Dragon in the room: US trade policy after Doha Round

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Summary

- With the Doha Round of world trade negotiations now effectively dead after ten years of talks the US is looking for ways to reboot the basis of its trade policy. The US is attempting to regain the leverage over China and the other BRICs it believes it has lost in the WTO.

- Over the next decade US trade policy will involve a proliferation of initiatives outside the multilateral negotiating machinery of the WTO. The most important of these is the Trans-Pacific Partnership which intends to advance liberalization in China's economic backyard in a way that is designed to put China at an explicit disadvantage and rebuild leverage over the long term. Other initiatives such as an EU-US FTA will have the same goal.

- This strategy of negotiating with China by not negotiating with China is uncertain at best, with Asian partners reluctant to be drawn into an explicit challenge to the regional hegemon, and China unlikely to be forced into reform or market opening on any timetable but its own.

At the level of high politics, the visit of Xi Jinping, the frontrunner to replace Hu Jintao as Chinese President, to the US last week was a minor public relations success. Xi made a culturally and politically savvy diversion to Hollywood where he endorsed a new joint venture between Dreamworks and two Chinese film groups. A few days later, China incrementally raised the quota for foreign film imports into its domestic market – although it retained the state monopoly on the distribution of those films. The visit was classic modern Chinese diplomacy. Snappy visuals, lots of talk of win-win, US business endorsement and just enough change to policy to blunt the edge of US official criticism.

This uneven progress is precisely why, at a more general level, the US system is deeply frustrated by China. An anxious debate about the US's economic recovery has only deepened its irritation at its inability to get a grip on high levels of state intervention, poor protection of intellectual property and uneven access for US exports and investment in China. As one senior foreign diplomat in Washington puts it: "in Washington at the moment, every conversation comes back to China". President Obama devoted significant chunks of his recent State of the Union speech to China, much of it negative.

A big contributor to official anxiety is the perception that in some respects the US has wasted a decade trying to force change in China through the WTO. With the Doha Round of world trade talks now effectively dead after ten stuttering years of negotiations the US is looking for ways to reboot the basis of its trade policy. The US's decision to walk away from the Doha Round is a reflection of a deeper dissatisfaction with the WTO process itself. India, Brazil and China in particular are at the centre of this dissatisfaction.

From the US point of the view, the almost universal membership of the WTO means that the self-selecting liberalisers of the early years of the post-war GATT have been replaced with a global membership in which the balance of ambition, especially among developing countries, is not

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necessarily in favour of deeper liberalisation at all.

It is certainly not ambitious in the '21st century issues' that the US prioritises: market access for services and investment, intellectual property protection and free movement of data. Effectively the US finds itself in the political position of wanting to take its trade and investment ball and start a new game. This Global Counsel Insight note looks at its emerging plans for doing that.

The US in the WTO: leverage lost

The essence of the problem from a US point of view is leverage. Alongside the EU, the US surrendered most of its scope for state intervention in industry on the creation of the WTO in 1995. The trade-off for this was a set of binding rules based on a neoliberal model of trade liberalization that was assumed to be both dominant and permanent. Putting unilateral trade-distorting weapons such as overt subsidies beyond political reach was regarded as a good thing in itself.

What this political calculus failed to appreciate in 1995 was just how seriously the BRICs and China in particular would challenge this consensus. Although it reduced its external tariff protection substantially in 2001 to enter the WTO, China nevertheless has a growth model that is structured around a high level of state intervention in the economy and in the value of its currency. In general the WTO has proved a very weak instrument for getting a grip on these 'behind the border' distortions. Although the US and the EU used the prospect of WTO membership as a serious driver for reform of China's external tariffs in particular, once China was in the WTO much of that leverage evaporated.

The WTO's dispute settlement system gives the US and the EU some leverage over China, but it is relatively slow, and its rulings only useful to the extent that the Chinese government implements them in full. Even then, in a market where subsidisation is pervasive, isolated strikes against particular distortions are in any event of limited value. Last year's WTO ruling against a range of Chinese export restrictions on minerals makes the point. It is a significant victory – although one that has yet to be implemented - and while it has established a useful point of jurisprudence with respect to China's use of export subsidies, China has many other tools for distorting both imports and exports should it wish, all of which will have to be individually challenged.

As President Obama indicated in his State of the Union, the US is likely to continue to pursue targeted cases in the WTO, seeking to widen and deepen the jurisprudence on China's primary modes of state intervention. The US's choice of cases over the last five years (Table 1) has deliberately aimed to test Chinese practice in areas of key US interest including export restrictions on raw materials, rules on the movement of financial data, and the subsidisation of the Chinese green energy sector.

	Subject of Case	Result
2005	VAT on integrated circuits	MOU signed 2006
2006	Duties and restrictions of automobile import duties	US complaint supported on appeal; implemented 2009
2007	Tax benefits to certain enterprises	MOU signed 2007
2007	Elements of Chinese copyright law	US complaint supported on appeal; implemented 2010
2007	Limits on import and distribution of AV products	US complaint supported on appeal; implemented 2012
2008	Regulations on the handling of financial information	MOU signed 2008
2008	State support for certain enterprises	Ongoing
2009	Export measures for raw materials	US complaint supported on appeal; not yet implemented
2010	Measures affecting electronic payment systems	Ongoing
2010	Anti-dumping duties on electrical steel	Ongoing
2010	Subsidies for wind power manufacturers	Ongoing
2011	Anti-dumping duties on broiler products	Ongoing

Table 1: US WTO dispute cases against China since 2005

Source: WTO 2012

Behind the likely proliferation of trade initiatives in US policy will be the simple idea of reestablishing leverage with China. The US will aim to build up a network of preferential FTAs and trading relationships under within the WTO rules that permit and legitimise bilateral or regional agreements within the WTO system. But the US would also like to use these rules to establish significant new coalitions on sectoral agreements with partners willing to meet the US's level of ambition in sectors like services where the US has key interests.

Liberalising China's backyard

The biggest of these alternate platforms will be the Trans-Pacific Partnership (TPP) with Australia, New Zealand, Brunei, Chile, Malaysia, Peru, Singapore and Vietnam, launched by President Obama in 2009, which produced a framework agreement at the end of 2011 and is now expected to be signed in 2013.

The draft texts for this agreement are heavily focused on services trade liberalisation especially on financial services, strong protection for intellectual property rights and rights of cross-border data flow, a key preoccupation for US financial service providers in the region who have come up against regulation on data movement that have required them to decentralize data storage in each jurisdiction rather than through regional hubs. The text also proposes new disciplines on the operation of state owned enterprises, notably in Vietnam, which maintains many of the structures familiar in China, including subsidised land values, tax exemptions and distorted capital costs.

Economically the agreement is of limited value to the US (Table 2). It already has FTAs with Australia, Chile, Peru and Singapore to which the TPP will add only a limited amount in new market access. Its exports to the TPP countries total about the same as its exports to China alone. However the TPP has been negotiated in an 'open architecture' structure that allows others to join the Agreement if they are willing to meet the standards it imposes. The US will push hard to encourage Japan to sign up, which would significantly increase the potential value. However the high levels of regulatory and political protectionism in the Japanese economy make this uncertain.

	TPP	EU	Japan	China	BRICs
US Exports 2010	89,303	239,583	60,485	91,880	152,561
US Exports 2011	105,412	268,635	66,168	103,878	131,790
US Outward FDI Flows 2010	44,165	168,077	64,85	9565	21077

Table 2: US exports and outward FDI TPP and other markets 2010-2011 ($mn)

Source: US Department of Commerce 2011; OECD 2011

But the real target of the TPP is China, whose own access to the preferential terms created by the TPP for the 'Pacific' market on its doorstep could only be bought at the price of agreeing to its disciplines on SOEs, intellectual property protection and market access.

Whether this will work is uncertain at best. China is deeply resistant to reform on anything but its own timetable, and is unlikely to see the greater market access in the US implied by the TPP as much of an incentive, even if it were to expand to take in Japan. It already has good access to goods markets in both the US and its region, and in its own network of regional FTAs.

China calculates that the combination of the significant prize of the Chinese domestic market and the density of advanced economy supply chains in China – half of Chinese exports are still produced by multinational companies – will ensure that the US and the EU will be reluctant to provoke serious trade hostilities, regardless of the political rhetoric. As a regional powerplay the TPP is also fairly transparent. As much as it unnerves them, there is little appetite for provoking the new regional hegemon among China's regional partners. Both Indonesia and the Philippines have declined to join the TPP and officials in these countries are privately dismissive of it.

Nevertheless it is likely to be the template for Washington's new approach to trade policy. The US should also be expected to be an enthusiastic convert to the idea of an EU-US FTA, which is also developing supporters in Europe, where many officials agree that the EU and the US should not allow China and the other BRICs to dictate the overall pace of trade and investment liberalisation. Although this negotiation is still technically the subject of a feasibility study that will report in the Autumn, expect a strong political signal at the G8 Summit in Chicago in May.

Negotiating with China by not negotiating with China

This suggests that US commercial policy engagement with China is likely to run on two distinct tracks for the next decade. High levels of both blue and white collar economic anxiety mean US politicians will continue to flirt with aggressive rhetoric on China's currency policy and general approach to state capitalism, much as Republican presidential frontrunner Mitt Romney has done on the campaign trail.

The lesson of the last two decades is that occupants of the White House of either party become considerably less inclined to take a confrontational approach in practice because of the complex nature of the US' strategic and commercial interests in China. President Obama rejected as President currency manipulation sanctions he twice supported from the Senate. But the war of words will continue. Chinese policymakers are used to this sort of rhetoric and are comparatively sanguine about it.

Levels of suspicion of Chinese direct investment will also continue to remain high, especially as a wave of Chinese capital investment is the likely to outcome of a Chinese strategy to start trading some of China's huge store of treasury and T-bill financial assets for concrete bricks and mortar investments in the US.

Below these volatile surface dynamics, US trade policy officials are settling in for a much longer term siege approach. This is based above all on reestablishing some of the leverage the US lost when China joined the WTO in 2001. Because this involves by its nature substituting a new approach for the multilateral WTO it is not clear how this will impact on the institution.

Although no party is likely to say so, it seems likely that a decade of relative dormancy for the multilateral negotiation arm of the WTO beckons, at least until the balance of member interests militates in favour of the whole membership coming back to the table on the issues on which the US is focused. This may never happen. EU officials are more overtly concerned at this prospect than their US counterparts, but many privately also share the US's concern that the WTO system gives them such little leverage in China.

Business has never been particularly enamored with the Doha Round, sensing, rightly, that that it was unlikely to deliver much in terms of new market access. The new US strategy presents opportunities for firms with specific dispute-related issues in China, and with commercial prospects in the markets which the US will aim to use as leverage with the larger BRICs. But it also suggests that the US has chosen to play a longer game on structural reform and market access in China. Rather than the frontal strategy of the WTO Doha Round over which China and the other BRICs possessed an effective veto, the US has chosen a strategy that negotiates with China chiefly by not negotiating with China at all.

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