a benchmark for assessing the outcome of the current EC policy.

The crux of every Round is the trade-off between increased market access and politically necessary exceptions (conveniently disguised as "flexibilities" in the Doha jargon). In their current haste to deliver, the Doha negotiators seem to head for a package with increased market access for "easy" products (those with initially small or moderate tariffs) combined with a host of exceptions for "difficult" products (those with high tariffs). Such a mix may increase the chances of getting a deal. But, it is almost certain to deliver a disappointing economic outcome because consumers' welfare gains are mostly generated by cuts in high tariffs, and because exporters find little comfort if only foreign low tariffs are dismantled, while the remaining high tariffs are frozen until the next Round. Ultimatly, an economically mediocre outcome is doomed to have a heavy political price, and to give a new blow to the WTO reputation.

Even in such a difficult context, the paper argues that the EC could and should (have) table(d) better proposals. In a nutshell, a bolder EC approach would have much benefited from following the wise suggestion of the European business community in industry (Section 3) and from tapping a potential degree of freedom in agriculture (Section 4). The detailed calculations made in order to provide a concrete sense of the alternatives suggest (much) higher welfare gains and an attractive result *more* political support than the support to be expected for the current EC proposals. Last but not least, these alternatives meet the two key constraints that the Doha negotiators have imposed on themselves – the "*less than full reciprocity*" and the "*comparably high level of ambition in market access for Agriculture and [Industry]*" conditions (section 2).

1. The 2006 Commisson's Proposal: Triggering a World Race to Bilaterals?

Many observers argue that the WTO is so severely undermined by a lack of leadership (from the US as well as from the EC) that "regional trade agreements" are the only remaining option. The Commission's working document, released in November 2006, echoes this view.[1] It reaffirms the EC support to the Doha negotiations. But, it develops such a massive European strategy in terms of future bilaterals no less than 24 with such a sense of urgent need for action that it gives a strong impression of a deep change of course in European trade strategy. The European Parliament's first reaction was rather negative, and a large share of the European business community remains unconvinced about the need to go on the bilateral track to such an extent.[2] As of March 2007, the Council has not yet fully endorsed this programme of bilateral negotiations.

There is thus a serious need for assessing the Commission's programme. Indeed, it is worrisome that there has been no impact assessment study of such a deep and vast change of trade policy, quite contrary to the 2001 Gothenburg Council decision requiring the Commission to make an impact assessment study of its proposals. Before providing a preliminary assessment of the Commission's document, the "rise of regionalism" has to be put in an appropriate perspective.

The "Rise of Regionalism": Perceptions vs Realities[3]

Supporters of an increasing recourse to preferential trade agreements (PTAs) see their views justified by the increasing number of PTAs notified to the WTO 211 as of September 2006. This figure strongly exaggerates and distorts the true importance of the rise of regionalism.

Firstly, the PTAs notified during the WTO years (post-1995) are overwhelmingly bilateral trade agreements (hereafter "bilaterals"). This is in sharp contrast with those notified during the GATT years (pre-1995), which are almost equally split between bilaterals and "regional" (more than two signatories) trade agreements. This structural change introduces a systematic overestimate of the post-1995 number of the PTAs, compared to its pre-1995 level.[4] Beyond the mere counting of deals, it also suggests a smaller economic impact of the post-1995 deals, since bilaterals are likely to be more severely constrained by restrictive rules of origin than regional trade agreements.[5]

Secondly, more than 30 percent of the current PTAs notified to the WTO consist of intra-European trade agreements (defined as deals between countries located on the European continent, excluding Belarus, Russia and Ukraine). This large number of intra-European deals mirrors the inefficient way (viewed in an institutional perspective) Europeans are building their Single Market. Any trade deal negotiated by the EC generates almost mechanically "clone" deals by the European countries linked to the EC by trade agreements the EFTA countries and Turkey (and Bulgaria and Romania before their accession in 2007). As a result, every time the EC trade policy changes, a vast number of bilaterals disappear or emerge. The former was the case in 2004 when ten Central European countries joined the EC (more than a dozen bilaterals disappeared on the spot) and it will happen in 2007 when the 24 bilaterals between the eight Balkan countries which are not yet EC Members will be replaced by the unique agreement signed in December 2006. Symmetrically, the number of Europe-related bilaterals will increase again if the EC decides to implement the above-mentioned policy of bilaterals tabled by the Commission.

Thirdly, the increase in the number of PTAs notified to the WTO reflects to some extent the increase of the WTO membership itself, as best illustrated by the substantial number of bilaterals between former Soviet Union republics, which have recently acceded to the WTO. Deflating the (increasing) number of PTAs by the (increasing) number of WTO Members suggests a much lower number of PTAs in 2006 about 50, rather than the 211 usually mentioned.

Fourthly, the breakdown of the post-1995 non intra-European bilaterals presents large countries as *followers*- not as leaders, in sharp contrast to general belief. There is no bilateral between the top 10 economies (the 10 largest GDPs under PPP-based exchange rates, taking into account individual EC Member states). There are only three bilaterals (on goods and services) between a top-10 and a top-20 economy (US-Australia, Japan-Mexico and Thailand-Australia). Remarkably, the role of the US and the EC remains relatively limited. The EC is signatory of 16 percent of the post-1995 non-European bilaterals (12 percent for the US). This last observation deserves a remark. The language of the Commission's proposal suggests that the EC is lagging behind in terms of bilaterals. But in fact the EC remains the most important source of bilaterals among the large economies, even if one ignores the intra-European deals.[6]

Lastly, the assertion that bilaterals are quickly concluded is not substantiated in the EC case. The negotiating time needed by the EC for concluding bilaterals with non-European countries has ranged from 2 years with Chile to 5 years with Mexico. Negotiations with the ACP and Mercosur countries have already lasted 4 and 11 years respectively, without delivering a successful outcome. The comparison is far to be as unfavorable to the WTO negotiations as many believe.

Assessing the 2006 Commission's initiative

THE STANDARD ECONOMIC analysis of bilaterals aims to estimate their expected net economic gains.[7] This approach has two serious limits. Firstly, it ignores what would happen in the rest of the world as a consequence of the bilateral examined. For instance, ignoring that the preferences granted by a bilateral to its signatories may be eroded by new bilaterals, is a severe shortcoming, in particular if there is a generalized rush to bilaterals. Secondly, the standard economic analysis has notorious difficulties to take into account the intrinsic limits of any bilateral, in particular the crucial limits imposed to effective market access by the "rules of origin" adopted by the signatories (these rules define the appropriate tariffs to be enforced on imports).

A MUCH MORE interesting approach seems thus to be to get a sense of whether the current and envisaged bilaterals are looking for "a market opening" or for "market preferences". The former case is valid for bilaterals between countries applying low tariffs on goods imported from countries other than the signatories of the deal (the "rest of the world") and enforcing domestic pro-competitive regulations on services and investment. Such bilaterals are likely to have a net positive effect on the signatories, and no significant negative impact on the rest of the world hence, they may be stepping stones to world trade liberalization.

In sharp contrast, the "market preferences" case applies to bilaterals between countries enforcing high tariffs on goods imported from the rest of the world, and anti-competitive domestic regulations on services and investment. Such bilaterals generate high "preferences" to the partners. Such preferences distort trade flows because they favour the inefficient firms of the EC partners at the detriment of the European consumers of highly protected European goods and services (they induce these European consumers to buy goods and services from inefficient partners rather than goods and services more efficiently produced in the rest of the world, and vice versa for the partners' consumers). The higher the preferences are, the more distorted the bilateral trade flows may be, the higher the costs of the bilateral deal may be for the consumers of the products and services imported from the trading partner (compared to a multilateral liberalization), the higher the likelihood of the collapse of the bilateral agreement would be, and the more painful the "erosion" of these preferences would be for the signatories. In short, such bilaterals are likely to be stumbling stones to world trade opening.

TABLE 1 FOLLOWS this approach. It aims at providing an admittedly crude sense of the "market opening" vs "market preference" nature of the 91 bilaterals signed by seven countries, and of the 100 bilaterals under negotiation or under consideration by these seven countries. These seven countries consist of two "small" economies (Chile and Singapore), one medium-size economy (Korea), and four "large" economies (China, the EC, Japan and the US). Column 1 gives the number of the bilaterals signed or under consideration for each of these countries.

Columns 2 and 3 give the GDP shares of the seven countries' trading partners in the world GDP (both at current and PPP exchange rates). Thus they give a sense of the *coverage* of the market preferences that could be created by the size of the partners in the existing and future bilaterals of the seven countries in question. Combining the coverage indicator with indicators focusing on the *level* of preferences (that is, the coverage times the level) would then give a sense of the *magnitude* of the expected preferences. Columns 2 and 3 show the diversity of the situations. The current bilaterals cover a very low share of world GDP, except for the two small economies, a feature echoing the above-mentioned lead of the small economies among the current bilaterals. But looking at the bilaterals under negotiation or consideration dramatically changes the picture. The most important observation is that the Commission's proposal generates such a change of scale in bilateralism that it could trigger a race to bilaterals among the large countries, if China and/or the US feel compelled to follow a strategy as aggressive as the one designed in the EC proposal.

COLUMNS 4 AND 5 of Table 1 focus on tariffs, the first key instrument that could determine the level of preferences in trade in goods (this is why the seven countries are ranked by the increasing level of the average tariffs applied by their partners in bilaterals). A low average in applied tariffs suggest bilaterals more focused on market opening than on market preferences (low average tariffs imply relatively few peak tariffs). By contrast, bilaterals behind a high average in applied tariffs are prone to market preferences. The same could be said in case of high average bound tariffs (such bilaterals may protect partners in bilaterals from tariff increases, at the detriment of the rest of the world). Column 4 shows that the EC partners have the highest average of applied tariffs if the bilaterals under negotiation or consideration by the Commission's proposal are concluded. Column 5 based on bound tariffs suggests again possible substantial market preferences for the bilaterals under negotiation or consideration by the four largest countries. In sum, the bilaterals involving the small economies tend to focus on market access, in sharp contrast with the EC bilaterals that are dominated by market preferences.

Table 1

Bilaterals: Seven Countries, Two Strategies

	Number of partners	Market size [a]		Average industrial tariff [b]		Regulatory ranking [c]				
		at current USD	at PPP USD	applied	bound	trading across borders	dealing with licences	ease of doing business	registering property	protecting investors
	1	2	3	4	5	6	7	8	9	10
A. Bilaterals signed										
Singapore	10	48.5	39.3	4.8	9.2	35.8	41.7	28.0	35.3	16.7
Chile	20	79.0	70.4	5.5	8.0	34.1	70.8	41.5	39.6	46.3
Korea	14	4.1	5.8	7.1	21.5	58.8	70.3	69.0	59.2	68.7
USA	15	7.6	6.5	7.5	19.6	42.9	41.9	29.2	50.1	34.0
China	14	2.9	5.9	8.0	25.4	63.1	77.3	72.8	66.7	55.4
EC	14 [d]	6.4	8.2	9.2	18.3	76.8	91.9	67.1	80.4	53.4
Japan	4	2.7	3.3	10.0	27.4	69.4	62.4	55.6	76.6	52.4
B. Bilaterals under negotiations or consideration										
Singapore	12	90.6	81.2	5.7	9.0	40.0	68.9	43.5	42.3	41.0
Chile	9 [e]	81.6	77.7	6.4	10.3	43.2	77.8	49.4	45.5	45.1
Korea	11	49.1	57.4	7.3	13.3	43.3	85.3	57.6	39.8	40.4
Japan	18	13.4	16.4	7.5	20.0	53.5	58.3	54.8	60.6	56.6
USA	14	14.9	16.5	8.8	21.3	54.1	69.7	52.2	64.7	44.2
China	12	10.4	17.0	10.1	25.5	83.1	96.4	83.5	76.1	47.2
EC	24	23.4	44.2	10.3	17.8	71.1	125.6	91.2	61.8	64.8

[a] GDP (in USD, 2004) as a share of world GDP. [b] WTO Trade Profiles. [c] Doing Business 2007.
[d] Counting as one the 10 countries having acceded to the EC in 2004. [e] Counting as one the EC.

Columns 6 and 7 of Table 1 focus on non-tariff barriers, the other key instrument that could determine the level of preferences in trade in goods. As there is no direct measure of such barriers, Table 1 relies on the ranking of the partners of the seven countries in two respects the ease of trading across borders and the ease of dealing with licences, two indicators estimated by the Doing Business database.[8] Ranks are crude indicators (there may be a much bigger difference between the first and second rank than between the second and third rank, or vice-versa). However, average ranks in columns 6 and 7 exhibit differences among of the seven countries' partners so large that they are likely to be meaningful. Once again, the bilaterals under negotiation or consideration by the EC appear the more prone to market preferences.

Column 8 to 10 of Table 1 look at services and investments, also with the help of indicators provided by the Doing Business database. The services dimension is captured by the global indicator of the ease of doing business with the various trading partners of the seven countries examined, whereas the investment dimension is reflected by the ranks in property registering and in investors' protection among trading partners. Once again, these indicators roughly show the EC and China on the one hand, and on the opposite side the five other countries. Once again, the bilaterals under negotiation or consideration by the EC appear the more dominated by market preferences.

The analysis based on Table 1 deserves a caveat. It assumes that the negotiations of the bilaterals will deliver successful outcomes. This assumption is far from being granted to bilaterals involving "not-so-small" partners, such as Brazil, China, India, and Russia. In this case, there are good reasons to expect a failure of the negotiations, or a very limited content of the deal.[9] This is all the more plausible since none of these four partners are especially known for being an easy partner to negotiate with. Indeed, it remains to be seen why the EC would get market access in a bilateral setting when it could not get such a result in the WTO forum by forging an alliance with other countries.

Danger Ahead: the "Spaghetti Bowl" Turning into an "Electron Collider"

To conclude, bilaterals under negotiation or consideration by the recent Commission's proposal seem to be seriously biased towards substantial market preferences, creating serious systemic risks in the world trade regime. In particular, they magnify the risk that the aggressive approach of the Commission might trigger a race to bilaterals, by inducing the US, China and Japan to "catch up" in terms of bilaterals. The intent shown by President Bush "*to negotiate more free trade deals*"[10] and the signature of the Korea-US trade agreement may be the first signs of this new turn.[11]

The November 2006 Commission's proposal is all the more strange because the EC is the only large WTO Member to have already experienced the negative shocks associated with the existence of many bilaterals. In the 1990s, following the fall of the Berlin Wall, the EC signed new bilaterals with the Central European economies, breaking up the ranking of preferences that it had established in the 1960s-1980s among its many partners in bilaterals (most of them being developing or least developed countries). The political strains of this development were so onerous for the EC that, in 1997, it decided a "pause" in its policy on bilaterals. It abandoned plans of making new bilaterals, and decided to merely conclude the already ongoing negotiations –successfully so in the case of Chile and Mexico, but failing to do so with the Mercosur countries.

In short, the EC history sends a clear signal the danger of the "spaghetti bowl"[12] turning into an "electron collider" where there are so many bilaterals that they clash against each other.

2. Back to the Doha Round: the Two Core Criteria Defining Success

Sections 3 and 4 investigate the possibility of bolder EC initiatives in the Doha Round, as well as in industry and agriculture. These initiatives should be consistent with the following two core criteria defined by the Doha negotiators.

The first criterion is embodied in paragraph 16 of the 2001 Doha Declaration that states: "*The negotiations shall take fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments* [...]". The "*less than full reciprocity*" condition does not make much economic sense (in fact, it may be harmful to the countries it is supposed to help, that is, the developing countries). But the negotiators seem to have lost all capacity to put it aside, the developing countries being adamant on this condition, which they see as the minimum expression of the "development" dimension of the Doha Round. As the criterion imposes some difference between the post-Doha level of liberalization in advanced economies and the corresponding level in developing countries, the challenge faced by the negotiators is to determine the magnitude of such a difference that could be acceptable to the key WTO Members and that would be the least harmful to the emerging and developing countries.

The second criterion is embodied in paragraph 24 of the 2005 Hong Kong Declaration that states: "[...] *we instruct our negotiators to ensure that there is a comparably high level of ambition in market access for Agriculture and NAMA.*" This statement is expressed in terms of goods (contrary to the previous one) but it also has a country dimension since it requires *de facto* some "parallelism" between the liberalization of the industrial markets of the emerging countries and the liberalization of the advanced economies' agricultural markets. This second criterion is economically neutral. It will be sound if it fuels a virtuous circle of substantial liberalizations by the two groups of countries. It will be harmful if it pushes both groups of countries into a vicious circle of limiting the liberalization scope and/or magnitude.

3. Assessing the Negotiations in Industry from the EC Perspective[13]

Non-agricultural market access (NAMA) issues cover all the industrial sectors, except the food industries, which are examined in the section devoted to the negotiations in "agriculture". The current balance in the negotiations between liberalization and exceptions is as follows.

The December 2005 Hong Kong Ministerial made a giant step in improving the negotiating process in NAMA by adopting the "Swiss formula" as the base instrument for negotiating tariff cuts.[14] The Swiss formula is an extremely efficient instrument from a *negotiating* point of view (it is as far as possible the simplest negotiating method, since it involves an agreement on one figure only, namely the Swiss coefficient), from an *economic* perspective (it cuts high tariffs more than small tariffs, hence it captures most of the welfare gains to be expected from liberalization, while the possibility to stabilize or even increase tariff revenues is kept open), and from a domestic *political* point of view (it keeps the pre-liberalization ranking of tariffs unchanged, so it does not trigger fights among domestic vested interests).

At the same time, the Hong Kong Ministerial has opened the door for exceptions to the use of the Swiss formula though only for developing countries. The need for exceptions to a base formula is an unavoidable component of negotiations in a forum with so many and so diverse Members as the WTO.[15] But, the Hong Kong Ministerial was unable to define the exceptions more clearly than the 2004 Framework Agreement. This failure has amounted to void the Swiss formula of any substance not only because the coverage of the exceptions has been left open, but also because the magnitude of the exceptions can be huge.

Why is an attractive trade-off between the base Swiss formula and predictable exceptions an outcome so difficult to find in the Doha Round? During the two last decades, many developing countries have cut their applied tariffs (unilaterally or in accordance with their Uruguay Round commitments) without binding their tariffs at their new, applied levels. (Under WTO rules, bound tariffs are the only ones that cannot be raised without compensating the affected trading partners, by so doing delivering legal certainty in market access.) The fact that a large number of WTO Members exhibit huge "tariff water" (the difference between bound and applied tariffs) makes the Doha Round very special.[16] It implies that, *even* if they do not lead to cuts in applied tariffs, cuts in bound tariffs have, more than in any previous Round, a huge intrinsic economic value that negotiators tend to undervalue while the business community is heavily insisting upon it.

The European Goal in NAMA: Listen to the European Business Community

It is often said that trade negotiators suffer from a lack of support from their business community. This has not been the case for the EC negotiators in NAMA. European firms have, clearly and repeatedly, defined the concessions they expect in NAMA from the emerging economies, namely "*no single [industrial] tariff above 15 percent at the end of the implementation period of the Doha Round (except for LDCs)*".[17]

Such a target is economically sound for three reasons clearly showing that it should be adopted by the EC negotiators. Firstly, its key virtue is to eliminate the tariff peaks that are the most detrimental to European exports, and that generate the bulk of the welfare costs imposed on the domestic consumers of the emerging economies. Secondly, this target would vastly increase the certainty of access to the emerging countries' markets for the European exporters an outcome that is highly valued by the business community. Lastly, this target is far from imposing a brutal trade liberalization on the emerging countries (as shown by the current level of the average applied tariffs, see column 3 of Annex Table 2) a feature that should help to reduce requests for exceptions, and to make them as simple and predictable as possible (see below).

The Base Swiss Coefficient for the Emerging Countries

Table 2 shows that the highest Swiss coefficients that would still fulfil the European business target would range from a Swiss20 to a Swiss25. It focuses on nine emerging economies, which represent 30 percent of the world GDP and can be split in three groups. Group I countries can offer notable liberalization opportunities, but in doing so they should take care to keep tariff water at their current low level.[18] Group II countries can also offer notable tariff cuts, but, above all, they should offer their trading partners substantially more certainty by cutting their high bound tariffs. Lastly, Group III countries can offer both substantial tariff cuts and certainty (binding).

The Swiss25 is the base Swiss coefficient chosen in this paper for three reasons. Firstly, almost all the post-Doha tariffs still above 15 percent with a Swiss25 are smaller than 16 percent (Indonesia) or 17 percent (India) which indicates that the Swiss25 is a very limited departure from the European business target. Secondly, the choice of a Swiss25 aims at changing the negotiating dynamics by promoting the notion that a more "generous" base Swiss coefficient should be "paid" by less numerous and/or complex exceptions. For instance, adopting a Swiss25 (rather than a Swiss22 or 23 which would completely eliminate tariffs higher than 15 percent) should be compensated by a more compromising attitude on exceptions from the EC trading partners.

Table 2

Calculations of possible tariff cuts, selected emerging countries

	Swiss factor = 20				Swiss factor = 25				Combined Swiss factor [a]			
	Average	Tariffs >15%		Maximum	Average	Tariffs >15%		Maximum	Average	Tariffs >15%		Maximum
	bound tariff	Number of lines	Average tariff	bound tariff	bound tariff	Number of lines	Average tariff	bound tariff	bound tariff	Number of lines	Average tariff	bound tariff
	1	2	3	4	1	2	3	4	1	2	3	4
I. Moderate bound and applied tariffs, low tariff water: offering notable liberalization while keeping certainty high												
Korea	6,0	0	0,0	13,0	6,5	0	0,0	14,9	6,7	190	18,8	22,1
South Africa	5,2	0	0,0	15,0	5,8	230	16,5	17,6	6,2	266	23,1	30,0
Malaysia	5,4	8	17,7	18,8	6,0	25	18,0	23,1	6,2	118	21,6	50,0
II. High bound tariffs, moderate applied tariffs and tariff water: offering notable liberalization while offering more certainty												
Philippines	8,1	0	0,0	14,3	9,0	159	16,4	16,7	9,3	384	17,7	27,3
Thailand	9,2	17	16,0	16,0	10,3	41	17,3	19,0	10,6	211	20,0	34,3
III. High bound tariffs, moderate applied tariffs, high tariff water: offering substantial liberalization and more certainty												
Brazil	11,6	1	16,2	16,2	13,2	1	19,3	19,3	13,4	201	20,1	22,1
Mexico	12,7	0	0,0	14,3	12,6	82	16,1	16,7	14,7	206	20,2	27,3
Indonesia	12,2	20	17,1	17,2	14,1	2692	15,4	20,8	14,4	2701	15,9	34,3
India	12,4	10	17,2	17,6	14,3	2571	15,8	21,4	14,7	2571	16,5	42,0

Notes: [a] Based on a Swiss factor of 25 combined with a Swiss of 40 for 4 percent of the tariff lines and a factor of 60 for 2 percent of the tariff lines. The two highest Swiss factors have been systematically applied to the currently highest applied tariffs.

Source: Forbes *et al 2004. Author's computations.*

Lastly – and crucially in the Doha context the choice of a Swiss25 would make the fulfilment of the "*less than full reciprocity in reduction commitments*" condition easier, as shown above.

In sharp contrast to this approach, some EC Member states have insisted on the use of a Swiss15 for the emerging economies. But, a Swiss15 would clearly go beyond the European business target, since it would generate maximum tariffs in the emerging countries of roughly 13 percent. Such an "overshooting" has pushed the emerging countries' negotiators to look for wide and far-reaching exceptions in NAMA, offering to the EC and about ten other industrial countries the excuse to do the same in farm and food products ultimately a self-defeating sequence for every WTO Member.

Predictable Exceptions for the Emerging Economies

Exceptions should be defined in such a way that negotiators could easily predict their impact on the final balance of concessions between their own country and its trading partners. In NAMA, simplicity suggests the use of Swiss coefficient(s) for exceptions higher than the base one. A 50 percent bound tariff seems to be the reasonably highest post-Doha tariff, since there are only two dozen applied tariffs higher than 50 percent in the nine emerging economies. As a result, a Swiss60 would be the highest Swiss coefficient, since it cuts a 300 percent tariff (the highest existing bound tariff for the 18 countries) into a 50 percent bound tariff. Moreover, the following calculations assume that 2 percent of the tariff lines could be eligible for a Swiss60, and that an additional 4 percent of the tariff lines could be eligible for a Swiss40 (an arbitrarily chosen intermediate figure between a Swiss25 and a Swiss60).

Based on this "combined Swiss formula", Table 2 shows that the emerging countries would exhibit average bound tariffs ranging from 6.7 to 14.7 percent, with a maximum bound tariff of 50 percent, but with very few tariffs higher than 30 percent.[19] Moreover, the fact that the number of tariff lines with a tariff higher than 15 percent does not increase notably (compared to those in the case of a Swiss25 alone, see Table 2) suggests that the combined Swiss coefficient is an interesting compromise between the exceptions to be introduced and the liberalization targeted by the European business community.

Table 3 summarizes the changes in protection generated by such a combined Swiss formula. Firstly, the average bound tariff would be cut by 4 to 22 percentage points (column 1), and the maximum bound tariffs by 15 to 250 percentage points (column 2). Secondly, cuts in bound tariffs would have an impact on the applied tariffs. This is clearly the case for the maximum applied tariffs that would be cut by 8 to 165 percentage points (column 4). Once again, this is an important result be-

Table 3
Summary of tariff cuts generated by a "combined Swiss formula", selected emerging countries

	Cuts in bound tariffs (percentage points)		Applied tariff cuts due to bound tariff cuts (percentage points)	
	average [a]	maximum [b]	avg [c]	max [d]
	1	2	3	4
III. Offering some liberalization, keeping certainty high				
Korea	-3,5	-14,7	0,0	-7,9
South Africa	-4,8	-30,0	-1,6	-24,5
Malaysia	-5,0	-250,0	-1,8	-165,6
China	n.a.	-22,7	n.a.	-22,7
IV. Offering some liberalization and more certainty				
Philippines	-7,4	-22,7	3,5	-12,7
Thailand	-9,6	-45,7	0,6	-45,7
V. Offering more liberalization and more certainty				
Brazil	-16,0	-62,9	0,7	-12,9
Mexico	-20,1	-22,7	1,3	-22,7
Indonesia	-20,6	-90,7	7,6	-45,7
India	-22,3	-108,0	-0,7	-10,0

Notes:
[a] (post-Doha avg bound tariffs) minus (current avg bound tariffs).
[b] (post-Doha max bound tariffs) minus (current max bound tariffs).
[c] (post-Doha avg bound tariffs) minus (current avg applied tariffs).
[d] (post-Doha max bound tariffs) minus (current max applied tariffs).

Source: Forbes *et al 2004, Table 2.*

cause it is a crucial source of welfare gains. Lastly, effective cuts in terms of average tariffs may be limited to three countries (column 3) but the average tariff water would be eliminated or reduced to a low level in all the other countries a result of considerable importance for, and highly valued by, the business community.

The Base Swiss Coefficient for the Advanced Economies and the Two Core Doha Criteria

The potential offer from the advanced economies is mostly limited to cuts in peak tariffs, and to cuts in bound tariffs for Australia and New Zealand. These cuts have a huge economic value for the emerging economies because industrial economies' tariffs peaks are concentrated on the major exports of the developing countries. But, negotiators do not capture this economic value because they often measure the "negotiating value" of concessions by weighting the negotiated tariff cuts by the existing imports.

Would a Swiss10 deliver enough tariff cuts from the advanced economies for them to be considered as complying with the "*less than full reciprocity*" criterion? Or should it be a Swiss coefficient lower than 10? It should be stressed that a Swiss coefficient, lower than 10, has a questionable economic value for the emerging economies. For instance, shifting from a Swiss10 to a Swiss5 would reduce the average bound tariffs of the industrial economies from a range of 1.4-4.4 percent to a range of 1.0-2.8 percent, and it would reduce the maximum bound tariffs from a range of 5.0-8.6 percent to a range of 3.3-4.6 percent. From the emerging economies' point of view, gains from such limited cuts of so low tariffs are not very attractive especially if, once enforced, they trigger more antidumping or safeguard actions from the advanced economies against exports from the emerging economies.

An economically sound alternative for the emerging economies may thus be a deal based on a Swiss25 for the emerging countries and a Swiss10 for the advanced economies reflecting the basic fact that the advanced economies have liberalized much more and earlier than the emerging countries, and the decision of the Doha negotiators not to allow exceptions on tariff cuts for the advanced economies. Clearly, this tentative conclusion depends very much upon the concessions of the advanced economies in the negotiations in agriculture. The deeper the concessions in agriculture from the advanced economies, the more a Swiss25-Swiss10 deal in NAMA would be acceptable to the emerging economies indeed, the more the "*comparably high level of ambition in market access for Agriculture and NAMA*" criterion would be met.

4. Assessing the Negotiations in "Agriculture" from the EC Perspective[20]

At the first glance, the "*comparably high level of ambition"* criterion seems to be a target out of reach, since trade liberalization in farm products is so much lagging behind liberalization in NAMA products. However, this first impression disappears when one recognizes the critical fact that talking about negotiations in "agriculture" is a misnomer. The current negotiations deal with many more agro-industrial (hereafter "food") goods (roughly 1,500 tariff lines) than with farm products (roughly 500 tariff lines). This little recognized feature is crucial because trade liberalization in food products is, by nature, close to trade liberalization in industrial products, and can thus benefit from the long experience in the latter. Making a clear distinction between these two very different types of products thus opens a window of opportunities in the Doha negotiations in "agriculture."

Table 4
Tabled propasals on farm tariff cuts, 2005

	EC proposal		G20 proposal		US proposal	
	definition of the tiers	tariff cut (%)	definition	tariff cut (%)	definition	tariff cut (%)
	1	2	3	4	5	6
Tariff cuts to be imposed on developed countries						
highest tier	>90%	60	>75%	75	>60%	85-90
medium high	60-90%	50	50-75%	65	40-60%	75-85
medium low	30-60%	45	20-50%	55	20-40%	65-75
lowest tier	0-30%	35	0-20%	45	0-20%	55-65
Tariff cuts to be imposed on developing countries						
highest band	>130%	40	>130%	40	>60%	[a]
medium high	80-130%	35	80-130%	35	40-60%	[a]
medium low	30-80%	30	30-80%	30	20-40%	[a]
lowest band	0-30%	25	<30%	25	0-20%	[a]
Other elements of tariff rates						
cap tariff (developed countries)	--	100	--	100	--	75
cap tariff (developing countries)	--	150	--	150	--	100

Source: The EC, G20 and US proposals. Note [a]: Reference to "slightly lesser reductions" without more precision.

The negotiators in farm and food products face a problem that does not exist in NAMA. The formulas, which, so far, have been tabled for cutting tariffs on farm and food products are much murkier than the Swiss formula adopted in NAMA. The negotiators have agreed to work on complex "tiered" formulas they are 16 times more complex than a Swiss formula, since, as shown by Table 4, striking a deal requires no less than 16 decisions (three thresholds defining four tariff ranges, four percentage cuts for each range, and a tariff cap).[21]

Thus assessing the economic and political impact of the tiered formulas appears essential. Paragraph 24 and common sense both suggest that a Swiss-like approach would be a useful benchmark for such a task since the "*comparably high level of ambition*" condition would be much easier to check if the same instrument is used for cutting tariffs in agriculture and in manufacturing. Figure 1 illustrates the EC tiered offer and two Swiss formulas, one with a coefficient of 60 and another with a coefficient of 70 for reasons explained below. The horizontal axis gives the current EC tariffs. The data used are very close to those used by the EC negotiators (since they include the *ad valorem* equivalents, as estimated by the Commission, of the many EC specific tariffs). The vertical axis illustrates the post-Doha tariffs, which would be obtained by using the alternative formulas. The EC tiered proposal is illustrated by the four straight lines, the Swiss60 coefficient by the lower and long curve line, and the Swiss70 coefficient by the higher and shorter curve line.

European Farmers Are Not the Main Beneficiaries of the EC Proposal

Figure 1 provides a crucial result for the EC domestic policy makers (for the sake of clarity, Figure 1 ignores the one EC tariff higher than 250 percent). A Swiss-like approach would impose *deeper* tariff cuts on the current (pre-Doha) highest tariffs than the EC tiered formula, and *smaller* tariff cuts on the currently less protected products than the EC tiered formula. For instance, the Swiss60 would cut an initial tariff of 90 percent into a post-Doha tariff of 36 percent (compared to 45 percent in case of the tiered formula) and it would cut an initial tariff of 25 percent into a post-Doha tariff of 17.6 percent (compared to 16.3 percent if the tiered formula is used).

A Swiss-like approach would thus *rebalance* the existing EC offer in an economically sound way, because cutting deeper into the highest tariffs would generate most of the welfare gains that European consumers especially the poorest would expect from a liberalization. But, its most surprising result is that it would also have a positive impact on *domestic politics*. European producers of the goods getting smaller tariff cuts would clearly support a shift to a Swiss-like approach, while those associated to deeper tariff cuts would fight against it.

Thus the key question is: Which producers would benefit from such a rebalance? Using a table of concordance between every tariff line and the level of processing

Figure 1
Assessing the EC tier-based formula for tariff cuts

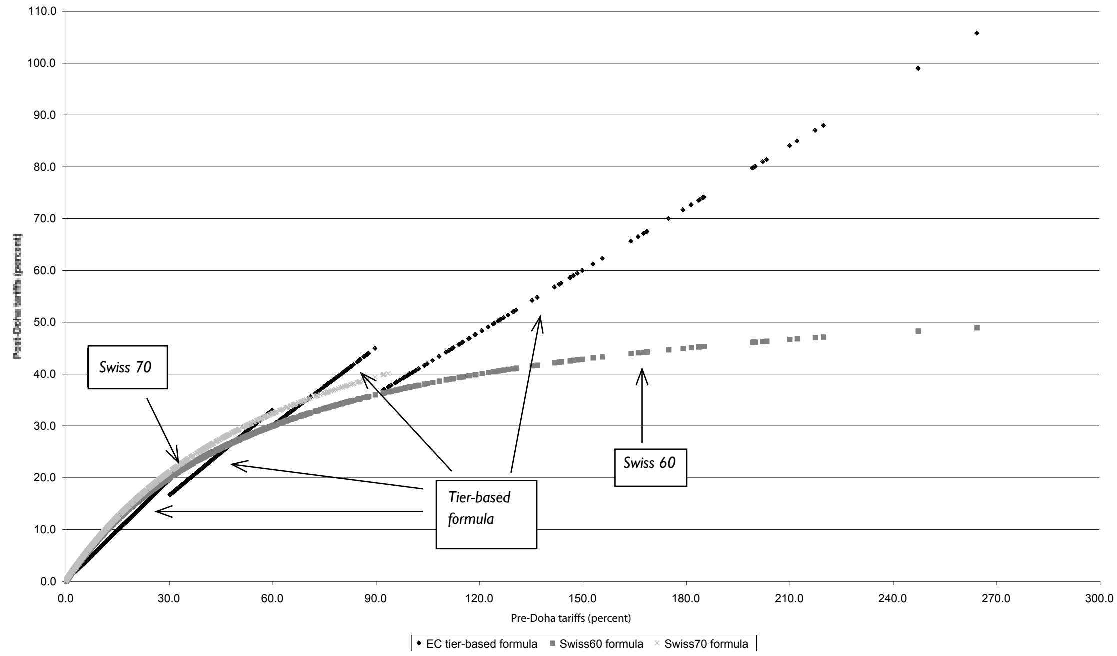

Table 5
Rebalancing the EC tariff proposal

	Current ad val. equivalent tariffs %	Post-Doha tariffs (%) EC offer	Swiss 70	Swiss 60	Swiss 50
All "agricultural" products (2011 tariff lines)					
average tariffs	24.4	12.9	13.9	13.1	12.2
Bulk farm commodities (117 tariff lines)					
average tariffs	19.7	10.7	11.8	11.1	10.3
maximum tariff	93.6	43.7	40.0	36.6	32.6
number of tariff lines with smaller cuts [b]			65	60	42
number of tariff lines with larger cuts [b]			8	13	31
Produces/horticulture products (273 tariff lines)					
average tariffs	13.6	8.0	9.7	9.3	8.9
maximum tariff	118.9	47.6	44.1	39.9	35.2
number of tariff lines with smaller cuts [b]			214	210	202
number of tariff lines with larger cuts [b]			5	9	17
Semiprocessed products (488 tariff lines)					
average tariffs	12.6	6.8	7.6	7.2	6.7
maximum tariff	174.9	70.0	50.0	44.7	38.9
number of tariff lines with smaller cuts [b]			262	243	226
number of tariff lines with larger cuts [b]			24	43	60
Processed products (1120 tariff lines)					
average tariffs	32.3	16.9	17.8	16.7	15.5
maximum tariff	264.3	105.7	55.3	48.9	42.0
number of tariff lines with smaller cuts [b]			949	847	749
number of tariff lines with larger cuts [b]			118	222	318

Notes [a] it was impossible to allocate ** tariff lines in the three categories of products.
[b] in case of using a Swiss formula instead of the EC tier-based formula.

Source: EC tariff offer in agriculture. Author's computation.

in farm and food products suggests several results summarized in Table 5.[22]

Firstly, Table 5 shows the strong "tariff escalation" among the initial EC tariffs the more processed the goods, the higher their level of protection. The average tariff of the bulk farm products (19.7 percent) is substantially lower than the average tariff of the processed food products (32.3 percent), and, even more strikingly, the highest tariff for the farm products (93.6 percent) is much smaller than the highest tariff on processed food (264.3 percent).

Secondly, the tariff cuts proposed by the current EC proposal protect *food producers* much more often than *farmers*. Table 5 shows that the post-Doha tariffs would be 10.7 percent for the bulk farm commodities compared to 16.9 percent for processed food products, while the post-Doha tariff peaks would be 43.7 percent for those farm products, compared to 105.7 percent for processed food. Interestingly, the food products that would remain the EC's most protected items after the Doha Round are a strange hodgepodge of waste products (dog and cat food, offal, whey, etc) goods with a tiny potential in international trade (yoghurts) and products of questionable importance (cucumbers, gherkins, etc).

Thirdly, protecting farmers does not require a protection of food producers. Farmers are, to a notable extent, immune to changes in the composition of the various processed food products, which can be derived from their farm production. For instance, milk can be used to produce butter, cheese, yoghurts, sweets, etc, in the same way as coal can be used for producing energy, steel or chemicals. If some processed dairy products are highly protected, it is above all at the detriment of the less protected processed dairy products. Re-balancing protection among food products would mostly generate a re-allocation of the farm production among its various possible uses in the food industry. This point is examined in more detail below.

Lastly, tariff escalation is no longer necessary for "immunizing" European food producers against the high protection granted to European farm products. This argument is largely obsolete because, today, farm products represent a small share of the total costs of the final food products (often within the range of 10-15 percent of the prices paid by the consumers) so that less protection of the food products (relative to the protection granted to the farm products) is unlikely to have a notable impact on the competitiveness of the food producers.

Re-balancing Tariff Cuts

That said, a better EC tariff offer should meet two conditions. It should be ambitious enough to fulfil the "*comparably high level of ambition*" criterion imposed by the Hong Kong WTO Ministerial. And, it should attract domestic European political support – it should be seen as a better deal than the current EC offer by a vast majority of the farmers and food producers. The following outline shows that it is possible.[23]

Table 5 suggests that a base Swiss coefficient of 60 (or its tiered equivalent) would be a substantial improvement over the EC current offer.[24] Firstly, it would generate an average EC tariff in farm and food products of roughly 13 percent a tariff level similar to the average tariff in NAMA products of some large emerging economies (Brazil, India, Indonesia, Mexico) and not far away from the average tariff of China, the Philippines and Thailand. In other words, it would meet the "*comparably high level of ambition*" criterion. One could argue that the EC tiered proposal does the same. But, the Swiss60 would meet the "*comparably high level of ambition*" criterion in another crucial respect and that is *not* the case of the EC tiered proposal. The Swiss60 would generate a maximum EC tariff on farm and food products very close to 50 percent, precisely the maximum tariff targeted in NAMA for the emerging economies.

Secondly, a Swiss60 would generate a notable re-balancing: 287 tariff lines would have larger tariff cuts than those currently proposed, and 1 360 tariff lines would have smaller tariff cuts than those currently tabled (364 lines would see no change). More crucially, the additional cuts would occur almost exclusively (in 92 percent of the cases) in the food sector.

In other words, re-balancing would clearly improve the situation of a vast majority of the farmers compared to their situation under the tiered proposal. Table 5 shows the very few bulk and horticulture products that would be concerned with additional cuts, and the many products that would benefit from tariff cuts smaller than those imposed by the tiered formula.

Although tariffs with larger cuts are concentrated in the processed food sector, rebalancing would keep the average tariff of all the processed food products almost unchanged. But it would cut 222 food tariffs more deeply on average from 45.5 to 35 percent, but by more than 5 percent for only 87 tariffs, and by more than 10 percent for only 46 tariffs (a dozen of which are various forms of whey). Meanwhile, it would cut 847 food tariffs less deeply (on average from 11.4 to 13.1 percent). A vast majority in the processed sector would thus gain from rebalancing, all the more if the food markets in the rest of the world would also be opened up.

However, it is important to check in more detail the case of the "sensitive" products for which food tariffs are often said to have an impact on farm products. In the case of poultry, lamb and beef, very few lines would face notably larger tariff cuts with a Swiss60, compared to a tiered formula. Only 2 (out of 100), 3 (out of 30), and

4 (out of 56) tariff lines (respectively) would face additional tariff cuts larger than 5 percentage points – a proportion so small that one would not expect serious problems for the farmers involved. In the case of dairy products, 40 tariff lines (out of 170) would face additional tariff cuts larger than 5 percentage points, and two dozen tariff lines would see additional cuts larger than 10 percentage points (half of them being whey). In the case of sugar, half a dozen tariff lines (out of 34) would face additional tariff cuts larger than 5 percentage points. In short, shifting to a Swiss60 could raise problems for less than 50 tariff lines. Moreover, as underlined above, many of the dairy products pertaining to this small group of products exhibit wide differences in post-Doha tariffs (under a tiered formula) which are totally or largely unrelated to farm coefficients for instance, a different packaging size or different but close varieties. In such cases, it is very unlikely that, with a Swiss60, the narrower range of post-Doha tariffs would have a notable impact on the farmers involved.

Bearing this in mind, and in consideration of the NAMA negotiations, there is a need to define predictable exceptions for farm and food products. Currently, the Doha negotiators are considering an intensive use of "tariff-rate quotas" as the preferred instrument for exceptions. However, when doing so, negotiators often misinterpret the basic nature of a tariff-rate quota hence the commitments that this instrument generates. When negotiated, a tariff-rate quota locks together three commitments: the "out-of-quota" tariff (to be imposed on the quantities imported above a given quota) the "in quota" tariff (to be imposed on the quantities imported within the quota) and the quota (which defines the tariff to be applied). Hence, liberalizing an existing tariff-rate quota is a three-dimensional operation: cutting the out-of-quota tariff, cutting the in-quota tariff, and increasing the quota. In short, it does not consist in simply cutting the out-of-quota tariff.[25]

This observation is crucial for analysing the current EC proposal dealing with the so-called "sensitive" products. The European Commission is suggesting an increase in the quotas of these products as a compensation for reducing their out-of-quota tariffs by less than (by half) the cut of the out-of-quota tariffs required by the EC tiered formula. This proposal has two flaws. Firstly, it does not include an offer on the level of liberalization of the two other components of the initial commitment (that is, the cut of the in-quota tariff and the increase of the quota) nor a compensation for the absence of such offers. Secondly, the increases in the in-quota quantity proposed by the Commission seem to rely on unitary elasticities (more accurate elasticities are within the range of 3 to 6 for most of the products concerned).

In a broader perspective, it is clear that a tariff-rate quota-based approach is self-defeating from the EC *farmers'* perspective. If the European demand becomes smaller than the quota, the EC price will reflect the low in-quota tariff, and the EC producers would then be (much) more strongly exposed to freer trade than expected by the negotiators. If the European demand exceeds the quota, the EC price will be determined by the world price plus the high out-of-quota tariff, generating huge rents for the quota beneficiaries. Who would get these rents? The answer depends on several parameters, but there is a sure bet: it would not be the European farmers but rather EC-based importing firms or foreign exporting firms (this second alternative raising the question whether these rents will go to the most efficient exporters, or not).

Thus there are good reasons for the EC farmers to avoid the trap of the tariff-rate quotas. As suggested above for the NAMA negotiations, the best solution may be the simplest one, which is (a) higher Swiss coefficient(s). Table 5 investigates this possibility with a Swiss70 (or its tiered equivalent) on the farm bulk commodities. Firstly, a Swiss70 would attract farmers' support because it would increase the average tariff on farm products to 11.8 percent, compared to 10.7 percent under the current offer, and it would reduce only 8 farm tariffs (with larger tariff cuts limited to 4.8 percent at most). Secondly, using a Swiss70 only for the bulk commodities amounts to making exceptions for only 5 percent of the total tariff lines in farm and food products, a figure close to the scope of exceptions in NAMA, hence meeting the "*comparably high level of ambition*" criterion. Lastly, this criterion would still be met if a few additional tariff lines such as some of the above-mentioned 50 tariff lines in the food sector were shifted under a Swiss70.[26]

Balancing Tariff Cuts and Domestic Support Cuts

Table 6 shows that the estimated amounts of domestic support granted in 2004 are much below the Uruguay Round final bound commitments for both the US and the EC. In other words, there is a huge "subsidy water" in the domestic support of these two countries (which echoes the huge tariff water observed in NAMA for

Table 6
Domestic support in the EC and the US (billion US dollors)

	U.S.	EC25
1. The Amber Box (the most trade-distorting subsidies)		
The Uruguay final bound commitments	19,1	89,0
Effective amounts in 2004	13,0	42,0
Estimated amounts in 2006-2010	[a]	26,0
The Doha final bound commitments: proposals based		
on the EC formula	7,6	26,7
on the US formula	7,6	15,1
on the G20 formula	5,7	17,8
2. Overall Trade Distorting Support [b]		
The Uruguay final bound commitments	55,0	149,0
Effective amounts in 2004	23,0	74,0
Estimated amounts in 2006-2010	18.0 [c]	40,0
The Doha final bound commitments: proposals based		
on the EC formula	22,0	44,7
on the US formula	25,9	37,3
on the G20 formula	13,8	29,8

Notes [a] Unknown (depend on world price evolution).
[b] Sum of the Aggregate Measure of Support (AMS), "de minimis" subsidies and Blue Box subsidies.
[c] Estimate based on the USDA Farm Bill 2007 Proposal.

Sources: EC, G20 and US proposals. Penn 2005, Jales and Nassar 2006, Kutas 2006.

the emerging economies). Table 6 suggests a somewhat easier negotiating position for the EC than for the US, because the EC has already introduced "decoupled" subsidies (it has moved roughly 25 billions euros out of the perimeter of the "overall trade distorting support"). By contrast, the US is still granting subsidies, which are responsive to world prices, hence eligible to the Amber Box. As of February 2007, the US position in the coming months remains hard to decipher since the legislative process for a new Farm Bill has just started.

However, the large amount of the EC post-Doha domestic support means that serious problems remain. Firstly, half of the EC AMS support is generated by the EC market price support scheme, the status of which critically depends on whether (and to which extent) the Doha negotiators will narrow the scope of allowable support. Secondly, there is a growing recognition in Europe that farm subsidies (including direct payments) go mostly to large farmers for which few Europeans want to fight. In this context, it should be stressed that the Europeans (including the French) are, on average, more favourable to serious cuts in farm subsidies than Americans,[27] and that some European farmers are beginning to distance themselves from the existing Common Agricultural Policy (CAP). Lastly, decoupled subsidies will undoubtedly face an increasing legitimacy problem. As time goes by, it will be increasingly politically unsustainable to grant subsidies to farmers on the basis of productions they managed in an increasingly far away past.

These EC problems (which would also emerge in the US once decoupled subsidies had been introduced) should induce the Doha negotiators to start to introduce disciplines, which would increasingly limit farm subsidies more or less to adjustment purposes (and "non-trade concerns"). This is a long-term goal, but it requires some immediate decisions, namely a stricter definition of the current "Boxes" in order to limit the at the moment wide open possibility that cuts in domestic support could be merely "box-shifting". In this respect, it should be stressed that the 2003 CAP reform has decoupled EC subsidies without bringing any new notable liberalization of the European farm sector, as best illustrated by the fact that the European overall level of protection merely decreased from 57 to 55 percent, all other things being constant.[28]

In such a context, it is crucial to evoke the worrisome boom in subsidies granted to biofuel production in key industrial countries precisely when the recent cut in the EC base sugar price has just revealed to efficient European sugar growers to what extent the CAP was their foe. By keeping alive inefficient European sugar growers (who are now turning to alternative crops) the CAP has made it impossible for the most efficient European sugar growers (such as those in France or Britain) to enter profitable markets (such as the Italian sugar market). Biofuel subsidies will simply push these efficient sugar growers further away from what they should do first be an efficient source of farm products for food at the risk of letting them down when new sources of energy will emerge (or if the oil price declines further). The Doha negotiators should thus start to make the production of (allegedly) clean energy difficult as an excuse for giving subsidies to clearly inefficient productions (such as the first generation of biofuels).

Would the Failure of the Doha Round Save the CAP?

Some European quarters are hoping to save the Common Agricultural Policy (CAP) by letting the Doha

Round fail. This is an illusion. The Doha Round even if unsuccessful has given a definitive stroke to the current CAP. Firstly, the anti-farmer bias of the tiered formula is a blunt mirror of the true balance between farm and food products that all the Member states' Agriculture Ministers have agreed to.

Secondly, the Doha negotiations are making European farmers increasingly aware of the fact that the impact of common European tariffs varies with each Member state's production structure. A Member state producing mostly farm goods protected by high EC tariffs is, on average, "more" protected than a Member state producing mostly farm goods protected by low or moderate EC tariffs. Table 7 illustrates this point by weighting the Member states' production by the EC-wide level of protection (be it measured by tariffs or by the combined protection granted by tariffs and subsidies as measured by the OECD "producer support equivalents").

Table 7

Level of protection by EC Member state [a]

Member states	PSEs [b]		Tariffs [c]	
	%	index	%	index
Austria	59	103	22,9	98
Belgium	57	99	22,7	97
Britain	72	126	25,5	109
Czech Rep	57	99	26,6	114
Denmark	54	94	26,1	112
Estonia	55	96	27,2	117
Finland	72	126	26,5	114
France	59	103	21,6	93
Germany	61	106	24,5	105
Greece	40	70	18,7	80
Hungary	44	77	23,5	101
Ireland	99	173	26,2	112
Italy	45	79	19,1	82
Latvia	59	103	25,3	108
Lithuania	62	108	26,6	114
Luxembourg	75	131	25,6	110
Malta	37	65	18,6	80
Netherlands	53	93	19,1	82
Poland	47	82	24,5	105
Portugal	43	75	18,3	78
Slovakia	54	94	25,2	108
Slovenia	57	99	21,2	91
Spain	43	75	19,1	82
Sweden	71	124	25,5	109
EC-15	55	96	21,9	94
EC-25	57	100	23,3	100

Sources: OECD, WTO, Messerlin 2006.
[a] There is no available information on Cyprus' farmsector.
[b] PSA: Producer support equivalents in 2002, OECD.
[c] Ad valorem tariffs in 2004 (specific tariffs excluded).

Table 7 shows that, on average, farmers in Ireland are roughly twice as protected as those in Southern European Member states, simply because the Irish production is much more concentrated (compared to the Southern European production) in such farm products that are the most protected by the EC. A "uniform" protection on all the farm products would be politically appealing to European farmers (it would be much fairer). It would be economically interesting for them (it would induce them to produce the crops in which they are best, not for which they receive high subsidies). And it would be beneficial to the European consumers since it would enhance not only farm efficiency, but also food diversity.

Ironically, Table 7 shows that, contrary to a wide belief, French farmers are not among the most protected in Europe. French farmers would be among the key beneficiaries of successful Doha negotiations in agriculture for two combined reasons. They would benefit from rebalanced tariffs, since they would be less disadvantaged than with the EC tiered offer. And, as they are often among the most efficient in Europe, they will be among the major beneficiaries from a deep CAP reform, as illustrated by the sugar case. Some French farmers are beginning to realize this, and to wonder whether they should not support a swift CAP reform.

5. Concluding Summary

The recent (November 2006) Commission's proposal to negotiate bilaterals with no less than 24 countries is embarking Europe into very dangerous waters. The danger becomes clearly visible when the bilaterals under negotiation or consideration by five other countries (Chile, Japan, Korea, Singapore and the US) are used as benchmarks. In sharp contrast with the bilaterals envisaged so far by these countries, the bilaterals considered by the EC are characterized by high tariffs and non-tariff barriers in goods, and by restrictive regulations in services and investment.

Bilaterals so heavily dominated by substantial trade preferences raise two major problems. The first is a diplomatic challenge, particularly in the case of a failure of the Doha Round. Why would the targeted partners be willing to open their protected markets to European exporters, and at the same time keep them closed to the exporters from the rest of the world? Secondly, if such bilaterals have some substance (a big "if" because of the diplomatic challenge) they would favour the inefficient firms of the EC partners at the detriment of the European consumers of highly protected European goods and services (and vice versa for the partners' consumers). And they would force European producers to undergo the painful adjustments required by the erosion of preferences (and possibly of their associated rents) when the partners would eventually open their markets to countries other than the EC (and vice versa for the partners' producers).

Costs and frustrations are thus the outcome to be expected from the Commission's proposal. Worst of all, the Commission's proposal could trigger a world race to bilaterals by pushing the US and other rapidly growing large emerging countries to make bilaterals between themselves marginalizing even more a European economy handicapped by its sluggish growth.

Turning to the Doha Round, the paper argues that the EC trade negotiators in industrial goods (NAMA) should (have) aim(ed) at achieving what the European business community is asking for namely no single industrial tariff above 15 percent. Such a target makes good economic sense. It would eliminate the tariff peaks that constitute the main obstacle faced by the European exporters, and that generate most of the protection costs imposed on the world consumers. It would vastly increase the certainty of access to the emerging countries' markets for the European exporters an outcome that negotiators heavily undervalue, while the business community is insisting on it. And, it should make it easier to negotiate exceptions as simple and as predictable as possible, hence to generate a "clean" Doha Agreement.

Focusing on the nine major emerging countries, the paper gives a concrete sense of the changes in protection associated to this 15 percent target (using a base Swiss coefficient of 25) and to simple and predictable exceptions (using Swiss coefficients of 40 and 60 for the 2 and 4, respectively, percent of tariff lines with the highest pre-Doha tariffs). The emerging countries would then exhibit average bound tariffs ranging from 6.7 to 14.7 percent, with a maximum bound tariff of 50 percent (but only a tiny portion of the bound tariffs would be higher than 30 percent). Effective cuts in average applied tariffs are limited to three emerging countries, but the average tariff water would be eliminated or reduced to a low level in all the others – a result that would be highly valued by the business community.

The Doha negotiations in "agriculture" are dominated by two not very well-known but crucial facts. Firstly, the negotiations deal with many more agro-industrial ("food") products than farm products. Only a quarter of the tariff lines involved are farm products, all the other products are food (semi-processed or processed). Secondly, the tariff cuts offered by the current EC proposal protect food producers *more* than farmers: the post-Doha *average* tariffs would be 10.7 percent for farm products, compared to 16.9 percent for processed food, while the post-Doha *maximum* tariffs would be 43.7 and 105.7 percent, respectively. Last but not least, the EC food products that would remain the most protected items after the Doha Round would be a strange hodgepodge of waste products (dog and cat food, whey, etc), goods with very little potential in international trade (yoghurts) or with questionable importance (cucumbers, gherkins, etc).

In such a context, "rebalancing" the current EC tariff proposal cutting the high tariffs more, and the low tariffs less is an attractive alternative. As shown in detail in section 4, it would deliver more *economic* welfare gains to the European consumers than the current EC proposal. And, it would deliver *political* benefits, since a vast majority of EC farm and food producers (all those protected by small and moderate tariffs) would find the rebalancing of the EC tariff proposal favourable for their interests, compared to the current EC offer.

Last but not least, all these results would meet the two key criteria imposed on the Doha Round namely, the "*less than full reciprocity in reduction commitments*" condition, and the "*comparably high level of ambition in market access for Agriculture and NAMA*" condition much better than the current EC proposal. And the approach adopted in the paper can easily be extended to the countries not examined, such as the developing countries, which are not emerging economies or among the least-developed economies.

All the above suggestions assume that the EC is ready to position itself as a WTO Member, by taking a *long-term* view of the world trade regime. They also implicitly assume that other Rounds will follow a successful Doha Round. Those future Rounds will take over the unfinished business left by (perhaps) a more modest but "clean" (i e, based on simple and predictable exceptions) Doha outcome much more easily than if they inherit a more ambitious Doha package for some products, which is riddled with more distorting exceptions on many more products. In short, the EC long-term interest is to promote the notion of a series of WTO Rounds of liberalization as a patient "peeling of the protectionist onion".[29]

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Notes

1. European Commission 2006.

2. Wallenberg 2006; Seillières 2006.

3. This sub-section relies heavily on Messerlin 2007a.

4. A regional trade agreement rapidly becomes equivalent to a large number of bilaterals. For instance, the EC in 1958 could be considered as equivalent to 6 bilaterals in goods (in trade in goods, the initial EC consisted in four customs territories, Benelux being one such territory) and to 15 bilaterals in services (in trade in services, the initial EC consisted in six countries).

5. Indeed, there is a clear shift away from customs unions and towards free trade areas between the pre- and post-1995 periods.

6. Indeed, there is little evidence of a US change of approach in terms of bilaterals. The US Administration has taken few initiatives in terms of bilaterals (Australia or Korea) and these initiatives were fundamentally driven by foreign policy motives (the Irak war). At this juncture, the US has no pending "grand vision" in terms of bilaterals. The Free Trade Area for the Americas looks like a sleeping beauty, the US calls for an Asian Pacific initiative are incantatory but inconsequential, while the China-US dialogue will most probably reduce the current trade flows between Asia and the US, be it via exchange rate adjustments by Asian trading partners or via US retaliatory measures. Lastly, the ordeals to get the recent bilaterals approved by the US Congress and the mood of the newly elected Congress (revealed by the request for a review of the bilaterals demanded by the new Democrat majority) do not suggest that strategic changes are on the agenda.

7. See for instance Evenett 2007 about the 2006 Commission's proposal.

8. Doing Business 2006.

9. Messerlin 2007a.

10. Washington Trade Daily, 31 January 2007, page 1.

11. To be fair, President Bush's statement may also be part of the fight between the Administration and the Congress on the extension of the Trade Promotion Authority in the Doha Round context, and it remains to be seen whether the Korea-US trade agreement will be ratified by Congress.

12. Bhagwati 1995.

13. A detailed version of this section can be found in Messerlin 2007b.

14. The basic Swiss formula is T=[rt/(r+t)] where 't' is the initial tariffs, 'T' the post-negotiation tariffs, and 'r' the reduction coefficient (hereafter the "Swiss coefficient"). The Swiss coefficient is thus the only element to negotiate on. In what follows, the expression "a Swiss60" means a Swiss coefficient of 60. A variant of the basic formula could be T = rt/(r + t)1/ where ' ' is a "political" coefficient (to be negotiated) aiming to reduce tariff cuts in the low tariff range, hence to boost political support–a feature that could be particularly useful for the negotiations in the agricultural products (see below). I would like to thank Jean Messerlin for having suggested this variant.

15. This necessity has induced negotiators to use the term "flexibilities." But, the term "exceptions" better describes the economic consequences of such flexibilities.

16. Out of the 143 WTO Members on which there is available information, 104 Members enforce applied tariffs lower than their bound tariffs, with 70 of them having an average tariff water higher than 10 percent. In some cases, tariff water can reach impressing average levels (about 100 percent) [WTO 2006]. Out of these 70 countries, 21 can be classified as emerging economies, the rest being developing countries.

17. UNICE 2006.

18. China's membership of Group I is an indirect way of reflecting its recent accession to the WTO.

19. Under WTO rules, "bound" tariffs are the only ones, which cannot be raised without compensating the affected trading partners; hence they are the only ones to deliver the legal certainty that is so crucial to good business practices. Although Table 2 is based on tariff data more aggregated (at the 6 digit level of the Harmoinzed System) than those used by the negotiators, it provides a good view of the situation, despite a few underestimated tariff peaks.

20. A detailed version of this section can be found in Messerlin 2007b.

21. Moreover, awkward discontinuities appear at the points connecting two different tiers. For instance, an initial tariff of 89 percent would be cut to a post-Doha tariff of 44.5 percent, whereas an initial tariff of 91 percent would be cut to a post-Doha tariff of 36.4 percent. Such discontinuities make it hard to get an agreement on defining the various tiers, and they fuel the need of exceptions to accommodate such an agreement.

22. The concordance table used has been established by the US Department of Agriculture. It splits the whole universe of the "agricultural" products into four subsets: the bulk farm commodities, the produce/horticulture products, the semi-processed products and the processed products.

23. It is expressed in Swiss-type terms for reasons already mentioned, but it should be stressed that it could be presented with a tiered formula (it is always possible to approximate a curve by a sequence of straight lines) though at the cost of discontinuities and complexities as those illustrated above in Figure 1.

24. For the sake of information, Table 4 includes the case of a Swiss50. Such a Swiss coefficient may create problems in the farm products, but interestingly, the political balance may still be positive in the processed food products.

25. For a general analysis of trade liberalization in the case of tariff-rate quotas, see Martin 2007.

26. A Swiss70 may be perceived as a too narrow exception for coping with European pressure groups. Then, one could discuss a higher Swiss coefficient (such as a Swiss100) for a very small percentage of tariff lines (an approach symmetrical to the one adopted in NAMA).

27. German Marshall Fund 2006.

28. OECD 2004.

29. Messerlin 2007a.

30. Forbes et al 2004.

Annex: The set of tariff data in NAMA

The Table below summarizes the tariff data used for presenting the alternative proposal in NAMA (section 3). As these data are defined at a level (Harmonised System 6 digit), which is more aggregated than the level used by the negotiators[30] the results presented in the paper do not reflect a few tariff peaks. That said, the calculations include already so many tariff lines that the averages presented are likely to offer a good view of the situation.

Annex Table 8

Bound and applied tariffs, selected advanced and emerging economies

	Number of tariff lines [a]	Average			Bound tariffs			Applied tariffs		
		bound tariffs	applied tariffs	tariff water	Maximum	Nber of tariff lines >15%	Nber of tariff lines >50%	Maximum	Nber of tariff lines >15%	Nber of tariff lines >50%
	1	2 [b]	3 [c]	4	5 [d]	6 [d]	7 [d]	8 [d]	9 [d]	10 [d]
I. Low bound and applied tariffs, minimal tariff water: offering cuts in peak tariffs										
Japan	4327	2,3	2,3	0,0	28,5	25	0	25,0	13	0
USA	4428	3,4	3,3	0,1	38,6	120	0	33,1	80	0
EC	4441	4,0	4,0	0,0	57,5	38	1	42,8	37	0
Singapore	4306	4,1	0,0	4,1	10,0	0	2	0,0	0	0
Taiwan	4266	4,7	4,7	0,0	60,0	72	0	40,0	66	0
Canada	4427	5,3	4,0	1,3	25,0	360	0	20,1	255	0
II. Moderate bound tariffs, low applied tariffs, moderate tariff water: offering more certainty (binding) and cuts in tariff peaks										
Australia	3911	11,0	3,8	7,2	55,0	577	101	25,0	213	0
New-Zealand	4095	11,1	3,4	7,7	45,0	1450	0	40,0	228	0
III. Moderate bound and applied tariffs, low tariff water: offering notable liberalization while keeping certainty high										
Korea	4347	10,2	6,7	3,5	36,8	552	0	30,0	59	0
South Africa	4247	11,0	7,8	3,2	60,0	1187	72	54,5	953	59
Malaysia	4247	11,2	8,0	3,2	300,0	1562	18	215,6	1234	10
China	4330	14.4 [e]	9,1	5.3 [e]	50 [f]	–	–	50,0	–	0
IV. High bound tariffs, moderate applied tariffs and tariff water: offering notable liberalization while offering more certainty										
Philippines	4053	16,7	5,8	10,9	50,0	1886	127	40,0	954	0
Thailand	3522	20,2	10,0	10,2	80,0	2289	24	80,0	1243	19
V. High bound tariffs, moderate applied tariffs, high tariff water: offering substantial liberalization and more certainty										
Brazil	4233	29,4	12,7	16,7	85,0	3994	1	35,0	2196	0
Mexico	4374	34,8	13,4	21,4	50,0	4349	76	50,0	2450	0
Indonesia	4229	35,0	6,8	28,2	125,0	3864	21	80,0	592	3
India	3736	37,0	15,4	21,6	150,0	3505	715	(52.0 [g])	3413	(708 [g])

Notes
[a] Data available at the Harmonized System 6 digit (Forbes et alii [2004]).
[b] Data available at the Harmonized System 6 digit, except for China (see note [e]).
[c] Data from WTO Trade Profiles (tariffs applied in 2005).
[d] Data from Forbes et alii [2004].
[e] Due to its recent accession, China's average bound tariff has been arbitrarily set at the level of her average applied tariff in 2002 (see text for explanation). China's current tariff water is nil.
[f] Data for these bound tariffs are those enforced in 2005.
[g] Data for the applied tariffs in 2000.

Sources: Forbes *et al* 2004, WTO Secretariat 2007.

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