

# The Hurdle of Free Trade

## The perspective of political economy

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### **Abstract**

The Doha Round is the latest trade negotiation of the World Trade Organization (WTO) that commenced in year 2001 and essentially stalled in year 2008. Although it was touted as the development round, today's analysts generally have a slim hope of productive outcome from the Doha Development Agenda. Will the Doha deadlock persist? This paper argues that it will persist as long as actors are rational and structural conflicts of interest exist, while multilateral efforts or temporary compromises will have no lasting benefits. In order to support this argument, this paper introduces a "structure-versus-actor" framework to analyze actors' decision making in the WTO. By focusing on the structure of the free trading system, this paper demonstrates how structural factors affect actors' strategies and thereby result in the persisting pitfalls in the Doha Round. On the other hand, it is also noticeable that free trade is growing rapidly among Asian developing economies despite the WTO's uncertain future. By referring to the Asian experience, this paper further constructively proposes alternatives for promoting trade liberalization and addressing the issue of global unbalanced development which is the original mission of the Doha Round.

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## 1. Introduction

The Doha Round is the latest trade negotiation of the World Trade Organization (WTO) that commenced in year 2001 and essentially stalled in year 2008. Although it was touted as the development round, today's analysts generally have a slim hope of productive outcome from the Doha Development Agenda. Designed as a basic framework for contemporary international trade, the WTO aims to promote global growth and enhance the standard of living around the world by promoting free trade. Unfortunately, its mission did not live up to expectations and exposed weaknesses during tedious negotiations over the past decade. Particularly, endless debates on agriculture and non-agricultural market access hindered progress of the Doha Round. Briefly reviewing the development of the WTO provides informative background for understanding the current deadlock.

### 1.1. The Doha Round

The birth of the Bretton Woods System marked the success of economic liberalism after WWII. It introduced principles of trade liberalization, open market and financial stabilization, upon which international trade was rebuilt and embodied in the GATT in 1948. In the Uruguay Round, GATT institutionalized the WTO which shaped today's extensive global free trading system. With an objective to improve standards of living, boost employment and utilize resources under the free trading system, the WTO devoted itself to eliminating trade barriers to create a free trading environment based on fair competition. Five basic principles constituting today's WTO framework are: (1) Non-discrimination including most-favored-nation and national treatment, (2) open market and free trade, (3) predictability and stability of trade, (4) promoting fair competition, and (5) encouraging development and economic reform. These principles formed the contemporary international trade regime (Zweifel, 2006, pp. 115-130).

In theory, the free trading system shaped by the WTO promises to promote global wellbeing. In reality, the global poverty gap has widened as a result of unbalanced development through the growth of free trade. In year 2000, the poverty gap doubled from the 1960s, while the average income per capita of the top 20 wealthy countries was 37 times that of the poorest 20 countries. Although trade grew 1.6 times from 1990 to 1996 in Latin America and the Caribbean, the poverty line remained as it was in 1987. During the same period, trade grew more than 1.2 times in south Asia and 6.8% in Sub-Saharan Africa, but the poor population increased by 26 million and 60 million respectively ("World Development Report 2000/2001," 2011). Although global poverty seems to have been alleviated gradually since the proposition of UN Millennium Development Goals, it still remains in a question why there was no significant improvement of the poverty problem during the past trade booming decades.

Developing countries answer by arguing that under the developed-versus-developing structure, the WTO's biased rules weakened their negotiation leverage and deprived them of opportunities. Since November 2001, the Doha Round sought to reform the international trading system by introducing lower trade barriers and revised trade rules to address developing countries' appeal and focus on development. Unfortunately, progress has been slow and uncertain. The interrelated conflicting interests of each member have left the deadlock unresolved to this day.

The tensions are two-fold: Non-Agricultural Market Access (NAMA) negotiations and trade in agricultural products. NAMA refers to all products not covered by the Agreement on Agriculture, including manufacturing products, fuels and mining products, fish and fish products, and forestry products that are sometimes referred as industrial products or manufactured goods. Over the past few years, NAMA products accounted for almost 90% of world merchandise exports (“Understanding the WTO,” 2011). The major dispute about NAMA is on tariffs. While developed countries reduced their average tariff from 6.3% to 3.8% in the Uruguay Round, developing countries manipulated tariffs on NAMA products by increasing the binding coverage from 21% to 73% and then approving certain concessions in real execution, resulting in low transparency and unpredictable trade. On the international bargaining table, developing countries are therefore required to reduce their effective tariffs on NAMA products but this has generally led to fierce domestic opposition as it not only reduces tariff revenue but also forbids protecting developing countries’ domestic producers.

In terms of trade in agricultural products, abolishing subsidies in developed countries has always been an issue since the Uruguay Round. Negotiations are difficult due to opposing interests among member governments: developed countries are under pressure from domestic farmers and agricultural industries to subsidize their shrinking and less competitive agricultural sectors. Inevitably, the subsidizing policies are criticized by developing countries for violating the WTO’s principle of fair competition. Since many developing economies depend on agricultural exports, they not only demand developed countries to cancel their subsidies, but also call for further liberalization of agricultural trade in the name of fair competition. Although developing countries may take countervailing measures to alleviate the impact of subsidies, but their effectiveness is limited as observed in the United States Subsidies on Upland Cotton case.

Facing these challenges, developed countries argues that proposals for narrowing the north-south gap should still be discussed and executed consistently with the five basic principles under the WTO framework, even though they hypocritically violate these principles in agricultural trade. Developing countries, however, have already lost confidence that the WTO framework is capable address fundamental disputes between the rich and the poor for three reasons. First, the issue of agricultural subsidies is accelerating the tension. Second, developed countries continuously justify their non-agricultural market expansions by upholding the open market and non-discrimination doctrines. Third, regarding intellectual property rights, developing countries must commit to more rigorous, complex protection and expensive programs for those industries from which they rarely benefit, even though they must pay high policy costs. The developing group chastises the game rules designed by developed countries, which are alleged to work in their interests. As a result, the Doha Round has been trapped by these core disputes since its kickoff in 2001, not to mention more complex and contentious topics such as Singapore Issues.

## **1.2. The argument**

Will the Doha deadlock persist? Governments, politicians and WTO officials have called for more multilateral cooperation in response to the current challenges. Although their optimism colors the gloomy Doha Development Agenda, most of the ongoing arguments are primarily policy advocacies which merely examine superficial phenomena.

This paper argues that Doha’s deadlock will persist as long as actors are rational and structural conflicts of interest exist, while multilateral efforts or temporary compromises will

have no lasting benefits for solving the deadlock. Although it seems that the current deadlock revolves around tariffs or market access, member governments in fact face something more fundamental. Before the establishment of the contemporary free trading system, actors competed based on their various endowments and comparative advantages. Since the establishment of the WTO, rational actors have stroven for membership to seek potential trade benefits or to preserve their relative competitiveness. Ironically, by advocating fair competition, the WTO ended up consolidating the extant distribution of interests in the hands of its wealthy architects, whereas developing countries suffer from conflicting interests due to the WTO's "fair" competitive structure. As the WTO structure itself has pre-determined winners and losers in global trade competition, these systemic failures will naturally challenge the WTO's architecture. This is what happens in Doha. In fact, as countries act rationally to protect their vested interests and fight for maximum gains, the Doha Round is a multiplayer battlefield with conflicting interests. While conventional minds believe that the current deadlock can be solved through behavioral and mindset adjustments from unilateralism to multilateral cooperation, they ignore the conflicts of interest under the existing developed-versus-developing structure. In this regard, deadlocks will repeatedly emerge under the conditions that the structural conflicts of interest exist and all actors are rational

In order to support this argument, a "structure-versus-actor" framework is introduced to analyze actors' decision making in the WTO. By focusing on the structure of the free trading system, this paper demonstrates how structural factors affect actors' strategies and result in the persisting pitfalls in the Doha Round. On the other hand, it is also noticeable that free trade is growing rapidly among Asian developing economies despite the WTO's uncertain future. The number of concluded FTAs has soared in the past decade along with the Asian economies' shifting focus from the world trade to FTA partners. In consideration of the stalled global trade regime, this bottom-up approach identifies a new possibility for the free trade. In my point of view, the Asian experience proposes alternatives for promoting trade liberalization and addressing the issue of global unbalanced development which is the original mission of the Doha Round.

This paper is organized as follows. The next section reviews related research on global trade, presenting perspectives on the Doha Round, discussions about free trade under the north-south structure and lessons learned from the Asian experience. The third section develops the theoretical argument of this paper; I explain rationales of actors' strategies in their interaction with the WTO and thereby demonstrate the big picture of the post-war international trading system. Following the line of reasoning in the third section, the fourth section explores alternatives for reaching Doha's goal. The final section concludes.

## **2. Review of literature**

Literatures contribute to this paper are composed of three parts: analyses on the Doha Round per se, discussions about free trade under the north-south structure, and the Asian experience.

To begin with, Schwab (2011, pp. 104-117) declares the death of the Doha Round. As the former Trade Representative of the United States, she poignantly emphasizes Doha's obstacles that jeopardized all the best intentions of negotiators and hindered this round from progress, such as conflicts on tariff issues and agricultural trade. More fundamentally, the Doha Round cannot address the respective roles and responsibilities of developed, emerging and developing countries. Since a global trading system is needed to stabilize the world

economy, “prolonging the Doha process will only jeopardize the multilateral trading system and threaten future prospects for the WTO liberalization and reform.” she argued. Schwab suggests that trade policymakers should admit the failure of Doha and launch new multilateral initiatives to restore trust in the WTO.

Mattoo (2009, pp. 15-26) indicates that the Doha Round is not the panacea of today’s urgent economic problems. Instead, we need a more comprehensive and unambiguous multilateral mechanism like Bretton Woods II. Mattoo discusses diverse issues including tariffs, food security, energy prices, environment protection, fair exchange, sovereign wealth funds and global financial stability. He argues that as the WTO is the sole official platform for the current global trade, Doha has distracted our attention from these issues and their trade consequences. Multilateral cooperation among the WTO, state actors and international organizations is needed to prevent protectionism. Mattoo believes that we must initiate a new agenda rather than resuscitate the inconsequential Doha Round.

In terms of free trade under the north-south structure, Stiglitz and Charlton (2005, pp. 11-86) posit that even though trade elevates economic growth, it does not bring development to the south. The problems of poverty, market risk and inequality in most developing countries suggest that the assumption of economic liberalism hardly be applied to these economies. As a result, some developing countries scarcely benefit from the current trading system and instead eventually fail. On the other hand, Rodrik (2011, pp. 47-66 & 135-158) focuses on the issue of distribution. He argues that the effects of trade are questionable, while there is a huge gap between academic trading theories and real world practice. With a historical survey from the Bretton Woods System to the WTO, Rodrik points out that the compromising nature of the WTO hinders the system from addressing unfair distribution issues.

As for the Asian experience, by reviewing the development of export sectors in East-Asian economies, Wan (2007, pp. 237-276) concludes that the rapid growth of trade contributed to the East-Asian economic miracle. His point on domestic political economy identifies how domestic politics interacts with trade decision making, enlightening the model building of this paper. Useful frameworks and abundant data in Wan’s work provide an excellent overview of East-Asian economies’ growth path and strategies in the past sixty years. On the other hand, Kawai and Wignaraja (2011) conclude that economically important Asia has emerged at the forefront of global free trade agreement (FTA). By examining key trends and challenges in Asian FTAs, they point out the “noodle bowl” problem and provide a set of policy recommendations.

Other works include: Evenett (2009, pp. 359-374) who concentrates on the WTO’s negotiation-based, non-judicial and deliberative functions, Capling and Higgott (2009, pp. 313-325) who emphasize the WTO’s role as an institution for global governance by providing public goods, Gilpin (2001, pp. 46-76 & 196-233) and Wallerstein (1974) who devote themselves to international political economic theories, and official reports from the WTO and World Bank. Although not directly related to the core of this paper, these works provide vast information on the WTO and a solid theoretical foundation for discussion.

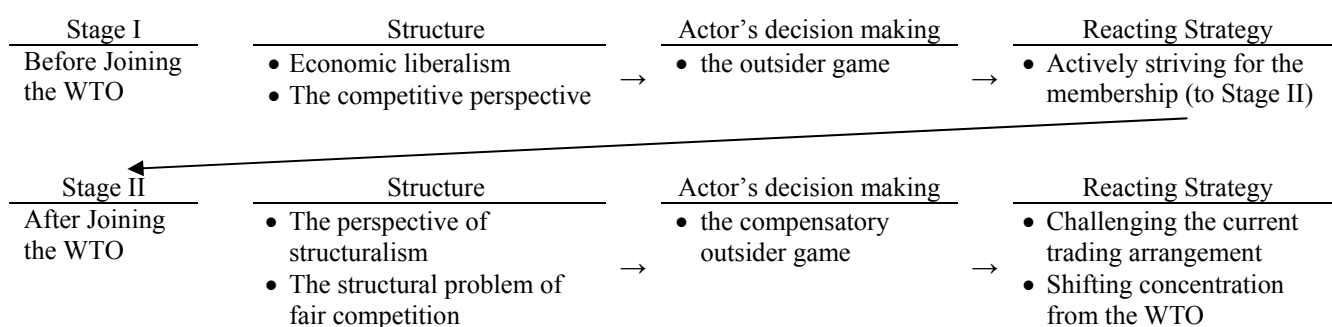
### 3. Analysis

Some literatures discussing the Doha Round provide false causality. They made conclusions about causes of the Doha deadlock without coherent logic through analytical causal connections. This paper argues that government positions on and reactions to specific issues on the bargaining table are only a resulting phenomenon rather than the cause of disputes. The following analysis explains why rational actors boycott each other and lead to a deadlock.

#### 3.1. The framework

This paper theorizes actors' decision making mindset in the WTO and further demonstrates actors' strategies and Doha's deadlock by introducing a "structure-versus-actor" framework. In terms of the former, the structure refers to intangible institutions, rules, regulations and tangible organizations that construct actors' identities, shape their behaviors and, in the perspective of the realists, reflect the distribution of power and interests among them. As for the latter, actors consisting mostly of sovereign states comingle with various non-state actors within the structure. In the context of this discussion, the structure is the WTO institution, including its principles, rules, agreements, mechanisms and organizations, and the contemporary free trading system based on the WTO framework, where both state and non-state actors trade with each other and react rationally to maximize their interests. Therefore, challenges to the WTO, if any, might come from either any other actor or the structure itself.

The analysis is divided into three parts: (1) before joining the WTO, (2) after joining the WTO, and (3) the big picture of the interaction between actors and the structure under the WTO framework. In consideration of its theoretical nature, the framework and findings of this paper in fact can be generalized and applied to international conflicts beyond this immediate scope.



#### 3.2. Before joining the WTO

During the 7-year Uruguay Round, over sixty countries voluntarily executed trade liberalization policies. To understand their incentives and the current deadlock in light of this voluntary nature, actors' rationales for participating in and opposing the WTO should be explained.

##### 3.2.1. Structure: economic liberalism and the competitive perspective

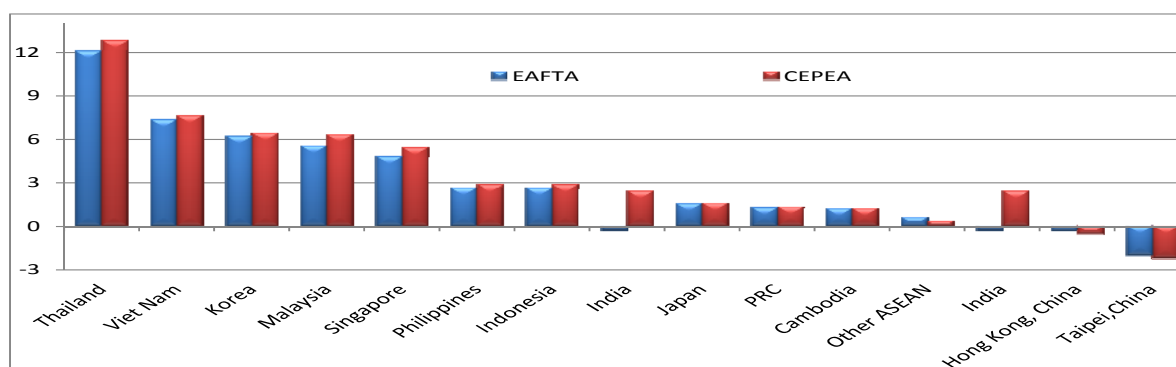
Two perspectives are often mentioned. First, it is commonly believed that free trade promotes growth. While potential profits generated by joining the WTO are attractive for any actors,

trade liberalization seems to be the key to growth for developing countries especially in the era of globalization. This desire is well explicated by economic liberalism. Since Ricardo introduced the principle of comparative advantage as the essence of trade, economic liberalism has sublimated from a theory into an implementable policy. Assuming each country applies its key industries to produce goods or services with better quality or lower price, a free trading network provides a platform for mutually beneficial exchanges. Therefore, people in every participated country of the exchanging network would consume goods and services with minimum costs, whereby further maximize their wellbeing.

Economic liberalism evolved into a gigantic free trading system. Liberals argue that global trade is a positive-sum game as reciprocal trade enhances production efficiency and increases participants' consumption levels and income in the long run. There may exist unequal gain among countries but total welfare will supposedly increase from trade. Governments therefore should let the "invisible hand" dictate the trading environment. As one of outputs of such economic philosophy, the WTO endeavors to lift trade barriers and discourage government intervention to clear the road for a free world market.

The second point of view stimulates deeper thoughts. The competitive perspective argues that the motive for participating in the WTO may not simply to be benefit from it, but indeed to avoid marginalization. As higher tariffs are borne by outsiders of the free trading system, higher production cost will weaken outsiders' relative competitiveness and lead to catastrophic chain effects. This is especially true for export-oriented economies, where loss of exports results in domestic economic depression, domestic industry shrinkage, foreign investment withdrawal, and eventual exclusion from the world economy. In fact, having the common feature of lowering the internal members' transaction cost, any type of reciprocal trading arrangement, including the WTO and FTAs, widens the competitiveness gap between their members and outsiders. By applying the CGE model, Kawai and Wignaraja analyze potential income effects on Asian countries under the CEPEA and EAFTA scenarios (cf. figure 1). Their findings conclude that Hong Kong and Taiwan will suffer from being excluded from the regional trade integration in both scenarios. Whereas Hong Kong's losses will be relatively small due to its trade connection with China, Taiwan's manufacture-based industrial structure will be significantly affected by the increasing costs and shrinking export markets. To sum up, the reason for participating in trade integration is twofold: either to gain from the free trade or to avoid being marginalized in trade competition.

Figure 1. Income effects of alternative scenarios compared to 2017 baseline (% change in GDP)



Notes: ASEAN = Association of Southeast Asian Nations; CEPEA, comprehensive economic partnership for East Asia; EAFTA, East Asia free trade area; GDP, gross domestic product.

Source: Kawai and Wignaraja (2011) based on the CGE model used in Francois and Wignaraja (2008).



### 3.2.2. Actor: the outsider game

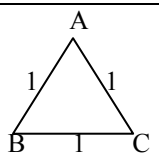
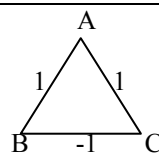
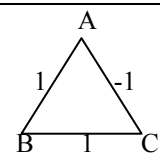
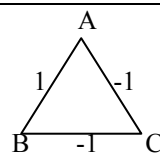
The aforementioned reasoning can be modeled through game theory. In competitive international trade, players in a zero-sum game maximize their interests by forming a strategic triangle. A player benefits through cooperation with another player but suffers if it fails to form alliances. Meanwhile, a player benefits when conflict arises between the other two players but suffers when the other two players cooperate. By adopting the concept of strategic triangle, the outsider game is derived to demonstrate the outsider's decision making.

Hypotheses include:

1. Engagement or containment are two options available to players. Engagement will be indicated by a "+" sign; containment will be indicated by a "-" sign. Players only act pursuant to rational choice. There is no particular preference toward either option.
2. Free trade will only be established when both players choose engagement, and the deriving gains are indicated by 1. If either one chooses containment, then the cooperation will fail, and the resulting losses are indicated by -1.
3. Free trade between A and B have been established, whereas C is the outsider.
4. All players have equal influence upon each other.
5. This is a simultaneous-move game.

When free trade is established between A and B (as the symbol of the WTO in the real world), relations between A, B and C can be categorized into the following strategic triangles (cf. table 1). We can calculate the payoff of each player.

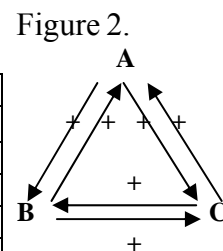
Table 1. The Payoff in the Strategic Triangle

Figure				
A-B relation	free trade established	free trade established	free trade established	free trade established
A-C relation	free trade established	free trade established	cooperation failed	cooperation failed
B-C relation	free trade established	cooperation failed	free trade established	cooperation failed
A's Payoff	$1+1-1=1$	$1+1-(-1)=3$	$1+(-1)-1=-1$	$1+(-1)-(-1)=1$
B's Payoff	$1+1-1=1$	$1+(-1)-1=-1$	$1+1-(-1)=3$	$1+(-1)-(-1)=1$
C's Payoff	$1+1-1=1$	$1+(-1)-1=-1$	$1+(-1)-1=-1$	$(-1)+(-1)-1=-3$

We can then insert the payoffs of specific relationships between individual players into Table 2. For instance, a2 represents: A contains C, B engages C, and C engages both A and B simultaneously. The three players thus form a romantic triangle; free trade is established between A and B, and between B and C but A-C cooperation fails. In this triangle, A's payoff = -1, B's payoff = 3, C's payoff = -1, and therefore a2 = (-1, 3, -1) (cf. table 2). By inserting payoffs in each cell, we can deduce a complete game.

Table 2. The Outsider Game

		a	b	c	d	e	f	g	h	
		C				C				
		+A , +B		+A , -B		-A , +B		-A , -B		
		B		B		B		B		
		+C	-C	+C	-C	+C	-C	+C	-C	
1	A	+C	(1,1,1)	(3,-1,-1)	(3,-1,-1)	(3,-1,-1)	(-1,3,-1)	(1,1,-3)	(1,1,-3)	(1,1,-3)
2	A	-C	(-1,3,-1)	(1,1,-3)	(1,1,-3)	(1,1,-3)	(1,1,-3)	(-1,3,-1)	(1,1,-3)	(1,1,-3)



The following demonstrates each player's decision making:

- For A:
  - (1) Under the condition C and A engages, regardless of B's attitude towards C, engaging C is more beneficial for A. ( $a_1 > a_2$  ,  $b_1 > b_2$  ,  $c_1 > c_2$  ,  $d_1 > d_2$ )
  - (2) Under the condition that C contains A, disregarding B's attitude towards C, it is indifferent whether A engages C or contains C. ( $e_1 = e_2$  ,  $f_1 = f_2$  ,  $g_1 = g_2$  ,  $h_1 = h_2$ )
  - (3) When three players make a decision at the same time and when A is unaware of C's motive based on rational decision A will engage with C.
  
- For B:
  - (1) Under the circumstance that C engages B, disregarding A's attitude towards C engaging C is more beneficial for B. ( $a_1 > b_1$  ,  $a_2 > b_2$  ,  $e_1 > f_1$  ,  $e_2 > f_2$ )
  - (2) Under the condition that C contains B, regardless of A's attitude towards C, it is indifferent whether C engages or contains B. ( $c_1 = d_1$  ,  $c_2 = d_2$  ,  $g_1 = h_1$  ,  $g_2 = h_2$ )
  - (3) When three parties make a decision at the same time and B is unaware of C's intentions out of rational decision making engages C.
  
- For C:
  - (1) Under the condition that A engages C, if C engages B. Regardless of B's attitude towards C, engaging A is more beneficial for C. ( $a_1 > e_1$  ,  $b_1 > f_1$ )
  - (2) Under the condition that A engages C, and under the hypothesis that C contains B, disregarding B's attitude towards C, engaging A is more beneficial for C. ( $c_1 > g_1$  ,  $d_1 > h_1$ )
  - (3) Under the condition that A contains C. If C engages B, disregarding B's attitude towards C, it is indifferent whether C engages A or contains A. ( $a_2 = e_2$  ,  $b_2 = f_2$ )
  - (4) Under the condition that A contains C, if C contains B. Regardless of B's attitude towards C, it is indifferent whether C engages A or contains A. ( $c_2 = g_2$  ,  $d_2 = h_2$ )
  - (5) Thus, regardless of the relation between B and C, if A engages C then engaging A is strategically beneficial for C. If A contains C, then it is indifferent whether C engages or contains A. Since all three parties simultaneously make decisions, when C is unaware of A's motive, based on rational decision C will engage A; similarly C will engage B.

In sum, equilibrium is at al: under the condition that A-B FTA has been established, A engages C, B engages C, and C will engage with A and B to retain its interests (cf. figure 2). This result can be generalized to explain competition among actors in the real world. Given that competitors (A and B) have allied as trading partners by joining the WTO, the impact to the outsider (C) is in two aspects. First, it implies that free trade may bring a certain degree of profit for the outsider's competitors. Second, this scenario may further relatively jeopardize the outsider's position in trade competition by enhancing its competitors' competitiveness.

Considering the negative impact, it is likely that any rational actor will participate in the WTO in an integrated global economy as illustrated by the game. Stated differently, some countries actively participate in the WTO to gain interests through free trade while others join apprehensively to preserve their advantages by reducing impact brought by their trading competitors. Regardless of their different motives, actors all realize the urgency to participate in the global trading system.

### ***3.3. After joining the WTO***

In a perfect world as illustrated, the Doha Round would never be dominated by chaos. The current deadlock evidences that conflicts of interest exist among WTO members and cause free trade obstruction. How does the conflict emerge both in theory and in the real world? What is its influence on actors' decision making? The following analysis explores the hidden rationales which are less discussed by extant studies.

#### ***3.3.1. Structure: the perspective of structuralism***

Wallerstein depicts the power structure in international trade and analyzes actors' restrictions in the World System Theory. Anarchy leads to the rapid expansion of capitalism, which has formed an efficient system to allocate resources and created production specialization. Developed countries, serving as core actors, determine the power distribution in this system, pushing developing countries to the system's periphery. It is therefore not surprising that the system operates with undue benefit to its designers at the expense of the developing counterparties.

Structuralists consider trade competition as a zero-sum game. Developed countries import raw materials and export high value-added goods. The trade between iPads and apples conspicuously leads to wealth accumulation in the core instead of the periphery, so the relationship between core and periphery states in fact is not as reciprocal as it is in the liberals' argument. In the periphery, the standard of living does not increase proportionately with trade income. With reference to data from the 1970s to 1980s, Hirst and Thompson (1999, pp. 75-76) indicates that the invisible hand did not render trade benefits to developing countries; instead, the poverty gap between the core and the periphery expanded. Structuralists rebut liberals by arguing that under the structure set by developed countries, redistributing trade wealth is futile and therefore unequal development and conflicts of interest inevitably exist.

#### ***3.3.2. The structural problem of fair competition***

The argument of structuralists is visualized in today's free trade practice. WTO principles and rules establishing the free trading system include non-discrimination, reciprocity, binding and enforceable commitments, transparency and safety valves. These seemingly fair and harmless values instead exposed actors, especially developing countries, to a formally equal but essentially unfair trading environment as evidenced through their imports and exports.

As importers, developing countries experience homogenous product competition between foreign and domestic producers. Advanced technology and substantial capital have consolidated developed countries' advantageous position in the trading system. As this makes developing countries inherently vulnerable in trade competition, they tend to protect their local industries by setting higher tariffs, imposing import quotas and setting stricter quality standards on import products. Although these protections can be effective, they are currently

prohibited or difficult to implement due to the WTO regulation. As a result, developing and developed countries with great resource disparities are placed on equal footing. Given that gaps in comparative advantage still exist, the structure of free trading system in fact promotes unequal trading development.

On the other spectrum, developing countries, as exporters of labor and raw materials, are still disadvantaged by unequal trading relations. Free trade opens up a huge world market for developed countries to acquire resources with lower costs than ever, while globalization incentivizes multinational companies to reduce production costs and increase profit margins by outsourcing and dividing production. Developing countries, however, often face stringent trade conditions with weak bargaining power against the developed countries or those profit-thirsty multinational companies; eventually, they are often forced to be price takers.

To be more specific, the free trading system takes both labor and raw materials from the domestic market into the world market; as more competitors and homogeneous goods emerge, wages and raw material prices decrease accordingly, thereby reducing the percentage gains of developing countries. With minimal profits from trade, developing countries barely accumulate capital to elevate their industries into more skill-intensive and value added level, not to mention improve generally work conditions and labor exploitation. Thanks to iPads, Apple Inc. is heralded as the avant-garde of global information technology. This corporation's stock valuation is over five billion US dollars, which exceeds most countries' GDPs and is equal to the 18<sup>th</sup> biggest economy in the world. The *New York Times* found that while raw materials represent the largest portion of total production cost for each iPad, the labor cost only accounts for 2%, meaning that, Apple maximizes profit by squeezing margins of its upstream manufacturers in developing countries. To sum up, as long as the developed-versus-developing structure exists, developing countries difficultly benefit from the free trading system; in the meanwhile, they still face challenges from the aggressive expansion of developed countries' export sectors.

### 3.3.3. Actor: the compensatory outsider game

Governments of developing countries would face public pressure if unequal trading relations under the WTO framework compromise their domestic industries' interests or even cause unemployment and dumping. Protests at the WTO conferences in Seattle (1999) and Hong Kong (2005) are examples. Stated differently, the governments have to balance among trade benefit, domestic interest groups and the unsatisfied and ireful public.

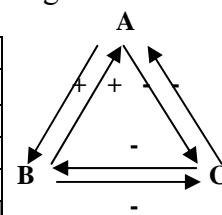
In such case, considerations for non-trade factors might skew the decision making of trade policies. Wan argues that political leaders often tend to weight short run, non-economic gains more than trade liberalization. This is especially obvious during elections as the political leaders may overlook free trade principles to satisfy voters and lobby groups. To reflect such situation, rational actors now react through a new model that incorporates non-trade factors.

We revise the outsider game by taking "el" for example. C receives two points of utility (-1→1) if it engages A. For non-trade factors to influence C to contain A, their utility must be  $\geq 2$ . C must benefit at least 2 points from non-trade factors to compensate for its international trade losses. Due to trade competition between A and C, C's 2 point gain in non-trade factors will be A's losses, so the 2 points should be deducted from A's payoff, resulting in  $e1 = (-1,3,-1) \rightarrow (-1-2,3,-1+2) \rightarrow (-3,3,1)$ . We remodel the new payoff distribution as Table 3 by using the same method to calculate the payoff in each chart.

Table 3. The Compensatory Outsider Game

		i	j	k	l	m	n	o	p	
		C				C				
		+A , +B		+A , -B		-A , +B		-A , -B		
		B		B		B		B		
		+C	-C	+C	-C	+C	-C	+C	-C	
1	A	+C	(1,1,1)	(3,1,-3)	(3,-3,1)	(3,-1,-1)	(-3,3,1)	(-1,3,-3)	(-1,-1,1)	(-1,1,-1)
2	A	-C	(1,3,-3)	(3,3,-7)	(3,-1,-3)	(3,1,-5)	(-1,3,-1)	(1,3,-5)	(1,-1,-1)	(1,1,-3)

Figure 3.



The following demonstrates each player's decision making:

- For A:
  - (1) Under the condition that C engages with A, regardless of B's attitude towards C's, it is indifferent whether A engages or contains C. ( $i_1=i_2$ 、 $j_1=j_2$ 、 $k_1=k_2$ 、 $l_1=l_2$ )
  - (2) Under the condition that C contains A, regardless of B's attitude towards C, containing C is more beneficial for A. ( $m_2>m_1$ 、 $n_2>n_1$ 、 $o_2>o_1$ 、 $p_2>p_1$ )
  - (3) When three parties make a decision at the same time, under the condition that A is unaware of C's intentions, based on rational decision A will *contain* C.
  
- For B:
  - (1) Under the condition that C engages B, regardless of A's attitude towards C, it is indifferent whether C engages or contains B. ( $i_1=j_1$ 、 $i_2=j_2$ 、 $m_1=n_1$ 、 $m_2=n_2$ )
  - (2) Under the condition that C contains B, regardless of A's attitude towards C, containing C is more beneficial for B. ( $l_1>k_1$ 、 $l_2>k_2$ 、 $p_1>o_1$ 、 $p_2>o_2$ )
  - (3) When three parties make a decision at the same time, when B is unaware of C's intentions based on rational decision making B will contain C.
  
- For C:
  - (1) Under the condition that A engages C, if C engages B, regardless of B's attitude towards C, engaging or containing A makes no difference for C. ( $i_1=m_1$ 、 $j_1=n_1$ )
  - (2) Under the condition that A engages C, if C contains B, regardless of B's attitude towards C, engaging or containing A makes no difference towards C. ( $k_1=o_1$ 、 $l_1=p_1$ )
  - (3) Under the condition that A contains C, if C engages B. Regardless of B's attitude towards C, containing A is more beneficial for C. ( $m_2>i_2$ 、 $n_2>j_2$ )
  - (4) Under the condition that A contains C, if C contains B. Regardless of B's attitude towards C, containing A is more beneficial for C. ( $o_2>k_2$ 、 $p_2>l_2$ )
  - (5) Thus, regardless of the relation between B and C, if A engages C, it makes no difference whether C engages or contains A. If A contains C, then containing A is strategically more beneficial for C. Since three parties simultaneously make decisions, under the condition that C is unaware of A's intentions and based on rational decision, it will contain A. Under similar conditions C will choose to contain B.
  - (6)

In sum, equilibrium will be at p2: under the condition that A-B FTA has been established, A contains C, B contains C, and C will contain both A and B at the same time. (cf. figure 3) While C becomes the isolated party, this result implies that even if its competitors ally in the WTO, the outsider will still contain them and disrupt free trade in consideration the greater non-trade interests.

### **3.4 The big picture**

It is therefore not surprising to find deadlock in the WTO. The outsider game suggests that in an integrated global economy, a rational strategy for any outsider is to cooperate with other actors. A WTO outsider strives for membership not only because of gains brought by free trade, but also to avoid being marginalized from the global market. In theory all actors will eventually participate in the WTO and therefore if any conflicts of interest emerge all actors will suffer.

Unfortunately, there is an inherent fracture in the structure of the WTO. Although actors may believe that free trade promotes growth, the assumption is only valid for certain members due to dynamic comparative advantages in the developed-versus-developing structure. Developed countries dominate most of the production process by having advanced technology and abundant capital. The lack of dominant industries in developing countries suggests a lack of comparative advantage which is a prerequisite to benefit from the trading network. During the mid-1970s, the percentage of primary agricultural production for export was relatively high for developing countries; some of them even reached 90 percent (Strayer, 1973). After two decades, this situation has not improved because even if developing countries have comparative advantage for low labor costs or abundant raw materials, they are unable to bargain for good prices against their wealthy trading partners. Since the value of goods produced in developing countries is relatively low and limits wealth accumulation, the periphery remains habitually poor.

The WTO design ignores this inherent inequality but places developed and developing countries at the same starting line. It consolidates the core-periphery structure and deprives developing countries of their opportunity to elevate themselves. While the biased international redistribution effect has aggravated poverty, the WTO would be incapable to effectively address this issue as long as it advocates free trade. Free trade therefore merely brings income for developed countries, but increases poverty with the asymmetrical accumulation of wealth. As a result, conflicts of interest inevitably emerge between the developing and developed worlds.

Findings from the compensatory outsider game illustrate developing countries' reactions under this kind of conflict. Once actors' interests are no longer satisfied by the WTO or their relative losses are greater than gains within the system, the compensatory outsider game identifies that disrupting free trade among other actors would be a rational strategy. The implications here are two-fold. On one hand, under the current rule of most-favored-nation treatment and national treatment, abdicating WTO membership would lose these rights and significantly increase the cost of export products, while competitive reduction would further increase risks of marginalization. Hence, rational actors may prefer to remain in the WTO after weighing the costs and benefits, except they would insist to modify the current arrangement and protect their stripped interests, causing trade negotiations to deadlock. On the other, rational actors may refocus on alternative bilateral or multilateral trade cooperation. This explains the increasing bilateral or multilateral free trade agreements (FTAs) established in the recent decade. To sum up, as long as actors are rational and interest-seeking, conflicts of interest will continually challenge the trading system and possibly collapse the WTO.

Any rectification is doomed for failure due to structural conflicts embedded in the nature of fair competition within the WTO. Especially for multilateral initiatives, the prerequisite for

their initiation is in settling the participants' interests, which, however, just forms the core of Doha's deadlock. In this regard, Schwab and Mattoo are either too optimistic or too naïve. While the current structure results from several past trade negotiations, every country's interests have been intertwined together and expected to be increasingly closer. Attempted modification would redistribute vested interests under current arrangements, causing reluctance to accept structural changes. This logic not only applies to the WTO reform but also to any multilateral initiative that redistribute participants' extant benefits. The absence of firm support from developed countries equates to a death knell of multilateral cooperation, not to mention that any developing countries' attempt to protect their interests might risk sanctions and be criticized as protectionism in consideration of the principle of fair competition. Realistically, north-south cooperation is undesirable and such effectiveness to reform the WTO is also questionable. This explains why multilateral cooperation is an infeasible solution to a structural problem.

#### **4. The way to a better world**

Doha's goal is to alleviate the unbalanced development status among actors. The way, nevertheless, is not necessary restructuring the WTO architecture especially when those extant obstacles seem to persist. In the view of this paper, the real concern is how to maximize the positive effect of free trade, whereas the WTO per se is merely a means to the ends. As the WTO is fraught with problems to fulfill its mission of promoting free trade, two related issues emerge: first, how could state actors pursue trade liberalization without the WTO framework; second, in consideration of Doha's uncertain future, how could state actors address the global unbalanced development which is the original mission of the Doha Round.

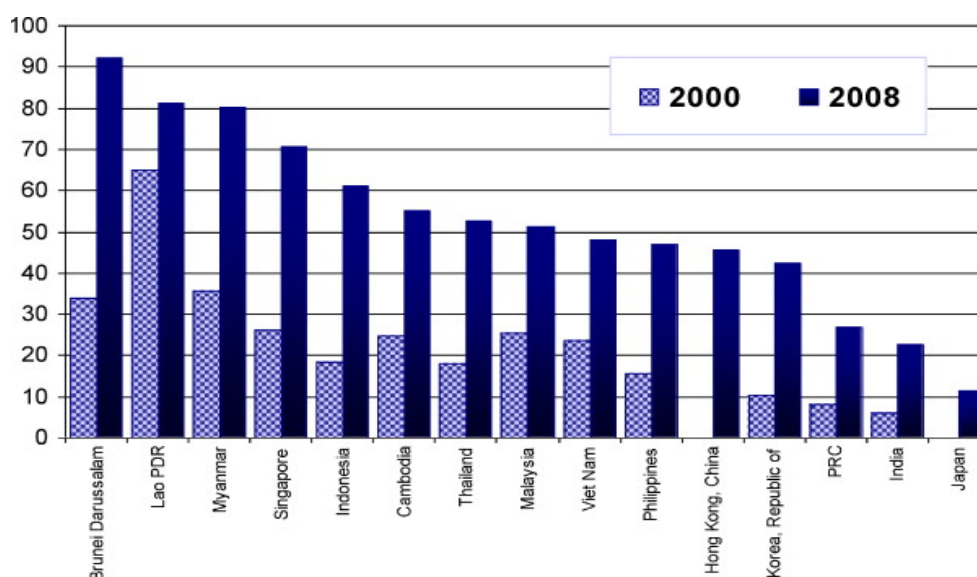
##### ***4.1. New possibility for free trade***

While this paper highlights structural obstacles in the WTO and argues that Doha's progress seems forlorn, should we bid farewell to free trade, which liberals consider as the most significant achievement in post-war international economics. Opponents might point to the nightmare of protectionism that caused WWII and claim that free trade brings growth in certain developing countries. In the 1980s, the four tigers including Hong Kong, Singapore, South Korea, and Taiwan developed rapidly and successfully created the East-Asian economic miracle by utilizing export-led strategies. (Stiglitz, 1996, pp. 151-177) By the year 2001, the term "BRICs" referred to the four new emerging markets of Brazil, Russia, India and China, for which Goldman Sachs predicted would contribute 40% to global growth by the year 2025. Apparently, countries pursuing wealth will not ignore free trade.

Indeed, free trade not only contributes to the post-war recovery and the growth of four tigers and BRICs, but is also growing with an unprecedented speed and scale in Asia (Feridhanusetyawan, 2005; Fiorentino, Crawford & Toqueboeuf, 2009). Despite the impeded global trade regime, Asian economies actively promote trade via FTAs. Information provided by the Asia Regional Integration Center (ARIC) FTA Database identifies this rapid growth trend in the same period of the Doha stalemate. The number of concluded FTAs in Asia as a group multiplies from only 3 to 61 during the period of 2000 to 2010. Among these, 47 FTAs are currently in effect, while another 79 are either under negotiation or proposed. In the meantime, almost every Asian country shifts its focus from the world trade to its FTA partners (Kawai and Wignaraja, 2011). Figure 4 shows the share of an economy's bilateral trade with its FTA partners in its total trade with the world for 2000 and 2008.

As Asian practices demonstrate, FTAs is a better approach than a global trade regime for two reasons. First, free trade can spur overall economic growth only when each participant has a comparative advantage to acquire mutual benefit. However, under open market and non-discrimination principles, developing countries must open themselves to all WTO members regardless of whether such trade is beneficial. This results in greater losses than gains for them when participating in the trading network. In this regard, developing countries in fact suffer more from the seemingly fair but indeed biased global trade regime.

Figure 4. Share of an economy's trade with its FTA partners. Relative to the economy's trade with the world: 2000 and 2008 (% of total trade).



Note: Only covers concluded FTAs for that year. Japan and Hong Kong, China had no FTA partners in 2000. Sources: ADB staff estimates based on Direction of Trade Statistics, International Monetary Fund (data as of November 2009) and ADB ARIC FTA database ([www.aric.adb.org](http://www.aric.adb.org)); data as of April 2010.

Second, even though the WTO provides equal status to both litigant parties via the disputes settlement mechanism, its democratic nature impedes further reforms aiming to correct the structural inequality of this system. The problem of “a fair trial before an unjust law system” exists in the WTO architecture. Developing countries can only repeatedly appeal to the dispute settlement body case by case, but are incapable to address the fundamental inequality existing in the developing versus developed structure.

One might argue that the Generalized System of preferences (GSP) and the Safeguard mechanism are designed to institutionally correct the structural inequality. Whereas this point is well taken, it is also difficult to deny that the conditionality of applying these WTO articles in practice is at the developed countries' discretion. It is the IMF who determines whether a country encounters difficulties in its balance of payments; also the US negated China's claim as a developing country for a long period. It can be seen that developed countries still dominate over these mechanisms that aim to alleviate the gap between the north and south.

In contrast, bilateral/multilateral FTAs are exceptions to the principle of non-discrimination. With the bottom-up nature, FTAs allow countries trading with each other based on their needs and advantages without constraint from comprehensive liability under the WTO framework. It creates more flexibilities and alternatives for policy making. By removing the



developed-versus-developing structure and allowing certain special rules, FTAs empower actors to design a trade regime which best suits each participant's needs and interests.

On the other hand, the FTAs demonstrate higher efficiency when adjusting themselves to the rapidly changing global business environment. As the Doha Round has shown, once an initiative is related to members' vested interests, it is difficult to reach any consensus or progress. In fact, the diversity of East-Asian FTA projects implies that different interests and concerns among state actors are competitive but also compatible. This dynamic co-opetition in trade benefit can be embodied by the FTA architecture, whereas it would scarcely happen in a world trade regime. In conclusion, the approach of FTA is more pragmatic and feasible for governments to promote free trade compared with the stalled WTO negotiation.

#### ***4.2. Solution to the global unbalanced development***

In order to alleviate the global unbalanced development, a new fair trade regime should be established to protect developing countries' interests in international trade. Mr. Lamy, Director-General of the WTO, argued that a global trade arrangement is ideal for most medium and small open economies as FTAs cannot provide a fair institution except the WTO. His point reveals the blind spot and paradox of the WTO. The emphasis on "institutional equality" makes the goal of "real equality in trade" unreachable and aggravates the unfair trade relation resulted from competitive differences among actors.

Instead of institutional equality, the fair trade prototype is a conceptual trading partnership that seeks greater equality in international trade. It contributes to sustainable development by offering better trade conditions that ensure rights of marginalized producers and workers in developing countries. Although the Doha Round has showed that the current free trading structure is difficult to modify, actors could be more instrumental in promoting a fair trading environment by changing their practices. The key to improving practice should not be establishing new international organizations or multinational institutions, but simply introducing market power to correct failures of the free trading system, endeavoring to change actors' trading behaviors rather than reforming the rigid competitive structure itself.

In this regard, consumers should utilize purchasing power as leverage against foreign producers to promote production justice. Instead of only focusing on material costs and profits, the social cost of production factors should also be considered. If consumers prefer goods and services with fair trade certifications, the market and its producers would respond to such demand and form a fair trade regime based on interest-seeking incentives. Progress would come from the market itself rather than trade negotiations. Meanwhile, since it is easier to legalize fair trade domestically, governments could regulate the certification of qualified trading partners, such as legally prohibiting domestic firms from cooperating with suppliers that hire child labor or violate basic human rights. By significantly increasing the cost of unlawful activities, domestic markets would send a clear signal to the world market for fair trade. For example, Apple Inc. has required its suppliers and component manufacturers to improve working conditions after pressure from public and governmental sectors.

### **5. Conclusions**

Doha's deadlock has exposed conflicting interests in the structure of the WTO. As member governments are rational actors, the emergence of the deadlock is inevitable under the developed-versus-developing structure. This paper demonstrates that by providing a logical

analysis with theoretical bases and real life examples. The Doha Round aimed to amend WTO rules to bring the system closer to its ultimate mission of promoting global growth and elevating the standard of living. Any structural reform, however, is futile, whereas free trade is more attainable by promoting FTAs and establishing a fair trade regime driven by market power. The courage of each generation determines the direction that our civilization will take. In order to realize the free trade's ultimate goal, we need great courage to foster these alternatives. Only in this way can we open trade for the benefit of all, tide over the deadlock under the north-south structure, and move forward to a better world.

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