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From Doha to Cancun

Delivering a Development Round

Edited by
Ivan Mbirimi
Bridget Chilala
Roman Grynberg

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Contents

Foreword by the Commonwealth Secretary-General v

1 Introduction 1
Ivan Mbirimi

2 Market Access Proposals for Non-agricultural Products 9
Sam Laird, Santiago Fernandez de Cordoba and David Vanzetti

3 Special and Differential Treatment 49
Christopher Stevens

4 From Doha to Cancún: Agriculture 65
Alan Swinbank

5 Using GATS Flexibility 91
Ivan Mbirimi and Bridget Chilala

6 Reform of the WTO Dispute Settlement Understanding: A Critical Juncture for Developing Countries 105
Dan Sarooshi

7 Transparency in Government Procurement 137
Peter Williams

8 Investment on the WTO Agenda: A Developing Country Perspective and the Way Forward for the Cancún Ministerial Conference 155
Nagesh Kumar

9 A Multilateral Competition Agreement and the Developing Countries 191
Michael Davenport

10 The State of Trade and Environment Negotiations within the WTO 239
Beatrice Chaytor

11 Small Vulnerable Economy Issues and the WTO 269
Roman Grynberg and Jan Yves Remy

12 WTO Fisheries Subsidies Negotiations: Implications for Fisheries Access Arrangements and Sustainable Management 291
Roman Grynberg

13 Trade, Debt and Finance: A Complex Agenda for the WTO 315
Pradeep Mehta

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Foreword

In the eyes of the world, the Cancún Trade Ministerial Meeting will act as a litmus test of the major industrial countries' commitment to inclusive globalisation, to meeting the Millennium Development Goals and to a stable and peaceful world. Increased trade opportunities provide the best means of placing poor countries on a higher trajectory of growth and poverty reduction. The current system does not work for many developing countries and imposes burdens on the consumers of the developed world.

The launching of the Doha Round gave a boost to the multilateral trading system. The lessons from Seattle and the perspective that emerged after 9/11 led to the recognition of the need for a new approach. It is a matter of considerable concern that progress in the Doha Development Round negotiations has been disappointing, particularly on the issues that matter most to developing countries. A number of important deadlines have been missed.

It is now important that Cancún delivers on the promises built into the Doha development agenda. Key areas where decisions at Cancún are essential are: agriculture, TRIPS and health; non-agricultural market access; special and differential treatment and implementation issues; review of the dispute settlement understanding; and the Singapore issues. It is important to make progress on non-agricultural market access to enable poor and vulnerable countries to enhance the resilience of their economies through diversification. They must be provided with a better framework to reduce the risks associated with their economies, if they are to cope effectively with globalisation.

Many developing countries are having to cope with multiple trade negotiations: the Doha Development Round; the ACP-EU negotiations on economic partnership agreements; and, in some cases, regional free trade agreements. Furthermore, some countries are still striving to implement the Uruguay Round Agreements. In such a context, it is necessary to consider carefully the capacity of the vast majority of developing countries to embark on the 'Singapore Issues': competition policy, investment, trade facilitation and transparency in government procurement.

The international community cannot allow Cancún to be a failure. It would set back global economic recovery and strengthen the hands of those who seek to exploit the increasing disparities in the world.

In the lead-up to the Cancún meeting, the Commonwealth Secretariat organised a series of regional workshops on developments in the Doha Development Round. This publication is a compilation of papers used at those meetings. It is intended primarily to assist policy-makers in Commonwealth developing countries, particularly small states and the least developed counries, in preparing their negotiating positions for Cancún.

Don McKinnon, *Commonwealth Secretary-General*

1
Introduction

Ivan Mbirimi*

Delivering a Development Round

The Doha Ministerial Declaration envisages negotiations lasting three years (November 2001–January 2005). This is a very ambitious target which many observers doubt can be achieved. The agenda is very large and the negotiations in the first two years have not been very productive. There are other reasons for this pessimism. A key one is the less than auspicious political and economic environment under which negotiations are being held. Another is the limited progress made on issues of particular interest to developing countries, notably agriculture, special and differential treatment (SDT) and the failure to achieve agreement on Trade-Related Intellectual Property Rights (TRIPs) and access to medicines. A number of key deadlines have also been missed. The situation is complicated by the dearth of expertise and limited financial resources in developing countries, which means that advocacy for developing country interests is relatively weak.

This book is a contribution to the debate on how the Doha Development Round might deliver on one of its central objectives: the 'promotion of economic development and alleviation of poverty'.[1] In general, each chapter assesses progress made in the negotiations and makes recommendations on the likely outcomes, concerns and interests of developing countries. This introduction covers the following: (a) the trading environment under which negotiations are being held; (b) a summary of the concerns of developing countries as seen by the authors of the articles in this book; and (c) a discussion of what might constitute a good Cancún deal from the standpoint of developing countries.

International Trading Environment

Several aspects of the current international political and trading environment have contributed to the slow progress made in the first two years of negotiations. Of particular concern is the relationship between the European Union (EU) and the USA. The issues that have caused dissent and controversy range from the war in Iraq to disputes on trade, international environmental agreements and the International Criminal Court. Past experience suggests that progress in multilateral trade negotiations is more likely

*The author is grateful to Dr Indrajit Coomaraswamy and Dr Roman Grynberg for advice and encouragement in the preparation of this introduction.

when governments, particularly those of leading industrialised countries, are seriously engaged and focused on the issues under negotiation. When other issues intrude, as in the case of the war on Iraq, there is often a ripple effect that tends to undermine commitment to multilateral trading negotiations.

On the economic front, a succession of bitter transatlantic trade disputes remain unresolved. These include disputes on taxation of foreign services corporations (FSC) by the USA, import protection for steel products entering the US market and the EU's authorisation system for genetically modified organisms (GMOs). At the general level, these disagreements have contributed to the loss of momentum in the Doha Development Round negotiations. More specifically, each one of these disputes raises concerns about particular aspects of the World Trade Organisation (WTO). Thus the steel dispute is a classic example of an industrialised country protecting a sensitive sector of its economy.

The GMO dispute brings into sharp relief the problem posed by standards harmonisation in the WTO. By insisting on the use of the precautionary principle in meeting environmental or human health objectives, the EU opens itself to the charge that it is effectively imposing its own standards on others. On the other hand, the way in which the USA has pursued this matter has only served to confirm the fears of those who argue that the ability of developing countries to regulate certain aspects of their trade in the public interest is being continuously eroded. The GMO controversy appears intractable, in part, because this is not a traditional 'at-the-border' trade dispute; rather, it reaches beyond borders, and affects such fundamental issues as the way in which American and European societies are governed and their economies regulated.[2]

The growth in bilateral and regional trading arrangements are another source of concern. Aside from the hemispherical Free Trade Area for the Americas (FTAA), which has been under negotiation for a number of years, the USA has already concluded free trade agreements (FTAs) with Jordan and Singapore and is looking into negotiations, or has already launched them, with several other countries and regions, including the South African Customs Union (SACU), Morocco, Bahrain and Australia. The debates in Washington highlight the importance of issues beyond the trade agenda. For example, the choice of trading partners reflects not only economic opportunities, but also judgements about geopolitical returns and support for the USA in the WTO and FTAA. This is the nub of the problem.[3] Unlike the open, rule-based multilateral trading system represented by the WTO, bilateral and regional trade arrangements are likely to mean less transparency and more discrimination in trade rules. And as the WTO gets marginalised, the weakest and poorest countries get squeezed.

Europe is also involved in negotiating regional trade arrangements with different regions of the Africa, Pacific and Caribbean (ACP) group of countries. There are two problems with the EU approach to future relations with the ACP. First, the policy is causing confusion in those regions of the ACP where there is overlapping membership

of regional organisations – for example Southern Africa – or where regional integration is not very advanced. Second, these negotiations compound the capacity problems of these countries; few of them have the organisation and capacity to pursue negotiations in multiple forums.

Concerns of Developing Countries

The major concerns of developing countries are many and varied, and sometimes there are conflicting interests, partly because there is so much diversity among them. For instance, there is no consensus among developing countries in the negotiations on market access. Sam Laird's rigorous assessment of various modality papers on tariff liberalisation points to some of the difficulties. Clearly, those countries that trade largely on a most favoured nation (MFN) basis will have interests in a liberalisation formula that removes tariff peaks in their main markets. Other developing countries, particularly least developed countries and beneficiaries of arrangements such as the Cotonou Agreement, whose exports are largely duty free and who benefit from high margins of trade preference, may see the lowering of these tariff peaks as damaging to their trade interests. Clearly, if developing countries seek any common objective, it is a flexible and differentiated approach. Some of the formulas proposed by countries such as India and Korea provide precisely that sort of flexibility. However, it is specifically this flexibility that may make these kinds of tariff liberalisation formula unacceptable to those WTO Members who are seeking elimination of tariffs by all countries in this current round.

Striking a deal on agriculture remains the biggest challenge faced by ministers at Cancún, despite the June 2003 agreement by the EU Council of Ministers to decouple subsidies from production. The reasons for this are clear from Professor Alan Swinbank's contribution to this book (although it was written before the EU agreement). Agreeing the modalities for negotiation before Cancún seems highly unlikely. Swinbank argues that the Peace Clause (Article 20 of the Agreement on Agriculture) might be the lever for change. This is because in the absence of a renewal of the clause, disputes on farm policies are likely to increase. Clearly one cannot prejudge the kind of trade-off that might emerge or whether developing countries will accept a roll-over of the clause. How developing countries will approach renewal of the Peace Clause will depend on the way they see their interests. Developing countries are, of course, a diverse group of countries with different interests reflecting their comparative advantage in agricultural production, their net trade position and existing trade preferences, and their focus on temperate or tropical products. For the majority of them, however, the biggest gains are likely to flow from tariff cuts and reduction of tariff peaks and tariff escalation in both OECD and other developing countries.

Ivan Mbirimi and Bridget Chilala also tackle the services negotiations from a

policy-maker's perspective. In particular, they explore ways in which developing country governments might use the policy flexibility of the General Agreement on Trade in Services (GATS). In their view, this should be the main focus of developing country efforts, particularly the poorest among them. Any services liberalisation ought to be placed in the overall context of the development of a viable domestic service sector that responds to the needs of the economy. Of course, some would argue that GATS flexibility is a myth, as developing countries are likely to come under pressure to commit sectors before they are ready to do so. However, the authors see this as an argument about the degree of flexibility. In their view, what matters is that the GATS is sufficiently permissive to allow countries to devise and implement domestic services policies that benefit their economies.

The Dispute Settlement System (DSS) is generally seen as one of the major achievements of the Uruguay Round. Its use over the last few years has, however, highlighted a number of difficulties that require attention. Dr Dan Sarooshi's paper identifies the key ones for developing countries. They include the initiation of cases; issues relating to the establishment, membership, composition and procedure of panels; issues relating to the membership and procedure of the Appellate Body; issues relating to the effect of panel and Appellate Body Decisions on developing country members and their lack of a development focus; improving the ability of developing countries to use the system; transparency of proceedings; and third party issues that concern developing countries. The paper recommends possible changes on each of these issues.

Chris Stevens explores ways in which the impasse on special and differential treatment could be broken. In his view all proposals on SDT face the twin hurdles of: (a) some Members refusing to agree to flexibilities that would apply to all developing countries; and (b) devising appropriate forms of differentiation, linking the differentiation to a specific development problem. Furthermore, the introduction of tighter dispute settlement procedures under the Uruguay Round means that vague formulations on SDT might not be accepted by developing countries, mainly because such vague formulations could be challenged under the dispute settlement mechanism. One way to break the deadlock at Cancún would be for industrialised countries to agree general principles that would be legally enforceable to the extent of providing guarantees against challenge in dispute settlement. It is also suggested that developing countries should identify areas of highest priority action in relation to SDT. Stevens sees agriculture as a prime candidate for priority action

In the paper on transparency in government procurement, Peter Williams evaluates the arguments for and against a WTO Agreement. In his judgement, developing countries might still be able to forestall a decision on negotiations at Cancún, particularly if there is no agreement on modalities for negotiations. But he argues that if the pressure for negotiations is irresistible, developing countries should insist that the Singapore issues are unbundled.

Dr Nagesh Kumar reviews the options available to developing countries on investment at Cancún. The paper is sceptical about the relevance of a multilateral investment framework to developing countries. This scepticism is based on evidence on the main determinants of Foreign Direct Investment (FDI), which tends to show that a host of other factors are perhaps more significant than investment rules and regulations. This leads Kumar to suggest that the most prudent option for developing countries at Cancún would be to resist a negotiating mandate. The success of this strategy, however, will depend on the ability of developing countries to put together an effective coalition against such a mandate. If a mandate is agreed, developing countries are urged to ensure that their key concerns are incorporated into each element of the proposed framework. Key concerns include limiting the scope of the multilateral framework on investment to trade-related FDI, resisting commitments on pre-establishment commitments, providing for flexibility to pursue selective policies and impose performance requirements by developing countries, incorporating investors' and home country obligations, and providing for transfer of technology, control of restrictive business practices and competition policy.

In the paper on competition policy, Dr Michael Davenport identifies the following developing countries' concerns: the inevitable reduction of 'policy space'; the likelihood that national firms will be at a competitive disadvantage vis-à-vis the larger firms from industrialised countries; and the financial and human resource costs of implementing the resulting agreement. Developing countries are also still opposed to the idea of the WTO taking responsibility for competition policy, and many of them are fearful of the possible application of the dispute settlement mechanism. Davenport's paper recommends a minimum body of domestic competition law to be agreed in a Multilateral Competition Agreement (MCA) and to be implemented by all members. The emphasis of the agreement will be on information-sharing and co-operation through both positive and negative comity, and on outlawing hard-core cartels; in the examination of mergers and acquisition, account would be taken of the interests of other members, in particular in regard to the potential dominance in their individual markets.

Beatrice Chaytor's paper notes a shift in focus in the approach of developing countries, with the link between trade and sustainable development receiving more attention compared to the narrow linkages between trade and the environment. This shift includes an emphasis on the liberalisation of trade in goods of special interest to developing countries. Chaytor urges developing countries to further refine their approaches across a whole range of trade issues that have a bearing on the environment, for instance by fighting for better market access for their agricultural goods, labelling of organic food products and improving trade in such goods in the Committee on Technical Barriers.

According to Dr Roman Grynberg, fisheries subsidies negotiations remain one of

the issues that straddles both unfinished business from the end of the Uruguay Round, and the so-called 'new issues'. At the end of the Uruguay Round, WTO Members left subsidies to the fisheries sector outside the disciplines and reduction commitments of the Agreement on Agriculture. Subsequently, concern that unsustainable fisheries subsidies were undermining the viability of global fisheries, as well as distorting trade, has created a synergy between trade and environment issues. Initial proposals on the architecture for such an agreement have been proposed by the USA and there has been support from the EU. However, other important fishing nations such as Japan and South Korea remain unconvinced by the need for new disciplines. As far as developing countries are concerned, considerations pertaining to SDT provisions in any future fisheries subsidies agreement that will cover their concerns have not yet been proposed.

The Doha ministerial mandate called for the creation of a work programme on small economies. Grynberg's and Jan Yves Remy's assessment of the work undertaken so far indicates that most of it has revolved around the questions of why and how provisions of the WTO should reflect their particular concerns. The paper on small economies addresses the development of positions during the dedicated sessions where progress has been very slow and, indeed, mirrors the progress on implementation and special and differential treatment. In general, developed countries have only shown flexibility on issues of minor economic significance such as allowing delegation of the implementation of WTO Agreements by small vulnerable economies (SVEs) through their regional bodies rather than national governments. Despite the narrow ministerial mandate from Doha, the paper addresses the issue of a definition of small vulnerable economies because without such a definition it is not possible to devise appropriate interventions that are focused on and limited to this group. The paper finds that an appropriate definition is possible and, in part, already exists in the UN system.

The paper by Pradeep Mehta of CUTS (Consumer Unity and Trust Society) assesses the scope and opportunities for reform of international economic policies on the basis of an integrated developmental approach to trade, debt and finance. This is a vast subject on which there is a divergence of views between developed and developing countries. The main concern of developing countries is that the current international trade and financial system does not provide sufficient long-term financial resources to enable them to achieve rapid and sustained economic growth through trade. It is clearly too early to see the direction in which the discussions on this subject will go, but the recommendations provide a valuable input to the debate.

A Cancún Compact for Developing Countries

Having been showcased as a development round, the negotiations must begin to show results in areas of major interest to developing countries. Certainly, the Cancún meeting

cannot be judged to be a success if tangible progress is not made in areas that matter most to developing countries. The best way to secure the interests of developing countries is by delivering improved market access across a broad range of products of interest to these countries. For the majority of developing countries, this requires positive outcomes at Cancún on a core group of issues that must include: (a) special and differential treatment; and (b) agricultural trade liberalisation. There must also be an agreement on TRIPs and access to medicines before or at Cancún to avoid a repeat of the Seattle débacle. It seems clear that a successful WTO fifth ministerial conference at Cancún should at least show enough progress on these issues for ambassadors to be able to make progress in subsequent negotiations in Geneva.

Notes

1 Doha Ministerial Declaration, November 2001 (WT/MIN(01)/Dec/W/1.
2 Joseph Quinlan, 'Drifting Apart or Growing Together? The Primacy of the Transatlantic Economy', Paul Nitze School of Advanced International Relations, Johns Hopkins University.
3 'Zoellick Says FTA Candidates Must Support US Foreign Policy', *Inside US Trade*, 16 May 2003.

2

Market Access Proposals for Non-agricultural Products

Sam Laird, Santiago Fernandez de Cordoba and David Vanzetti*

1 The Significance of Market Access Negotiations, the Mandate and the Main Proposals

Economies which have been able to diversify towards the production and export of manufactures have grown faster and been better able to withstand economic downturns than economies which remain highly dependent on basic commodities, including the least developed countries (LDCs).[1] However, the process of diversification and expansion of developing countries' production and exports of manufactures has been hindered by tariff and non-tariff barriers in major markets. Yet while there are considerable trade and welfare gains to be made from liberalisation of trade in manufactures, this was not included in the WTO's built-in agenda, agreed at the end of the Uruguay Round. This was remedied by the WTO's work programme adopted at its fourth ministerial meeting held in Doha, November–December 2001.

At the Doha meeting, WTO ministers agreed, in the part of the Ministerial Declaration relating to non-agricultural market access, 'by modalities to be agreed, to reduce or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing countries. Product coverage shall be comprehensive and without *a priori* exclusions' (paragraph 16, Doha Ministerial Declaration). Full account is to be taken of the special needs and interests of developing and least developed country participants, 'including through less than full reciprocity in reduction commitments, in accordance with the relevant provisions of Article XXVIII *bis* of GATT 1994 ...'

The current market access negotiations in non-agricultural products are being handled procedurally in a negotiating group that is mainly concerned with tariff reductions, while most non-tariff barriers affecting trade in these products are being covered in groups dealing with rules negotiations, for example on anti-dumping (AD), rules of origin, technical barriers to trade (TBTs) and sanitary and phyto-sanitary (SPS) agreements. The main negotiable non-tariff barriers (NTBs) affecting non-

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agricultural products are those in textiles and clothing, which are scheduled to be phased out in 2005 under the provisions of the Uruguay Round Agreement on Textiles and Clothing. The NTB negotiations, and any possible replacement of textiles and clothing restraints with alternative forms of contingency protection, such as anti-dumping or safeguards, will need to be taken into account in evaluating what might be agreed in relation to industrial tariffs (as well as in the overall broad package covered by the Single Undertaking).

In relation to industrial tariffs, the main focus of discussions has been on finding a modality that would meet the criteria set out in the Doha Declaration and, ultimately, meet the negotiating and trade policy objectives of the participants in the negotiations. In the first phase of the negotiations, the main attention has revolved around finding a formula to meet these goals, unlike the Uruguay Round where the main modality was request and offer (although in a number of sectors tariffs were reduced on a zero-for-zero basis, by which a critical mass of countries cut tariffs to zero in ten sectors). By mid-June 2003, no decision had been made on modalities but a number of proposals were on the table. This paper looks at approaches which have been used in the past and at the current proposals, and attempts a preliminary evaluation of these proposals, based on certain assumption about elements in the proposals that are yet to be defined or perhaps negotiated.

2 Techniques and Formula Approaches for Tariff Negotiations

Historical Background[2]

Procedures used in trade negotiations have evolved since the first such negotiations were initiated. At the outset of the General Agreement on Tariffs and Trade (GATT), the initial approach used was the request-and-offer procedure, under which contracting parties negotiated reciprocal bilateral market access concessions, which were provided to other contracting parties by virtue of the most favoured nation principle. This procedure reduced average tariffs by around 20 per cent on industrial products. This technique was also used during the next four rounds of negotiations (Annecy, 1949; Torquay, 1950–1; Geneva, 1955–56; and the Dillon Round 1960–62) with, however, much less liberalisation (barely an average of 2.5 per cent reduction in average tariffs).

During the Kennedy and Tokyo Rounds more comprehensive tariff reduction formulas were used. The simplest method used was the proportional cut or the linear reduction approach, used in the Kennedy Round (1963–67) (50 per cent coefficient of reduction, but because of the exceptions, the final average was only a 35 per cent reduction). Only during the Tokyo Round (1974–79) was the so-called Swiss formula introduced, achieving a 30 per cent reduction in average tariffs. This is also called a harmonising approach as it makes more than proportional cuts to higher rates. It is therefore particularly useful for reducing tariff peaks and tariff escalation.

These two approaches yielded greater market access concessions for products with high tariffs than for products with low ones, i.e. they produced greater improvements in market access for goods typically exported by developing countries, except that the permitted exemptions were often precisely in these product areas.

During the Uruguay Round (1986–94), the procedure used was targeted 30 per cent average reduction on industrial products, leaving the distribution between the tariff lines to be negotiated bilaterally, i.e. by request and offer. Simultaneously, the Quad countries (EC, USA, Canada and Japan) agreed in the Uruguay Round to ten 'zero-for-zero' initiatives (beer, brown spirits, pulp and paper, furniture, pharmaceuticals, steel, construction equipment, medical equipment, agricultural equipment and toys) and one 'harmonisation' initiative – chemical products. After the Uruguay Round, the Information Technology Agreement (ITA) used a zero-for-zero approach, by which a critical mass of countries agreed to reduce all tariffs to zero on the selected range of products.

Comparison of Linear Cut and Swiss Formula

The linear approach used to cut tariffs across the board in Kennedy Round tariffs can be expressed as:

$$T_1 = a \times T_0 \qquad (1)$$

where T_0 is the initial bound tariff rate and T_1 the final bound rate and $(1 - a)$ is the percentage reduction. The effects of a linear cut of 40 per cent and 30 per cent are shown in Figure 2.1. While this formula brings large reduction in the absolute value of higher tariffs, proportionally it does not reduce higher tariffs more than lower tariffs.

The progressive effect of higher reductions of tariffs for highly protected products is achieved through a harmonisation formula, of which the so-called Swiss formula is an example:

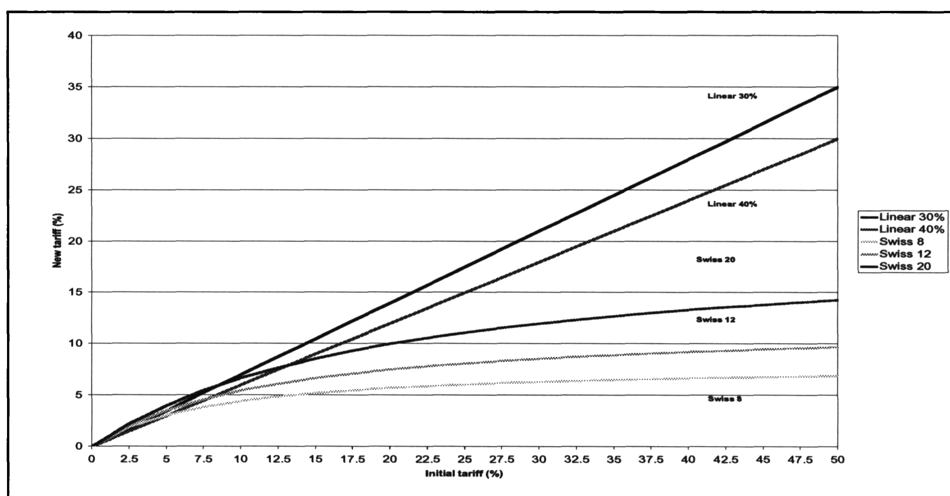
$$T_1 = \frac{(a \times T_0)}{(a + T_0)} \qquad (2)$$

where a is a maximum coefficient and no tariff included in the negotiating list can be higher than that of this expressed coefficient. It is a harmonising approach as it makes more than proportional cuts to higher rates (see Figure 2.1 below). It is therefore particularly useful in reducing tariff peaks and tariff escalation. The Swiss formula was used for industrial products during the Tokyo Round with a maximum ceiling of 16 per cent. The Swiss formula with coefficients of 20, 12 and 8 is illustrated in Figure 2.1.

As may be observed from Figure 2.1, because of its progressive nature the Swiss formula reduces higher tariffs by more, in absolute and relative terms, than lower tariffs. For example, let us compare the application of a 40 per cent linear cut and a Swiss formula with a coefficient of 8 to two initial tariffs, the first being a low rate of 5

per cent and the second being a higher rate of 50 per cent. With the linear cut the new tariffs would be 3 per cent and 30 per cent, respectively, with a percentage reduction of 0.6 in both cases.[3] After applying the Swiss formula, the new rates would be 3.1 per cent for the first tariff and 6.9 per cent for the second, giving a percentage reduction of 0.14 and 0.62. This illustrates that, under a linear cut, the percentage reduction is, in fact, equal for all tariff rates, but under the Swiss formula the percentage reduction declines, implying that the higher initial tariff rates are subject to larger percentage cuts. The importance of these basic approaches is that in the current WTO negotiations all approaches are essentially variations of these two alternatives, with various adaptations. This paper discusses below the implication of the application of these alternative approaches for developing countries.

Figure 2.1: Comparison of Linear Cut and Swiss Formula Tariffs for 0–50 per cent



The New Formulae Dilemma

Given the mandate of the Doha Declaration, namely to reduce trade barriers on non-agricultural products, and in particular on products of export interest to developing countries, negotiators are in search of a formula that would achieve these objectives. In our view, this formula should fulfil certain basic criteria: it should be simple, transparent and address the high rates facing developing countries' exports. However, the approach adopted also has to take account of the special needs of developing countries and LDCs, including through less than full reciprocity, as envisaged in the Doha Ministerial Declaration. In essence this means that while there should be an effort to make deep cuts in rates facing developing countries' exports, the developing countries should be required to make lesser cuts. The notion here is that developing countries

should be allowed some flexibility, or 'policy space', to use tariffs for industrial policy purposes (as envisaged also in GATT Article XVIII:A). This parallels the use of non-tariff measures for health and safety, environmental, security and other reasons that are linked to externalities – where private and social costs and benefits diverge. While it is now widely recognised that liberalisation is beneficial in the longer term (other than in respect of externalities, which merit long-term intervention), there is also evidence from the World Bank and in other studies of important short-term adjustment costs; the differentiation in the treatment of developing countries in WTO rules and procedures is also a recognition of the validity of a more cautious approach to reform in those countries.

A number of countries have submitted proposals to the WTO Negotiating Group on Market Access. However, only the following countries presented clearly defined formulas: People's Republic of China, European Communities, India, Japan, Korea and the USA. It is important to remember that all of these particular proposals cover non-agricultural products and that they do not include services or agricultural products that are covered by other negotiating groups.

China has presented the following formula:

$$T_1 = \frac{(A + B \times P) \times T_0)}{(A + P^2) \times T_0)} \tag{3}$$

where:

T_0 = Base rate
T_1 = Final rate
A = Simple average of base rates
P = Peak factor, $P = T_0/A$
B = Adjustment coefficient, e.g. for 2010, $B = 3$; for 2015, $B = 1$

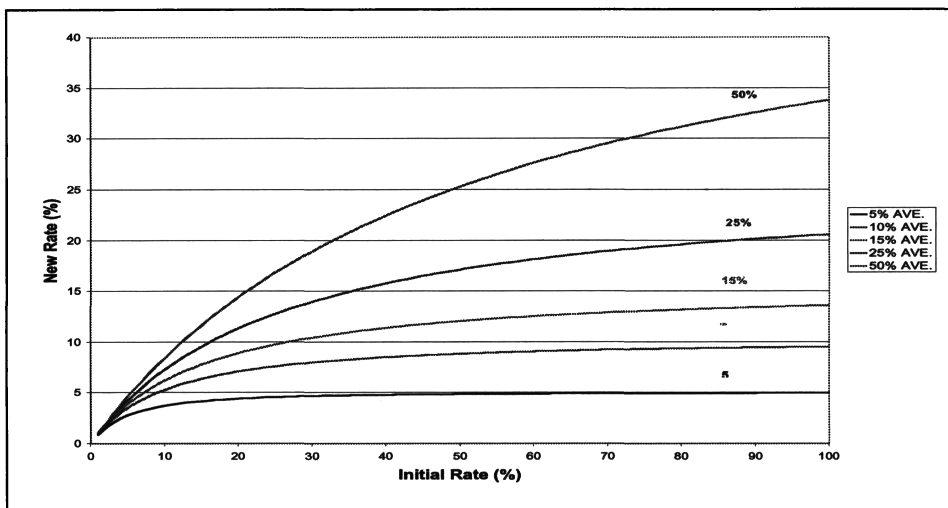
When applied, this formula works like the familiar Swiss formula with a variable coefficient dependent on the simple average of the base rates. The base rate would be different for developed and developing countries. For developed countries, the base rate would be the applied rates in 2000 (essentially the bound rates since these countries have almost 100 per cent binding coverage), and for developing countries and newly acceded countries it would be a simple average between applied rates in 2000 and their final bound rate. For the current example we have used $B = 1$.

In Figure 2.2 it is possible to see how the Chinese formula works in a similar way to the Swiss formula.

The ratio cut for the Chinese formula would be:

$$\frac{T_1}{T_0} = \frac{(A + B \times P)}{(A + P^2)} \tag{4}$$

Figure 2.2: People's Republic of China Formula (*B* = *1*)



This, in essence, is similar to the one analysed above for the Swiss formula but with the difference being the starting curve for each country, which in itself depends on the simple average of the base rates. As with the Swiss formula, the Chinese formula has the advantage of bringing about larger proportional reductions to higher tariffs, but the degree of harmonisation depends on the initial average rates. Therefore, the same initial rate would be reduced by varying amounts depending on the countries' average rate.

The European Commission has proposed a 'compression mechanism':

$$\left\{T_1 = B_1^L + (T_0 - B_0^L) * \frac{(B_0^U - B_1^L)}{(B_0^U - B_0^L)}\right. \quad (5)$$

with B_0^L and B_0^U as lower and upper limits in base bracket, and as same limits in the new bracket, and where T_0 = initial duty.

Technically, the number of ranges that can be specified is unlimited. In this formula the *B* parameters, as well as the base and final bracket levels in the formula, have to be negotiated. For the purpose of illustration the following parameters have been used for *B*:

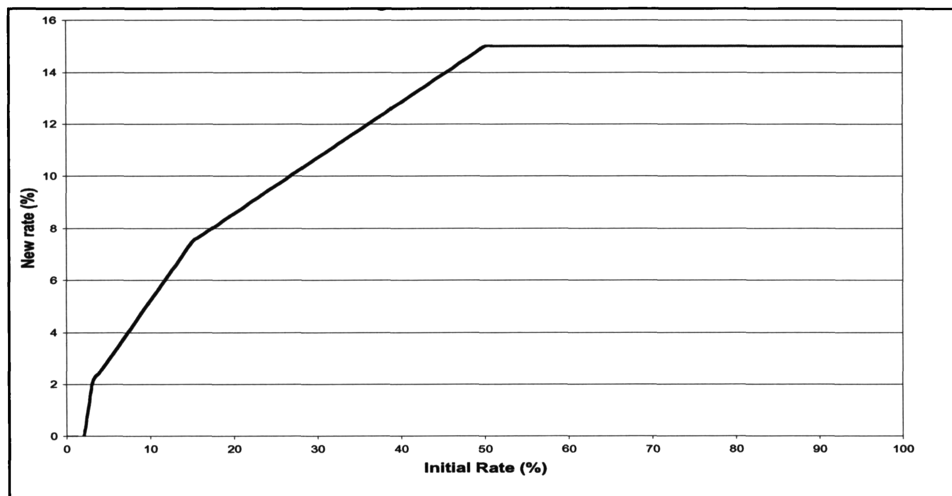
T_0 from 0–2 per cent, B = 0 per cent
T_0 from 2–15 per cent, B_L = 1.6 per cent, B_U = 7.5 per cent
T_0 from 15–50 per cent, B_L = 7.5%, B_U = 15 per cent
T_0 above 50 per cent, B =15 per cent.

In Figure 2.3 it is possible to observe how this formula would reduce tariffs. With this

example all tariffs above 50 per cent become 15 per cent. Between 2 per cent and 50 per cent the formula behaves like a linear cut. And below 2 per cent they are basically eliminated.

This formula is sensitive to the B parameter. It works like a linear formula with a maximum cap for tariffs. Because of this cap, all the tariffs are compressed to a maximum, aggressively reducing tariff peaks and escalation; in this sense, the EC approach is similar in effect to the Swiss formula..

Figure 2.3: EU Formula



The Indian proposal is for an as yet unspecified linear reduction, with developing countries making two-thirds of the cuts of developed countries. India also envisages tackling tariff peaks by specifying that no rate should exceed three times the national average. India also makes proposals on the binding coverage, taking account of flexibilities for development.

The mathematical proposal for tariffs is:

Step 1:

$$T_{F1} = (1 - \frac{AY}{100}) * T_0 \qquad (6)$$

Step 2:

$$T_F = T_{F1} \text{ or } 3 * T_A \text{ whichever is less} \qquad (7)$$

where:

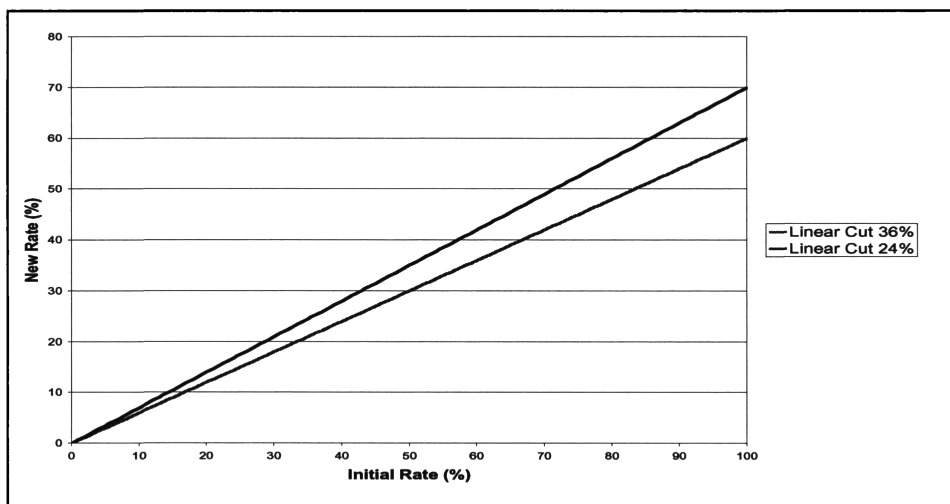
A = less than full reciprocity parameter;

A = 1 for developed countries and

A = 0.67 for developing countries

Y = Reduction percentage (to be negotiated)
T_0 = Present bound tariff on an individual tariff line
T_{FI} = Reduced tariff after Step 1 on the individual tariff line
T_A = Simple average tariff after Step 1
T_F = Final bound tariff on the individual tariff line

Figure 2.4: Example of Indian Formula



The notion of a two-thirds reduction for developing countries derives from previous negotiating rounds. The Uruguay Round Agreement on Agriculture had a linear 36 per cent tariff reduction for developed countries and 24 per cent for developing countries and, to demonstrate the approach, we have arbitrarily applied these percentages in the Indian formula in Figure 2.4 (and in later computations). This approach incorporates the 'less than full reciprocity' concept in reduction commitments. It tries to reflect the special and differential treatment that developing countries should have when addressing market access liberalisation. It also introduces an element of flexibility for developing countries by granting them lesser cuts in their tariffs.

Korea has presented a mechanism that combines linear cuts with minimum cuts per tariff line. To start, it has defined a target of 40 per cent reduction of the trade-weighted average tariff rate with at least 20 per cent reduction through a linear cut of all bound tariffs.

To attack tariff peaks and escalation, Korea proposes that tariffs above twice the national average after the 20 per cent reduction should be further reduced by 70 per cent of the difference between them and twice the simple national average:

$$T_l = (T_0 \times 0.8) - 0.7 \times (T_0 - 2 \times T_a) \quad (8)$$

where:
T_1 = maximum tariff rate after reduction
T_0 = tariff rate before reduction (above twice the national average)
T_a = national average tariff rate

Furthermore, tariffs above 25 per cent, after 20 per cent reduction, will be further reduced by 70 per cent of the difference between them and 25 per cent.

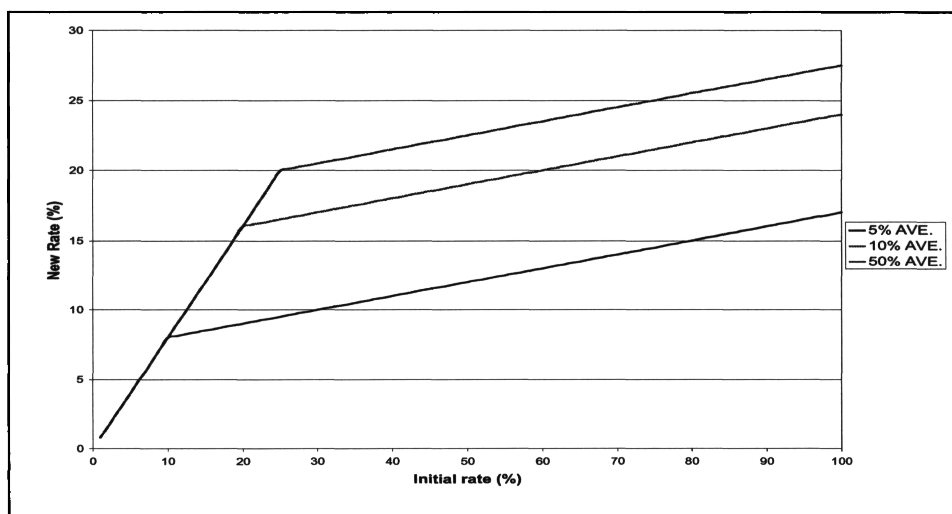
$$T_1 = (T_0 \times 0.8) - 0.7 \times (T_0 - 25) \quad (9)$$

where:
T_1 = maximum tariff rate after reduction
T_0 = tariff rate before reduction (above 25 per cent)

If a tariff is above twice the simple national average and also above 25 per cent, the final rate will be whichever is lower after the reduction described above. If the resulting average after applying both cuts is still above the 40 per cent target, each country should make further reductions at its own discretion.

In Figure 2.5 it is possible to see that the new tariff profile after applying the Korean proposal has elements of simplicity (linear cut), harmonisation or compression within a country and differentiated treatment across countries. The formula is a linear formula that cuts tariffs depending on the trade-weighted average. It also introduces minimum cuts per tariff line and at the same time addresses tariff peaks and escalation through more aggressive linear cuts to tariff lines with 'elevated' tariffs.

Figure 2.5: Korean Formula



The USA has proposed that tariffs should be phased out as shown in Table 2.1:

Table 2.1: US Proposal for Industrial Products

Phase	Period	Products Covered	Target Tariff	Modality
First	2005–2010	Products with tariffs of 5% or below	0%	Zero
		Products with tariffs above 5%	Maximum: 8%	Swiss formula with a maximum coefficient of 8%
		Highly traded sectors*	0%	Zero-for-zero
Second	2010–2015		0%	Not defined

* Agricultural equipment, bicycle parts, chemicals, civil aircraft, construction equipment, environmental technologies, fish and fish products, furniture, information technology and electronics products, medical equipment, non-ferrous metals, paper, pharmaceuticals, scientific equipment, steel, toys and wood products.

The US proposal could be defined as a 'cocktail' approach: in the first phase until 2010 'zero-for-zero' and a harmonisation formula (Swiss formula), and in a second phase from 2010 until 2015 a linear cut formula.

The pressure to reduce low or 'nuisance' tariffs to zero is not new. Quad countries first used the 'zero-for-zero' initiative during the Uruguay Round.[4] This is said to reduce transaction costs, but the same paperwork is required to justify non-payment as to compute the level of a non-zero duty, and rules of origin still have to be applied as well as other border controls and fiscal adjustments. Removing 'nuisance' tariffs can lead, during the transitional period from 2005 to 2015, to greater than proportionate reductions in tariffs on raw materials on which initial tariffs are often below 5 per cent, increasing effective protection (more protection for value added) on the next processing stage. Cutting low tariffs on raw materials has been a deliberate strategy of some industrial countries in the past; it fosters their processing industries, with developing countries as sources of raw materials.

For the first phase (preceding full global free trade as far as tariffs are concerned), the USA proposes a Swiss formula with an 8 per cent coefficient. As seen above, the formula would look like:

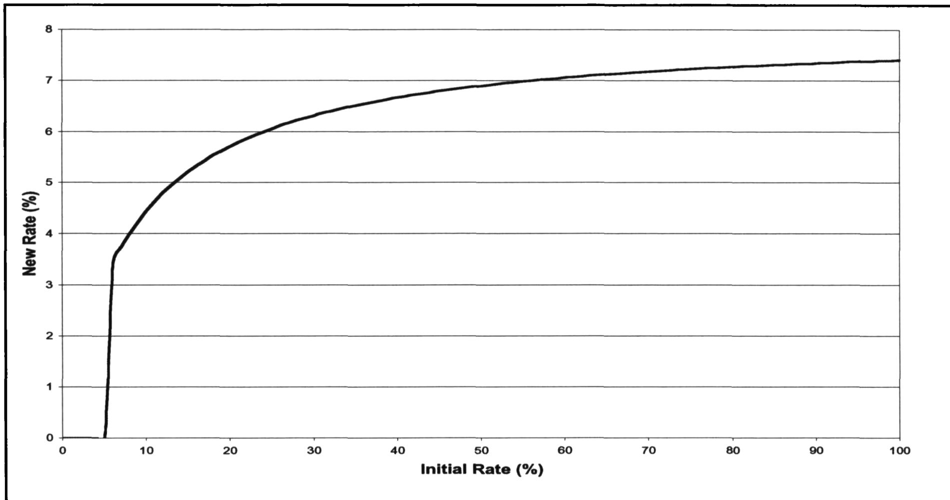
$$T_1 = \frac{(A \times T_0)}{(a + T_0} \qquad (10)$$

where a is 8. This is also illustrated in Figure 2.6.

Under the US proposal the average industrial tariffs in developing countries of 40 per cent would be reduced to 6.7 per cent in this first phase. On the other hand, developed countries would reduce their average bound tariffs from 3.5 per cent to zero. With

this proposal no tariff can ever be higher than that expressed in the coefficient – in this case 8 per cent. Most tariffs in developing countries would in fact fall to around 6 per cent in the first phase and then to zero.

Figure 2.6: US Formula



Japan has presented a 'hybrid approach', with a formula that simply introduces a target average tariff rate. This average would be different depending on the level of development of each WTO member. How the reductions would be distributed between the different tariff lines is left to each member to decide.

After viewing these proposals, the Chairman of the WTO Negotiating Group on Market Access has put forward his own version.[5] First, all tariffs would be converted to percentage form (*ad valorem* equivalents), and a base rate would be established under which 95 per cent of lines and 95 per cent of imports would be bound (except for LDCs), with some credit being granted for autonomous liberalisation since the end of the Uruguay Round.[6] Then, tariffs would be cut according to a Swiss formula with the maximum coefficient set equal to the simple average tariff times a common factor yet to be negotiated. No time period is specified for implementation. In addition, tariffs would be eliminated in specific sectors, namely electronics and electrical goods, fish and fish products, textiles, clothing, footwear, leather goods, motor vehicle, parts and components, stones, gems and precious metals, which are said to be of export interest to developing countries, and where the transition period to duty-free trade by all developing countries except LDCs would be three times longer than for developed countries.[7] These cuts would then be supplemented by further liberalisation by request-and-offer, zero-for-zero and sectoral negotiations. Least developed countries

would not be required to undertake reduction commitments, except to make efforts to increase their binding coverage.

The WTO formula component is given by:

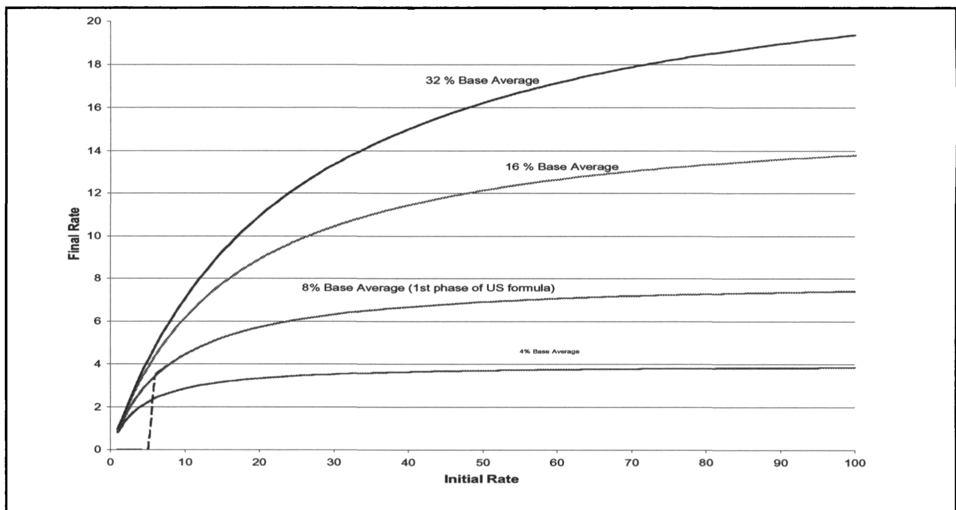
$$T_1 = \frac{B \times ta \times T_0}{B \times ta = T_0} \qquad (11)$$

where *ta* is the national average of the base rates, T_0 the initial rate, and T_1 the final rate. *B* is a coefficient common to all countries yet to be determined. *B* set at 1 implies that the average bound rates become the maximum. Hypothetical rates for four different averages are shown in Figure 2.7. For example, if the base average tariff is 8 per cent, then a 10 per cent duty would be reduced to 5 per cent, and if the base average tariff is 16 per cent, then 10 per cent would be reduced to 8 per cent. However, tariffs above the average are reduced more than proportionately. Thus, if the base average is 8 per cent, then a 30 per cent duty would be reduced to 6.5 per cent, and if the base average tariff is 16 per cent, then a 30 per cent would be reduced to 10.5 per cent.

If $B = 2$, and there is a base average tariff of 8 per cent, then an initial individual rate of 10 per cent would be reduced only to 6.5 per cent rather than the 5 per cent when $B = 1$.

Under this proposal, developed and developing countries with the same average initial tariffs would make the same percentage reduction. In other words, the proposal does not contain any specific and differential component, unless the *B* factor is set at a higher level for developing countries.

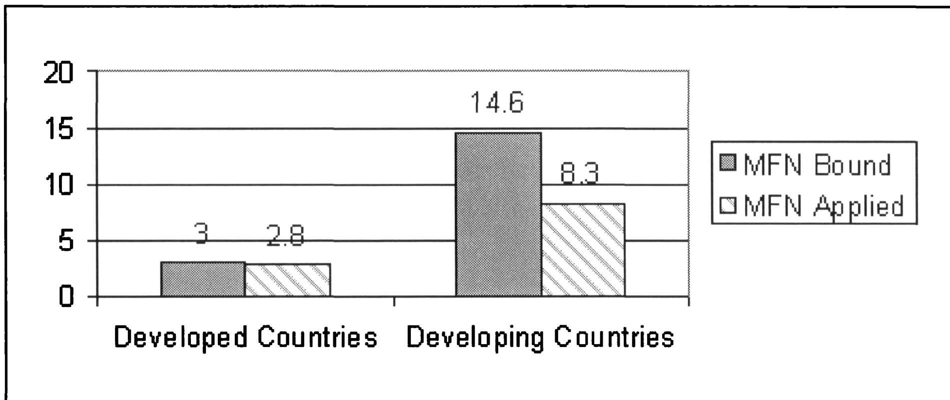
Figure 2.7: WTO Proposal (*B* = 1)



Implications for developing countries

The implication of applying these approaches becomes clear from Figure 2.8, which shows that developing countries tariffs are, on average higher than those of the developed countries. If the Swiss formula with a coefficient of 8 from Figure 2.1 were applied, then average developed country tariffs would be reduced from 3.5 to 2.4 per cent, while the developing country average would be reduced from 25.2 to around 6.1 per cent. Under a linear cut of 40 per cent, the corresponding numbers would be 3.5 to 2.1 per cent for developed countries, and 25.2 to 15.1 per cent. In other words, the larger proportionate and absolute cuts would be made by the developing countries under Swiss-type formulas, while the larger absolute but similar proportionate cuts would be made by developing countries under a linear approach.

Figure 2.8: MFN Bound and Applied Tariffs



However, historical practice and the legal basis for earlier GATT and WTO negotiations is to base tariff reductions on bound rates (rates set in earlier negotiations and set out in legal schedules). In practice, almost all developed country applied MFN rates on non-agricultural products are identical to their MFN bound rates, but in the case of the developing countries, as a result of unilateral reforms under Bank–Fund programmes in the last 10–15 years, their average applied MFN rates are some 30 per cent lower than their MFN bound rates, so that a linear cut of 30 per cent on their bound rates would leave their applied rates untouched on average. However, there is considerable variation across products and countries, so that detailed calculations are necessary to allow countries to compute the effect of the proposals on their particular case.

As pointed out earlier, the deeper cuts imply longer-term welfare gains but higher short-term adjustment costs, and may also imply foregoing some leeway or policy space for the use of tariffs as an instrument of industrial policy. On the other hand, if a linear formula of some 30 per cent or a Swiss formula with a coefficient of around 30 were

applied to developing countries MFN bound rates, then there would be little immediate effect on developing countries applied tariffs, although there would be greater security of access to their markets for trading partners, and this would constitute a valid and valuable contribution to the WTO negotiations. Such greater security of access might also be expected to have positive effects on investment and trade, as well as paving the way for further liberalisation in future rounds.

3 Issues Facing Developing Countries

Tariffs and Development Strategies

As noted earlier, it is generally accepted that, at least in the long term, trade liberalisation improves efficiency in the allocation of scarce resources in an economy, lifts economic welfare and contributes to economic growth.[8] However, this relationship between openness and growth is essentially an empirical matter, as economic theory provides no formal linkage. Thus, other economists criticise the econometric evidence and emphasise the importance of governance rather than openness *per se*.[9]

However, despite the long-term case for liberalisation, the short-term effects can often be negative, so that the pace and sequencing of liberalisation is also a political question.[10] Despite nearly 20 years experience of reform, there is no clear-cut formula that guarantees that reform will bring about a monotonically increasing level of welfare. Thus, for many countries, a more measured approach to liberalisation is indicated. Indeed, if a reform is pushed too hard with negative consequences, then the reform process itself may be endangered – a case for 'make haste slowly'. In any case, it is also necessary to design social programmes to offset these negative effects and to facilitate the reform process, but all of this takes time and money. Of course, countries at different stages of development and holding different viewpoints have different perspectives and priorities in this regard, hence the difficulty in finding an approach to negotiations that satisfies all.

The potential gains from liberalisation are greater when a number of countries liberalise at the same time – the rationale for the WTO multilateral process. In addition to the longer term gains from restructuring at home, there are new export opportunities, and these potential gains make liberalisation more palatable.

It should be noted that 'liberalisation' does not necessarily mean free trade, even in tariffs, as there can be an economic case based on externalities for long-term intervention, as noted earlier, but rather a process of allowing the play of dynamic comparative advantage by making an economy more responsive to economic forces.

The various formulae proposals now tabled remove some of the latitude for the use of tariffs for development purposes, as envisaged by GATT Article XVIII:A (and as practised by the major developed countries at the early stages of their own industrialisation).[11] However, some of the proposals presented imply a more rapid or deeper

reform in trade policy than others, notably the US proposal that seeks full tariff elimination, 'free trade'. While a few developing countries that have already moved far in their own trade reforms might find this to be feasible, for the large majority of developing countries such an approach may mean going 'too far, too fast' with reform, and could entail unacceptable adjustment costs. A quantitative evaluation of the proposals, making some assumptions in respect of undefined elements, is provided in Section 4 below.

Non-full Reciprocity and Special and Differential Treatment

From past practice, the 'non-reciprocity' that is mentioned in the Doha Declaration would normally mean that lesser tariff cuts would be applied by developing countries and LDCs and that longer transition periods would be available for the implementation of negotiated tariff cuts. As an example, in the Uruguay Round developed countries cut their industrial tariffs by 38 per cent and their agricultural tariffs by 36 per cent, while developing countries made tariff reductions of 34 per cent for industrial products and 24 per cent for agricultural ones. Both groups of countries cut their industrial tariffs in six equal annual instalments, but in agriculture the developing countries had ten years to make the cuts, while the developed countries completed the cuts in six.

Very few of the proposals currently before the WTO have a detailed elaboration of how non-reciprocity should be handled, and it might be useful to invite the proponents to spell this out to permit a fair comparison of the proposals.

Preference Erosion

Reductions in bound rates that also reduce applied rates (and non-zero preferential rates) will lead to changes in preference margins with possible consequent effects on trade flows (trade diversion). Developing countries whose margin of preference is eroded may face negative trade diversion (on a comparative static analysis) unless their exports are regulated by import quotas. On the other hand, they may gain from the erosion of preferences within regional trade arrangements (RTAs) and preference schemes of which they are not beneficiaries. LDCs and ACP (African, Caribbean and Pacific) countries with deep preferences are very likely to face negative trade diversion, but much depends on their utilisation of such preferences. Where utilisation ratios are low, possibly associated with the application of rules of origin, then the gains from trade creation would be more important.

It is also important to take account of a number of other factors. First, if there is a general stimulus to trade and investment as a result of the current WTO negotiations, then the dynamic effect on general economic growth may offset any possible negative effects from trade diversion. Second, much depends on the supply capabilities of developing countries to take advantage of preferences; it is widely accepted that more needs to be done to improve the supply capabilities of the developing countries,

particularly the LDCs, to allow them to take advantage of trade opportunities. Third, the benefits received depend on rules of origin and other formalities, which are often restrictive, so that even LDCs, which often face zero preferential tariffs, may gain from MFN liberalisation on many items. Fourth, the potential advantages of preferences are often offset by conditionalities imposed by the donors in relation to other social or economic conditions in the beneficiary countries. Fifth, most least developed countries are not participants in regional trade agreements and would be likely to gain from MFN liberalisation in other developing country markets. Sixth, taking account of the above points, it may be preferable for most developing countries to obtain more secure MFN reductions on their key exports, rather than the preservation of preference margins on high MFN rates. To some extent, developing countries have been relatively quiescent about the barriers that they face because they fear the possible loss of preferences. Finally, the large majority of preferences have been captured by relatively few players and their overall value for many developing countries is quite small.

Tariff and Government Revenues

Tariff revenues are an important source of government revenue for many developing countries. IMF data indicate that the contribution of tariff revenues ranges greatly from virtually nothing in Italy to 75 per cent in Guinea. Less extreme examples are Cameroon and India, where tariff revenues represent 28 and 20 per cent of government revenues, respectively; these are still substantial shares in revenues to be replaced by alternative forms of taxation.

Eliminating tariffs altogether implies that tariff revenues would be reduced to zero. However, while tariff reductions, short of elimination, reduce revenues from existing imports, these reductions may be wholly or partly offset by the increased demand for imports, creating a higher revenue base. Any revenue losses would need to be replaced with taxes on income, profits, capital gains, property, labour, consumption or non-tax revenues. This is a long-term process that can be expensive to implement. In small countries where most goods are imported, a sales or consumption tax could replace tariff revenues, but such important changes to fiscal systems are costly and take time to implement.

The probable effects on tariff revenues of the various proposals now being discussed in the WTO are examined in Section 4 below.

Tariff Bindings and Coverage

Bound tariffs are the only legal basis for WTO negotiations; Members bind and reduce tariffs in accession or multilateral negotiations and these binds are included in schedules of commitments. Binding tariffs means that in future a WTO Member will not be able to raise bound rates without entering into Article XXVIII tariff re-negotiations.

In the current WTO negotiations, there is considerable pressure on developing countries to increase the share of their trade covered by binding commitments and also to reduce applied tariffs. Indeed, the WTO proposals explicitly provide for an increase in binding coverage to 95 per cent of tariff lines and 95 per cent of imports by all countries except LDCs. Since binding coverage for some African countries is as little as 3 per cent, this would be a very large increase in commitments.

This gap between applied and bound tariffs that exists in developing countries is a result of autonomous reforms by these countries in the last 10–15 years. Many developing countries have reduced applied tariffs unilaterally under recent reform programmes and they have sought credit for such liberalisation. This was discussed in the Uruguay Round; some countries have indicated that account was taken of such liberalisation, but there is no public evidence of their having received credit for such actions. Indeed, the general reaction by developed countries is that only bindings matter and credit could only be afforded if cuts in applied rates were bound in the WTO. The argument is that applied rates could again be increased – despite the fact that the reductions were mostly a condition of lending operations by the World Bank and the International Monetary Fund (IMF), where the board voting systems favour the developed countries.

If developing countries are obliged to reduce MFN bound rates to levels that are below their applied rates, then this would eliminate any flexibility that they have to use tariffs for development purposes, as discussed above. Moreover, there would be an increased likelihood of resort to anti-dumping actions and other contingency measures that can be costly to apply and tend to be captured by protectionist interests.

On the other hand, if after the current negotiations developing countries cut MFN bound rates, leaving applied rates as they are or only partly reduced, such MFN reductions should still be seen as affording increased security of access to their market. This would itself be considered a valid legal commitment in the negotiations in non-agricultural products, even where rates are set at ceiling levels, higher than applied rates, as was done in the Uruguay Round agriculture negotiations by many developed and developing countries.[12]

The probable effects of the current proposals in the WTO on bound and applied rates are given in Section 4 below.

Potential Trade and Welfare Gains

An assessment of the impacts of across-the-board global liberalisation is best undertaken with an applied general equilibrium model the captures both intersectoral and trade linkages. One study, cited in the US proposal, has estimated that developing countries could see welfare gains of more than US$500 billion from duty-free trade.[13] The modelling includes assumptions of economies of scale and imperfect competition. These assumptions tend to inflate the gains from trade. Most importantly, the analysis

assumes liberalisation in the services sector that accounts for the major part of the gains. In turn, this depends on some estimates of the trade effects of measures used in the services sector that are themselves estimated by econometric techniques. A more conservative approach is to assume constant returns to scale, perfect competition and, in the absence of reliable data, no liberalisation of the services sector. Such an approach is followed in the next section, in which six alternative proposals are analysed.

4 Quantitative Assessment of Alternative Proposals

The six alternative market access proposals for tariff reductions in non-agricultural products are those of the EU, the USA, China, India, Korea and the WTO. These were described earlier in the paper. In simulating these proposals, there are no reductions in tariffs on agricultural products or in tariffs on services. In addition, tariff reduction commitments for the 49 least developed countries have been arbitrarily excluded, although it is not clear whether this was the intention in some of the proposals. The simulations are described in Table 2.2.

Table 2.2: Alternative Liberalisation Scenarios
(based on proposals modified to take account of undefined elements)[14]

Scenario	Description
'EU'	Initial tariffs under 2 per cent are eliminated, tariffs between 2 and 15 per cent are reduced by 50 per cent, tariffs between 15 and 25 per cent are reduced by 55 per cent with final tariffs capped at 15 per cent. No reductions in agriculture or services or in least developed countries.
'Korea'	For industrials, as specified by formula. No reductions in agriculture or services or in least developed countries.
'India'	Thirty-six per cent reduction in bound import tariffs in developed countries and 24 per cent reduction in developing countries for industrials. No reductions in agriculture or services or in least developed countries.
'China'	For industrials, as specified with B=1. No reductions in agriculture or services or in least developed countries.
'WTO'	Tariffs reduced according to a Swiss formula with maximum coefficient equal to country average. Tariffs eliminated for electronics and electrical goods, fish and fish products, textiles, clothing, footwear, leather goods, motor vehicle, parts and components, stones, gems and precious metals. No reductions in agriculture or services or in least developed countries.
'US'	All tariffs eliminated. No reductions in agriculture or services or in least developed countries.

Note: Under the 'WTO' simulation, the binding of developing country tariffs at double the applied rate follows the WTO proposal, except that the WTO proposes to bind 95 per cent of tariff lines and imports. Obviously, it could be very important which lines are excluded.

Simulations are undertaken using GTAP, a static general equilibrium model that includes linkages between economies and between sectors within economies. Industries are assumed to be perfectly competitive and are characterised by constant returns to scale. Imports are distinct from domestically produced goods as are imports from alternative sources. Primary factors (land, labour, capital, etc.) are substitutable but as a composite are used in fixed proportions to intermediate inputs. The GTAP database (Version 5.3b) is used. This has 78 countries and regions and 65 sectors that are aggregated into 21 regions and 21 sectors as shown in Table 2.3.

The reductions in bound tariffs under the various proposals outlined in Table 2.2 are calculated at the HS six-digit level for 148 countries from UNCTAD's TRAINS 2002 database. Where bound rates are missing, applied rates are used (except under the 'WTO' proposal, where applied rates are bound at double the current levels, or 5 per cent where applied rates are zero). Specific tariffs are ignored. The proposed bound and applied rates are then compared to provide new applied rates that were then aggregated to the GTAP category level using trade weights, implying that tariffs on products with no trade are ignored. Applied tariff reductions are calculated bilaterally, taking account of a number of regional arrangements that have been included in the GTAP database (but full preferential data are not yet included). In the GTAP database, bilateral tariffs also differ according to the trade weights applied to the different applied tariffs.

Table 2.3: Country and Commodity Coverage

Regions		Sectors
1	European Union 15	Unprocessed agriculture
2	United States	Processed agriculture
3	Japan	Fisheries and forestry
4	China	Resources
5	India	Petroleum and coal products
6	Canada	Textiles
7	Oceania	Leather
8	Other West Europe	Apparel
9	Indonesia	Non-metallic manufactures
10	South East Asia	Lumber
11	South Asia	Paper products
12	Rest of Asia	Chemicals, rubber and plastics
13	Central America and Caribbean	Metal manufactures
14	Mercosur	Iron and steel
15	Andean Pact	Non-ferrous metals
16	South Africa	Fabricated metal products
17	Central and Eastern Europe	Manufactures nec
18	North Africa	Electronic
19	Middle East	Motor vehicles
20	Sub-Saharan Africa	Other transport nec
21	Rest of World	Services

To give an indication of the likely impacts of the various proposal, the levels of initial and final bound and applied tariffs are shown in Table 2.4 for developed and developing countries. These are calculated as an import-weighted average at the six-digit level of the non-agricultural tariffs. Bound rates are the subject of negotiation, but the changes in applied rates are what are used in the estimates of the economic effects in subsequent tables. The data indicate that the developing countries start from a higher base and hence are asked under the various proposals to make the largest cuts in bound and applied rates, at least in terms of percentage points. The greatest change occurs under the US proposals, while the changes for developing countries' bound rates under the EU, Chinese and WTO (B = 1) proposals are similar (around 60 per cent reduction), while the least reductions take place under the Korean and Indian proposals. All proposals imply reductions of applied rates for developing countries as a whole. There would of course be considerable differences across countries and sectors.

Table 2.4: Bound and Applied Non-agricultural Tariffs Before and After Application of Various Proposals

	Developed Countries		Developing Countries	
	Bound %	Applied %	Bound %	Applied %
Initial	3.1	2.8	14.5	8.3
Proposal				
EU	1.6	1.5	5.6	4.5
Korea	2.1	1.8	11.4	6.9
Indian	1.9	1.7	10.2	6.6
China	1.1	1.1	5.7	5.0
WTO (B = 1)	0.7	0.6	5.8	4.1
USA	0.0	0.0	0.0	0.0

Source: Derived from GTAP database, Comtrade, TRAINS and AMAD

Results of Simulations

In the simulations we focus on changes in imports, tariff revenues, exports, domestic production and economic welfare (i.e. impact on national income). We also examine the sensitivity of the WTO proposal to changes in the B factor and to the inclusion of free trade in the special sectors said to be of interest to the developing countries.

The global change in imports is estimated to range from 1.8–5 per cent under the US free trade proposal (Table 2.5). Corresponding to the tariff changes, the greatest increase in imports result from the US free trade proposals; the EU, Chinese and WTO (B = 1) proposals are next, and the Korean and Indian proposals imply the least increase in imports.

Table 2.5: Change in Imports Relative to Base*

	Scenario					
	EU	Korea	India	China	WTO	USA
	%	%	%	%	%	%
European Union 15	0.2	–0.1	0.1	0.2	0.2	0.4
United States	2.2	1.4	2.1	1.9	2.1	2.0
Japan	4.7	2.7	4.3	4.9	4.9	6.1
China	14.1	7.4	12.8	14.0	12.2	17.0
India	16.6	2.5	11.8	14.3	12.6	22.8
Canada	0.1	–0.2	–0.2	–0.2	–0.2	–0.8
Oceania	2.1	0.6	2.1	3.0	2.2	4.0
Other West Europe	1.6	0.0	0.1	0.0	0.1	–0.6
Central and Eastern Europe	10.5	4.3	8.9	10.3	9.5	15.3
Indonesia	10.2	6.4	9.4	10.2	9.7	12.4
South East Asia	5.8	3.3	4.6	5.6	5.2	6.8
South Asia	18.6	13.2	17.3	18.5	18.0	20.7
Rest of Asia	9.1	5.0	8.3	9.5	8.6	12.4
Central America and Caribbean	2.2	–1.0	1.4	1.9	1.5	5.5
Mercosur	13.2	4.6	9.1	12.2	11.0	22.9
Andean Pact	5.8	1.6	3.7	5.4	3.9	10.3
North Africa	17.3	3.0	13.3	15.1	14.3	21.7
Middle East	10.8	5.3	7.9	8.2	7.8	10.3
South Africa	3.8	0.8	2.8	3.5	4.3	5.3
Sub-Saharan Africa	6.6	2.9	4.9	8.5	8.8	10.1
Rest of World	4.7	3.1	4.5	4.7	5.6	5.6
World	3.9	1.8	3.3	3.7	3.5	5.0

*The changes are relative to the whole tariff revenue base, not just for non-agricultural products. This is why the percentages in the US scenario – free trade – are not 100.

Source: GTAP simulations

Many developing countries are concerned that trade liberalisation will have a significant adverse impact on government revenues because tariff revenues make up a substantial contribution to public revenue. The value of import taxes from the GTAP database is shown in the Annex. This is a combination of tariff rates plus trade flows. Total taxes are calculated in the database at $304 billion, of which $104 billion is in unprocessed and processed agricultural products (not liberalised in these simulations) and $45 billion in textiles, leather and apparel, a sector of great interest to developing countries. There are also sizeable amounts in chemical, rubber and plastics, manufactured metal products, electronics and motor vehicles. There is virtually nothing in services; this is probably a reflection of poor quality data.[15]

Across the regions, import revenues are significant in Europe, the USA, Japan and China, but there are also significant amounts in developing regions. Indeed, 64 per cent of the estimated tariff revenues are collected in regions outside the developed

countries (i.e. the EU, USA, Japan, Canada, Oceania and other Western Europe). Almost 50 per cent of the estimated tariff revenues on imports of agricultural products is collected by developing countries. For example, the Middle East appears to gain significant revenues from imports of agricultural products.

The effects of the various proposals on tariff revenues are shown in Table 2.6. The simulation results indicate a fairly substantial decline in global revenues but significant variation across countries, depending on the specific initial protection levels and trade flows. Again, the results correspond to the changes in tariffs and to the level of imports, with the greatest losses resulting from the US proposal, followed by the EU, Chinese and WTO ($B = 1$) proposals, and with the least impact coming from the Indian and Korean proposals.[16] However, the losses are not in direct proportion to the tariff cuts, as these reductions are assumed to be passed on to consumers, leading to increased demand for imports and hence an expansion of the revenue base.

Nevertheless, given the importance of tariff revenues in total government revenues, all countries will have to consider how to replace these revenue losses from alternative sources. Many developing countries would have to raise taxes on income, profits, capital gains, property, labour and consumption or increase non-tax revenues to compensate. Broad-based taxes have the advantage of being less distorting, but they are not as simple to collect as tariff revenues, particularly for countries with poorly developed administrative systems. As noted in Section 3, tax changes may require some time to implement.

The overall effects on exports similarly correspond broadly to the degree of tariff liberalisation under the various proposals. However, there is also likely to be considerable variation across regions and products. Countries that export products that are currently highly protected are likely to see the ambitious US proposal as attractive (Table 2.7), followed by the EU, Chinese and WTO ($B = 1$) proposal, while the least expansion in exports occur under the Indian and Korean proposals.

Table 2.8 reveals some significant changes in output, positive and negative, across regions, under the various proposals. This results from the combined effects of change in the prices and volumes of imports and exports under the various scenarios. A potential problem is falling output and, probably, employment in Europe, the USA and Japan, as well as among the developing countries, in the Central American and Caribbean region and in Africa. A closer scrutiny of detailed data not reproduced here shows that the fall in output is driven by terms of trade rather than quantity effects, and the changes in terms of trade are driven by negative export price effects in resources, other motor vehicles and other manufactures. Asia and sub-Saharan Africa enjoy positive export price effects in services, other manufactures and textiles.

Overall, it seems that European and American producers are worse off from liberalisation in the industrial sector, whereas other regions appear to gain. The result implies that most governments might see scope for switching labour from agriculture to the

Table 2.6: Change in Tariff Revenue Relative to Base

	Scenario					
	EU %	Korea %	India %	China %	WTO %	USA %
European Union 15	–53	–31	–52	–54	–56	–66
United States	–67	–40	–67	–67	–70	–80
Japan	–14	–8	–14	–14	–15	–16
China	–62	–28	–53	–61	–47	–81
India	–65	–10	–46	–56	–49	–93
Canada	–40	–23	–39	–42	–41	–51
Oceania	–56	–19	–54	–74	–56	–95
Other West Europe	–4	–3	–4	–4	–4	–5
Central and Eastern Europe	–39	–4	–29	–39	–30	–72
Indonesia	–55	–30	–44	–54	–47	–87
South East Asia	–59	–33	–48	–60	–54	–82
South Asia	–49	–37	–41	–48	–45	–61
Rest of Asia	–38	–18	–33	–38	–33	–58
Central America and Caribbean	–32	–4	–26	–31	–28	–72
Mercosur	–50	–14	–41	–49	–44	–91
Andean Pact	–39	–10	–29	–40	–28	–81
North Africa	–40	–3	–27	–35	–31	–65
Middle East	–31	–19	–28	–32	–28	–45
South Africa	–27	–6	–20	–25	–30	–42
Sub-Saharan Africa	–46	–19	–37	–56	–46	–71
Rest of World	–39	–25	–36	–37	–46	–52
Total	–44	–20	–38	–44	–40	–62

Source: GTAP simulations

industrial and service sectors. On the other hand, we are unable to comment on possible cross-sectoral effects, for example as between industry on the one hand and agriculture and services on the other. Judging from the study by Brown, Deardorff and Stern (2001), EU and US policy-makers may well see significant scope for output gains following liberalisation in these sectors.

The pattern across regions is quite diverse and appears to be less systematically linked to the various proposals than trade and revenue effects. It is important to note that there could be even greater effects in specific sectors in some countries, and policy-makers will be concerned to look at the need for social safety nets in those sectors that are likely to suffer the greater negative effects from changes in their own countries.

The static annual gains and losses in welfare from the tariff reforms are shown in Table 2.9. This is essentially a comparison of income levels – GNP – before and after liberalisation, with no account taken of the adjustment process. The global gains range from some $21 billion under the Korean proposal to over $40 billion under the US free trade scenario. The EU, Chinese and WTO (B = 1) proposals produce similar results, some $33–34 billion, while the Korean proposal produces the least welfare gains.

Table 2.7: Change in Export Revenue Relative to Base

	Scenario					
	EU %	Korea %	India %	China %	WTO %	USA %
European Union 15	0.8	–0.1	0.7	0.2	0.7	0.4
United States	4.3	1.4	4.2	1.9	4.3	2.0
Japan	6.5	2.7	5.8	4.9	6.4	6.1
China	12.4	7.4	11.3	14.0	11.1	17.0
India	11.5	2.5	8.1	14.3	8.9	22.8
Canada	0.4	–0.2	0.2	–0.2	0.3	–0.8
Oceania	2.8	0.6	2.7	3.0	2.8	4.0
Other West Europe	0.1	0.0	0.2	0.0	0.2	–0.6
Central and Eastern Europe	5.7	4.3	5.0	10.3	5.3	15.3
Indonesia	9.2	6.4	8.6	10.2	8.9	12.4
South East Asia	4.2	3.3	3.6	5.6	4.1	6.8
South Asia	12.3	13.2	11.7	18.5	12.0	20.7
Rest of Asia	7.5	5.0	6.9	9.5	7.2	12.4
Central America and Caribbean	2.4	–1.0	1.9	1.9	2.0	5.5
Mercosur	13.5	4.6	9.6	12.2	11.5	22.9
Andean Pact	4.6	1.6	3.4	5.4	3.6	10.3
North Africa	9.5	3.0	8.1	15.1	8.6	21.7
Middle East	3.5	5.3	3.4	8.2	3.4	10.3
South Africa	2.4	0.8	2.0	3.5	2.6	5.3
Sub–Saharan Africa	3.5	2.9	2.7	8.5	4.7	10.1
Rest of World	4.9	3.1	4.7	4.7	5.4	5.6
World	3.7	1.8	0.7	3.7	3.5	5.0

Source: GTAP simulations

Under all the scenarios analysed here, the large majority of the welfare gains goes to the developing countries, and hence they gain more under the more radical reforms. This is because, in this kind of analysis, the allocative efficiency gains come predominantly from one's own liberalisation. However, changes in terms of trade also play a role. Under the analysis, the EU and the USA lose because of a decline in terms of trade in the services sectors for which export prices fall in this analysis (probably reflecting the lack of protection data in this sector). As terms of trade effects net out to zero globally, these losses represent gains to regions that import from these countries.

This analysis has two obvious limitations. First, these gains are comparatively static, as with all the results, and do not take into account any adjustment costs that may have to be faced before obtaining the benefits. Second, although all regions gain, it is likely that some countries within those regions will lose. This is particularly the case with food importers who may face higher food bills as export subsidies are eliminated under the agricultural part of the simulation. These countries are adversely affected by terms of trade movements and do not receive the (long-term) allocative benefits from reform.[17]

Table 2.8: Change in Value of Output Relative to Base

	Scenario					
	EU	Korea	India	China	WTO	USA
	%	%	%	%	%	%
European Union 15	−1.1	−0.7	−1.1	−1.1	−1.1	−1.2
United States	−1.1	−0.5	−1.0	−1.1	−1.1	−1.5
Japan	0.8	0.5	0.7	0.9	0.9	1.3
China	0.9	0.8	1.2	1.0	1.5	0.6
India	−0.8	0.1	0.0	−0.5	−0.2	−1.8
Canada	−1.4	−0.9	−1.4	−1.5	−1.5	−2.0
Oceania	−1.3	−0.5	−1.2	−1.6	−1.2	−2.0
Other West Europe	−0.2	−0.2	−0.1	−0.2	−0.2	−0.5
Central and Eastern Europe	3.2	2.4	3.4	3.3	3.6	3.6
Indonesia	1.0	0.5	1.3	1.1	1.3	0.7
South East Asia	0.4	0.4	0.7	0.4	0.5	0.2
South Asia	2.5	1.5	3.0	2.6	2.9	1.9
Rest of Asia	2.9	1.9	2.8	2.9	2.7	3.5
Central America and Caribbean	−1.6	−1.1	−1.5	−1.5	−1.6	−1.9
Mercosur	−1.1	−0.4	−1.4	−1.3	−1.2	−1.2
Andean Pact	−0.9	−0.2	−0.6	−0.9	−0.6	−1.9
North Africa	0.6	0.7	1.4	0.9	1.2	−0.7
Middle East	1.2	0.9	1.4	1.1	1.2	0.9
South Africa	−0.6	−0.1	−0.4	−0.5	−0.5	−1.0
Sub-Saharan Africa	−1.6	−0.6	−1.0	−1.8	−0.6	−2.6
Rest of World	−1.2	−0.7	−0.8	−1.2	−1.2	−2.0

Source: GTAP simulations. Note: Value of output is measured as the change in the value of GDP. This abstracts from changes in terms of trade

Sensitivity Analysis

Two questions remain. The first relates to the significance of the B value in the WTO proposal. This parameter, which determines the level of liberalisation, is assumed to be common across all countries in the current analysis. The default value, 1, in the analysis implies that all tariffs are reduced using the Swiss formula with a maximum in each country equal to its current average bound tariff. A value of 2 implies a maximum of twice the average and so forth. To assess the importance of this, the WTO proposal was simulated with a B of 2. A second question relates to the importance of eliminating tariffs in specific sectors. To assess this, the WTO proposal was simulated with tariff reductions in these sectors set as for other non-agricultural sectors.

The calculated tariff changes are shown in Table 2.10 for developed and developing countries. For example, the initial developed country average bound tariff of 3.1 per cent is reduced to 0.7 per cent under the standard WTO proposal, 1.0 if $B = 2$ and 1.2 per cent if all sectors are treated similarly without the elimination of tariffs. It is clear that the elimination of tariffs in specific sectors is important in reducing

developed country tariffs, but it also has a significant impact on developing country average applied tariffs, reducing them further from 6.7 to 4.1 per cent, accounting for more than half the reduction from the initial applied tariff of 8.3 per cent.

Table 2.9: Change in Welfare Relative to Base

	Scenario					
	EU	Korea	India	China	WTO	USA
	%	%	%	%	%	%
European Union 15	–6990	–6264	–8442	–7220	–8784	–5274
United States	–3870	–1531	–3739	–4234	–4451	–5561
Japan	7035	3806	5718	7548	6933	10762
China	4856	3678	5342	4987	5940	4321
India	1019	449	1150	1099	1116	718
Canada	–688	–520	–723	–712	–779	–1175
Oceania	–117	34	–133	–240	–113	–273
Other West Europe	2141	1832	2225	2146	2161	2067
Central and Eastern Europe	5484	3933	5566	5537	5928	6189
Indonesia	2829	2322	2859	2863	2886	2883
South East Asia	3147	2040	3220	3197	3197	3227
South Asia	1503	1063	1543	1522	1560	1422
Rest of Asia	6892	4385	6443	7127	6605	8487
Central America and Caribbean	–279	–1028	–555	–304	–499	–122
Mercosur	3021	1598	1817	2770	2547	4352
Andean Pact	895	511	772	907	841	1069
North Africa	1891	878	1833	1914	1951	1644
Middle East	4427	2974	4542	4361	4326	4798
South Africa	497	227	431	526	580	516
Sub-Saharan Africa	251	176	258	286	616	205
Rest of World	370	133	490	447	605	–94
Total	34312	20696	30616	34527	33165	40162

Source: GTAP simulations
Note: welfare is measured as equivalent variation. These are static, annual gains

The effect on imports of simulating these alternative tariff reductions is shown in Table 2.11. The first column, WTO = 1, is a repeat of the standard WTO simulation shown in Table 2.5. Raising the Swiss coefficient to twice the national average reduces the annual global increase in imports from 3.5 to 3.2 per cent. The impact varies somewhat across regions, depending on the composition of the trade. The importance of eliminating tariffs in specific sectors has a greater impact, reducing the increase in global imports to 2.4 per cent. The largest increases in imports, in percentage terms at least, occur in developing countries, but exports would also increase by a similar amount, given the constraints of the model.

Table 2.10: Average Trade-weighted Bound and Applied Tariffs under Alternative Assumptions

	Bound			
	Initial	WTO (*B* = 1)	WTO (*B* = 2)	WTO (*B* = 1 without elimination)
Developed	3.1	0.7	1.0	1.2
Developing	14.5	5.8	7.7	9.3
	Applied			
	Initial	WTO (*B* = 1)	WTO (*B* =2)	WTO (*B* = 1 without elimination)
Developed	2.8	0.6	0.8	1.0
Developing	8.3	4.1	4.5	6.7

Source: Derived from COMTRADE, TRAINS and AMAD

Table 2.11: Changes in Imports in WTO Scenario with Alternative *B* Coefficients and without Specific Sector Tariff Elimination

		Scenario	
	WTO = 1	WTO = 2	WTO = 1, no exclusions
	%	%	%
European Union 15	0.2	0.1	0.0
United States	2.1	2.1	1.8
Japan	4.9	4.5	3.9
China	12.2	11.7	7.8
India	12.6	11.1	5.9
Canada	−0.2	−0.2	−0.2
Oceania	2.2	2.1	1.5
Other West Europe	0.1	0.2	−0.1
Central and Eastern Europe	9.5	8.6	6.4
Indonesia	9.7	9.1	7.4
South East Asia	5.2	4.8	4.1
South Asia	18.0	17.5	16.2
Rest of Asia	8.6	7.9	6.1
Central America and Caribbean	1.5	1.4	−0.8
Mercosur	11.0	9.5	6.8
Andean Pact	3.9	3.1	2.0
North Africa	14.3	13.2	7.5
Middle East	7.8	7.6	6.2
South Africa	4.3	4.0	3.0
Sub-Saharan Africa	8.8	7.4	7.2
Rest of World	5.6	5.3	4.7
Total	3.47	3.22	2.41

Source: GTAP simulations. Note: In the third scenario tariffs in the specific sectors, namely electronics and electrical goods, fish and fish products, textiles, clothing, footwear, leather goods, motor vehicle, parts and components, stones, gems and precious metals are treated as other sectors.

Finally, the results for welfare are shown in Table 2.12. The first column, WTO = 1, is once again a repeat from Table 2.5, i.e. $B = 1$ with specific sectoral elimination. Doubling the Swiss coefficient reduces annual global welfare gains (cf. $B = 1$) by an estimated $2.1 billion to $31.0 billion. Eliminating tariffs in specific sectors contributes to global gains of $6.5 billion compared with the standard scenario. Where these sectors are included, most of the gains go to the regions doing the additional liberalising, Japan and Rest of Asia (Korea and Taiwan). Nonetheless, consistent with the earlier modelling results that greater liberalisation produces higher welfare in the longer term (again without taking account of adjustment costs or externalities), with the exception of China and Rest of World, developing regions enjoy greater welfare gains under $B = 1$ rather than $B = 2$, and benefit also from eliminating tariffs in specific sectors.

Table 2.12: Change in Welfare in WTO Scenario with Alternative *B* Coefficients and Without Specific Sector Tariff Elimination

		Scenario	
	WTO = 1	WTO = 2	WTO = 1, no exclusions
	%	%	%
European Union 15	–8784	–8862	–9093
United States	–4451	–4014	–4073
Japan	6933	5884	4818
China	5940	5867	6168
India	1116	1114	957
Canada	–779	–683	–702
Oceania	–113	–101	7
Other West Europe	2161	2210	1880
Central and Eastern Europe	5928	5665	5323
Indonesia	2886	2865	2701
South East Asia	3197	3171	2753
South Asia	1560	1566	1439
Rest of Asia	6605	6258	5014
Central America and Caribbean	–499	–537	–686
Mercosur	2547	1989	2422
Andean Pact	841	720	681
North Africa	1951	1893	1652
Middle East	4326	4325	3771
South Africa	580	537	522
Sub-Saharan Africa	616	583	586
Rest of World	605	573	488
Total	33165	31024	26630

Source: GTAP simulations. Note: In the third scenario tariffs in the specific sectors, namely electronics and electrical goods, fish and fish products, textiles, clothing, footwear, leather goods, motor vehicle, parts and components, stones, gems and precious metals are treated as other sectors.

6 Market Entry

Both the possibility of entering foreign markets and the ability to do so are essential for exports. The possibility of entering depends on market access conditions, which are determined by the legal and administrative conditions imposed by the importing countries under internationally agreed trade rules. The ability to enter a market, however, is a function both of the competitiveness of the exporter, which in turn is determined by the relative cost and quality of the product, and the characteristics of supply chains and the structure of markets (for example the degree of oligopoly).

While the exporter can do much to improve the competitiveness of its products, market access conditions, market exigencies and the characteristics of supply chains are to a large extent exogenous to developing country exporters, which are often small and wield little power. Naturally, international trade rules broadening market access are the result of intergovernmental negotiations, and therefore all States Members of WTO have the right, if not the power, to affect the scope and content of these rules. Governments, however, have neither direct involvement, nor much leeway, in influencing the characteristics of market structures and supply chains, apart from implementing rules for competition. Here, large firms determine the *modus operandi* of supply chains and, thus, effectively the distribution of value added and who gains how much from trade. Smaller firms can influence the functioning of the supply chains and the distribution of total value added only if they have specialised and differentiated products – in other words, if they can turn the value chain into a producer-driven one. A new phenomenon that is radically changing market entry conditions, particularly in the case of agro-food, is the recent growth of international supermarket chains.

As noted earlier, negotiations within the WTO on NTBs are taking place in the context of negotiations on rules, rather than market access *per se*. In this context, measures covered by the WTO Agreements on the application of sanitary and phytosanitary measures and on technical barriers to trade are of particular significance. Meeting the requirements of the SPS Agreement is one of the principal concerns of agro-food exporters. This is complicated by the multiplicity of these requirements across different markets. Considerable costs must be borne in order to meet the health and environmental requirements, and to apply the Hazard Analysis Critical Control Point (HACCP) principles. These requirements would definitely create difficulties in the short term, but in the long run exporters would be forced to increase their competitiveness. Considerable difficulties are, however, presented by the way the standards are set, and challenging their legality is extremely difficult, particularly for developing countries. Even in the case of internationally agreed norms, developing countries' concerns are often inadequately reflected owing to their lack of technical skills and negotiating ability.

While market access barriers and international trade measures implemented by

governments comprise the first hurdle to selling in international markets, clearing this hurdle does not guarantee that market entry will be assured and the product will appear on retailers' shelves. For instance, SPS requirements define the necessary, but not sufficient, conditions for being able to export. Many, and in most cases much more stringent, quality and labelling requirements, as well as conditions regarding production and processing practices, are imposed by importing firms themselves. Particularly in the case of food items, meeting the requirements of importing firms and distribution and retailing channels is the ultimate prerequisite for success. Moreover, these requirements are usually more stringent than the government regulations reflected in measures undertaken in accordance with the requirements of the SPS Agreement. When requirements are made by private enterprises, there is no way to contest them legally, except in situations where rules of competition are violated.

The requirements set by governments and firms go beyond product specifications to cover the way in which the product is produced. Competitiveness and market entry, in many instances, depend more on the production process than on the product itself. Not only do small producers lack the financial means and technical skills to meet these requirements, but when they do meet them, they have significant disadvantages. Traceability is important: buyers want to know for sure how production has been carried out by all suppliers. When a large number of small producers are involved, the transaction costs incurred by the buyer are significantly bigger than those involved in dealing with a small number of large producers. A rational buyer would like to avoid these extra costs by using large suppliers.

Another agreement, the implications of which for diversification are sometimes overlooked is the TRIPs (Trade-Related Intellectual Property Rights) Agreement. For example, the rules governing geographical indications (GI) have been designed with the products of industrial countries in mind, and traditional knowledge is not sufficiently protected. Moreover, importers are sometimes apprehensive about purchasing from developing countries because they worry that seeds and other inputs utilised in production may not satisfy the requirements of the TRIPs Agreement. This has affected some high-value horticultural products such as cut flowers, which offer significant opportunities for export and diversification.

7 Some Concluding Comments

There are serious policy dilemmas for developing countries in reconciling their own trade and industrial policy strategies with the constraints that may be set in the ongoing WTO negotiations in the area of market access for non-agricultural products. Most countries want to advance their liberalisation processes, but the timing and sequencing is not clear. Also, the state of trade policy is at different stages across the developing world and there are different trade and production interests. While there

are expected to be longer-term gains from liberalisation, there are also short-term adjustment costs and there may be unexplored options for developing countries in the use of tariffs for industrial development purposes. For many countries a cautious or measured approach may be preferable. This seems to be feasible within the framework of the Doha Ministerial Declaration, which recalls that Article XXVIII *bis* states that non-full reciprocity is required from developing countries and LDCs and that special and differential treatment is to be applied. From past practice, this would normally mean that, if developing countries choose to make offers, then lesser tariff cuts would be required than from other developing countries, and that, where they do participate, there are longer transition periods.

On the whole, a formula approach would seem best to address the needs of developing countries for improved access to major markets, given their lack of bargaining power. Swiss formula-based approaches more dramatically attack tariff peaks and escalation in their export markets, but they represent a problem for developing countries that tend to have higher initial tariffs and would therefore be required to make larger cuts under such harmonising formulae. The WTO proposal goes some way to addressing this by basing the tariff reductions on the initial average, so that countries with higher tariffs are not obliged to reduce them to the level of those with lower initial tariffs. However, the assessment of the WTO proposal hinges to a large extent on the value of *B*. If this were higher for developing countries as a form of 'less than full reciprocity' or special and differential treatment, then the reductions that they make would be less and they would preserve a degree of policy space.

Given the latitude that developing countries have from the negotiating mandate in affording them less than full reciprocity, the low binding-coverage and the gap between applied and bound rates, then a differentiated simple linear cut would also preserve some policy space for developing countries. Special and differential treatment could be afforded by a differential percentage cut on MFN bound rates. In this respect, the Indian and Korean proposals provide similar latitude to developing countries and similar trade and welfare effects. Consideration might be given to allowing lesser cuts for sensitive sectors, subject to a minimum cut of, say, 15 per cent (as in the Uruguay Round Agriculture Agreement), while tariff peaks could be addressed by establishing that no rates should exceed three times the national average. Allowing for such exceptions means setting a target (for example overall differentiated percentage cuts for developing/developed countries) as well as the overall formula for most cases. Zero-for-zero, or elimination of nuisance tariffs – which have advantages and disadvantages economically – could similarly be accommodated within such a mixed approach. This approach would also allow developing countries latitude for the development of their own trade and industrial policies.

In any case, the analysis shows that, whatever the approach, the developing countries will be required to make the greater cuts in their bound tariffs and in imports.

They will also lose substantial tariff revenues – and this will be a serious concern in a number of cases. The greatest cuts take place under the US 'free trade' proposals, followed by similar cuts in the EU, Chinese and WTO ($B = 1$) proposals (from 14.5 to 5.6 per cent), while the lowest cuts are under the Indian and Korean proposals (to 10.2 and 11.4 per cent respectively, assuming that India followed the 36/24 per cent cut as in the simulations). The developing countries are also being asked to make the greater commitments by way of extension of the tariff-binding coverage, which is itself a valid and valuable commitment, irrespective of the effects on applied tariffs. All of this is a significant reversal of the normal concept of special and differential treatment. On the other hand, the formulas with deeper cuts also offer greater export opportunities, significant gains in production and, in the longer term (once adjustment costs are met), should lead to greater welfare gains.

In order to realise the estimated gains for developing countries, it is necessary that concomitant work be carried out in the areas of WTO rules to ensure that the gains from tariff liberalisation are not obviated by the application of non-tariff measures, including TBT/SPS, anti-dumping, rules of origin, etc. More work is also needed to tackle other measures affecting market entry and the competitiveness of developing country exports.

Prima facie, it appears that countries that benefit from unilateral preferences could lose from the effects of erosion of preferences in the market access negotiations on non-agricultural products. This could be particularly significant for LDCs, ACP countries and other groups that obtain relatively deep preferences under various schemes. However, even in markets where preferences appear important, in practice there is often considerable under-utilisation of preferences and, even on a comparative static analysis, LDCs could gain from MFN liberalisation. The situation is highly variable by country and product. On a dynamic basis, LDCs may gain from the general boost that successful negotiations give to world production and trade. Where preference erosion leads to clear-cut negative effects, then preference-receiving countries may need some kind of assistance to help offset the negative impacts of trade liberalisation and undertake economic restructuring to enable them to new international trading conditions.

Under MFN liberalisation, those countries that have particularly deep unilateral preferences may gain from the erosion of preferences within regional trading agreements to which they are not parties. Such countries should also be active in discussions on RTA rules in goods and services to ensure that the rapid trend to RTA formation does not lead to greater discrimination against LDCs that are mostly outside such schemes.

South–South trade is also a priority for developing countries, particularly in large, fast-growing developing country markets. This is particularly the case given the considerable degree of industrialisation in a number of developing countries and the growing complementarities among developing countries. Therefore developing countries

might also be expected to gain from MFN liberalisation in other developing countries, where typically they face MFN rates.

Overall, there are some difficult dilemmas for developing countries, in particular for those that receive deep preferences, in ascertaining their own best interests in the current WTO negotiations on non-agricultural market access and in reconciling the options with their own trade and industrial policy strategies. They will want to take account of the potential gains from MFN trade liberalisation, which could be quite substantial, against possible losses from preference erosion. In making such judgements, they will need to look at their particular situation, their specific products and main markets, the degree of preference utilisation, the effects of RTAs, potential gains in other developing countries, the operation of rules of origin, TBT/SPS and TRIPs issues, other factors affecting market entry and their own supply capabilities.

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Annex

Table A2.1: Import Tax Revenues in the GTAP 5.3 Database (US$ million)

	EU	USA	JPN	CHN	IND	CAN	OCE	OWE	CEE	IDN
Unprocessed agriculture	2897	1873	8463	2153	246	134	15	2200	843	153
Processed agriculture	10862	3207	16258	3116	386	2046	148	6927	2802	289
Fisheries and forestry	100	5	130	39	11	0	0	1	7	1
Resources	1	176	–708	16	1078	0	0	3	37	41
Petroleum and coal products	398	137	277	436	133	43	3	168	229	87
Textiles	2574	1920	868	4751	268	268	388	52	899	293
Leather	1252	2837	892	331	14	209	126	20	262	25
Apparel	4296	4430	1559	629	11	400	392	103	500	23
Non-metallic manufactures	522	620	66	598	255	46	78	14	325	54
Lumber	452	206	385	184	22	38	51	4	218	20
Paper products	285	64	26	794	105	13	83	1	320	52
Chemicals, rubber and plastics	2652	1841	522	4137	1645	223	318	27	1382	504
Metal manufactures	3003	2831	102	5673	1515	304	700	53	2156	461
Iron and steel	299	442	118	915	514	74	53	10	352	183
Non-ferrous metals	401	179	44	466	1460	8	17	2	123	36
Fabricated metal products	461	467	48	399	115	78	100	9	407	179
Manufactures nec	729	634	185	486	440	58	73	9	191	83
Electronic	4508	1587	0	3412	493	95	154	46	798	274
Motor vehicles	2602	1399	0	1241	221	279	660	2	1852	1045
Other transport nec	615	233	0	303	53	33	23	35	139	83
Services	0	0	–4	–3	0	0	12	0	15	0
Total	38909	25091	29232	30077	8984	4349	3395	9686	13856	3886

Table A2.1 (continued): **Import Tax Revenues in the GTAP 5.3 Database** (US$ million)

	SEA	RSA	RAS	CA&C	MER	AND	NAF	MDE	SSA	SAF	ROW	Total
Unprocessed agriculture	1040	275	5498	836	367	280	814	4387	237	105	300	33117
Processed agriculture	2104	741	2729	1989	856	576	2672	9037	1076	750	2454	71023
Fisheries & forestry	28	6	112	6	7	4	7	5	5	0	7	483
Resources	56	276	1179	167	394	80	42	164	73	3	215	3293
Petroleum and coal products	759	1113	298	290	164	56	74	404	300	4	101	5476
Textiles	1227	814	473	618	504	209	1123	1030	475	168	653	19574
Leather	151	19	114	187	222	63	152	280	162	148	368	7832
Apparel	223	35	240	860	218	89	475	508	192	84	894	16162
Non metalic manufactures	416	181	349	205	240	146	262	409	228	70	304	5389
Lumber	160	20	157	140	124	44	197	421	139	30	524	3535
Paper products	320	160	150	159	365	156	212	231	201	54	203	3952
Chemicals, rubber and plastics	1873	914	1435	802	1799	674	765	1320	763	209	1055	24859
Metal manufactures	2830	996	3178	1189	3856	1038	1567	2939	1244	383	1498	37516
Iron and steel	632	270	609	188	266	231	311	577	246	30	290	6611
Non ferrous metals	257	147	484	51	136	50	64	174	37	13	81	4230
Fabricated metal products	651	161	211	219	372	139	284	362	487	69	353	5570
Manufactures nec	260	110	171	279	351	104	133	555	300	61	211	5424
Electronic	1702	172	2142	619	1499	307	232	672	381	76	524	19695
Motor vehicles	2701	416	1051	623	3594	1158	980	1557	643	665	1055	23746
Other transport nec	464	145	118	1275	187	76	276	413	365	4	313	5154
Services	0	0	39	191	0	237	0	140	506	0	167	1302
Total	17855	6971	20737	10892	15523	5717	10639	25585	8061	2925	11571	303943

Notes

1 For a more detailed discussion of the issues, see UNCTAD (2002).
2 For further reading on the history of the different tariff-cutting formulas refer to Stern (1976), Laird (1998), Laird and Yeats (1987) and Panagariya (2002).
3 The percentage reduction or ratio cut is defined as T_1/T_0. In the case of the Linear Cut this is equal to $c = (1 - a)$. In the Swiss formula the ratio becomes $a/(a + T_0)$.
4 It was applied on ten specific commodities: beer, brown spirits, pulp and paper, furniture, pharmaceuticals, steel, construction equipment, medical equipment, agricultural equipment and toys.
5 WTO (2003). 'Draft Elements of Modalities for Negotiations on Non-Agricultural Products', TN/MA/W/35, Geneva.
6 Newly acceding countries would also be granted some latitude on reduction commitments to take account of concession made in the accession process.
7 Trade statistics suggest that developed countries also have important interests in several of these sectors, exceeding developing countries in their share in world exports.
8 See, for example, Sachs and Warner (1995).
9 Rodrik (1999).
10 Mosley, P. (2000).
11 Rodrik (2001).
12 In the Uruguay Round negotiations on agriculture, where all tariffs had to be bound by all participants, many developing countries set their new bound rates at 50 per cent.
13 Brown, Deardorff and Stern (2001).
14 For the actual details of proposals, see Section 2.
15 Brown, Deardorff and Stern 2002 had significant levels of protection on services, and most of the gains in their study come from liberalisation of this sector.
16 The US proposal does not eliminate tariff revenue because it is modelled here as leaving some tariffs in the agricultural and service sectors.
17 Vanzetti and Peters (2003) analysed potential gains from agricultural trade liberalisation using UNCTAD's partial equilibrium Agriculture Trade Policy Simulation Model that covers 175 countries and 36 commodities. Only 50 countries experience welfare gains under the EU agricultural liberalisation scenario.

3

Special and Differential Treatment

Christopher Stevens

1 Why Special and Differential Treatment is Important

For many the Uruguay Round heralded the end of the road for special and differential treatment. The popularity of the theories that had underpinned it in the GATT was in decline and the provisions in the WTO Agreement were seen as a transitional phase leading to the eventual disappearance of special treatment for particular types of members.

The picture today is very different. The experience of many developing countries with what they perceive to be inadequacies in the WTO has led to a strong renewal of interest in robust differentiation. The current negotiations, dubbed the Doha *Development* Round, give SDT a central position.

In many respects this is a reflection of the WTO's success in becoming a universal organisation taking decisions that are binding and extending its rule-making agenda into many 'beyond the border' areas that were hitherto sovereign territory for Member States. But these advances have brought their own problems that SDT needs to address. Moreover, contrary to some expectations at the end of the Uruguay Round, debate and controversy over appropriate development strategies are not a thing of the past.

The historical case for and against SDT has been couched in developmental terms. The key argument is whether lower levels of development justify special treatment or, by contrast, make the adoption of 'standard' rules even more desirable. Originally, the debate was cast mainly in broad terms related to a country's position in the 'centre' or 'periphery' of the world economy. This broad argument over whether or not there should be general provisions for all developing countries, or for all least developed countries or for some hybrids still continues. But in addition there is more focused analysis of the desirability of specific rules.

A core objective of the Agreement on Agriculture, for example, is the removal of the substantial Organisation for Economic Co-operation and Development (OECD) distortions that have led to higher agricultural output than can be justified economically. For many poor developing countries, though, the agricultural problem is quite the reverse: through neglect and bias, their production is far below what it should be. Instruments designed to curb excessive subsidy to agriculture in rich countries might easily get in the way of much needed increased support to agriculture in poor ones.

In addition to these 'traditional' themes, there are new ones that relate to the more recent characteristics of the WTO compared to the GATT. Parts of the new trade agenda may be developmentally desirable but it is argued that the opportunity cost of

implementation *at this stage* is is too high. This is because it is expensive in terms of finance, human resources or governmental/judicial attention. At the same time, the cost to the world trade system of non-implementation is trivial (for example because the country's share of relevant trade is miniscule). For example, Malawi would benefit from introducing the WTO customs valuation code – but not by as much as it would benefit from alternative uses of the resources required. And there would be few external repercussions from non-implementation.

Another justification for SDT arising from the WTO's character is that it is essential for decision-making. Without strong SDT provisions it will be difficult to conclude the Doha Round because of the need for consensus. During the final negotiations of the Uruguay Round many developing countries were persuaded to accept vague formulations with promises that turned out to be unenforceable. Because of the surge in use of dispute settlement, it is unlikely that by the end of the Doha Round countries will be willing to put their trust in vague phrases that might subsequently be defined judicially in unexpected ways.

This leaves only four obvious alternatives for achieving closure:

- Weaken the current provision of binding dispute settlement;
- Re-introduce the multiplicity of plurilateral agreements that characterised the GATT;[1]
- Extend the General Agreement on Trade in Services (GATS) 'positive list' approach, making certain obligations applicable only in sectors/contexts where countries so specified;
- Create new, more robust forms of SDT.

2 The Current State of Play

Arguably, the last of these – more robust SDT – is the more attractive. If so, the success of the Doha Round rests on the ability of the negotiators to build a stronger SDT regime. This is proving to be difficult. The Doha Declaration accorded SDT a central place in the current round of rule negotiation. It stated that:

> *... provisions for special and differential treatment are an integral part of the WTO Agreements ... We therefore agree that all special and differential treatment provisions shall be reviewed with a view to strengthening them and making them more precise, effective and operational.*
>
> WTO, 2001

Yet negotiations have failed to make any progress. In the period since Doha, developing and least developed countries have made nearly 90 proposals on SDT but by the end of February 2003 no agreement had been reached on any of them. As part of con-

sultations between mid-March and April 2003 the Chairman of the WTO General Council circulated an 'approach paper' that categorised the proposals into three broad groups (WTO JOB(03)/68, 8 April 2003). Category 1 covered 12 proposals agreed *in principle* plus 26 others on which progress seems likely. Category 2 contained 38 proposals that relate to the negotiations and discussions happening in other WTO fora. The remaining 12 proposals in Category 3 are ones where agreement seems unlikely.

So far, the talks have been more about negotiating tactics and the eventual price to be paid for any 'concessions' than about the substance of what needs to be done. This is partly because, as explained below, SDT must, if it is to be worthwhile, confer on developing countries some tangible and enforceable benefit that would not otherwise accrue; the industrialised countries have been unwilling so far to agree to this outside the sectoral negotiations in which they would expect some concessions in return. This impasse is serious – and is taken up again in the following sections and the recommendations.

There is disagreement over which should come first: decisions on cross-cutting issues or on provisions within specific agreements. The former include the principles and objectives of SDT, whether there should be one, two or multiple tiers of provisions, technical assistance and capacity-building, transition periods and graduation. Some developing countries have feared that a premature decision on cross-cutting issues might limit the scope for subsequent agreement-specific SDT.

In the absence of any serious progress in the negotiations, the analysis of appropriate themes for SDT has occurred largely outside the WTO. NGOs, academics, multilateral agencies and some development ministries have all sponsored studies and discussions on the subject. It is clear that there is no consensus outside the WTO just as there is none inside.

3 SDT in the GATT and WTO: Key Themes

A Multi-track System

Part of the problem may arise from SDT's historical baggage. SDT has been a recognised concept since the early days of UNCTAD and is the focus of the WTO's Committee on Trade and Development (CTD), but the provisions conventionally clustered under the acronym do not represent the full range of possibilities. On the one hand, 'special and differential treatment', in its literal sense, has had much broader application than via the measures conventionally described as special and differential treatment. On the other hand, there are methods for protecting development interests in future negotiations that do not involve formal SDT. In other words, 'SDT' is only a part of the picture.

The term is often misconstrued as a two-track system in which developing countries are allowed to distort their economies, to their own and others' detriment, to a

greater extent than are other WTO members. But this is not correct. The reality is that:

- The WTO is already 'multi-track' since it provides a varied set of 'rules' that apply very differently to members according to their specific circumstances;
- Binding dispute settlement has removed much of the flexibility that characterised the GATT and allowed these differences to co-exist;
- In order to avoid adverse, unintended consequences from dispute settlement (or the threat thereof), the WTO needs new mechanisms to balance precise rules with appropriate flexibility;
- The extension of the Doha Round into many 'behind-the-border' and regulatory issues makes this even more necessary.

Binding Dispute Settlement: The New Ingredient

Scope for special differentiation applied extensively in the GATT and benefited a very wide range of members. This 'informal' SDT was achieved by incorporating into the GATT texts vague phrases that could be interpreted in different ways by different members. Such vagueness included such current *causes célèbres* as the Article XXIV requirements that a free trade agreement/customs union should cover 'substantially all trade' and be completed 'within a reasonable period of time'. This allowed countries with different views of what should be done to sign up to the same set of words, secure in the knowledge that they could apply them in their chosen way once the ink was dry.

The innovation of the Uruguay Round in making dispute settlement binding removed this escape route. This fact was not necessarily fully recognised by all (or even most) parties. The subsequent striking down by the WTO of the US offshore tax regime and the European Union banana regime, for example, has concentrated minds. In neither case was the defendant wilfully flouting WTO rules: both believed that, on their interpretation of the rules, they had a strong defence.

There are two reasons why this sea-change from the GATT to the WTO needs to be borne constantly in mind. The first is that proponents of SDT are not necessarily pressing for loopholes to be inserted into a well-established system based upon uniform treatment. On the contrary, the GATT provided a highly permissive framework. The exemptions for temperate agriculture and the Multifibre Arrangement's quantitative restrictions on developing country textile and clothing exports represented only the most visible signs that 'non-discrimination' remained a goal and not an achievement. Substantial exceptions still exist, and developing countries would argue that many are to their disadvantage. Hence, the proponents of SDT are arguing merely for the reality, rather than the rhetoric, of the WTO to apply, and to recognise that binding

dispute settlement requires that this be done *ex ante* rather than *ex post*. Some go further and argue that 'special' treatment for developing countries now is required to offset bias against them in the present rules that were drafted under heavy industrialised country influence.

The second implication of change is that binding dispute settlement has altered the character of the WTO and its image. The WTO appears to be a more litigious forum than the GATT. All sorts of policies that had been in existence for years have been placed in the WTO's dispute settlement spotlight. And the proportion of cases brought by industrial against developing countries has increased: a review of cases brought between 1995 and 2000 found a threefold increase compared with the GATT period in the proportion of cases that were brought by industrialised countries against developing countries (Delich, 2002: 76). A corollary is the vastly more controversial image of the WTO compared with the GATT.

There now exists a greater need for formal constraints on the extent to which WTO rules can compromise development objectives. Since the WTO's rules are the result of hard political negotiations and not the application of textbook economics, there is every reason to suppose that some rules could compromise development objectives, whatever one's opinion on the latter; it would be remarkable if this were not the case. Without such formal safeguards there is the real danger that 'speculative litigation' by interested parties in the WTO will, at best, cast the organisation in an anti-developmental light, reducing its public legitimacy, or at worst actually lead to pro-development policies being struck down.

The Status Quo

Even though SDT is not the whole story, it is at the centre of current discussion. An analysis of the *status quo* is an essential part of identifying new SDT for the Doha Round. This must both plug gaps in the *status quo* and learn from the lessons of the past. The history has been well covered (for example by Michalopoulos, 2001; Whalley, 1999; and Fukasaku, 2000). In essence, it is that:

- SDT had its origins in a view of trade and development that questioned the desirability of developing countries liberalising border measures at the same pace as industrialised countries;
- The popularity of this approach was (possibly temporarily) in decline in many developing country governments during the negotiation period for the Uruguay Round Agreement;
- Consequently, many SDT provisions on border measures and subsidies envisage developing countries (other than the least developed) following a similar path to that of the industrialised countries but at a slower pace;

- Other SDT provisions (particularly those covering positive support to developing countries via financial and technical assistance or technology transfer) were not agreed in a form that is enforceable within the WTO system.

The presumption of many was that the Uruguay Round represented the beginning of the end for SDT. Increasingly WTO members would accept the same obligations. But, as suggested above, this presumption appears now to have been misplaced. What is clear, though, is that the SDT incorporated into the Uruguay Round texts is unsatisfactory for many members and observers.

There are currently three areas of SDT, and they apply to three principal groups of countries. The types of treatment are modulation of commitments, trade preferences and declarations of support, while the main country groups are the industrialised countries, the developing countries and the least developed. Developing countries want Doha to improve some of the types of treatment; some industrialised countries propose a re-visiting of the country groups.

Modulation of Commitments

The most substantial SDT provisions are those which allow for a modulation of commitments by different types of member. Hence, for example, the Agreement on Agriculture requires the industrialised countries to reduce their tariffs by 36 per cent over six years, but developing countries have to do so by only 24 per cent over ten years and least developed countries do not need to cut their tariffs at all. As noted above, TRIPs provides similarly extended timetables.

This aspect is 'legally enforceable' in the following sense. A WTO member may use the dispensations granted under SDT in its defence if its trade policies are challenged by another WTO member on the grounds that they do not conform to the Uruguay Round commitments. Hence, for example, if India were challenged on the grounds that it had not reduced its agricultural tariffs by 36 per cent, it would have a watertight defence in dispute settlement by pointing to the fact that it is required to liberalise by only 24 per cent.

Trade Preferences Market Access for Developing Country Exports

The second area is the provision of enhanced market access via trade preferences (mainly by industrialised countries to developing and least developed countries). Under the 1979 Enabling Clause, WTO members are permitted to suspend the granting of MFN treatment in cases where they are offering better-than-MFN tariffs to developing countries.

The extent to which these provisions on trade preferences are legally enforceable is questionable and may be clarified by the current dispute of India against the EU. A strong case can be made that the standard Generalised System of Preferences (GSP) of

most industrialised countries can be justified under the SDT provisions of the Enabling Clause where it provides equal treatment to all developing countries. In other words, if the EU were to be challenged in dispute settlement by, say, the USA on the grounds that the standard GSP tariff available to all developing countries was lower than the MFN tariff being applied to imports from the USA, the EU would probably be able to cite the SDT provisions of the Enabling Clause in its defence.

However, as has been seen in the case of the challenges from Latin America and the USA to the EU banana regime, other aspects of trade preferences are less securely underpinned by legally enforceable SDT. Problems arose in the case of bananas because:

- The differential tariff was challenged on the grounds that it favoured one group of developing countries over another (and, hence, could not be justified under the Enabling Clause);
- The system of import licensing for companies was challenged on the grounds that it contravened the EU's commitments under the GATS.

The current Indian challenge focuses on the fact that the EU's *generalised* system of preferences actually offers several different regimes, with some beneficiaries being treated more favourably than others.

But, even where these provisions provide a permissive framework, it is not necessarily a supportive one. The 'beneficiaries' of SDT have limited rights to ensure that industrialised countries take advantage of the latitude that the WTO texts make available. There are many areas where SDT *could* be provided on market access, but the industrialised countries do not do so; on the contrary, they target their restrictions on developing countries. The misuse of anti-dumping actions is a case in point. Far from using the provisions that exist within the WTO sensitively to reduce the disruption to developing country trade, the OECD states are frequently accused of claiming that dumping has occurred when it is simply a case that developing countries are more competitive than domestic suppliers. As in so many cases, the WTO *status quo* provides the industrialised countries that largely drafted it with substantial opportunities for special and differential treatment in their own cause, but only limited opportunities in that of the developing states!

This lack of support is especially marked because the only clearly 'WTO-legal' policies – the standard GSP – are wholly autonomous undertakings by the industrialised countries. In other words, they can be introduced, amended or withdrawn unilaterally. They also often include major limitations that restrict their commercial value to developing countries. These can include zero, or limited, GSP preferences on products of particular importance for developing countries (such as clothing or footwear) and onerous rules of origin that either negate the commercial value of the

preferences (for example by requiring inputs to be sourced uneconomically from the GSP granting state) or deter regional trade.

Those preference agreements that are negotiated are often more generous – but they are not available to all developing countries. Hence, not only is their WTO-legality questionable, but the gains they provide to beneficiaries may be obtained at the expense of other developing countries.

Ancillary Support

The third area of SDT is wholly unenforceable. It comprises the large number of declarations of support for developing countries that litter the Uruguay Round texts. For example, Article 4 of GATS deals with encouraging the increased participation of developing countries in international services trade through 'negotiated specific commitments' relating to the strengthening of their domestic services capacity, improvement of their access to distribution channels and liberalisation of market access in sectors and modes of supply of export interest to them. Similarly, the *Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries* requires members to review the level of food aid to ensure that it is sufficient to meet the legitimate needs of developing countries, to adopt guidelines to ensure that an increasing proportion is provided to least developed countries and net food-importing developing countries, and to give full consideration in their aid programmes to help improve agricultural productivity and infrastructure. There are many other such references.

As is well known, there is no action that an aggrieved developing country can take either inside or outside the WTO to force another member (or an international organisation) to take actions that it believes are consistent with these undertakings. A considerable element of the discontent expressed by developing countries in the WTO about the failures of SDT derives from resentment that they were 'hoodwinked' into signing the Single Undertaking through promises that were, literally, not worth the paper they were written on. The Doha negotiations need to resolve these problems either by making the SDT provisions enforceable in some sense or by amending current rules (or tailoring future rules) to take account of their non-enforceability.

4 New Ideas

What is the Primary Purpose of SDT?

Given this impasse in the negotiations, it may be helpful to revisit the primary purpose of SDT in the WTO. It can be argued that this is to provide a framework for development in cases where it is not possible to agree a standard rule, applicable to all Members, that achieves this objective.

Such cases may arise from technical aspects of an issue: some countries need to do different things than do others, and so a rule that is appropriate to the first group will

necessarily be less so for the second. Most OECD states, for example, need to scale back the huge direct and indirect subsidies that distort their agriculture; in many developing countries the problem is the exact opposite – inadequate support has led to agricultural underproduction.

Alternatively, or additionally, the case may arise from political factors: a standard rule that would apply appropriately to all parties can be identified but there is no consensus in the WTO to agree it. Agriculture includes both types of issue: rules required to discipline effectively OECD distortions would be inappropriate for many developing countries but, in any case, it seems improbable that the political will exists in key OECD states to accept rules that would sweep away the major distortions. Hence, developing countries need flexibility both to expand the development potential of their agricultural sector and to deal with the consequences of the continuing OECD distortions.

In order to achieve this goal, the SDT framework needs to provide, at a minimum, a permissive and, at best, a supportive one. The permissive element relates to the key role of the WTO. This is to agree rules that are then maintained by the threat of sanctions applied under the dispute settlement mechanism. At a minimum, SDT must ensure that developmentally desirable actions are not constrained by the fear (or actuality) of challenge under dispute settlement. TRIPs provides a salutory lesson. Some aspects of the agreement are now widely perceived to be wrong headed (see CIPR, 2002) but re-negotiation to protect developing countries from the threat of sanctions is proving to be very difficult.

SDT must be effective, therefore, in the negative sense that it provides a developing country with a clear defence in dispute settlement. If it can also provide a positive, supportive environment (for example, by directing resources to needy developing country sectors or by giving better-than-MFN access to protected markets), then this is desirable although there are clear problems in linking WTO rules and resource flows. By the same token, to the extent that it is able to facilitate consensus building between developing countries, with other development actors and with the wider community, these are all plus points. But they should not divert attention from the primary objective.

Problems with the Status Quo

How does the existing provision measure up to this minimum task? There are two principal problems with the *status quo*. One is that the existing, legally enforceable provisions are eroding assets. The other is that large areas of trade policy are without any legally enforceable SDT.

Most legally enforceable SDT is an eroding asset in the sense that it provides modulation of commitments, the vitality of which will decline directly (if time limited) and indirectly (if it relates to removal of barriers that all members are reducing

over time). Hence, the implementation delays under TRIPs and the Agreement on Agriculture cease to provide differential treatment once the extended timetable has expired. Similarly, SDT provisions that require developing countries to liberalise/ reduce subsidies etc., but to a lesser extent than industrialised countries, will in due course cease to have validity when the developing countries' remaining barriers reach very low levels. It is true that in cases where least developed countries have been exempted from tariff/subsidy reduction altogether their concessions will not be eroded in this way. But many vulnerable developing countries do not fall within the least developed group.

The other problem, found especially severely in the 'new areas' of trade policy (such as TRIPs, services, government procurement and competition policy) is that no effective SDT exists and it is often far from clear what form more robust provisions would take. Evidently, the removal of formal market access barriers is either irrelevant or a minor aspect of rule formation. Hence, the 'traditional recipe' of slower, more limited barrier removal is not relevant. Yet, unless the proposed rules are 'analysed' and not just 'negotiated', extended implementation may be all that is on offer.

At the same time, even in cases where the form of SDT has been identified, the modalities remain an area of controversy, as noted above under TRIPs. A variation of this problem is to be found in the Agreement on Agriculture, which aims primarily to solve a problem that developing countries do not have: excessive direct and indirect subsidies to inefficient domestic agriculture. Given this 'wrong' focus (and the very partial coverage of the new rules), the existing SDT provisions have been described as 'upside down': developing countries are allowed flexibility in reducing distortions that they do not have, but face potential gaps in coverage over vital aspects of food security (Michalopoulos, 2003).

5 Negotiating Change

Existing SDT provisions are not adequate: hence the Doha Declaration commitment to strengthening them and making them more operational. Even if the current Round succeeds in extending and reinforcing the current rules, it will throw up new areas in which SDT is required in a form that avoids the problems of the current provisions. Yet for existing provisions to be improved and new arrangements made the WTO members have to agree change – and this is proving to be problematic.

The major problem in dealing with the deficiencies in the *status quo* is not technical but political. It is possible to identify, even at this early stage in the negotiations, flexibilities that would address major concerns. But they must necessarily be couched in quite broad terms given the absence of specific texts for new rules. And there is an evident unwillingness on the part of industrialised countries to agree broad, enforceable provisions at this time. Hence the dispute, noted above, over the appropriate

forum for SDT negotiations – the CTD or the sectoral committees negotiating change to specific agreements.

All proposals for effective SDT face the twin hurdles that some Members will be unhappy agreeing flexibilities that would apply equally to all developing countries, but differentiation will be very difficult to negotiate. The problems are both technical and political. The technical issues involve identifying appropriate forms of SDT and the countries to which they should apply. The political problem is the one of selling the idea of differentiation to an organisation that acts by consensus. Categories are all very well until a country discovers that it is excluded from one! There will be pressure to make more fuzzy the parameters of any proposed group until it becomes so vague that other countries (including, but not necessarily exclusively, the industrialised countries) are no longer willing to agree significant SDT for such a varied group.

If there is a problem with broad provisions now, how about more tightly drawn ones at a later stage? While this would still face the political problem of differentiation, the technical one would at least be more soluble when there are draft texts to be amended. The problem here is likely to be the dynamic of the negotiations.

If the Doha Round proceeds in the same way as its predecessor, introducing appropriate SDT at a later stage will not be easy. The Uruguay Round made erratic progress. A Draft Final Act had been produced by the end of 1991, but the agricultural proposals were rejected by the EU (Croome, 1995: 328). There followed two years in which most of the 'action' took place in bilateral talks between the EU and the USA from which other states were largely excluded. Even when the formal negotiations were relaunched in July 2003, there were at least three tracks: the discussion in the formal GATT groups; the personal 'facilitating' of the new Director General, Peter Sutherland, who 'kept up a punishing series of whirlwind visits to top-level political leaders in the major countries' (ibid.: 349); and bilateral negotiations between the EU and USA, with their respective chief negotiators, Sir Leon Brittan and Mickey Kantor, having from November 'a crucial series of meetings ... that were to continue with only short breaks over a period of more than three weeks' (ibid.: 364).

In other words, while some broad positions had been established by 1991, many of the critical details were not agreed until the final months, weeks (and even hours) of the 11-year marathon. Many of these details were hammered out in fora from which the majority of GATT members were excluded. Some of the non-actionable SDT provisions that are causing the greatest developing country bitterness were hatched in this way.

The Doha dynamic will probably be similar because it appears to be inherent in the task of negotiating a wide range of complex provisions simultaneously. There can be no agreement until the major WTO members have obtained compromises with which they can live, and then there is a strong imperative to finalise the deal as quickly as possible before this consensus is disturbed. John Croome, a close observer of the

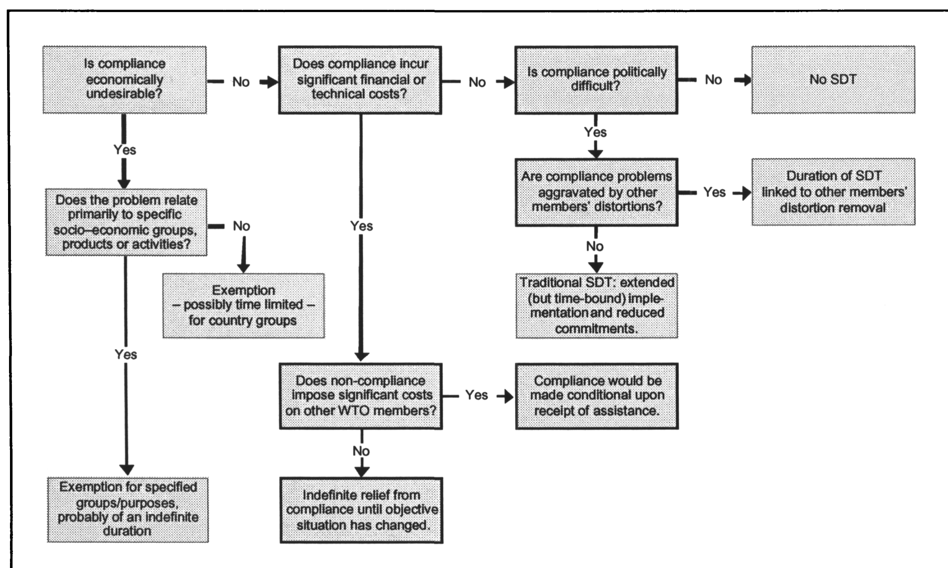
process, attributes a significant part of the final success in the Uruguay Round to Peter Sutherland's refusal to countenance any further delay (Croome, 1995). A consequence is that all other members have to scuttle around to establish their willingness to accept the compromises and to secure their own interests.

Hence, we have an impasse.

- To be effective, any development provisions must be actionable within the WTO.
- In the absence of agreed details to any WTO rule changes, such a guarantee can be provided only in broad terms.
- In the absence of agreement on sub-groups of developing countries, these broad, actionable provisions would apply either to all developing countries or just to the least developed countries.
- The industrialised countries are unwilling, currently, to agree general exemptions, partly because they want to link them to the negotiations of substance and they are unwilling to agree them for *all* developing countries; but SDT limited to the least developed would be cast too narrowly.
- The developing countries are unwilling to discuss differentiation and graduation, at least until substantial offers are on the table, and are reluctant to link provisions which, to their mind, 'restore the balance' to negotiations on further WTO rules.

In this unpromising environment, there is an urgent need for a regular review of the ends to be achieved by SDT in specific circumstances and the means to do this. The analytical matrix in Figure 3.1 aims to identify the multiple different reasons that might justify SDT and the appropriate mechanisms to achieve the desired outcomes. The questions posed in the figure are different from those often tabled (but not answered) in the Doha talks. It is not intended as an alternative to the negotiations but as a complement. Some of the boxes in the figure can be filled in already in broad terms – for example in agriculture (Michalopoulos, 2003; Stevens and Kennan, 2003). As the negotiations progress and proposed rules become clearer, the boxes can be refined. But at least all parties will have been sensitised before the final negotiating rush to the types of problems that different developing countries and least developed countries might face and the type of SDT that would be appropriate.

Figure 3.1: Check-list for Classifying SDT Issues and Solutions



6 Recommendations

The discussion of SDT in the WTO is at an impasse; indeed, some members argue that what happens in the CTD are not even 'negotiations'. Intransigence on one side has provoked intransigence on the other. One way to break the deadlock that would be developmentally desirable and respond to the realities of the WTO would be for the industrialised countries to agree at Cancún *some* general principles that would be legally enforceable in the sense that they would provide a cast-iron protection against challenge in dispute settlement regardless of what goes into the small print of specific agreements at a later stage.

So far, the industrialised countries have been unwilling to proceed in this direction. Given the current structure of the WTO such principles would have to apply either to all members, or to developing countries and LDCs or to LDCs alone. The first would not provide any special treatment; the third would miss out many WTO Members. Hence, only the second – general, enforceable principles applicable to all (or virtually all) countries currently classified (if only by themselves) as developing countries and LDCs would fit the bill. (Some further sub-groups of members might become acceptable later in the negotiations – but not by the time of the Cancún conference.)

While there is no strong evidence that the industrialised countries are willing to go down this route, its desirability is so great that it would be worth elaborating it a little further. In particular, some detail needs to be given to the word 'some' above. What are the highest priority areas? Are they food security, behind-the-border measures,

flexibility for small producers (regardless of the product) even in economically not so small countries? If any compromise can be reached, it is more likely to be for a list of issues that is shorter than many developing countries would wish but longer than some industrialised countries are currently willing to concede. A combination of socio-economic analysis and diplomatic opinion polling might throw light on the prime candidates for inclusion in the list.

Another area for action is for developing countries and LDCs to consider their highest priorities for action in relation to detailed SDT provision. This is necessary even if Cancún does agree some general, binding SDT principles, and it will be even more necessary if it does not. While each state has its own priorities, some common areas can be identified in which the *right sort* of WTO action is better than no action. Hence, developing countries and LDCs have an interest in avoiding the use of their blocking majority if it can be avoided: this provides the last line of defence, but a better outcome would be new rules that advance development interests (for example restricting the misuse of anti-dumping).

Agriculture is a prime candidate. Serious OECD 'liberalisation' (in the textbook sense) seems unlikely to happen. The Harbinson compromise would leave many important OECD product markets largely closed to import competition (Stevens, 2003). But there may nonetheless be many rule changes that could help or hinder agricultural development. If the negotiations progress, it is vital that the potential effects of what is actually being proposed (rather than vague concepts such as 'liberalisation') have been analysed in advance to show the ways in which specific socio-economic groups in particular countries could be affected. Otherwise, the chances of appropriate SDT being proposed – let alone agreed – are low.

Concentrating upon some areas means a relative neglect of others. This is inevitable. The trade-off can be made less severe if countries are able to collaborate and share out the responsibilities and if international organisations are able to help boost analytical capacity. But a trade-off will remain.

This needs to feed back into the list of highest priority general principles. One clear candidate for inclusion in the list would be a general limitation restricting the extent to which developing countries and LDCs would be subject to dispute settlement in areas that are low priorities for their limited analytical and negotiating capacities. This might be some form of halfway house between core WTO texts and plurilateral agreements. All members would be parties to an agreement, but the right to take a member to dispute settlement, and the obligation to accept such settlement, would only apply to those states that specifically agreed to be so bound. This would be just one way in which the limited membership and agenda organisation of the GATT would be transformed into the more pluralist WTO.

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Note

1 Plurilateral agreements need not be signed by the entire membership. While these were plentiful under the GATT, the Uruguay Round results made most of them multilateral (all members were obliged to accede).

4

From Doha to Cancún: Agriculture

Alan Swinbank

... without progress on agriculture, there will be no progress on other areas such as services and manufactured goods. This is not a threat, or an attempt to hold the Doha Round hostage to farming interests. It is simply a statement of fact – a negotiating and political reality.

The Hon. Mark Vaile, MP, Australian Minister for Trade, 4 March 2003

For societies from Mauritius to Malta, from Bangladesh to Sri Lanka, from South Korea to Sweden, farming also concerns the environment, food safety, safeguarding the food supply and protecting the rural way of life. Strong exporting countries flatly refuse to accept these concerns, conveniently ignoring the Doha declaration, which clearly states they have to be taken into account.

EU Commissioners Franz Fischler (Agriculture) and Pascal Lamy (Trade), 1 April 2003

The agriculture negotiations that are underway in the Doha Development Agenda were first mandated by Article 20 of the Agreement on Agriculture, signed at Marrakesh in April 1994;[1] and to a considerable extent current debates are coloured by the participants' perceptions of their negotiating successes, or failures, in the Uruguay Round. Furthermore, any new agreement is likely to adopt, and adapt, the architecture of the existing Agreement on Agriculture. Thus, this chapter begins by referring back to the aspirations expressed in the early 1990s before moving on to an examination of the negotiating proposals currently on the table and an assessment of the likely outcome. It is written from a policy-maker's perspective, in that it explores the extent to which WTO Agreements limit governments' ability to frame national farm policies and exchange market access 'gains' for 'concessions' in trade negotiations, rather than from a neo-classical economist's perspective that would predict domestic gains from unilateral tariff reduction.[2]

1 The Legacy of the Uruguay Round Agreement on Agriculture

Prior to 1995 agriculture had acquired, largely *de facto*, a special place in the GATT legal system. On the whole, import barriers were much higher on agricultural products than they were for other goods, very few tariffs were bound and a plethora of non-tariff barriers applied. Foreign suppliers jostled to gain preferential access to highly

protected (and thus lucrative) markets. In many developed, and some developing, economies, protected markets and direct subsidies encouraged production, thus reducing imports or promoting exports to the disadvantage of trading partners. Export subsidies, expressly permitted on 'primary products' by GATT Article XVI, went largely unchecked despite the provision that they should 'not be applied in a manner which results in that contracting party having more than an equitable share of the world export trade in that product'. And although GATT Dispute Settlement panels found against a number of farm policies, some important reports remained unadopted (and hence unenforced) because of the pre-1995 'consensus to accept' rule that determined the outcome of panel findings (Swinbank, 2003b). This really was 'world agriculture in disarray' (Johnson, 1973).

Post-1995, it might be argued, little changed. Countries that subsidised exports in the 1980s can still do so, albeit to a reduced extent (and the introduction of export subsidies on new product lines was prohibited). Domestic subsidy programmes are still in place, and there have been only marginal improvements in market access.

Thus, despite the process of tariffication, and the binding of most tariffs on agricultural goods, many import barriers remain prohibitive. There are a number of reasons for this. In part it stems from the choice of base period (1986–1988) for tariffication which meant that historically low world market prices were locked-in to the tariffs. In other instances, as a result of domestic policy reform, internal support prices were reduced without offsetting reductions in tariffs (Swinbank, 1999: 397). Undoubtedly, in some cases, 'dirty tariffication' occurred, in that countries deliberately widened the gap between 'domestic' and 'world' prices to maximise the size of the tariff applied.[3]

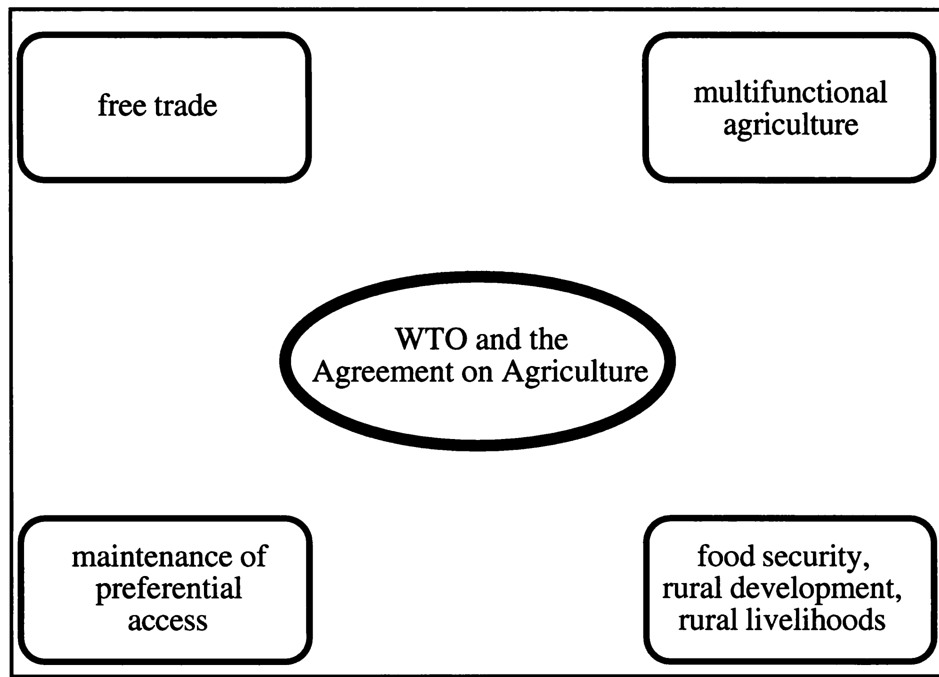
But a further important factor is the continued operation of the Special Safeguard Provisions (Article 5 of the Agreement on Agriculture). These provisions are not widely available: they apply only on tariff lines which had undergone tariffication, and where the letters 'SSG' had been written into the country's tariff schedule. But where they do apply, they allow a country to charge an additional import duty either following an import surge, or – on a consignment basis – when imports are offered at less than a trigger price which is basically the country's average cif (cost, insurance, freight) price over the period 1986–1988 for the product concerned. Consequently, if a country's imports in 1986–1988 were dominated by supplies from a preference-receiving partner, with cif prices well in excess of world market prices, then that will be reflected in the trigger price. For example, as Noble (2003: A/1) points out, 'because of the way the system was set up' most favoured nation imports of sugar into the EU face additional duties 'virtually continuously'. The EU's imports of sugar in the base period, of course, had been dominated by shipments from the African, Caribbean and Pacific (sub-Saharan) states under the sugar protocol of the then Lomé Convention (for details see McQueen *et al.*, 1998: 143–145).

All this led India to conclude: 'It is by now well established that despite reduction commitments, the level of distortions in agricultural trade continues to be high. The anticipated benefits [of the Uruguay Round agreements] in terms of an increase in exports for developing countries have consequently not materialized' (WTO, 2001a: paragraph 13). Of course, India went on to say: 'On the other hand to maintain the income entitlement of people engaged in agriculture it is imperative that the developing countries are allowed to maintain tariffs commensurate with their development and trade needs while at the same time undertaking relevant measures to enhance productivity and improve the quality of output' (WTO, 2001a: para. 13).

2 Alternative Policy Perspectives (and Emerging Alliances?)

WTO Members, and indeed members of the Commonwealth, have a range of complex aspirations on farm policy, that are not easily categorised. Figure 4.1 represents in stylised, and highly simplified, fashion four perspectives.

Figure 4.1: Alternative Perspectives on Farm Trade Liberalisation



Commonwealth countries can be found in each of these four groupings

Australia and other members of the Cairns Group, broadly speaking, would fall into the 'free trade' camp. Their view would be that agriculture is an economic activity like

any other and that market forces will lead to efficient production worldwide. Importing countries gain from trade liberalisation, as do exporting states. As efficient agricultural producers wishing to see their exports expand (and world market prices increase), Cairns Group members are strong supporters of trade liberalisation. Moreover, this view of the world extends to developed *and* developing economies. As Australia notes: 'high tariffs and other import restrictions in ... developing countries will harm efforts to make food more accessible and affordable for their populations. ... With developing countries increasingly trading with each other – roughly half of exports from developing countries go to other developing countries – dismantling trade barriers will contribute to food security and economic development throughout the developing world' (WTO, 2001b: 3).

European states (including the EU), Japan and South Korea would argue, broadly speaking, that agriculture is not like other industries. Agriculture has multifunctional characteristics valued by society that cannot easily be separated from farm production. These beneficial externalities (landscape, fauna and flora, and cultural and social identity), together with other non-trade concerns (food security in the case of Japan and South Korea, food safety, animal welfare, the integrity of traditional production methods, etc.), need to be borne in mind in defining WTO rules for this special sector (see Swinbank, 2002, for a discussion of multifunctionality).

Many developing countries, also, have non-trade concerns, including food security. They argue that in largely agrarian societies, rural development is an essential component of the development process. Mechanisms to protect domestic market prices from downward pressure brought about by imports in receipt of export subsidies from elsewhere,[4] and flexible green box measures to allow developing countries to develop their rural sectors, are seen as crucial by this group. However, if it might be thought that this represented a confluence of interests between the group represented in the top right-hand corner of Figure 4.1 and those in the bottom right-hand corner, this compact is illusive. India, for example, remarks: 'In this context, it should also be noted that the "Food Security and Livelihood Concerns" of developing countries are on a totally different plane and should not be confused or equated with the non-trade concerns advocated under "Multifunctionality of Agriculture" by a few developed countries with a view to provide legitimacy to and thereby perpetuate their trade distorting subsidies' (WTO, 2001a, paragraph 13). In short, the trade-distorting policies of developed countries should be curbed, while developing countries should be given more flexibility to pursue their own domestic policy concerns. This begs the question – *what is a developing country?* – to which we return below.

But if developed countries are to reduce market prices and trade barriers, who gains market access, and at whose expense? Swaziland captured these concerns in its comment: 'There are many developing countries that are exporting to the developed countries under preferential arrangements. They are able to develop and diversify

their economies precisely as a result of the preferential arrangements that are intertwined with domestic support measures in the developed countries. Accordingly, energies should be focused on a gradual and orderly reduction rather than substantial down-payment [*i.e. the proposal for an early and substantial reduction*] and prohibition' (WTO, 2000: 1). Understandably, such a view accords with the EU's, and others', wish to see support for the farm sector retained for some little while longer. Indeed, the EU has attempted to capitalise on this perspective in its 'Everything but Arms' initiative, which will eventually result in duty and quota free imports into the EU for the 49 least developed countries (Page and Hewitt, 2002). When Stuart Harbinson released his first draft modalities in February 2003 (see below), the EU's Farm Commissioner is reported to have said that 'Proposed sweeping import tariff reductions, and increased tariff quotas, would benefit developed nations and the most advanced developing countries, not the poorest states in the world' (reported in *Agra Europe*, No. 2042, 21 February 2003: EP/1).

Furthermore, although a number of developing countries (and others) have voiced worries about subsidised exports disrupting domestic markets, concerns are also expressed by Net Food-Importing Developing Countries (NFIDCs) that agricultural trade liberalisation will result in an increase in world market prices and jeopardise their capacity to import. Their particular complaint is that little has come of the Marrakesh Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least Developed and Net Food-Importing Developing Countries, adopted at the conclusion of the Uruguay Round.

3 Developed and Developing

The perception that developing countries felt short-changed by the outcome of the Uruguay Round, despite claims that 'special and differential treatment for developing countries' had been 'an integral element of the negotiations',[5] and had felt threatened in Seattle, is not really disputed in trade policy circles. A major lesson from Seattle was that, in the new WTO, rules are made by consensus, and developing countries discovered that they could influence the outcome of the debate by threatening to withhold their assent. In launching a new round of trade negotiations, the Doha Development Agenda, negotiators were mindful of the need to capture the commitment of developing countries (Laird, 2002). Thus, in the section dealing with agriculture, the Doha Ministerial Declaration asserted that 'special and differential treatment for developing countries shall be an integral part of all elements of the negotiations and shall be embodied in the Schedules of concessions and commitments and as appropriate in the rules and disciplines to be negotiated, so as to be operationally effective and to enable developing countries to effectively take account of their development needs, including food security and rural development' (see Box 1).

Box 4.1: Extract from the Doha Ministerial Declaration – Agriculture

13. We recognize the work already undertaken in the negotiations initiated in early 2000 under Article 20 of the Agreement on Agriculture, including the large number of negotiating proposals submitted on behalf of a total of 121 Members. We recall the long-term objective referred to in the Agreement to establish a fair and market-oriented trading system through a programme of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets. We reconfirm our commitment to this programme. Building on the work carried out to date and without prejudging the outcome of the negotiations we commit ourselves to comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support. We agree that special and differential treatment for developing countries shall be an integral part of all elements of the negotiations and shall be embodied in the Schedules of concessions and commitments and as appropriate in the rules and disciplines to be negotiated, so as to be operationally effective and to enable developing countries to effectively take account of their development needs, including food security and rural development. We take note of the non-trade concerns reflected in the negotiating proposals submitted by Members and confirm that non-trade concerns will be taken into account in the negotiations as provided for in the Agreement on Agriculture.

14. Modalities for the further commitments, including provisions for special and differential treatment, shall be established no later than 31 March 2003. Participants shall submit their comprehensive draft Schedules based on these modalities no later than the date of the Fifth Session of the Ministerial Conference. The negotiations, including with respect to rules and disciplines and related legal texts, shall be concluded as part and at the date of conclusion of the negotiating agenda as a whole.

Source: WTO, 2001c

The existing Agreement on Agriculture refers to developed and developing countries, and – in the developing country group – further reference is made to the least developed countries and to net food-importing countries. Longer implementation periods, and smaller reduction commitments, were demanded of developing as compared to developed countries, while the LDCs were not obliged to undertake reduction commitments, and other special and differential treatment was available to developing countries with respect to domestic support programmes. For example, although the Uruguay Round formula for tariff reductions for developed countries was 36 per cent on average over six years, with a minimum reduction of 15 per cent per tariff line, this

was reduced to 24 per cent over ten years, with a minimum reduction of 10 per cent per tariff line, for developing countries.

When the WTO was established, countries themselves decided whether they would declare themselves to be developed or developing; the WTO's website reports that over three-quarters of its 146 Members are developing countries.[6] The WTO has taken from UNCTAD the LDC classification. Of the 49 LDCs in UNCTAD's list, 30 were WTO Members on 1 January 2002. In addition, the WTO has recognised a further 23 WTO Members as NFIDCs.[7] At the margin, the boundaries between groupings can appear quite arbitrary. The difference between a very poor developing country not quite poor enough to qualify as an LDC (or NFIDC) and an LDC might be slight, but it results in different treatment in the WTO. Similarly, some developing countries have a profile of agricultural production and exports that raises questions about why they need SDT. Indeed, in its submission to the WTO negotiations on agriculture, the EU suggested that both developed *and advanced developing countries* should offer 'duty-free and quota-free access' for all agricultural imports from LDCs (European Commission, 2003). The category 'advanced developing countries' was not, however, defined.

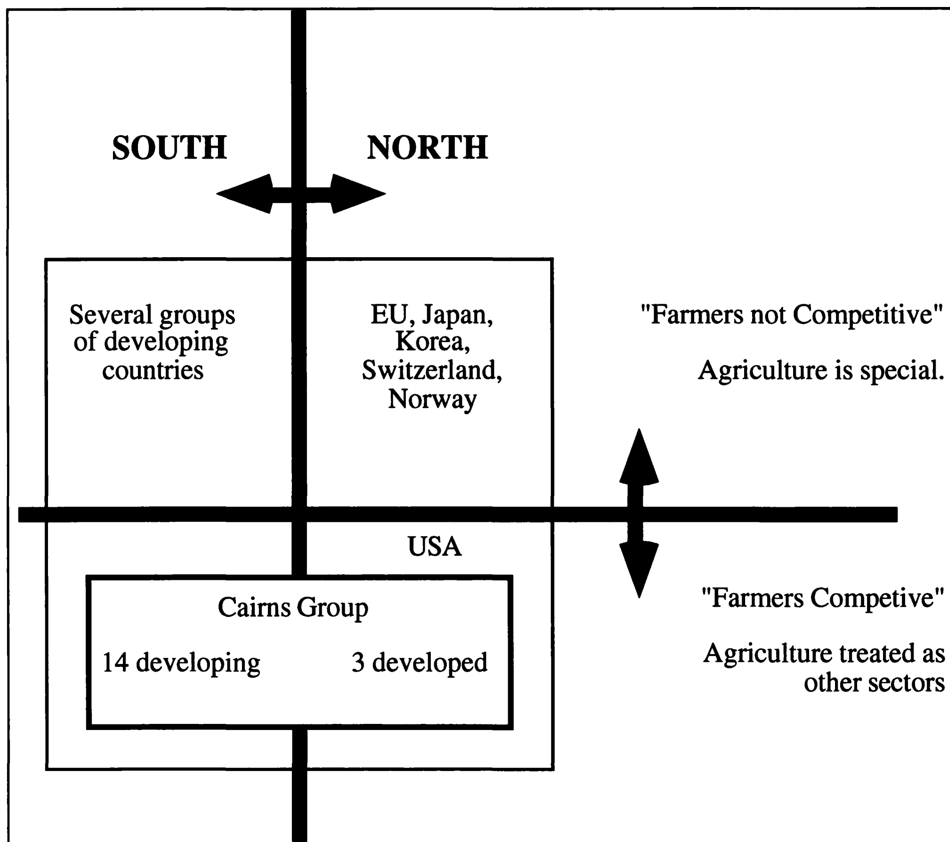
In short, 'developing countries' are a highly diverse group of countries with different interests, reflecting their comparative advantage in agricultural production, their net trade position and existing trade preferences, and their focus on temperate or tropical products. In Figure 4.1, developing countries can be found in each of the four quadrants. Thus a key premise of the Doha Agenda – that there should be special and differential treatment of developing countries – is not reflected in the various combinations of groupings one could easily extract from Figure 4.1.

Diaz-Bonilla *et al.* (2003) grapple with the same issue in Figure 4.2. In their analysis they show 'four main groups in the negotiations, presenting divisions along two main axis: South/North and whether countries considered their agricultural sectors competitive or not in world markets, and whether agriculture is 'special' or not. In the upper left quadrant there is a variety of developing countries, which see their agricultural sector as vulnerable, and consider that agriculture is special and require some sort of special treatment in the WTO' (p. 14). However, 14 members of the Cairns Group are developing countries, in the bottom left quadrant, and their negotiating perspective differs from those in the top left quadrant.

EU Commissioners Fischler and Pascal (2003: 19) suggested yet another way of viewing the groupings when they claimed there were

> *at least four main operators: the EU, which argues – along with others – that agriculture is more than just a matter of economics; the big exporting countries, led by the Cairns Group, which reject any support for the farm sector; the US, which is interested in opening other countries' markets but which spends as much as the EU on farm support, if not more; and –most importantly– the developing countries, which recognise the importance of the non-economic aspects of farming but have little money to support the sector.*

Figure 4.2: Different Negotiating Positions (Diaz-Bonilla *et al.*, 2003)



Adapted from Diaz-Bonilla *et al.* (2003: Chart 1)

4 Dispute Settlement and Evolution of the Rules

The Uruguay Round Accords also introduced a new Understanding on Rules and Procedures Governing the Settlement of Disputes which overturns the pre-1995 'consensus to accept' approach and replaces it with a 'consensus to reject' rule. While the new system doubtless has its imperfections, and there is always the danger that WTO Members might, in the extreme, withdraw from the WTO system rather than accept its rulings, there is a growing number of instances in which agricultural policies are being shaped by the dispute settlement procedures. Thus, even if there were no Doha Agenda, it would be wrong to conclude that the mosaic of agricultural policies across the world seen in the post-1995 period was a stable set that fully reflected implementation of the Agreement on Agriculture and GATT 1994. Policies are being challenged and changed. Furthermore, if the peace clause (discussed below) is allowed to lapse at the end of 2003 the judicial process could be enlivened.

Space does not permit a full discussion. Three instances will be cited to recall the importance of the dispute settlement procedure in the evolution of farm policy.

Two points, from many, can be drawn from the EU's attempts to defend its preferential import regime for bananas (Reid, 2001). First, the EU decided that the trade preferences encapsulated in the Lomé Convention would not be acceptable in the WTO, which led the EU to seek an interim solution – the Cotonou Agreement and the associated waiver of these tariff preferences until 31 December 2007 agreed in Doha – and the EU's current attempts to negotiate GATT-compatible Economic Partnership Agreements with the ACP States, and to the EU's decision to extend tariff- and quota-free access to *all* LDCs in the form of 'Everything but Arms'. Second, it is extremely difficult to allocate country-specific tariff quotas in a manner that does not infringe GATT Article XIII on non-discriminatory administration of quantitative restrictions. Thus from 1 January 2006 the EU's import regime for bananas will be a tariff only system (Reid, 2001: 277). At the very least, the outcome of this saga raises questions about the sustainability of other country specific tariff quotas to be found in the Schedules of many WTO Members.

Canada has had difficulty convincing the WTO that its exports of dairy products do not benefit from cross-subsidisation. If government delegates regulatory authority, as it did in the Canadian dairy industry, and then a dual-price system is applied under which exports are lower-priced than domestic sales, 'Allocation of production costs toward the higher of the two prices in order to cross-subsidize the lower one can be regarded as an export subsidy' (Mussell, 2003: 10). In particular, as Mussell (2003: 3) points out, the Appellate Body 'determined that industry average costs were the relevant benchmark', rather than marginal costs, in determining whether in such circumstances exports were subsidised. Presumably Australia, Brazil and Thailand, in claiming that the EU's C sugar exports (on which no export subsidy as such is paid) 'effectively benefit from the EU's main quota regime, and are therefore in contravention of the EU's WTO commitments on subsidised sugar exports' (*Agra Europe*, No. 2047, 28 March 2003: EP/3), were mindful of the outcome in the Canadian dairy case.

On a number of occasions it has been suggested that one way in which developing countries could counter a surge in cheap imports disrupting domestic producers' investment plans is to have in place a variable import tax regime: if world market prices fall, the import tax can be increased up to the level of the tariff binding. Chile had such a scheme, but it was challenged by Argentina. The Appellate Body has ruled that the Chilean 'price band system is a border measure that is similar to variable import levies and minimum import prices' and as such is 'inconsistent with Article 4.2 of the Agreement on Agriculture' and needs to be amended (WTO, 2002a, paragraphs 288(c)(i) and (iii), and 289).

It is clear from this brief review that countries need to be careful in designing their agricultural policies to ensure they are in conformity with WTO rules; and further-

more it suggests that a number of existing farm policies may yet be challenged by trading partners.

5 The Mandate and the Timetable

Further negotiations on agriculture were mandated by Article 20 of the Agreement on Agriculture. Article 20 is worth quoting in full, as WTO Members have an understandable tendency to place different emphasis on its constituent parts. Article 20, headed 'Continuation of the Reform Process' reads:

> *Recognizing that the long-term objective of substantial progressive reductions in support and protection resulting in fundamental reform is an ongoing process, Members agree that negotiations for continuing the process will be initiated one year before the end of the implementation period, taking into account:*
> *(a) the experience to that date from implementing the reduction commitments;*
> *(b) the effects of the reduction commitments on world trade in agriculture;*
> *(c) non-trade concerns, special and differential treatment to developing country Members, and the objective to establish a fair and market-oriented agricultural trading system, and the other objectives and concerns mentioned in the preamble to this Agreement; and*
> *(d) what further commitments are necessary to achieve the above mentioned long-term objectives.*

The 'other objectives and concerns mentioned in the preamble to this agreement' presumably refers in particular to the paragraph in the preamble that reads:

> *... that commitments under the reform programme should be made in an equitable way among all Members, having regard to non-trade concerns, including food security and the need to protect the environment; having regard to the agreement that special and differential treatment for developing countries is an integral element of the negotiations, and taking into account the possible negative effects of the implementation of the reform programme on least-developed and net food-importing developing countries.*

The agreement had also established a Committee on Agriculture that has met regularly in Geneva to monitor the implementation of the agreement. Mindful of the commitment in Article 20, and at the suggestion of the Committee on Agriculture, the Singapore ministerial conference of November 1996 established a process of analysis and information exchange that became an informal part of the committee's work (the AIE process). Thus many ideas and concerns had been voiced in the non-papers and discussions that constituted the AIE process, and the WTO Secretariat had prepared a number of detailed background papers. The AIE process was concluded in preparation for the Seattle ministerial conference. Equally, before the Seattle meeting, a number of

position papers were circulated. The agriculture negotiating group in Seattle made quite good progress in reconciling the interests of *developed* economies, although in developing his compromise paper the group's chairman is reported to have said he was walking a tightrope between the various concerns of WTO Members (*Agra Europe*, 3 December 1999: EP/1).

Following the failure of the Seattle ministerial conference to launch a Millennium (or Seattle) Round, it was quickly agreed that the Article 20 negotiations would proceed within the framework of the existing Committee on Agriculture, with the special sessions formally separate from the regular business of the committee, but held 'back-to-back' with the regular meetings of the committee. At the first meeting of the special session in March 2000 it was agreed that Members would submit their negotiating proposals by the end of December 2000, with a stock-taking of all the proposals submitted at the March 2001 meeting of the special session. At the March 2001 special session a further work programme through to March 2002 was agreed, at which time a further 'review of progress' would be undertaken. However participants did not yet have a common vision of how and when the process would end. Some argued that Article 20 provided a mandate for a 'stand-alone' negotiation on agriculture to be undertaken and concluded, and considered that the demise of the peace clause at the end of 2003 set the natural end-date for the process. Others argued that they could not accept a deal on agriculture alone, and wished to see the agriculture negotiations subsumed into a larger round in which trade-offs between sectors would be possible. In the event, the negotiations were engulfed in the Doha Development Agenda.

The Doha Declaration set new deadlines. First, as seen in Box 4.1, the modalities (i.e. the detailed rules) of the new agreement were to be established by 31 March 2003, and Members' draft schedules, incorporating the reduction commitments agreed in the modalities, were to be tabled by the time the fifth ministerial conference convenes in Mexico in September 2003. The entire Round was to be concluded by 31 December 2004, but as this is a 'single undertaking' nothing can be agreed until everything is agreed. There is some inconsistency in this framework: if the Doha Agenda is a single undertaking, with nothing agreed until everything is agreed, how can the modalities (i.e. the new Agreement on Agriculture) be agreed before the rest?

With a new mandate from the Doha Declaration, the special session of the Committee on Agriculture set out a new timetable of meetings to comply with the 31 March 2003 deadline. In particular, it mandated the chairman of the special session, Stuart Harbinson, to circulate an overview paper, based on discussions to date, by 18 December 2003. That document was published on time (WTO, 2002b). The purpose of this was to inform the January 2003 meeting of the special session which was to undertake a comprehensive review of the negotiations to date. Harbinson was then to prepare a first draft modalities document for the February meeting of the special session. This was officially published on 17 February 2003 (WTO, 2003a), but it had

been made widely available the previous week prior to an informal meeting of trade and agriculture ministers from 22 WTO Members, and the WTO Secretariat, in Tokyo. In due course the text was discussed at the special session on 22–28 February 2003.

Stuart Harbinson's mandate was now to produce a second draft for consideration by the special session at its March meeting, with the rather forlorn hope that final agreement could be reached before the Doha deadline of 31 March 2003. In the event, this text reports:

> *The present draft is an evolution of the first draft of modalities based on the discussions at the Special Session held on 24–28 February. On that occasion, participants engaged in intense and focused debate. A number of participants indicated that the draft did not correspond in various ways with their vision of the modalities to be established. Others found the paper useful or expressed interest in various ideas presented. Overall, while a number of useful suggestions emerged, positions in key areas remained far apart. In the circumstances, there was insufficient collective guidance to enable the Chairman, at this juncture and in those areas, significantly to modify the first draft as submitted on 17 February 2003. The present paper must therefore be considered as an initial, limited revision of certain elements of the first draft of modalities* (WTO, 2003b: paragraph 2).

Not unsurprisingly, this text failed to cement agreement between the participants, and the 31 March deadline was not met. Delegates did, however, agree to continue their discussions over the summer, in an attempt to agree the modalities prior to the Cancún Ministerial, and put the Doha Agenda back on track (*Financial Times*, 1 April 2003: 11).

6 The Issues

As indicated above, the formal and informal negotiations for the new agreement began as soon as the Uruguay Round was concluded. At an official level, the AIE process was launched in 1996 and the Article 20 negotiations in March 2000, and a stream of papers and conference presentations has emerged from international organisations, NGOs and academics. The difficulty Harbinson saw in 'building bridges between widely divergent positions and ... the consequent lack of guidance on approaches to solutions' (WTO, 2003a: paragraph 3), and the failure to reach agreement on the modalities by the agreed deadline of 31 March 2003, is perhaps, therefore, a little surprising. One interpretation could be that WTO Members have set themselves an impossible task and that the divergent views are irreconcilable, however deft the diplomacy.

An alternative explanation might focus on Members dragging out the process to the last possible moment because of an unwillingness to face domestic constituencies hostile to reform. Thus, in his December overview, Harbinson commented that 'While

a number of participants have submitted fully-fledged possible modalities for further commitments in the areas of market access, export competition and domestic support, opponents of these proposals have not yet specified their counter-proposals at a corresponding level of quantitative detail. This has made it difficult to move the process forward' (WTO, 2002b: paragraph 9). The EU had been unable to table its proposals in 'quantitative detail' until 27 January 2003 (European Commission, 2003); Japan had still failed to do so by 31 March 2003.

To add to the mountains of WTO documents and other papers, publication of the Harbinson texts triggered a rash of new reports (see for example Diaz-Bonilla *et al.*, 2003; Ruffer and Swinbank, 2003; Agricultural Policy Research Division, 2003). All three reports concluded that the Harbinson text was a genuine attempt to bridge the gaps between participants, but recognised that the gulf was wide. Others took a more hostile view; Das (2003), for example, suggested that the text was 'grossly inadequate in tackling the main problems' faced by developing countries, and suggested the preparation of 'an altogether new text as an alternative' to the tabled document.

The negotiations have proceeded thus far on the assumption that there will be an agreement on agriculture in place following the Doha Round, whether it ends in success or failure. The existing agreement on agriculture would simply prevail if the WTO cannot command a consensus to amend, or repeal, the existing agreement, although a key element – the peace clause – would lapse at the end of 2003. The potential demise of the peace clause in itself raises questions about the stability of the system post-2003 in the absence of an agreement in Cancún, which we explore below.

As far as this author is aware, no-one has suggested that the existing agreement should simply be repealed, leaving agriculture to be governed by GATT 1994 and the other WTO Agreements. The Harbinson text proposed a series of *amendments* to the existing agreement, with its present structure basically intact. Thus it refers to market access, domestic support and export competition; it contains proposed drafting amendments to specified articles of the present Agreement; and, broadly speaking, it takes as its base the tariff and other commitments bound at Marrakesh. Despite the set-back of 31 March 2003, this seems to be the most likely structure of any new agreement on agriculture, and the remaining comments in this section are arranged accordingly. Only partial coverage of the proposed modalities is attempted here (see Chapter 6 of Ruffer and Swinbank, 2003, for a more complete overview). Lack of space precludes discussion of the (non)-treatment of non-trade concerns in the draft modalities.

Import Access

A large number of issues arise under this heading, including the treatment of state trading import enterprises, the potential incorporation of non-trade concerns (e.g. animal welfare), the problems associated with tariff escalation, preferential access for exports from LDCs, etc. These are non-trivial issues, each of which would warrant a

detailed evaluation, but two key questions seem to be: to what extent will *developed* countries be required to reduce their trade barriers and increase market access, and how will special and differential treatment for developing countries be built into this?

On tariff reductions for developed countries, three propositions seem to be on the table. First the US and the Cairns Group have advocated sweeping cuts, using an arithmetic formula known as Swiss-25. Under this formulation the new tariff T_1 is a function of the old tariff T_0 and a coefficient a (= 25 in the US proposal), according to the expression

$$T_1 = (T_0 \times a)/(T_0 + a)$$

The effect is to reduce larger tariffs (tariff peaks) by a proportionally greater amount than smaller tariffs, and the maximum tariff will never exceed a. Thus, if T_0 is 1,000 per cent, then T_1 becomes 24.4 per cent. The formula is immediately applicable for *ad valorem* tariffs; but specific tariffs (i.e. those expressed in money, e.g. €100 per tonne) would first have to be converted into an *ad valorem* format.

To the EU, the Swiss-25 formula is unacceptable. Instead they have proposed a repeat of the Uruguay Round format. For developed countries this would involve an average reduction in tariffs of 36 per cent, with no tariff line being reduced by less than 15 per cent. However, it is slightly disingenuous to present this as a repeat of Uruguay, for it is 36 per cent of a lower base. To maintain the momentum of the tariff reductions agreed in the Uruguay Round would imply a 50 per cent reduction now (Swinbank and Tanner, 1996: 147). Furthermore, given the perceived need to reduce tariff peaks, it would be unfortunate if countries were able to opt for a minimum reduction for any particular product in both agreements. Applying the minimum cut in both rounds would result in an overall tariff reduction of almost 28 per cent from the 1986–88 base, compared with an average tariff reduction of 59 per cent. A preferable outcome would be a cumulative approach, insisting for example on a minimum tariff cut of 40 per cent over the two rounds.

Harbinson's draft modalities adopt the middle ground. A banded approach is proposed, under which a Uruguay Round-like formula would apply within each tariff band (see Table 4.1). Thus, for developed countries, any *ad valorem* tariff of more than 90 per cent would have to be reduced by at least 45 per cent, with an average tariff reduction of 60 per cent for all tariffs in this tariff band (over 90 per cent). Clearly, where *specific* tariffs apply, they have to be converted into their *ad valorem* equivalent to determine which tariff band to use. It would seem to be a lost opportunity, having undertaken this exercise, not to then insist that all *specific* tariffs be re-expressed in *ad valorem* terms in Members' new commitments. Figure 4.3, which maps out the new tariff against the old tariff for developed countries, clearly demonstrates the power of the Swiss-25 formula to reduce peak tariffs, compared with the rather limited impact of the Uruguay Round formula and the middle ground occupied by the draft modalities.

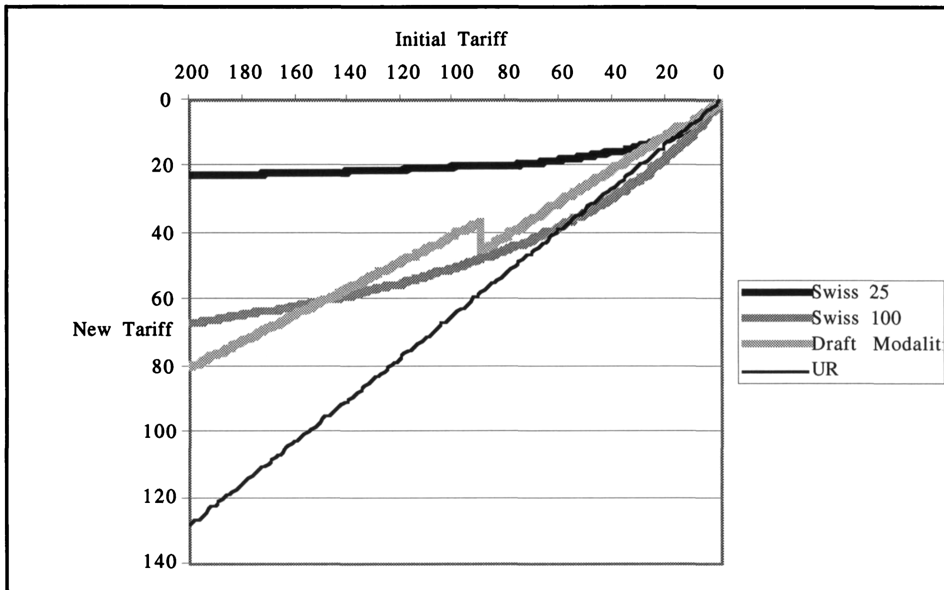
Table 4.1: Draft Modalities Proposals for Tariff Reductions

	Tariff Band		Reduction Commitment		Implementation Period	
	Developed	*Developing*	*Developed*	*Developing*	*Developed*	*Developing*
Tariff bands	> 90 %	> 120 %	60/45 %	40/30 %	5 years	10 years
	> 15 – ≤ 90 %	> 60 – ≤ 120 %	50/35 %	35/25 %	5 years	10 years
	≤ 15%	> 20 – ≤ 60 %	40/25 %	30/20 %	5 years	10 years
		≤ 20 %		25/15 %		10 years
'SP' products				10/5 %		10 years

SP products refers to the proposal in paragraph 11 that developing countries can designate an unspecified number of special products 'with respect to food security, rural development and/or livelihood security concerns'. The reduction commitments show the average and minimum reductions proposed.

Source: WTO, 2003b, paragraphs 8–15; as presented in Ruffer and Swinbank, 2003: 20

Figure 4.3: The Impact of Various Tariff Reduction Formula



Four alternatives are shown: the proposed Swiss-25 formula, a hypothetical Swiss-100, the proposal in the draft modalities for *average* tariff reductions for developed countries and a linear 36 per cent average reduction as in the Uruguay Round. See also Ruffer and Swinbank, 2003: 22.

It is easy to imagine an alternative Swiss formula. With Swiss-25 the curve asymtotically approaches the maximum tariff of 25 per cent. With higher reduction coefficients (e.g. a = 100 in Swiss-100) the curve is pulled lower in the diagram; so Swiss-100 would produce bigger cuts than would the draft modalities for initial tariffs in excess of 150 per cent, and lower cuts for initial tariffs lower than 150 per cent.

Clearly, many formulations are possible. It has been said by some that the proposals in the draft modalities lack ambition in that the proposed reductions are too modest. Others have claimed they are too sweeping, with, it is said, a majority of WTO Members (75, counting the EU as 16) in favour of the Uruguay Round approach of a linear reduction (*Agra Europe*, 28 March 2003: EP/2). Thus it appears that a further 36 per cent average reduction in tariffs for developed countries could readily be agreed by WTO Members – in itself an impressive achievement compared with the situation that prevailed prior to the Uruguay Round – but it does not yet meet the aspirations of many WTO Members. It is doubtful, however, that the proposition that 'no deal is better than a bad deal' applies in this context. Thus, a final agreement that lies somewhere between the Harbinson text and the linear 36 per cent cut agreed in the Uruguay Round would seem to be the most likely outcome.

However large the tariff cuts finally agreed, their effect is likely to be muted unless there are comparable reductions in the trigger prices that WTO Members established for products subject to the special safeguard provision (Article 5 of the existing Agreement on Agriculture). The draft modalities drawn up by Stuart Harbinson are silent on this issue (WTO, 2003b). As noted earlier in this chapter, in some instances (e.g. sugar for the EU) trigger prices were based on the cif price of preferential imports which means that high 'additional' duties could apply even if the MFN tariff was reduced to zero.

Harbinson's draft modalities document contains many examples of special and differential treatment, as illustrated by Table 4.1. The LDCs, as in the Uruguay Round, would be exempt from any reduction commitments. Developing countries would enjoy a longer implementation period (ten as opposed to five years), and face a smaller reduction commitment (reflected in both lower percentage reductions and wider tariff bands) than would developed countries. In addition they could designate a number of special products (SP products) – those related to food security, rural development, and rural livelihood concerns – which would enjoy three 'concessions'. First, there would be smaller tariff reductions on these products, as detailed in Table 4.1; second, they would not be subject to increased tariff rate quotas; and third, an extension of Article 5-like special safeguard provisions to these products (and perhaps others) is envisaged (Ruffer and Swinbank, 2003: 19).

6.2 Export Competition

There are 25 WTO Members (counting the EU as one) that can grant export subsidies

as a result of the Uruguay Round agreements. The EU is by far the most important player, accounting for 89 per cent of export subsidy *expenditure* of all WTO Members in 1995, for example (WTO, 2002c: Table 1). Neither Japan nor South Korea, countries that both wish to retain significant flexibility to protect their farm sectors, have this facility. Some countries on the list, for example Australia and Brazil, have made very limited use of export subsidies. Thus the EU is rather isolated on this issue, and is under strong pressure to agree a substantial reduction, and an eventual elimination, of export subsidies. At Doha it was the drafting of the phrase in the Ministerial Declaration that referred to 'reductions of, with a view to phasing out, all forms of export subsidies' that caused the EU delegation (particularly France and Ireland) so much anguish, and threatened to stall the proceedings (*Agra Europe*, No. 1978, 16 November 2001: EP/1). The EU, for its part, is determined that export credits, which figure much more strongly in US policies, should be subject to international disciplines (see Thompson for a discussion of OECD countries use of export credits in farm trade).

Many developing countries have argued that export subsidies, and domestic subsidies in developed countries that distort trade, must be eliminated before the developing world can be expected to reduce its tariff protection. The Cairns Group has argued for a phased elimination of export subsidies, with a substantial reduction (50 per cent) in year one of the new agreement. For its part, the EU offered to 'scale back' 'all forms of export subsidies by 45%' (European Commission, 2003). Specifically, it proposed that *expenditure* on export subsidies be reduced by 45 per cent, an 'average substantial cut' in the *volume* of subsidised exports, and the elimination of export subsidies 'for certain products' 'provided that no other form of export subsidisation, including export credits and deficiency payments, is given for the products in question by other WTO Members'. A 45 per cent cut in expenditure on export subsidies might seem to be a surprising large 'offer' from the EU, but it reflects the fact that in aggregate (but not on a product-specific basis) the EU has some slack in its export subsidy constraints. In 2000/01, for example, it used only 37 per cent of its overall export subsidy commitment (i.e. expenditure on export subsidies amounted to €2.8 billion compared to a commitment of €7.4 billion) (WTO, 2002d).

Thus, once again, a minimalist agreement can be envisaged. No-one seems to be opposed to the notion that export subsidies should be reduced, and so at the very least the EU's proposal could be adopted, and this again would be a major advance on the situation pre-Uruguay. But many countries argue that this is not sufficient; and Harbinson's draft modalities would deliver more. In particular, disciplines would apply on a product-specific basis on both expenditure and volume, export subsidies for ten of the new agreement and annual reductions would not be linear, as in the Uruguay Round, but instead would be concentrated in the earlier years (in year one, in one grouping, there would be a 30 per cent reduction of the base entitlement, then in year two a further 30 per cent cut in the reduced entitlement, etc.). The few developing

countries that are still allowed to grant export subsidies would have a longer period over which to phase them out. If adopted, the basic parameters would be:

	Developed Countries	**Developing Countries**
Products accounting for at least 50 per cent of bound budgetary outlay:	reduce by 30% per year, set at zero in year 6	reduce by 25% per year, set at zero in year 11
Remainder:	reduce by 25% per year, set at zero in year 10	reduce by 20% per year, set at zero in year 13

Source: Ruffer and Swinbank, 2003: 28.

6.3 Domestic Support

The existing provisions in the Agreement on Agriculture are complex – and unique. No other sector of the economy has comparable rules written into WTO Agreements. Reference is often made to the Green, Blue and Amber Boxes, but the reality is slightly more complicated. To give the discussion some context, Table 4.2 reports on EU and US declarations of domestic support for 1998. It shows Green and Blue Box expenditure, the bound Aggregate Measurement of Support (AMS) limit for the year, the actual Amber Box AMS support declared for the year (which in both instances were well inside the maximum permitted) and the amount of trade-distorting support that did not have to be included in the Amber Box declaration because it fell within the *de minimis* limits. The final row shows the total value of farm output, which gives some order of magnitude for the earlier numbers.

Green box payments are not subject to reduction commitments. They must meet tightly defined criteria, and have 'no, or at most minimal, trade-distorting effects or effects on production'. They are listed in Annex 2 to the Agreement on Agriculture. On public stockholding for food security purposes, and domestic food aid, developing countries are allowed slightly more flexibility than are developed nations. Many countries are concerned that, despite the injunction that policies have no, or at most minimal, trade-distorting effect, the sheer size of the expenditures in some developed countries must have an impact on production and trade. It is suggested that 'wealth' and 'insurance' effects, which enhance the producer's willingness and capacity to respond to market signals, as well as the fungiblity of transfers leading to cross-subsidisation of activities, leads to this response. Consequently, there have been suggestions that the rules be tightened, and the scope of the Green Box narrowed. Harbinson's draft modalities propose some tightening of the criteria and suggests some additions for developing countries. Thus various concepts that proponents of multifunctionality in developed countries would like to adopt, such as 'Payments to small-scale producers/family farms for the purpose of maintaining rural viability and cultural heritage', would be Green-boxed in developing, but not developed, countries. For developed countries the

fundamental structure of the Green Box would not change, although the text does suggest that payments to meet the 'extra costs or loss of income involved' in complying with a 'clearly-defined … animal welfare programme' might become a legitimate Green Box measure.

Table 4.2: EU and US Declarations of Domestic Support, 1998

	EU (€ billion) 1998/99	US ($ billion) 1998
Green	20.5	49.8
Blue	19.2	–
AMS Binding	69.5	20.7
Amber (AMS)	46.7	10.4
de minimis	0.5	4.7
Total value of output	213.5	190.9

Source: WTO 2001d, 2001e

Amber Box support does have a trade-distorting effect. Some Amber Box support in developing countries is, however, exempt from any WTO constraint, provided it meets the criteria set out in Article 6(2) of the Agreement on Agriculture: thus 'investment subsidies … generally available to agriculture' in developing countries, and 'agricultural input subsidies generally available to low-income or resource-poor producers' in developing countries, are exempt. The Harbinson text would further extend this list. As noted elsewhere in this chapter, special and differential treatment for developing countries permeates the proposal; whether this is enough to assuage the demands of developing countries without causing undue alarm to developed country Members is a key unknown.

Other Amber Box support is eliminated from the calculations as a result of a *de minimis* clause (Article 6(4)(a) of the Agreement).[8] Again, special and differential treatment is implicit in the existing Agreement, and would be enhanced by the draft modalities.

Amber Box support that is not in some way or other excluded from the reduction commitments must amount to less than the final bound Aggregate Measurement of Support. For many countries, of course, this is zero (as are their export subsidy constraints), but for those countries that have an AMS entitlement, the draft modalities would reduce this by 60 per cent over five years (40 per cent over ten years in developing countries) (WTO, 2003b, paras 46–50). The EU had suggested a reduction of 55 per cent, but this did not include the product-specific AMS constraints incorporated into Harbinson's draft modalities, and was premised on an unchanged Blue Box. Even more so than with export subsidies, the Blue Box is predominantly an EU concern.[9] The EU declares expenditure on its area and headage payments in the Blue Box, but if the European Commission's current proposals for further decoupling of these pay-

ments were to be adopted the EU would no longer be making use of this provision.[10] The decoupled Farm Income Payment, that would replace area and headage payments, would be declared under the Green Box – and, as can be seen from Table 4.2, Green Box expenditure would double!

Blue Box payments, under production-limiting programmes, are not subject to any constraint under the existing Agreement on Agriculture. If the draft modalities were accepted, they would be subject to limitation; they would either be capped at existing payment levels, and then reduced by 50 per cent over five years, or incorporated into the Amber Box (with presumably no offsetting increase in AMS entitlements) (WTO, 2003b, paras 44–45). Either formulation would mean that no country could introduce new Blue Box payments, and both would encourage the EU to adopt the European Commission's reform proposals.

7 Cancún and Renewal of the Peace Clause?

Although a deal on modalities cannot be precluded in the run-up to Cancún, or even at the ministerial conference, this now seems unlikely. However, the pending expiry of the peace Clause (Article 20 of the Agreement on Agriculture) may well give leverage for change.

The peace clause is complex, untested and difficult to understand.[11] It relates to all domestic subsidy programmes (Amber, Blue and Green Box, as well as the *de minimis* clause and the Article 6(2) exemptions), and export subsidies, in differing degrees. It may be that the legal protection it affords is more apparent than real, but the political context in which Members decide how, and when, to use WTO provisions will doubtless change if the modalities are not agreed at Cancún. An increase in WTO litigation, with Members challenging aspects of their trading partners' agricultural policies is thus likely to ensue with the expiry of the peace clause. The EU, in particular, wishes to see it renewed, but the draft modalities make no mention of the peace clause, and it is the author's understanding that it has not been discussed formally in the special sessions of the Committee on Agriculture.

All Members that make use of Green Box and *de minimis* provisions have an interest in securing an extension of the peace clause for these items. Only those Members that make use of export subsidies and the Blue Box will see a need to extend the Blue Box provisions in this domain. An extension of the peace clause would require the assent of all WTO Members. It will presumably be on the agenda at Cancún.

An agreement on the modalities would seem to be a precondition for extension of the peace clause. The question that then arises is what trade-offs might emerge to secure its extension? Will the Cairns Group be able to exert enough pressure to demand modalities that go beyond the Harbinson text, and will those countries that wish to retain protection for their agricultural sectors be willing to pay the price? Will

developing countries simply accept a roll-over of the peace clause, or will they too exert leverage to ensure that their interests are reflected in the agreed modalities? And given the diversity of views in developing countries, what are their interests?

If agreement cannot be reached at Cancún, or early in 2004, the Doha deadline for completion of the Round by 31 December 2004 will be difficult. But with a probable increase in the number of dispute settlement procedures focused on farm policies following failure to renew the peace clause, and with the US Congress scheduled to vote on a renewal of US membership of the WTO in 2005 and support in Congress somewhat uncertain,[12] the future of the WTO system could be at risk unless WTO Members can learn to agree. This suggests that a WTO package might come together towards the end of 2004, or early in 2005.

A Conclusion?

Thus a possible outcome is an agreement in 2004/05, with an implementation period stretching into the mid-2010s and a set of modalities based on the Harbinson text. Whether those who believe that Harbinson's draft modalities are already over-ambitious or those that believe it lacks ambition will win the day is unclear. But if the gap between them is to be bridged, the Harbinson text does offer a framework around which agreement could coalesce. A minimalist agreement among developed countries is attainable; the EU's offer on the three pillars (export competition, import access and domestic support), but not on non-trade concerns, would in itself continue the reform process initiated by the Uruguay Round, although Japan and some others might need persuading. But there are three problems with this minimalist approach: first, that many countries believe it lacks ambition; second, that a reconciliation of divergent views on non-trade concerns remains illusive; and third, that it is not yet clear whether some developing countries can accept any new package that imposes further reductions in their import tariffs without the prior eradication of export subsidies and Blue and Amber Box support, and tighter constraints on Green Box payments in developed countries. The stakes are high; it is the future of a rules-based system of world trade that is at risk.

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Notes

1 The Uruguay Round of multilateral trade negotiations, under the GATT, was launched at Punta del Este, Uruguay, in September 1996 and concluded in Geneva in December 1993. The agreements were signed in Marrakesh, Morocco, in April 1994, and – following ratification – came into force on 1 January 1995 under the auspices of the WTO. The Uruguay Round Agreements, including that on Agriculture, can be obtained from the WTO web site: www.wto.org. On the Agreement on Agriculture and the negotiations see Josling, Tangermann and Warley (1996), and Swinbank and Tanner (1996).

2 Nor does this chapter attempt to assess the economic impact of any potential Doha package (by contrast the Agricultural Policy Research Division of the Danish Research Institute of Food Economics (2003: 32) has undertaken a GTAP (Global Trade Analysis Project) modelling exercise of the Harbinson draft (the Harbinson draft is outlined and discussed below).

3 Ingco (1996), in particular, has made this claim; but I would caution that her results need should be used with care. Note that with an increase in world market prices between 1986/88 (the base period), and 1 January 1995 (the start of the new trade regime) the fixed import tariff applied on 1 January 1995 could often exceed the variable import levy applied on 31 December 1994.

4 A case that is often cited is disruption to the fresh milk industry in Jamaica attributed to imports of milk powder in receipt of export subsidies from the EU, following trade liberalisation by Jamaica (see Oxfam, 2002:116).

5 As noted in the introduction to the Agreement on Agriculture.

6 http://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr04_e.htm (accessed 16 January 2003). Elsewhere the website reports that 'other members can challenge the decision of a member to make use of provisions available to developing countries'. http://www.wto.org/english/tratop_e/devel_e/d1who_e.htm (accessed 16 January 2003).

7 See Annex 1 of Ruffer and Swinbank (2003) for a list of WTO Members, showing LDC and NFIDC status, on 1 January 2002.

8 In 1998 the USA paid out $2.8 billion of emergency aid ('market loss assistance payments') to compensate for the collapse in commodity prices in the period following the enactment of the 1996 FAIR (Federal Agricultural Improvement and Reform) Act and – claiming these payments were not crop specific – declared them to be non-product-specific payments within the 5 per cent *de minimis* franchise allowed to developed countries (WTO, 2001e: 31). See also Ayer and Swinbank, 2002. The Green Box contained $5.7 billion of decoupled 'Production Flexibility Contract Payments' introduced by the FAIR Act, but the biggest Green Box item for the USA is domestic food aid at $33.5 billion.

9 Norway and Japan also declare Blue Box payments (WTO, 2002c).

10 On the mid-term review see Swinbank 2003a.

11 An earlier attempt to outline its provisions is Appendix II of Swinbank, Jordan and Beard (1999).

12 The Republican chairman of the House of Representatives Ways and Means Committee has already suggested withdrawal (*Financial Times*, 14 February 2003: 11).

5

Using GATS Flexibility

Ivan Mbirimi and Bridget Chilala

Introduction

Negotiations on further services liberalisation were mandated as part of the Uruguay Round's 'built-in' agenda.[1] The negotiations formally commenced in January 2000, with the aim of achieving higher levels of liberalisation. Little actual services liberalisation took place during the Uruguay Round. As a result, developing countries have been under considerable pressure to give greater market access to foreign providers. However, as the negotiations have progressed, concerns have been expressed, mainly by representatives of civil society, about the perceived threat posed by further liberalisation to countries' sovereign rights to regulate the production, distribution and trade in public services.

But supporters of further liberalisation point to the flexible structure of the GATS and its 'bottom-up' approach. The agreement allows developing countries to select sectors, modes of supply and regulatory conditions under which liberalisation commitments are made (Article XIX.2). Countries can even decide to leave entire sectors out of their schedules of commitments. This article looks at how developing countries can best use the policy space provided by a flexible GATS framework. It argues that there is ample opportunity for developing countries to develop policies for their services sectors that support their development policies.

Background

The ongoing negotiations will take place within and respecting the existing structure and principles of the GATS. At the general level, this means two things. First, countries are expected to include more sectors and modes of supply in their schedules of commitments. Second, further elaboration of certain principles included under the framework of general obligations is envisaged, most notably principles relating to an emergency safeguards clause (Article X), disciplines on government procurement (Article XII) and subsidies (Article XVI), and general principles on domestic regulation (Article VI).

The approach to the negotiations was laid out in the Guidelines and Procedures for Negotiations on Trade in Services concluded in March 2001. While building on the core articles of the GATS, the guidelines included additional principles, among them

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an elaboration of the modalities for negotiations. Under the agreed modalities, liberalisation should be advanced through bilateral, plurilateral and multilateral negotiations, using the request-and-offer approach. The guidelines also make it clear that special attention shall be given to sectors and modes of supply of export interest to developing countries. The principles therefore encompass special considerations for developing countries.

The mandate for the Working Party on Domestic Regulation is 'to develop any necessary disciplines to ensure that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not continue to constitute unnecessary barriers to trade in services'. Members also have an understanding that domestic regulations should take account of, and build on, the transparency provisions of Article III (Transparency) of the GATS. The following areas or issues will require to be addressed in work ahead, namely issues related to: (i) transparency; (ii) monopolies; (iii) whether a necessity test is necessary; (iv) the scope and limits of Article VI:5;[2] and (v) harmonisation and mutual recognition. It is important to ensure that empirical investigations or analyses of the costs and benefits of such disciplines are made, while recognising that multilateral disciplines on any of these issues could also be costly and burdensome, especially for developing countries.

The primary objective of negotiations on trade in services is to liberalise trade in services rather than to deregulate the services sector. Liberalisation of trade in services refers to the removal of measures and regulations that hinder trade among trading partners and discriminate against foreign firms and entities. Deregulation is much broader because it refers to the reduction of the role of government in regulating the economy, which may be achieved by a combination of liberalisation and privatisation (the sale to the private sector of companies previously owned by the state). Thus, the GATS does not require privatisation, commercialisation or deregulation of the services sector, although these processes may help the liberalisation of trade in services.

The traditional economic justification for regulation was the existence of natural monopolies – industries for which production was far cheaper if undertaken by one firm rather than many different firms (reflecting the importance of large-scale economies of production). Natural monopolies mean that competition is not feasible or sustainable. Utilities such as railways and roads traditionally fell into this category. Regulation became essential to curb the excesses of monopoly power, for example to protect consumers from overcharging by the monopolists. A major reason for the continued regulation of certain industries is that many of them include firms that have so much market power that their regulation is considered to be in the public interest.

But certain dimensions of regulations remain central to government policy. They include the desire to provide services to isolated areas where supply is expensive and unprofitable (universal service provision) and protection of consumers, employees and the environment. A major reason for the continued regulation of certain industries is

that many of them include firms that have so much market power that their regulation is considered to be in the public interest.

The Doha Declaration of November 2001 reaffirmed the guidelines and principles of negotiations and also established the timetable for negotiations, including the deadline for conclusion of negotiations. Of crucial importance is the requirement that the conclusions of the negotiations will be part of a single undertaking. This inevitably brings into play tactical considerations which may not work to the advantage of developing countries.

2 Process and Modalities for Negotiations

Both the process and modalities for negotiations are laid out in the Guidelines and Principles for Negotiations adopted in March 2001 and in a note on Technical Aspects of Requests and Offers prepared by the WTO. The adoption of the guidelines marked the end of the first phase of the negotiations, which focused on the development of a road map. The second phase, which lasted about a year (April 2001–March 2002) was taken up by a consideration of the negotiating proposals tabled by members. The third phase, to be concluded in January 2005, is to be devoted to request-and-offer negotiations.

The guidelines and principles of negotiations underscore the commitment of member governments to a multilateral framework of rules and principles and the progressive liberalisation of trade in services. There is also an acknowledgement that the liberalisation process must respect the needs and rights of governments to regulate in order to pursue national objectives (Article IV). The fact that barriers to trade are so heterogeneous and difficult to quantify makes a comprehensive approach to their disciplines extremely difficult to conceptualise. Many advocates of liberalisation of trade in services see the argument for free trade internationally as linked to the purported benefits of deregulation domestically. Yet whether strict liberalisation or liberal regulation maximises domestic welfare depends on complex judgments about market failures, and the costs and benefits of a particular regulatory approach in light of the risk preferences of a country's own citizens.

Furthermore, the participation of developing countries must be facilitated through reinforcement of capacity, efficiency and competitiveness of their domestic service industries. The implication of these principles is clear: WTO members have the flexibility to decide on the scope and pace of liberalisation of their services sectors.

One of the key principles enunciated in the guidelines for negotiations relates to the modalities for negotiations. This will include the request-and-offer approach and encompass bilateral, plurilateral and multilateral negotiations. The outcome of negotiations will be extended to all WTO Members through the MFN commitment.

Members also agreed during the February session on the modalities for treatment of liberalisation measures taken unilaterally since the previous multilateral negotiations. Each member, therefore, will be expected to assess the value of autonomous liberal-

isation using the agreed criteria, and the granting of credit will be through bilateral negotiations. For the LDCs the Services Council has agreed to establish modalities for the special treatment for LDCs in the negotiations. Paragraph 13 of the GATS Negotiating Guidelines and Procedures provides that 'based on multilaterally agreed criteria, account shall be taken and credit shall be given in the negotiations for autonomous liberalisation undertaken by Members since previous negotiations'. It is not yet clear how many developing countries have sought credit for autonomous liberalisation. It can, however, be said that for any developing country claiming credit for autonomous liberalisation, the processes and details that will be required will be as burdensome as preparing requests or offers for bilateral negotiations.

The WTO note on technical aspects of the request-and-offer approach provides details on what is actually involved in the process of preparing requests and offers in terms of content, format and process. Process issues should not be underplayed. For example, the WTO note points out a fact that smaller developing countries sometimes appear to miss, namely that initial requests and offers need not be exhaustive or perfect. They simply mark the start of the process. This means that the opportunity to make new requests/offers is not closed by the passing of the agreed deadlines. Improvements to initial requests/offers can be submitted. As the WTO Secretariat's technical note makes clear, the negotiations in the request-and-offer stage will consist of '... a succession of requests and offers and offers will be subject to several revisions as a result of the negotiations'.[3]

Developing countries face several challenges in the request-and-offer stage of the negotiations. One challenge relates to their ability to make requests and offers. Failure to make requests or offers, or to seek credit for autonomous liberalisation, effectively limits their participation in the request-and-offer stage of the negotiations. To make good the provisions of Article XIX regarding appropriate flexibility for individual developing countries and respect for national objectives, developing countries must table their own requests and where offers are to be made they should take into account national objectives. As noted above, developing countries still have plenty of opportunities to submit their own requests and where feasible make offers because initial requests and offers can be modified and new ones introduced as negotiations proceed. Developing countries that wish to seek credit for autonomous liberalisation need also to take into account the fact that any such credit could entail scheduling their autonomous liberalisation measures in the seeking country's schedule in accordance with Part III of the GATS and could lead to termination of an MFN exemption where one exists.

Related to the ability to make requests and offers is the make-up of the requests/offers and also measures on which to seek credit for autonomous liberalisation. Requests should be based on an assessment of potential trade opportunities, existing GATS commitments, and an assessment of the conditions and terms of access in key markets. The requests should also reflect commitments undertaken at the regional level.

A second challenge concerns what developing countries could do to achieve the objective of Article IV, on increasing their participation in world trade. This objective is unlikely to be fulfilled unless requests are conceived as part of a broader framework of liberalising domestic competition in the services sector. This would entail addressing the complex transitional issues and challenges of regulatory design. This, after all, is the reason why developing countries have sought to protect their policy space, rather than be constrained by multilateral access agreements.

To participate effectively in the GATS negotiations, governments need to have already identified their own service sector related policies with a clear domestic strategy in order to determine what proposals would be in their interest.

3 Analysis of Positions

In the first phase of negotiations, around 160 proposals were tabled, with about half of them coming from developing countries. However, few developing countries had tabled their requests by the end of the initial deadline for submitting requests (June 2002) and offers (March 2003). Without tabling some requests and offers, developing countries are effectively outside the arena of negotiations.

Some major trading partners have taken different approaches to the tabling of requests and offers. The latter have not yet been made public, but it has been made clear that the proposals concentrate on removing discriminatory trade restrictions in sectors such as telecommunications, express delivery, energy services and environmental services.[4] The USA has adopted a modal approach, with specific requests for some members. The EU has gone for a 'tailor-made' approach, in which it requests other countries to improve their existing level of liberalisation commitments under the GATS. In each case, it proposes specific new commitments, both horizontal (cross-sectoral) and sector-by-sector.[5] The EU has made individual requests to 109 different countries covering horizontal commitments and the following sectors: professional services, other business services, telecommunication services, financial services, news agency and transport services. The EU is seeking both improved commitments and, apparently of almost equal importance, detailed clarification of existing commitments. Furthermore, it is looking for a reduction in scheduled restrictions whether these are horizontal or specific in nature.

These current GATS negotiations have aroused great concern from NGOs, who have claimed that the GATS is essentially a set of rules restricting governments from making their own decisions on how trade in services takes place. The EC has been specifically named as one of those WTO Members that is requesting others to liberalise public services such as sewer and water facilities. Responding to NGO allegations about possible control of utilities in developing countries – notably water – by industrialised countries, the EU has publicly stated that it would not seek the dismantling of

public services or the privatisation of state-owned companies. Japan has followed a mixed approach, with some 'tailor-made requests' and some modal requests.

The least developed countries have jointly tabled specific proposals in regard to modalities for the special treatment of LDCs in the third phase of negotiations. The main elements of the proposal include among others the need for Members to present requests which are compatible with the developmental, economic and financial needs of the LDCs and the need for LDCs to retain maximum flexibility in undertaking commitments in a manner consistent with their development needs. No LDC Member has so far tabled any initial request or offers, while they have received requests from both developed and developing countries covering several sectors and modes of supply in certain cases.

The negotiations in the second phase – the request-and-offer phase – are being conducted largely on a bilateral basis and with a high degree of confidentiality among Members. The requests are also confidential, thus making it fairly difficult to know what is being requested and what is going on in the bilateral negotiations. It has, however, been reported that there is a healthy exchange of views in bilateral consultations, both in terms of clarifying initial offers and, in a few cases, requesting deeper commitments. Most Members feel that the 26 initial offers circulated to date are a positive sign of engagement though more work still remains to be done in other areas of interest to developing countries such as agriculture and implementation issues to encourage progress in services. Some developing country Members have expressed disappointment that sectors which they had indicated as being of interest to them have not thus far been sufficiently reflected in the offers tabled.

Very few developing countries have made requests and they have yet to make initial offers; as a result, progress to date has been moderate in terms of initial requests and offers tabled, especially by developing countries. All is not lost, however, in that those countries that want to effectively participate and direct issues in a manner that addresses their national objectives can still table their initial requests or offers or seek credit for autonomous liberalisation.

4 Issues for Developing Countries

The GATS is an untested agreement. It raises major concerns for developing countries, especially in the public policy arena. Among the key issues are those related to domestic regulation of services, the future shape of subsidies and the asymmetry of commitments between Mode 4 on movement of persons and Mode 3 on commercial presence.

First, the article on domestic regulation (Article VI) has been much debated both at the WTO and by civil society. This is mainly because it deals with the sensitive issue of how much control developing countries should retain over policy on their domestic services sectors. The need for public policy intervention in the services sector is gener-

ally recognised by both developed and developing countries. Problems arise due to disagreements over the way that countries choose to pursue public policy objectives. In sectors such as education, health and professional services, measures identified in Article VI (4) – qualification requirements and procedures, technical standards and licensing requirements – vary as between countries. The three criteria laid out for disciplines under this provision, that they should be: (a) based on objective and transparent criteria, such as competence and ability to supply the service; (b) not more burdensome than necessary to ensure the quality of the service; and (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service, point to the need of a 'necessity test'. The development of a 'necessity test' is thus the key challenge for negotiators. Whether this can be achieved through negotiation or whether it will have to await a dispute resolution case remains to be seen. What is clear is that the uncertainty that this creates must be resolved.

Second, the future shape of subsidies is an issue of importance to developing countries. The GATS 'recognises that in certain circumstances, subsidies may have distortive effects on trade in services' (Article XV). It also recognises, however, the 'role of subsidies in relation to the development programmes of developing countries and takes into account the needs of Members, particularly developing country Members for flexibility in this area'. In the ongoing negotiations on subsides in services, attention is likely to focus on ways of identifying, measuring and disciplining services. An important first step would be to clarify the meaning of the term 'subsidy' in the services context. Key considerations in defining a subsidy might include the form of the subsidy, the benefit it confers, to whom it is granted and who grants the subsidy.[6]

Irrespective of what is agreed, developing countries need to fight for the preservation of the flexibility they enjoy under the GATS as a whole and the recognition given to the role of subsidies in development under Article XV. However, developing countries might also want to seek clarification on the definition of subsidies given that Article I (3) excludes from the scope of GATS 'services supplied in the exercise of governmental authority' – in other words, services in which government has a monopoly. This might have implications on developing countries' trade in services such as education and health.

Third, the absence of an emergency safeguards clause is seen as a major omission by developing countries. Given that a number of key WTO Agreements already incorporate an emergency safeguards clause (GATT Article XIX, Article 5 of Agriculture Agreement, Article 6 of Agreement on Textiles and Clothing), the decision at the end of the Uruguay Round to embark on 'negotiations on the question of emergency safeguard measures' (GATS Article X) is not surprising. However, differences between goods and services trade mean that a straightforward application of the principles of safeguards in GATT Article XIX is not feasible. Part of the problem is how services imports would be defined, given the four modes of supply.[7] Thus, while Mode 1 imports

of services could be treated in the traditional way – by limiting sales of foreign service suppliers – Mode 3 'imports' cannot be defined in the same way because they include sales of foreign corporations established in the host country as well as the initial establishment of the foreign corporation.

When the case for emergency safeguards measures has been made, it has tended to be in the context of specific sectors, for example the proposal by ASEAN on financial services. It is not apparent that safeguard measures to cover 'unforeseen problems caused by liberalisation commitments' across a broad range of services can be easily crafted. As Sauvé points out: 'It can be safely predicted that those countries – mostly OECD members – which do not believe a GATS ESM is warranted, feasible, or desirable will seek greater commitments as a negotiating quid pro quo'. For tactical reasons, it may be better for developing countries to use the flexibility they have under the GATS rather than open themselves up to demands for further market opening as a *quid pro quo*. There are also potentially negative consequences in using safeguard measures for Mode 3 as this is likely to create uncertainty regarding the investment regime of the host country.

A fourth area of concern is the asymmetry of commitments between Modes 3 and 4. When Mode 4 was included in the GATS, the expectation was that liberalising movement of capital – the main interest of industrialised countries – would be matched by liberalisation of movement of labour – the major interest of developing countries. Yet in sectors such as health, legal and accountancy services, in which cross-border mobility of labour is important, few countries have scheduled commitments; and where commitments have been scheduled, they are subject to many market access and national treatment restrictions. The commitments in Mode 4 are further limited by the bias in horizontal commitments toward liberalising the movement of higher-level services personnel. More than one-third of Mode 4 entries refer to intra-corporate transferees.[8]

If there was greater liberalisation of movement of people, developing countries would be able to export a significant labour content in services such as construction, distribution, health and transport. However, no country has yet shown a willingness to consider unrestricted flows of semi-skilled and unskilled personnel into its labour market, despite long-standing shortages in these sectors and the lower-skilled end of the health and care professions. Additionally, in business services, industrialised countries apply several restrictions, covering educational and professional qualifications, residence requirements and economic needs tests. There is, therefore, a need for greater transparency and consistency in the way these restrictions are applied.

Some concerns are sector specific. For example, in telecommunications, the interface between privatisation/deregulation and liberalisation must be carefully handled with due attention paid to issues like universal service provision, access to networks, inter-connection charges, and competition with Internet Service Providers and

Application Service Providers. In business and professional services, the question of mutual recognition agreements (MRAs) is very important. But these agreements are difficult to negotiate and also costly to implement. There is, however, some merit in developing regional MRAs. In computer software and consultancy, the key issues centre on movement of workers rather than regulation. The same applies to health and education, where the movement of teachers and nurses to industrialised countries has raised fears about the brain drain. For construction and engineering services, the major problem is the size of enterprises from developing countries. They are small in terms of both number of employees, capital and market share, making it difficult for them to have a commercial presence abroad.[9] Most are not big enough to be able to compete for contracts in developed countries. Their strategy should therefore focus on subcontracting services from industrialised countries.

5 Services Liberalisation and Development

Fundamentally, policy on liberalising trade in services is about more than satisfying a country's commitments under the WTO; it is a component of a country's overall development strategies. Either by default or through a failure to get to grips with the complexities of the services sector, developing countries have sometimes proceeded on a path that lacked coherence in relation to their overall development strategies. The risks of this approach are particularly high in the services sector, because services are essential inputs in the production of other goods and services.

It is also worth noting that the main driver of change in key infrastructural services – telecommunications, finance, transport and energy – is technology. Most of the regulatory reforms seen in these sectors in the last 20 years have to a large extent been driven by changes in technology. Once liberalisation of the service sector in developing countries is viewed in this context, it becomes clear why liberalisation cannot be regarded as the primary goal of policy. Both deregulation and re-regulation have an important role to play in pursuit of objectives such as universal service provision (telecommunications, financial services); consumer protection (particularly in financial services); small and medium enterprise development (both as consumers and producers); and producers in other sectors (user industries).

For these reasons, the policy flexibility provided by the GATS must be fully utilised. The GATS is unique among WTO Agreements in that it recognises the broader development role of services, with its 'bottom-up' approach and the flexibility given to countries in regard to how fast and in which sectors liberalisation will be undertaken. This flexibility is what makes the GATS arguably the most development-friendly agreement in the WTO. But one must also recognise the asymmetry in negotiating capacities between developed and developing countries. It means developing countries may fail to use the policy space provided by the GATS. Within this context

four general considerations appear to be relevant:

- Development needs and priorities must be paramount in any liberalisation exercise, including the needs of under-serviced sectors and communities. Priorities should be based on an assessment of services export and import interests, including potential interests. The best way to do this is to formulate national priorities before adopting a negotiating position on services. The key point is that government must retain control over the sequencing, phasing and pacing of trade liberalisation so that the process of liberalisation reflects underlying social, economic and regulatory realities.[10]
- Every effort should be made to harness the latest advances in technology and opportunities created by the globalisation of business. It is worth noting that most of the liberalisation seen in trade in services in the last few years is the result of technological advances, particularly in telecommunications. One by-product of these advances is that most services in which information technology now plays a major role (telecommunications, banking and financial services, business and professional services, and even tourism) are built on the economics of networks and not the economics of factories.[11] Competitiveness for such industries depends on the ability to connect with related services and producers. In other words, companies compete by expanding the reach of their networks. Ignoring these trends is not a viable option for developing countries. India's success in attracting back-office jobs from companies in Europe and North America shows what can be achieved. One estimate puts the value of financial services activity (by turnover) that will be moved away from first-world economies in the next five years at US$356.[12]
- The human capital constraint needs to be addressed, otherwise the benefits of reform will be limited. Apart from the investment in education, training and skills required to strengthen the capacity of policy-makers and managers, developing countries also need to be creative when it comes to designing their regulatory regimes. Simply mimicking the practices and approaches of industrialised countries is unlikely to serve them well. As Messerlin argued in a recent paper, reproducing industrialised countries' approaches is likely to result in: (a) costly regulatory regimes in terms of design and implementation costs; and (b) unsuitable regulatory regimes.[13] Moreover, it might take a long time before such regimes begin to have a noticeable impact, partly because adjustments will have to be made.
- Focusing on regional liberalisation first, before moving to multilateral liberalisation, may bring greater benefits to a country. Key benefits of this approach include capacity-building and enhancement of regional competitiveness. It is also the case in certain service sectors, for example construction, transport and tourism, that adopting a regional approach is likely to yield better results.

However, developing countries continue to be put under pressure to compromise their development priorities by allowing access to their service sectors. Most serious, perhaps, is the danger that their development interests will be put at risk by premature opening of their services markets before they have had sufficient time or assistance to establish their priorities. Under the GATS, unlike in the process of unilateral liberalisation, there is no adequate mechanism for revoking liberalisation. Once commitments have been made, the development space is lost. The best defence against being pressured into premature concessions is for developing countries to be clear about their policy priorities and to be able to defend them analytically.

6 GATS Flexibility

From the standpoint of developing countries, the GATS provides a highly flexible framework. Given this, it is helpful to consider what developing countries might do to take advantage of this flexibility. The laid-out criteria for scheduling specific commitments (Article XX) suggests that developing countries must do two things:

- Select service sectors they are prepared to subject to GATS market access and national treatment disciplines;
- Identify measures they intend to keep in place even though they violate market access and national treatment requirements.

Clearly this can only be done following an identification of priority sectors and modes of delivery that are most likely to bring real economic benefits to the country. Sectors targeted must include those likely to result in significant benefits. It is also important in this process to identify service sectors that are significant at the regional level because the extent of cross-border trade in certain services is limited to neighbouring countries, for example, water and electricity exports from Lesotho to South Africa.

Another important consideration is the need for involvement and participation in the negotiations. While negotiations will take place at bilateral, plurilateral and multilateral levels, in practice countries that have not tabled requests cannot enter the arena of negotiations. An essential first step in preparing requests is an assessment of the current and potential export and import interests of the country and, where possible, the scope of commitments already made by others. This assessment is also important in preparing a country's 'defensive' position against offers targeting its services sector.

At the general level, the GATS process of progressive liberalisation is about moving to a non-discriminatory regulatory regime. Not surprisingly, it entails significant changes in the service sectors, particularly in sectors where change is partly driven by technology. These changes raise issues concerning the pace and sequencing of liberal-

isation. A basic consideration in determining the sequencing of reforms is the need to attract foreign investment into infrastructure services. Developing country state enterprises need inflows of external resources, technology and ideas in order to build themselves into viable entities able to compete both domestically and internationally. Another important consideration is the need to develop suitable regulatory mechanisms to govern competition and ensure that important social objectives are met.

The wrong order of reform could have profoundly negative consequences for the whole process. Part of the achievement of the GATS framework is the recognition that liberalisation of trade in services need not be inconsistent with a country's right to regulate services for purposes of consumer protection, prudential management of the economy, control of monopolies or achievement of social objectives. Thus, the challenge for developing countries is to ensure that any requests and offers they table reflect national decisions on reforms they want to implement in the services sector.

Developing countries are unlikely to be in a position to meet the challenges of services negotiations if they do not have strong institutional foundations for trade liberalisation and negotiations. This is not just about establishing appropriate national processes for trade negotiations and creating institutions to manage trade liberalisation and its aftermath. It includes understanding current trade developments and the forces shaping them. For example, many of the key service industries operate as networks. How a particular sector is regulated will depend on the economics of related sectors.

Given that the GATS framework provides developing countries with ample opportunity to pursue their development objectives means that it may be unnecessary for them to push hard for traditional measures of protection such as emergency safeguards. This is not to belittle their value, especially their political value, to developing countries. Rather, developing countries have the opportunity to use the GATS framework to craft and implement a trade policy for the service sector that is designed to deal with their development problems. As argued above, key components of that policy must include the following:

- Research into the economics of the services sector and its place in the economy as a whole. This would cover cross-border exports and imports of services as well as foreign direct investment in services. On the basis of this research, governments should identify priority sectors and modes of service delivery where negotiation of concessions could result in tangible economic benefits;
- Undertaking sectoral studies, beginning with the priority sectors, which for most developing countries are likely to include basic infrastructure services in telecommunications, transport and communications;
- Wide consultation on the horizontal and sectoral issues raised in the negotiations.

This process will also aid in the learning involved in preparing policy for the service sector;

- Identifying the type of regulatory mechanisms and institutions required to handle the post-reform arrangements. This should involve training for the staff to implement policy.

7 Conclusion

This brief description suggests two important objectives for developing countries in the GATS negotiations. The first is the need to be clear about their objectives in services negotiations, based on their vision of the role of services in the national economy. As already indicated, this requires identification of their development priorities, an assessment of current and future trade opportunities, and the creation of appropriate institutional structures for managing liberalisation of trade in services. The starting point for developing countries must always be the promotion of their development. Trade negotiations in GATS or in the WTO as a whole cannot be a substitute for a proper trade policy rooted in clear development objectives. The starting point for industrialised countries is different, so that to assume that they broadly share the same objectives in their approach to the negotiations is a mistake.

The second imperative is the need for creativity in designing domestic regulatory regimes; without this, the result is likely to be expensive and inappropriate regulatory regimes. Once developing countries put their own objectives at the centre of their negotiating strategy, they are less likely to end up mimicking rules and regulations used by industrialised countries.[14]

The GATS framework is permissive enough to enable developing countries to be creative about how they deregulate and liberalise their service sectors. Provisions for special and differential treatment, whether through emergency safeguards clauses, subsidies or the extension of rules on domestic regulation, while politically desirable, may not be the central issue. Rather than expend their limited negotiating capital seeking carve-outs from GATS rules, developing countries might be better served by an approach that seeks to exploit fully the policy space provided by the GATS framework. While the developed countries seek out markets for their service providers, developing countries must focus on developing their services capacity. The GATS happens to provide a framework suitable for such an approach. Thus, at the policy level, the challenge is to have a vision for service sector development.

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Notes

1 Article XIX of GATS foreshadowed successive rounds of negotiations by committing members to enter into 'successive rounds of negotiations ... with a view to achieving a progressively higher level of liberalisation'.

2 'In sectors in which a Member ..., the member shall not apply licensing and qualification requirements and technical standards that nullify or impair such specific commitments in a manner which ...'.

3 Annex to technical note.

4 See http://www.ustr.gov/

5 Trade in Services, Support to Commonwealth Countries on ACP-EU Negotiations for Economic Partnership Agreements (2003).

6 Robert Prylinski and Dariusz Mongialo (April 2003).

7 Pierre Sauvé (2001).

8 Rupa Chanda (2002). 'Movement of Natural Persons and the GATS', World Bank.

9 This point was highlighted in Mauritius's proposal on behalf of small economies, 'Small Economies as Small Suppliers of Services', WTO document TN/S/W/8).

10 Arkell, Background Paper on GATS (February 2003).

11 Carl Shapiro and Hal Varian 'Information Rules: A Strategic Guide to the Network Economy', *HBR* 1999.

12 'Focus: The Great Indian Takeaway', *Sunday Times*, 8 June 2003.

13 Patrick Messerlin 'Companies and Developing Countries: A Common Agenda for Cancun?', June 2003.

14 See the example of Guatemala in Patrick Messerlin (2003).

6

Reform of the WTO Dispute Settlement Understanding: A Critical Juncture for Developing Countries

Dan Sarooshi*

1 Introduction

The WTO Dispute Settlement System is one of the most effective mechanisms of inter-state dispute settlement that exists today under international law. A reflection of its success has been its use by states to resolve a large number of disputes.[1] This rich experience has, however, highlighted a number of difficulties that require attention to increase the efficacy and fairness of the system. From the perspective of developing country Members (DCMs), there are a number of changes to the Dispute Settlement Understanding (DSU) that would considerably improve their ability to participate on an equal footing in the system and thereby increase their share of the trade benefits offered by the WTO Agreements. By the same token, there are proposed changes to the DSU that, if implemented, would be likely to have a negative impact on DCMs.

WTO Members have tabled more than 44 formal proposals for DSU reform since March 2002. Due to considerations of relevance and length not all the details of all these proposals are considered in this paper. Instead, it focuses on those proposals – made both by DCMs and developed country Members (DdCMs) – that affect the position of DCMs. It discusses the proposals in the context of the broader issue that has led to their being tabled, and evaluates both the likelihood of particular proposals being adopted and the potential impact the proposals will have on DCMs.

The reform proposals that potentially affect DCMs can be categorised into the following seven general subject areas: the initiation of cases; issues relating to the establishment, membership, composition and procedure of panels; issues relating to the membership and procedure of the Appellate Body; issues relating to the effect of panel and Appellate Body decisions on DCMs and their lack of a development focus; improving the ability of DCMs to use the DSS (cost issues, adequacy of remedies and improving compliance measures); transparency of DSS proceedings; and third party issues that concern DCMs.

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2 The Initiation of Cases under the DSU

There are three main areas that have been the focus of proposal and discussion in the context of DSU reform in relation to the initiation of cases. These are the use of good offices and the initiation of proceedings; the notification and consequences of mutually agreed solutions; and injury suffered by DCMs as a result of measures that are withdrawn before or after the commencement of proceedings.

The Use of Good Offices and the Initiation of Proceedings

Paraguay, Jordan, Haiti and the EC have all made separate proposals regarding the use of good offices and the initiation of dispute settlement proceedings. The first three states have made proposals that relate directly to the position of DCMs, while the EC proposal is more general in nature.[2]

The government of Paraguay proposes that the following main changes be made to Article 5 of the DSU:

> 1. Good offices, conciliation and mediation are procedures that are undertaken voluntarily if the parties to the dispute so agree. *In disputes involving developing country Members, and at the request of any of the parties, such procedures shall be mandatory.*
>
> ...
>
> 3. Good offices, conciliation or mediation may be requested at any time by any party to a dispute. They may begin at any time and be terminated at any time. *On no account may such procedures exceed a maximum period of 90 days.*
>
> 4. Once procedures for good offices, conciliation or mediation are terminated, a complaining party may then proceed with a request for the establishment of a panel. *If the parties to a dispute agree, and if one of the parties is a developing country Member, procedures for good offices, conciliation or mediation shall continue while the panel process proceeds.*[3]

The reasons put forward by Paraguay in favour of this type of proposal are that it will contribute to the prompt settlement of disputes and that the costs of pursuing disputes through the dispute settlement system can be prohibitive for DCMs. However, it is not at all clear that such a reform proposal would benefit DCMs, and it should be firmly resisted by other DCMs for three main reasons. First, it is not at all clear that making such procedures compulsory would lead to a more prompt settlement of disputes. In fact, by interposing an additional 90-day maximum period for good offices, conciliation and mediation, the total length of a dispute that goes through to a panel would be likely to increase. In any case, states can already agree at any time after a panel has been established to resolve a dispute by agreement. Second, to require DCMs to conduct simultaneously litigation before a panel or Appellate Body and to continue to

negotiate – as both the Paraguayan and Jordanian proposals do – clearly increases the cost and material demands of such a dispute for a DCM. Third, the advantage of the more rules-based system of the DSU is that DCMs are less subject to political and economic pressures by DdCMs; to move back to a situation where DCMs are *required* to undertake good offices, conciliation and mediation, where the economic power of DdCMs will necessarily exert their influence, seems a retrograde step. The one advantage the proposal may have had is an extension of the time that DCMs may have as a respondent in a case, since they have 90 days extra to prepare their case under the proposed changes to Article 5.1. This is, however, too high a price to pay for making these processes compulsory. In any case, such increased timelines in cases where DCMs are respondents should be a separate negotiating objective and not be attached to any such onerous conditions.

In contrast, a proposal by Haiti that relates to Article 24 and the initiation of a case against least developed country Members (LDCMs) does seem particularly useful and possibly should also be considered in relation to DCMs. The proposal is that Article 24 should be amended by adding the following paragraph 3:

> 24.3. A *developed country Member shall not commence a request for the establishment of a panel before fully using the good offices, conciliation and mediation before the Director-General or the Chairman of the DSB. When requesting for the establishment of a panel against a least-developed country Member, a developed-country Member shall provide the DSB with a written account of how it has exercised due restraint in accordance with paragraph 1. Where the DSB grants the request for the establishment of the panel, the developed country Member shall file the written account on due restraint with the panel, which shall make preliminary findings, before proceeding with the case, on the written account, on the basis of the provisions of paragraph 1, and on the existence and adequacy of efforts to reach a mutually agreed solution. Where the panel finds that due restraint has not been exercised or that no efforts or inadequate efforts had been made to reach a mutually agreed solution, it shall refer the matter to the DSB, which shall take those findings into account and make preliminary recommendations and rulings on the matter. In this regard, the DSB shall request the Director-General to provide good offices, conciliation and mediation.*[4]

The dual requirements of this proposal that a DdCM has to provide the DSB with a statement on how it has exercised due restraint because of the least-developed status of the state, as well as providing for a system of panel oversight in relation to the content of this statement, will certainly ensure that the least-developed status of the State is taken seriously by a complainant state. The only difficulty is how to provide a panel with a mandate to review 'the existence and adequacy of efforts to reach a mutually agreed solution'. In practice this will be a difficult task for a panel to fulfil and, more importantly, not a mandate that DdCMs will be keen to confer on a panel. Having said

this, however, it is this type of decision-making power that the panel and Appellate Body have, for example, exercised in the *Shrimp-Turtle* case in deciding on the adequacy of US efforts to negotiate a multilateral agreement on the measure that the USA eventually enacted unilaterally.[5] So there is at least a precedent for a panel being able to exercise this type of power of review, and from the perspective of LDCMs such a requirement would be very useful indeed.

The EC has made two useful proposals that would seem to benefit DCMs. First, that a provision should be added to Article 4 of the DSU to enable a Member to withdraw formally a request for consultations;[6] and, second, that consultations which have not been followed by a request for the establishment of a panel within a certain time frame (e.g. 18 months) should be implicitly considered as having been withdrawn.[7] These proposals would benefit DCMs since they would allow the removal of dormant cases that are still technically open and thus able to be revived by a state at any time against a DCM. The removal of these dormant cases from a list of potential cases is important in order to ensure that they cannot be used as a bargaining tool in trade relations between DdCMs and DCMs.

The Notification and Consequences of Mutually Agreed Solutions

Although the resolution of disputes between Members by mutual agreement is one of the objectives of the DSS, it presents difficulties of a systemic nature. For example: are other Member States aware of the terms of the settlement? And, more importantly, are any benefits being offered as part of the settlement being applied to all Member States pursuant to the most favoured nation obligation[8] contained in Article 1 of the GATT?[9] These problems have the potential to affect DCMs more significantly since they do not have the same degree of WTO representation, and thus information gathering capacity, of most DdCMs. Possibly in response to these difficulties, Cuba, Honduras, India, Jamaica, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe proposed the insertion into Article 3.6 of the DSU a time period by which mutually agreed solutions should be notified to the DSB and other relevant WTO bodies, as well as the insertion of a requirement to specify sufficient details such that other Members have an opportunity to assess the impact of such solutions on their trade. Their proposal to amend Article 3.6 DSU reads as follows:

> 6. *Terms of settlement of* mutually agreed solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements shall be notified *within 60 days from the date of such agreement and in sufficient detail* to the DSB and the relevant Councils and Committees, where any Member may raise any point relating thereto.[10]

Such a proposal would be useful in ensuring that DCMs are able to obtain any benefits that are being offered a complainant state as part of a negotiated settlement.

Injury Suffered by DCMs as a Result of Measures that are Withdrawn Before or After the Commencement of Proceedings

The small size of the economies of most DCMs means that measures restricting their exports, even if for a short duration, causes them serious injury. There have been no adequate remedies for injury suffered as a result of such measures that are withdrawn by a Member either before the commencement of proceedings or after finalisation of the proceedings under the DSU. In relation to the withdrawal of measures before finalisation of the proceedings, there are two reform proposals made by the African Group to Articles 3.6, 21 and 22 of the DSU. The first is that a rule should be adopted which provides that measures withdrawn by Members in the course of consultations shall be notified to the DSB as mutually agreed solutions in accordance with Article 3.6 and, where the mutually agreed solutions are notified, the DSB shall recommend compensation for injury suffered by the Member.[11] The second is that a further rule should require that measures withdrawn without, or prior to the commencement of, any proceedings under the DSU shall entitle a Member to compensation that shall be enforceable under the DSU at the instance of the Members affected.[12] Specifically, the African group usefully propose that Article 3.6 of the DSU should be amended by renaming the current provision as paragraph (a) – as amended – and by adding the following paragraphs:

> *(b) Developed-country Members that adopt measures against developing or least-developed country Members and withdraw them in the course of consultations or 90 days before the commencement of consultations pursuant to Article 4 of this Understanding shall notify them individually or jointly to the DSB within 60 days of their withdrawal. The notification shall, describe the measure and the reason or circumstances for the withdrawal, state whether consultations were held and finalised, and indicate the amount of injury to the developing or least-developed country Member resulting from the measure. Disputes over the amount of injury may be referred to arbitration under Article 25 of this Understanding.*
>
> *(c) Where injury has resulted from the withdrawn measure, and if the developing or least-developed country Member so requests, the DSB may recommend monetary and any other appropriate compensation taking into account the nature of injury suffered. The level of compensation shall be determined by arbitration in accordance with Article 25 of this Understanding and shall be implemented mutatis mutandis in accordance with Articles 21 and 22.*
>
> *(d) The requests referred to in paragraph (c) may be made at the meeting of the DSB considering the notification of the withdrawn measures or subsequently within a period of 60 days, unless there are exceptional circumstances justifying the consideration of the request at a later date.*[13]

The substance of this provision is absolutely key to ensuring that DCMs are not the subject of 'hit and run' practices by Members who may provide short-term trade protection to various sectors that compete with DCM exports. It is for the same reason that the additional proposal made by the African Group – that takes into account Articles 19.1, 21.8, 22.1 and 22.2 of the DSU – relating to compensation for measures withdrawn after finalisation of proceedings is also crucial. In cases where proceedings have been finalised, the provisions and practice on compensation have not satisfactorily reflected the interests and injury suffered by industries of DCMs, since the key for DCMs is that compensation should be in the form of monetary compensation – as opposed simply to market access – that should be continually paid pending and until the withdrawal of the measures that are in breach of WTO obligations. Such monetary compensation would address the loss suffered as a result of, and for the duration of, the measures in breach of WTO obligations, without being a substitute for the withdrawal of those measures.[14]

3 Panel Issues

There are three main areas that have been the subject of DSU reform proposals and discussion relating to panels. These are the proposed establishment of permanent panellists, the composition of panels and the input of the WTO Secretariat in panel proceedings.

Permanent Panellists

The European Communities (EC) proposed a move from *ad hoc* membership of panels to more permanent panellists.[15] Four arguments have been made in support of this proposal. First, there is a growing quantitative discrepancy between the demand for and availability of *ad hoc* panellists. This has resulted in increased delays in the selection of panellists, and an increasing recourse to the WTO Director-General for the appointments of panellists. The EC clarified in a later communication that it did not mean there are not enough *ad hoc* panellists potentially available, but that it is becoming increasingly difficult to find and agree on them at such short notice.[16] Second, the increased complexity of the cases – both from a procedural and substantive viewpoint – being brought before panels has led to the cases taking more time to handle. The EC refined this point in a later communication when it clarified that *ad hoc* panellists often do not have the experience necessary to deal with procedural matters or have the time to become fully acquainted with WTO case law;[17] and, moreover, that a system of permanent panellists would help in attaining more consistent rulings both procedurally and on substance.[18] The EC also contends – as part of this second point – that moving to a system of permanent panellists would be very likely to result in less reversals of panel reports by the Appellate Body than is currently the case, thereby reducing

the total timeframe of the procedure, the workload of the Appellate Body and the costs for all the parties. The third reason cited in favour of a permanent panel system is that it would enhance the legitimacy and credibility of the panel process in the eyes of the public, since the possibility of conflicts of interests would be eliminated and the independence of the panellists would be protected as is the case in domestic proceedings or in the Appellate Body. Fourthly, it would increase the involvement of DCMs in the panel process.

The first three of these arguments possess a degree of cogency, but the fourth argument is questionable, in the light of the past record. The real issue is whether greater DCM participation in a permanent panel system will be written into any DSU reform. This seems an important condition for DCMs to be able to accept this proposal. Under the current system only 35 per cent of the panellists who have served since 1995 came from a DCM, and there is no reason to suppose that this type of figure would in practice increase unless there was an express stipulation in a new DSU provision. This may as such pose an advantage to DCMs who may be able to secure – in return for their support for the proposal – a guarantee that a certain number of appropriately qualified panellists would come from DCMs. This would certainly assist in the development of DCM knowledge of and expertise in the DSS. The fixed membership of the standing Appellate Body provides a good example of how this can be achieved: as at March 2002, 45 of the 47 reports issued by the Appellate Body were issued by a division having at least one member from a DCM, and 24 of the 47 reports were issued by a division having two of its three members from a DCM. An attempt was made at an early stage by the government of India to request clarification on this point when it asked 'Which number of permanent panellists from developing countries would be representative of the WTO Membership?'[19] In response, the EC stated that 'While it is difficult to assess precisely the number of panellists from developing countries without having established the total number of the permanent panellists, it is clear that panellists from DCMs would probably constitute a substantial part of the roster. ... It should be noted that the limited number of *ad hoc* panellists from developing countries [to date] is probably due to the fact that it is difficult for a developing country diplomat to assume the additional duties derived from serving in a panel. This would be corrected under a system of permanent panellists.'[20]

However, the African Group is against the establishment of a standing body of panellists since they argue that there is no case for change. It states that if the system is in need of change, consideration should be given to redefining the functions of the panels to be the following: 'the establishment of the facts and issues, and compilation of concise factual reports'. It proposes that these factual reports of the panel would be forwarded to the Appellate Body for application of the relevant provisions and, accordingly, the Appellate Body could then be renamed – as, for example, 'the WTO Tribunal'.[21] The serious reduction in the judicial role of a panel decision that this

proposal contains cannot be countenanced under any circumstances. The whole point of the present two-tier process is to ensure that Member States have recourse to an Appeal Body in relation to an alleged misapplication or mistake in the law. It would not be prudent to remove this protection inherent in the system that benefits all Members, both developing and developed.

The EC took on board discussions in a DSB special session and modified its own proposal to amend Article 8 that now, in part, reads as follows:

> *1. Panels shall be composed of individuals included on the roster of panellists established by the DSB. The panellists shall be appointed by the DG on a random basis within 5 days from the establishment of the panel.*
>
> *2. Notwithstanding paragraph 1, the parties may agree at the time of the establishment of the panel that panels may include up to two individuals from outside the roster with particular expertise on the subject matter of the dispute. The Chairman of the panel shall always be an individual included on the roster of panellists and will be appointed by the DG on a random basis within 5 days from the establishment of the panel. The parties may agree on the individuals outside the roster to serve on the panel or request the Director-General, in consultation with the parties and the Chairman of the panel to nominate these individuals. If no agreement has been reached on the panellists from outside the roster or no request for their nomination to the DG has been made within 10 days from the establishment of the panel, at the request of a party, those members of the panel shall be drawn from the roster by the DG on a random basis.*
>
> *3. The roster shall include a number of persons as determined from time to time by the General Council. The DSB shall include persons on the roster for six-year terms and no person shall be re-appointed. However, the terms for the initial inclusion on the roster shall be either [three, four, five or six years], with an equal number appointed for each period, as determined by lot [and with those appointed for [three or four] years eligible exceptionally for re-appointment to six-year terms]. The roster should comprise persons of recognized authority, with demonstrated expertise in international trade law, economy or policy and the subject matter of the covered agreements generally, and/or past experience as a GATT/WTO panelist. It shall be broadly representative of membership in the WTO. All persons included on the roster shall stay abreast of dispute settlement activities and other relevant activities of the WTO. ...*[22]

However, the remaining difficulty with this proposal is that it does not, from the DCM perspective, specify the proportion of panellists to come from DCMs. All that it says, in the proposed Article 8.3, is that membership 'shall be broadly representative of membership in the WTO'. The decision to include an individual in the roster of permanent panellists being made by the DSB does of course mean that the numerical weight of DCMs in the DSB makes it likely that a number of qualified panellist would

come from DCMs. As such, this EC proposal is more preferable – from the DCM perspective – than the Canadian government's proposal to establish a permanent panel system due to the latter's proposed process of selection of membership. The Canadian government proposes the following method of selecting membership of a roster of permanent panellists (as part of its proposed amendment to Article 8):

> Article 8
>
> ...
>
> 4. ... *Each Member may nominate one individual, who may or may not be a national, for placement on the roster. In nominating an individual, each Member shall provide a statement of qualifications that identifies the nominee's capabilities and capacity to serve as a panelist in reference to the qualifications outlined in paragraph 1. A committee composed of the Chairs of the General Council, the DSB and the Goods, Services and TRIPS councils, will examine the nominations and accompanying qualification statements to verify that the nominees meet the requisite level of expertise to serve as a panelist. On completion of the selection process, the Committee will submit the roster to the General Council for approval.*[23]

The proposed veto power in the Canadian proposal that the Chairs of the General Council, the DSB, and the Goods, Services and TRIPs councils are to possess over proposed nominations is not a desirable institutional mechanism for selecting membership of permanent panellists, and the EC mechanism of decision by the DSB on recommendation by Member State seems far more appropriate as a process of reflecting the will of the WTO membership more generally.

The Composition of Panels

In terms of the composition of panels as presently provided for by the DSU, the Least Developed Country Members propose that Article 8.10 should be modified to the effect that in any dispute involving a DCM that there should be at least one panellist from a developing country. As such, they propose that the words 'if a developing-country Member so requests' should be deleted from Article 8.10, and it should be amended to read as follows:

> 10.a. When a dispute is between a developing-country Member and a developed-country Member the panel shall include one panelist from a developing-country Member, and if the developing-country Member so requests, there shall be a second panelist from a developing-country Member.
>
> 10.b. When a dispute is between a least developing-country Member and a developing or developed-country Member, the panel shall include at least one panelist from a least-developed country Member, and if the least developed-country Member so requests, there shall be a second panelist from a least-developed country Member.[24]

The likelihood of these proposals being accepted by DdCMs seems remote. Moreover, there is very little, if any, support for this proposal that can be gleaned from the practice of other international court and arbitral tribunals in terms of one of the parties to a dispute being able to appoint two out of three decision-makers. The only way it is envisaged that this proposal of a DCM being able to require the inclusion of two persons from a DCM on a panel would be feasible is if there was a system of permanent panellists in place, and the selection of two such persons was made from among those who were already serving as permanent panellists. However, if the LDCM's proposal goes too far, the proposal of Jordan does not arguably go far enough. Jordan proposes that Article 10.8 be amended to read as follows:

> In disputes involving developing country Members and/or least developed country Members the following shall be applicable:
>
> *a. When a dispute is between a developed-country* Member *and a developing-country* Member *the panel shall include one panelist from a developing country* Member *should the latter request same within (85) days from the establishment of the panel.*
> *b. When a dispute is between a least-developed country* Member *and a developed-country* Member *the panel shall include one panelist from a least-developed country* Member *should the latter request same within (5) days from the establishment of the panel.*
> *c. When a dispute is between a developing-country member and a least developed-country* Member *the panel shall include a panelist from a developing-country* Member *or a least-developed country* Member *should either one or both request same within (5) days from the establishment of the panel.*[25]

What is needed here is a *mandatory* requirement that in a case involving a DCM that there shall be a panellist from a DCM. In this respect part of the proposal of Haiti can be commended. Haiti proposes that Article 8.10 should be amended as follows:

> *10. When a dispute is between a developing-country* Member *and a developed-country* Member *the panel shall include one panelist from a developing-country* Member*, and if the developing-country* Member *so requests, there shall be a second panelist from a developing-country* Member*.*[26]

The latter part of the Haitian proposal is, however, subject to the same criticism as that made above of the LDCM proposal.

The Input of the Secretariat in Panel Proceedings

It is arguably important that, as a matter of transparency in dispute settlement proceedings and fairness to the parties in a case, any substantive input by the WTO Secretariat to a panel – in terms, for example, of the provision of legal opinions – should

be disclosed to the parties. As such, Cuba, Honduras, India, Jamaica, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe have proposed that any input by the Secretariat to a panel should be disclosed to the parties in a case. They propose, in particular, that the following sentence be inserted as the third sentence of Paragraph 10 of Appendix 3 of the DSU:

> *Any document, notes, information, etc., other than case summaries, submitted by the Secretariat to the panel shall be provided promptly to the parties to the dispute, whose views on such documents, notes, information, etc., shall be taken into consideration by the panel.*[27]

This relatively straightforward proposal is certainly in the interest of all WTO Members, and as such is likely to be adopted.

4 Appellate Body Issues

There are two, relatively straightforward, issues that have arisen in relation to reform of the Appellate Body. These are a proposal to increase the number of Appellate Body members, and a proposal to fix the term of membership of Appellate Body members to six years. The first of these proposals would ensure that the delays in appeal proceedings that have occurred in a number of cases could be avoided;[28] while a fixed term of membership would ensure that Appellate Body members are not dependent on renewal by WTO Member States after only four years of being in office – the implication seeming to be that this guarantees beyond doubt the independence of the Appellate Body in all cases. This proposal was supported by a number of WTO Members, including India, European Communities, Dominican Republic, Egypt, Cuba, Honduras, Jamaica, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe.[29] One of the proposals – all of them in substance being the same – is that Article 17.2 be amended to read as follows:

> *The DSB shall appoint persons to serve on the Appellate Body for a six-year term which shall be non-renewable.*

The only difficulty with this proposal is that six years may be too short a term, especially since the term is non-renewable. It would be far better for the Appellate Body as an institution – and for the cogency and coherence of its jurisprudence – were the term to be for the longer period of, say, eight years. This would attenuate the loss of knowledge and experience that always occurs with changes in membership, and eight years is in any case the present maximum term that an Appellate Body member can serve – two four-year terms – according to Article 17.2.

5 Issues Common to Both Panel and Appellate Body Decisions

There are a number of issues that are controversial from the perspective of DCMs that are common to both panel and Appellate Body decisions and that have been raised in the DSU reform proposals. These include the proposals to regulate *amicus curiae* submissions, the effect of decisions on DCMs and LDCMs and the evolution of WTO law in favour of development.

The Regulation of Amicus Curiae *Submissions*

The EC and the USA separately make the proposal that it may be useful to provide a framework – including the preconditions – for the submission of *amicus curiae* briefs to panels and the Appellate Body. The EC, for example, states that such briefs should be directly relevant to the factual and legal issues under consideration by the panel, or the legal issues raised in the appeal, and that the acceptance of such briefs should not lead to a delay in the proceedings or create substantial additional burden for DCMs.[30]

A number of DCMs, led by India, vigorously opposed the concept of *amicus curiae* briefs as part of the WTO DSS. It has been thought necessary to reproduce verbatim sections of the exchange on this issue in order to illustrate the extent to which DCMs consider this issue important. India, in response to the EC proposal, formally asked the question: 'Would the EC agree that if *amicus curiae* briefs are permitted then the present disadvantages suffered by developing-country Members in international trade would get further accentuated as very few entities in the developing countries would be in a position to make *amicus curiae* submissions, while on the other hand, developing-country Members would have to assume the added burden of defending themselves against any arguments which such submissions might contain?'[31] The EC responded to this in the following terms: 'The EC's proposal expressly stresses that the acceptance of *amicus briefs* should not create substantial additional burdens for the developing Members. While it is true that some entities with the capacities to make *amicus curiae* submissions may at present exist more in developed countries than in developing ones, this does not mean that such entities will always take positions in favour of the interests of developed countries. Indeed, recent experience shows the opposite: on various issues (e.g. access to medicines), non-governmental organisations in developed countries have frequently taken positions radically different from those adopted by their governments.'[32] This statement reflects a perception among DCMs that NGOs who wish to submit *amicus curiae* briefs in cases will generally support the position of the DdCMs where they are often headquartered.[33] However, this is questionable, not least because many of the NGOs in question consider that they are operating to serve the interests of those in developing countries.

However the substantive debate – and the concern of DCMs – is not so much about NGOs as about private corporations and industry bodies being able to use *amicus*

curiae briefs to support a Member's case where it has implications for a large corporation or an industry. This concern is revealed in the following additional statement made by the Indian government which argued that '[t]he proposal of the EC regarding submission and consideration of *amicus curiae* briefs amounts to changing the intergovernmental character of the WTO. For one, ultimate compliance is to be done by governments, not by others. Furthermore, governmental position in disputes is arrived at after consultations with all domestic stakeholders. If governments know that their non-governmental agencies have a further chance to influence the dispute settlement mechanism, then they would pay less attention to finalising their positions and even worse, there may be implications for compliance by the governments themselves.'[34] An almost identical concern was expressed by Cuba, Honduras, India, Jamaica, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe in a joint proposal that argues against the submission of *amicus* briefs, contending that it would undermine the intergovernmental character of the WTO and that it would add to the obligations on Member governments participating in DSU proceedings, making it particularly burdensome to DCMs having regard to the prescribed time limits involved.[35] As such, India, Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia propose that the following footnote be added to Article 13 of the DSU in an attempt to limit considerably the acceptance of *amicus* briefs by a panel:

> 'Seek' shall mean any information and technical advice that is sought or asked for, or demanded or requested by a panel. A panel shall not accept unsolicited information.[36]

Moreover, the same group of Members propose the following footnote to Article 17.6 of the DSU in order to exclude *amicus* briefs being submitted to the Appellate Body:

> The Appellate Body shall neither seek nor accept information from anyone other than the parties and third parties to a dispute.[37]

The EC and USA, in response to this opposition, seem to have withdrawn their proposals on this issue. All that remains is the statement by the USA that it 'notes with interest the procedures proposed by the European Communities for handling *amicus curiae* submissions (TN/DS/W/1) and looks forward to working with the European Communities and other Members on this issue. The United States does not believe that an amendment to the Dispute Settlement Understanding is necessary for this purpose'.[38] Rather surprisingly, in the light of this history, Jordan in a later proposal supported the regulation of the submission of *amicus* briefs and went on to propose the establishment of a fund that would remit all costs and expenses that may be incurred by DCMs or LDCMs in reviewing, analysing and responding to issues raised in an unsolicited *amicus curiae* brief in a dispute before the panel or the Appellate Body.[39] The chances of this proposal being adopted are very low indeed based on the more general opposition of DCMs and the dropping by the USA and EC of their proposals in this area.

The Effect of Decisions on DCMs and LDCMs

The DSU contains a number of provisions on special and differential treatment that are to supposed to confer advantages on DCMs. It is well known, however, that these provisions have been largely ineffective in practice. In an attempt to provide more practical import to these SDT provisions, a number of DCMs have made proposals to bolster the substance of these provisions – in particular Articles 4.10, 7, 12.11 and 22 of the DSU.

Article 4.10 provides that 'During consultations Members should give special attention to the particular problems and interests of developing country Members'. India, Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia propose that the word 'should' in Article 4.10 be replaced with the word 'shall' to require Members in consultations to take account of the particular problems and interests of DCMs; moreover, they propose that the phrase 'give special attention' be defined in such a way that the proposed amended Article 4.10 would read as follows:

> Article 4.10.
> During consultations Members *shall* give special attention to developing country Members' particular problems and interests *in the following manner:*
> (a) *if the complaining party is a developed country Member and if it decides to seek establishment of a panel, it shall explain in the request for establishment of panel as well as in its submissions to panel and the Appellate Body as to how it had taken into account or paid special attention to the particular problems and interests of the developing country Member concerned;*
> (b) *if the developed country Member is a defending party, it shall explain in its submissions to the panel as to how it had taken into account or paid special attention to the particular problems and interests of the developing country Member concerned;*
> (c) *the panel, while adjudicating the matter referred to it, shall make a ruling on this issue.*[40]

The LDCMs have not, to date, used the DSS to resolve a trade dispute. The reason for this, according to them, is due to the structural and other difficulties the system poses for them.[41] As such, the LDCM Group propose that Article 4.10 should be amended to read as follows:

> 10. During consultation Members should give special attention to the particular problems and interests of developing country Members, *especially those of least-developed country Members.*

The LDCMs state that the severe resource constraints they are under require them to be treated differently even from other DCMs. For example, their severe resource constraints mean that they are unable usually to carry out consultations with other Members in Geneva, and as such due consideration should be given to the possibility of

holding such consultations and other meetings in the capitals of LDCMs.[42] Haiti makes the very useful specific proposal in this context that Article 4.10 be amended to read as follows:

> *10. During consultations Members shall take into account the particular problems and interests of developing country Members especially those of least developed country Members. Possibilities of holding consultations in the capitals of least developed country Members shall always be explored and a joint note to this effect made, which shall be considered in the event of the request for a panel and any proceedings.*[43]

Although this proposal is useful and may even be adopted due to the importance that all Members place on being seen to try and involve LDCMs even in dispute settlement, the impact of such a change is not likely to be important in practice. Requiring consultations to take place at a location convenient to the LDCM is certainly helpful, but it is unlikely to change the reality that these countries will not in general be able to afford to participate in WTO cases. It is for this reason that the establishment of a fund, considered below in Section 6, to assist participation by LDCMs in the DSS is of particular importance.

One of the most far-reaching – but potentially effective – proposals made by DCMs concerns Article 7. This provision sets out the terms of reference of a panel in a case unless the parties to a dispute agree otherwise. The African Group proposes that Article 7 should be amended by adding paragraphs 4 and 5 as follows:

> *4. Where a developing or least developed country Member is a party to any dispute under this Understanding, the panels, in consultation with relevant development institutions where necessary, shall consider and make specific findings on the development implications of the issues raised in the dispute and shall specifically consider any adverse impact that findings may have on the social and economic welfare of the developing or least developed country Member. The DSB shall fully take those findings into account in making its recommendations and rulings.*
>
> *5. This Understanding is an important mechanism for achieving the development objectives of the WTO Agreement. Accordingly, the findings of the panels and the Appellate Body, and the recommendations and rulings of the DSB shall fully take into account the development needs of developing and least developed country Members. The General Council shall review this Understanding every five years in order to consider and adopt appropriate improvements to ensure the achievement of the development objectives of the WTO Agreement.*[44]

These proposals would, if adopted, contribute considerably to the injection of the development agenda into the WTO DSS. It is largely for this reason that they are likely to be resisted by a number of states. The proposals are closely linked to the other

proposal in this area made by DCMs, that Article 22 of the DSU should include a rule that requires the DSB – before adopting panel and Appellate Body findings and recommendations and before authorising the suspension of concessions – to fully take into account reports to be prepared by relevant international organisations such as UNCTAD and the United Nations Development Programme (UNDP) on the development implication of the implementation of the findings and recommendations.[45] The objective of this proposal, according to its sponsors, is to ensure that the adoption and authorisation is done on appropriate terms and conditions that will ensure the promotion of the development prospects of DCMs.[46] It should be said that the likelihood of these ambitious proposals being adopted is not promising. In addition to resistance from WTO Members on an individual basis, the approach also raises an institutional problem. It does not seem likely that the DSB will agree in effect to follow the decision of separate international organisations such as UNCTAD and the UNDP.

The considerably more useful proposal made by LDCMs is that panel reports should explicitly indicate the form in which account has been taken of the relevant provisions on differential and more favourable treatment for DCMs and LDCMs contained in the covered agreements.[47] Moreover, the additional useful proposal is made that the phrase 'which have been raised by the developing country Member in the course of the dispute settlement proceedings' should be deleted from Article 12.11,[48] since the current requirement in Article 12.11 that the DCM needs to highlight any provisions on differential and more favourable treatment in the course of the dispute settlement procedures place an unnecessary additional legal burden on them and falls foul of the legal principle that the judge or court is supposed to know the law. This approach is taken further in Haiti's proposal that Article 12.11 should be amended to read as follows:

> *11. Where one or more of the parties is a developing or least developed country Member, the panel's report shall explicitly take into account the provisions on differential and more favourable treatment for developing or least developed country Members that form part of the covered agreements.*[49]

This proposal is reasonable since the panel or Appellate Body is already vested in a case with the authority to invoke all applicable legal principles, and it is also useful from the perspective of DCMs since it will encourage panels and the Appellate Body to develop a body of rules on how *they* should apply the SDT provisions. As such, these would seem to be proposals that all DCMs should usefully support.

The Evolution of the Law in Favour of Development

Some commentators identify particular decisions of the dispute settlement bodies – the panels or the Appellate Body – as taking interpretative stances which run counter to the interests of DCMs. For example, Bhagirath Lal Das (the former Indian Ambas-

sador and Permanent Representative to GATT) identifies cases which in his view give emphasis to DdCMs environmental policies over DCMs trade interests (e.g. the *Shrimp-Turtle* case).[50] A strong emphasis on environmental protection measures, on this analysis, poses difficulties for DCMs as they are ill-equipped to comply with onerous environmental protection requirements.[51] As a reflection of this view, LDCMs argue for the need for dissenting opinions in panel reports. This is necessary, the LDCMs argue, in part to enhance the evolution of a 'development-friendly jurisprudence' by avoiding the 'excessively sanitised concern with legalisms' that the panels and the Appellate Body have displayed, 'often to the detriment of the evolution of a development-friendly jurisprudence'.[52] The LDCMs contend that dissenting judgments should be allowed in the DSS through a rule that the members of the panel or Appellate Body should each deliver a judgment and the final decision be taken on the basis of a majority as, for example, is the practice adopted by the International Court of Justice (ICJ) and certain national court systems.

There is, however, a flawed logic in this approach. WTO panels and the Appellate Body are very different from that of the International Court of Justice and national court systems for two main reasons: First, the ICJ and national courts are clearly judicial organs *per se* and have the accompanying authority that goes with this status. This means that their decisions are complied with to a very considerable degree. Panels and the Appellate Body are purposely not called courts, and a process of majority decision-making may detract from the authority of a decision in a case leading to problems of implementation by a losing party. Second, the number of members of the panels and the Appellate Body are very considerably less than, for example, the International Court, which is composed of 15 judges.[53] This means that when ICJ judges give dissenting opinions there are often still a large number of judges who will align themselves with the majority opinion of the court, thus conferring a large degree of authority on the court's decision. This would be notably lacking in the case of the much smaller panels and Appellate Body.

6 Improving the Ability of DCMs to Use the DSS

DCM Resource Constraints

One of the most problematic issues for DCMs who seek to use the DSS is that of resource constraints. DCMs not only face considerable financial constraints in being able to utilise the DSS, but are also severely hampered by the lack of adequate numbers of trained officers or access to legal advisors with experience in WTO law and the dispute settlement process in particular. Moreover, the length of dispute settlement proceedings – lasting from initiation, through consultation, panel proceedings, appellate proceedings and any subsequent arbitration, so that the proceedings can last for years – also adds to the drain on resources. This serves as a significant disincentive to the

initiation of proceedings under the DSU. Obviously, there is an equal drain on resources when DCMs find themselves on the respondent's side to a complaint. There are, however, a number of proposals that, if adopted, might attenuate these difficulties.

Establishment of a Fund to Assist DCMs

The African Group emphasised that the DSU is complicated and overly expensive, and that they need supplementary resources and means to be provided to develop both the institutional and human capacity for using the DSS. They argue that this is not adequately covered by technical assistance programmes,[54] and that financial assistance is necessary. Examples of how this could be done include specific measures such as the establishment of a permanent standing fund that receives contributions from Member contributions or otherwise within the framework of the Doha Development Agenda Global Trust Fund.[55] They also state that the WTO Advisory Law Centre is not a panacea for all institutional and human capacity constraints of developing countries, since its terms of reference are equivocal in certain instances and it does not cover all developing countries.[56] To these reasons may be added two further difficulties that would arise if the Advisory Centre for WTO Law were seen as a solution to the problems that DCMs face in participating effectively in the DSS.[57] The first is one of legal resources. It is envisaged that the centre will have only five lawyers to work, possibly simultaneously, on a number of cases. This level of staffing will mean that the centre will have to choose carefully the cases that it can take from start to finish, and there will obviously be a need for sub-contracting of its work to qualified law firms that have the litigation expertise and support necessary for such cases. This may involve additional expenses for the developing country in question. The second, more principled, issue is that of being able to represent fully the interests of a developing country in a particular case. The establishment of an independent WTO Advisory Centre, which can act objectively in the interests of its DCM clients is obviously a more satisfactory solution than relaxing the obligations of impartiality of the WTO Secretariat in any way. However, it is still arguably not the best solution from the perspective of DCMs, since even the staff of the Advisory Centre owe an institutional loyalty to the centre itself which is an international organisation with its own organisational interest. This might mean that directions from the Advisory Centre's decision-making organs could be issued to the centre's staff which hampered them in advising on the optimal way to prepare the substance of a complaint in order to gain a favourable outcome for a developing country.

Because of these difficulties with the present system, the African Group proposal to establish a fund for dispute settlement is very much warranted. The African Group proposes that a new Article 28 be introduced in the following terms:

Article 28

WTO Fund on Dispute Settlement

1. There shall be a fund on dispute settlement to facilitate the effective utilisation by developing and least developed country Members of this Understanding in the settlement of disputes arising from the covered agreements.

2. The fund established under paragraph 1 of this Article shall be financed from the regular WTO budget. However, to ensure its adequacy, the fund may additionally be funded from extra-budgetary sources, which may include voluntary contributions from Members.

3. The General Council shall annually review the adequacy and utilization of the fund with a view to improving its effectiveness and in this regard may adopt appropriate measures and amendments to this Understanding.[58]

This proposal, while worthwhile, may take time to build up sufficient resources to allow DCMs to participate effectively in the DSS.[59] In the light of this, the next proposal is very much worth pursuing since it gives DCMs the ability to organise their own legal representation in strong cases and would mean that they would not have to rely on contributions from other states.

The Awarding of Costs in Favour of DCMs

Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe put forward the joint proposal that panels and the Appellate Body should be able to award costs against a DdCM either where it has been found in violation of its WTO obligations in relation to a DCM or where a DdCM has failed to prove its claim against a DCM in a dispute brought by it before a panel or the Appellate Body. The proposal of these states is that a provision to this effect be included in the working procedures of the panels in Appendix 3 of the DSU and of the Appellate Body.[60] This approach of payment of costs for DCMs is also supported by, for example, Jamaica which suggests that it would enable a DCM with a strong case to pursue dispute settlement proceedings against a DdCM where this would otherwise not be possible because of the burden of legal costs.[61]

The Adequacy of DSU Remedies for DCMs

The 'remedies' provided by the DSS often offer ineffective outcomes for DCMs.[62] One of the difficulties with the remedies offered by the DSS is that they have traditionally been viewed as being prospective. This has had the consequence for all WTO Members that, for example, any anti-dumping duties or countervailing duties paid as a consequence of an unlawful measure imposed by another Member are not recoverable. The lack of an effective remedy in such cases has hit DCMs particularly hard, since

they are very often the target of exactly such duties. It was thus not surprising that a DCM, Mexico, proposed that the notion of retroactivity be introduced into WTO dispute settlement proceedings, at least to some extent. Such a reform also has the more general advantage that it removes any incentive for a Member to artificially delay negotiations or other dispute settlement proceedings. There are three alternatives put forward from which date the determination of nullification or impairment can be calculated if a measure is found to be in violation of a covered Agreement. These are: (1) the date of imposition of the measure; (2) the date of the request for consultations; or (3) the date of establishment of the panel.[63] As such, Mexico proposed the following amendment to Article 22.7:

> 7. The arbitrator acting pursuant to paragraph 6 shall not examine the nature of the concessions or other obligations to be suspended but shall determine whether the level of such suspension is equivalent to the level of nullification or impairment, *measuring such nullification or impairment from the date of [imposition of the measure] OR [request for consultations] OR [establishment of the panel]. If actions have been authorized under Articles 12.6 bis and 12.6 ter, the trade impact of such actions shall be accounted for in the calculation of the nullification or impairment*. The arbitrator may also determine if the proposed suspension of concessions or other obligations is allowed under the covered agreement. The parties shall accept the arbitrator's decision as final and the parties concerned shall not seek a second arbitration. *However, if the level of nullification or impairment has changed, in order to conform to this change, parties may request the DSB to modify its authorization or a new arbitration may be sought*. The DSB shall be informed promptly of the decision of the arbitrator *or the determination pursuant to Articles 15 or 17* and shall upon request, grant authorization to suspend concessions or other obligations where the request is consistent with the decision of the arbitrator *or the determination pursuant to Articles 15 or 17*, unless the DSB decides by consensus to reject the request.[64]

This is one of the most important reform proposals that DCMs should push for in the negotiations for the reasons outlined above. An alternative proposal may be one that only allows the award of retroactive damages in the case of a DCM, although in practice such a proposal would be likely to be strongly resisted by other Members.

Measures to Ensure Compliance

DSU mechanisms to ensure compliance by states with a decision of a panel or the Appellate Body are often illusory in the case of DCMs. Article 22 of the DSU envisages temporary compensation or counter-measures as the mechanism that is used to pressure a state to bring its measures into compliance with a finding of inconsistency by a panel or Appellate Body. If requested, the Member in violation must enter into negotiations with the complainant party with a view to developing mutually accept-

able compensation. If there is no agreement as to compensation (which is voluntary), the complainant party may request authorisation from the DSB to suspend concessions or other obligations to the other non-compliant Member. The DSB shall grant authorisation to suspend concessions or other obligations unless it decides by consensus not to do so.

If DCMs cannot negotiate compensation, then they may have very limited meaningful measures open to them. A DCM often cannot in practice impose trade countermeasures against powerful DdCMs' interests since these would probably damage the DCM's own economic interests[65] and it is unlikely to have trade sectors open to it in which it will be meaningful to impose retaliatory measures (even where such measures are imposed they are unlikely to have a high impact on the target market). The imposition of high tariffs on imports from DCMs is impractical because the levels of imports from DCMs are unlikely to be high in volume and it will often be difficult to suspend concessions to a level which will be 'equivalent to the level of nullification or impairment'. Conversely, if a developing country is, as a respondent to dispute settlement proceedings, found to be in default, it does not in practice have the range of options in response that are open to DdCMs – the payment of compensation will not be a realistic option. This leaves DCMs open to suspension of concessions that will prove very harmful to their economies. As such, the issue of compliance for DCMs is one fraught with difficulties and in need of urgent reform. There are, in particular, four areas that need consideration: the time frame available for implementation by DCMs of a panel or Appellate Body decision; giving DCMs the choice of sectors in which trade counter-measures can be taken; the necessity for collective counter-measures; and the necessity for financial compensation in cases involving DCMs.

Time Frame for DCMs

Due to the resource-constraint difficulties often faced by DCMs in implementing panel and Appellate Body decisions, a number of DCMs have proposed that Article 21 – the DSU provision relating to surveillance of implementation of DSB rulings – should stipulate what constitutes a 'reasonable period of time' for DCMs to comply with a DSB ruling. At present, Article 21.2 is intended to provide DCMs with special treatment, but its vague terms have meant that it is largely redundant in practice: 'Particular attention should be paid to matters affecting the interests of developing country Members with respect to measures which have been subject to dispute settlement'. India, Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia have therefore proposed the following changes:

> **Article 21.2**
> *Notwithstanding anything contained in this Article*, particular attention *shall* be paid to matters affecting the interests of developing country Members with respect to measures which have been subject to dispute settlement *in the following manner:*

(a) if the party complained against is a developing country Member and the complaining party, a developed country Member,

(i) the reasonable period of time under paragraph 3 of this Article below should normally not be less than 15 months. If the measure at issue requires change of statutory provisions or change of long held practice/policy, the reasonable period of time should be at least two years. The arbitrator under paragraph 3 (c) of this Article may indicate, where the situation warrants, the requirement of a reasonable period of time beyond two years;

(ii) the complaining party should request consultations with the party concerned prior to seeking recourse to the proceedings under the terms of paragraph 5 of this Article. The time for completion of such proceedings should be increased from 90 days to 120 days. The panel should give consideration as may normally be given to the particular situation of developing country Members.

(iii) Filing of status report under the terms of paragraph 6 of this Article should be in alternative meetings rather than in every regular meeting of the DSB.

...

(c) if the complaint is by a developing country Member against a developed country Member: reasonable period of time under the terms of paragraph 3 below should not exceed 15 months. Existing 90 days time limit for proceedings in accordance with paragraph 5 of this Article should be observed strictly. In case of delay the developed country Member concerned should offer mutually acceptable compensation for continuing trade loss to the developing country complainant.[66]

These proposals would assist DCMs considerably in being able to implement DSB rulings in a manner that does not adversely affect their development situation while also allowing them to comply fully with their obligations under the covered agreements. The proposals are likely to encounter resistance from other Members who may argue that a 15 to 24-month minimum time period – depending on the domestic measure to be changed – is excessive and that this would compromise the binding nature and effectiveness of the WTO Agreements. Using this, as well as other arguments, opposing states may try and press for a reduced minimum period of implementation. The basis for such an argument does not, however, stand up to scrutiny. It is well-known that even DdCMs have taken long periods of time to implement DSB rulings (e.g. the EC in *Bananas* cases), and the special position of DCMs would seem to justify granting them the proposed treatment.

Allowing DCMs to Choose the Sectors in which they can Suspend Concessions

A number of DCMs have proposed that in order to secure effective compliance from a defaulting Member, DCMs should be permitted to seek authorisation for suspending concessions and other obligations in sectors of their choice.[67] They should not, in

particular, be required to go through the process of proving that: (1) it was not 'practicable or effective' to suspend concessions in the same sector or agreement where the violation was found;[68] and (2) that the 'circumstances are serious enough' to seek suspension of concessions under the agreement other than those in which the violation was found to exist.[69] Discharging this burden of proof is difficult, as Ecuador found in the *Bananas* dispute.[70] Accordingly, DCMs have suggested the insertion of a new Article 22.3 *bis* that provides as follows:

> Notwithstanding the principles and procedures contained in paragraph 3, in a dispute involving a developing country Member as complaining party and a developed country Member as a party complained against, the complaining party shall have the right to seek authorization for suspension of concessions or other obligations with respect to any or all sectors under any covered agreements, if the party complained against fails to bring its measures into compliance with the rulings and recommendations of the DSB or a covered agreement.[71]

The adoption of such a provision would enable DCMs at least to begin to try to use the mechanisms for compliance that the DSU provides. Due, however, to the relatively low levels of trade of a large number of DCMs there is still arguably a need for further reforms to be adopted in this area of compliance.

Collective Counter-measures

A number of DCMs consider that in order for the suspension of concessions to operate effectively as a means of encouraging compliance by a Member in breach of WTO obligations owed to a DCM, it is necessary for all WTO Members to be authorised to suspend collectively concessions to a non-compliant Member.[72] This proposal in relation to DCMs should, it is argued, be adopted notwithstanding the requirement that the suspension of concessions is to be based on the equivalent level of nullification and impairment of benefits.[73] Thus Haiti, for example,[74] proposes that Article 22.6 should be amended by renaming the current provision as paragraph (a) and adding, *inter alia*, the following paragraph (b):

> *(b) Where the case is one brought by a least developed country Member against a developed country Member and the situation described in paragraph 2 occurs, and in order to promote the timely and effective implementation of recommendations and rulings made in favour of least developed country Members, the DSB, upon request, shall grant authorization to all Members to suspend concessions or other obligations within 30 days unless the DSB decides by consensus to reject the request. The following principles and procedures shall apply to such a request.*
>
> *(i) Before making such a request, the least developed country Member shall refer the matter to arbitration for determination of the level of nullification and impairment,*

which shall be done taking into account the legitimate expectations of the least developed country Member. *The arbitration shall further take into account any impediment to the attainment of the development objectives of the* WTO *Agreement and as further elaborated upon by the least developed country* Member *concerned.*

(ii) The arbitration shall consider whether suspension of concessions or other obligations in other sectors by the least developed country Member *would be appropriate to effectively encourage the withdrawal of the measure found to be inconsistent with a covered* Agreement, *taking into account possible adverse effects on that least developed country* Member.

(iii) Where the DSB grants authorization to all Members *to suspend concessions or other obligations, the level of suspension for each* Member *shall be an appropriate percentage of the nullification and impairment determined under arbitration. In a case brought by a least developed country* Member, *the level of suspension for each* Member *shall be the level determined under arbitration to have been suffered by the least developed country* Member.[75]

This approach is important both as a matter of principle and of practice. As a matter of principle it demonstrates that all WTO Members are concerned about ensuring that DCMs can also benefit from the WTO Agreements, and as a matter of practice the utilisation of the economic power of WTO Members to assist DCMs may enhance compliance with DSB rulings in cases involving DCMs. Whether, however, this leads to DdCMs imposing counter-measures on behalf of DCMs remains to be seen. Employing a realistic approach, it seems unlikely that DdCMs will jeopardise their own trade interests on behalf of a DCM to enforce a decision against another DdCM. Nonetheless, the facility of being able to do so may prove important since there may be cases where a DdCM decides to take such action, whether it is motivated by systemic or other interests.

The most attractive proposal, however, in this area is for DCMs to receive monetary compensation for the duration of non-compliance.

Compensation Issues

A more general difficulty with retaliation measures as a method of inducing compliance is that, as the government of Ecuador points out, such measures are not likely to be effective in the case of large developed economies. The government of Ecuador points to the example of the *Bananas* dispute where, despite the withdrawal of concessions, the EC took a further 30 months to comply with the ruling after the expiry of the reasonable period of 15 months established by the DSB, and easily withstood 27 months of retaliatory measures.[76] It is for this reason that, among others, the government of Ecuador proposes the strengthening of the system of compensation. Ecuador suggests that the level of compensation should be consensual but that it should be

based on a determination by the panel of the level of nullification and impairment caused to the complaining party,[77] and that in terms of the type of compensation this could be made up of a package of trade benefits or any other form of compensation that does not affect other Members under the agreements concerned.[78] This system of compensation still, however, suffers from the failings of the present system – set out above – as far as DCMs are concerned.[79] A more useful proposal put forward by Ecuador is to make compensation compulsory so that it would become a sanction imposed by the multilateral system on Members that fail to comply with their obligations in relation to DCMs. The specific proposal is that the DSB, when adopting the report of the panel responsible for verifying compliance, could decide that the Member concerned must obligatorily compensate the complaining party; and in this case the non-compliant Member must submit a compensation package to the next DSB meeting for its approval. This proposal has some merit, especially in the case of DCMs where the threat of retaliation is ineffective as a mechanism for ensuring compliance with a Member's WTO obligations. However, it would be important to ensure that this measure would not, of course, be available against DCMs, since in their case the present system of the threat of retaliation is sufficient to ensure effective compliance with DSB decisions.

The African Group does not, however, go as far as Ecuador, the LDCMs and Haiti to propose that Article 21.8 *requires* monetary compensation when it states that the provision should be amended by adding the following sentence:

> *Further, if the case is one brought by a developing country* Member *against a developed country member, the DSB may recommend monetary and other appropriate compensation taking into account the injury suffered. The quantification of injury and compensation shall be computed as from the date of the adoption of the measure found to be inconsistent with covered agreements until the date of its withdrawal.*[80]

This kind of proposal by DCMs may attract support, since the EC has itself proposed making trade compensation a more realistic alternative to the suspension of concessions or other WTO obligations in order to implement a DSB ruling.[81] The EC points out 'that trade compensation is currently not a realistic option before the application of trade sanctions',[82] since the very structure of the DSU is such that Members are first required to request suspension of concessions. Article 22 only gives 20 days after the end of the reasonable period of time to conclude negotiations of compensation, and, more importantly, it is only in requesting the suspension of concessions and in triggering an Article 22.6 arbitration that the parties will know the level of nullification and impairment, i.e. the main element for the negotiation of compensation can only be obtained in requesting the authorization to apply sanctions. The EC suggests that this element of the DSU should be changed by allowing the complainant party to obtain an independent decision from a WTO arbitrator about the level of nullification and

impairment *before* the request for suspension of concessions is submitted.[83] DCMs could usefully support such a proposal, in return for which they could seek support for the above proposals relating to special treatment in relation to compensation. In any case, making compensation a more available mechanism can only benefit DCMs as opposed to their having to rely on the impractical mechanism of retaliatory measures.

7 Third Parties

Dispensing with the 'Special Interest' Requirement

Article 10 of the DSU and the Working Procedures, contained in Appendix 3 of the DSU, determine the status and participation of third parties in dispute settlement proceedings. Normally, third parties which possess a 'substantial interest' have 'the opportunity to be heard by the panel and to make written submissions to the panel' which, in turn, are given to the complainant and respondent and are reflected in the final panel report. Paragraph 6 of Appendix 3 provides that third parties shall be invited 'to present their views during a session of the first substantive meeting of the panel set aside for that purpose. All such third parties may be present during the entirety of this session.' The rights of third parties do not as such extend to being able to be present at meetings of the panel with the parties.[84] They simply 'receive the submissions of the parties to the dispute to the first meeting of the panel'. The panel in *EC-Bananas III*[85] departed from the usual practice under Article 10. The panel's approach in this case is usefully summarised by Footer:

> *It* [the panel] *ruled that, after consulting with the parties, it had decided, contrary to usual practice under Article 10 of the DSU, to admit members of governments of third parties 'to observe the second substantive meeting of the panel with the parties', i.e. with the complainants and respondent present. It also afforded them the right to make a brief statement 'at a suitable moment during the second meeting' but cautioned them that they were not expected to submit additional written material beyond responses to questions, posed at the first meeting. The panel based its decision on a number of factors, including the large economic effect of the disputed EC banana regime on certain third parties, the fact that certain third parties derived rights from a non-WTO international treaty between them and the respondent and that broader third-party rights had been granted in the previous two banana disputes. However, the limits of this 'enhanced status' were reached when the panel refused to entertain the grant of further participatory rights to third parties, following the second substantive meeting of the panel with the parties, including their involvement in the interim review process. Thus, certain DCMs (*in casu *the ACP third parties) did achieve a limited extension of their third-party rights, leading to greater involvement in the panel proceedings. However, the panel took the trouble to point out that they 'enjoyed broader participatory rights than are granted to third parties under the DSU.*[86]

In the light of this experience, the African Group proposes that Article 10 should be amended by adding the following to paragraph 2:

> *For purposes of developing and least developed country Members, the term 'substantial interest' shall be interpreted to include, any amount of international trade; trade impact on major domestic macroeconomic indicators such as employment, national income, and foreign exchange reserves; the gaining of expertise in the procedural, substantive, and systemic issues relating to this Understanding; and protecting long-term development interests that any measures inconsistent with covered agreements and any findings, recommendations and rulings could affect.*[87]

The African Group also propose that Article 10 should be further amended by replacing paragraph 3 with the following:

> *Third parties shall receive all the documentation relating to the dispute from the parties, other third parties, and the panel without prejudice to the provisions of paragraph 2 of Article 18. Third parties, if they request, shall have a right to attend the proceedings and to be availed the opportunity to put written and oral questions to the parties and other third parties during the proceedings.*[88]

The African Group proposes that DCMs should not be required to demonstrate a trade or economic interest in a case as a precondition for admission as third parties, and that DCMs may also be admitted as third parties at whatever stage a case may be. The important objective of this proposal is to gain valuable legal expertise and experience in utilising the DSS,[89] and as such it should be supported by DCMs.

Time Limits for Third Party Intervention

The EC contends that Article 10.2 should be amended so as to provide expressly that the time frame for notifying a third party interest is 10 days.[90] This would clarify the current situation that is based on 'past practice'. This short time period is necessary since the notification of third party interests is a prerequisite for the composition of the panel (as panellists may not be nationals of third parties). DCMs should push for considerable more time than a 10-day notification period, since, due to DCM resource constraints, it will often take much longer than 10 days in order to analyse the issues in the case and decide whether third party participation in the case is warranted.

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Notes

1 The EC, for example, notes in its Communication on DSU reform that 244 cases have been brought under the DSU as at February 2002: 'Communication from European Communities', TN/DS/W/1, p. 1.

2 See also the related proposal made by India, Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia, who propose that Article 12.10 (which provides for the extension of time periods for dispute settlement consultations relating to a measure taken by a DCM) be amended as follows:

'Article 12.10 of the DSU

In the context of consultations involving a measure taken by a developing-country Member, the parties may agree to extend the periods established in paragraphs 7 and 8 of Article 4. *If, after the relevant period has elapsed, the parties fail to agree that the consultations have concluded, the Chairman of the DSB shall, at the request of the developing country Member concerned, decide to extend the relevant period for not less than 15 days, in cases of urgency as envisaged in paragraph 8 of Article 4, and not less than 30 days in all other cases. In addition, in examining a complaint against a developing-country Member, the panel shall allow sufficient time, not less than two additional weeks in normal circumstance, for the developing-country Member to prepare and present its first written submission and one additional week thereafter at each stage of written submission or presentation. The additional time taken above shall be added to the time-frames envisaged in Article 20 and paragraph 4 of Article 21.'* ('Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia', TN/DS/W/47, p.3.) (Please note that proposed additions to the text of DSU provisions throughout this Chapter are consistently denoted by placing the added text in italics.)

This proposal has a number of features that will, if adopted, prove of importance to DCMs. The first part of the proposal gives guidance to the DSB Chair, upon being approached by either party, for extending the period at least 15 or 30 days as the case may be in normal circumstances. In the case of exceptional circumstances, (the expression used in Article 21.4), the Chair can exercise a discretion and give more time to the parties. The second part of the proposal directs the panel to give extra time of at least two weeks for the first submission, one week each for the second submission, first and second oral presentations and for interim submissions, if any. The third part of the proposal seeks to extend the overall time-frames in dispute settlement proceedings involving a DCM as a respondent.

3 Similarly, the government of Jordan proposes that after the first sentence in Article 5.1 that the following sentence be added: 'In disputes involving developing country or least developed country Members, such procedures shall be mandatory'. ('Communication from Jordan', TN/DS/W/43, p.2.) Moreover, Jordan proposes in relation to Article 4.4. that after the first sentence the following second sentence be inserted: 'If one of the parties is a developing or a least developed country Member, procedures for good offices, conciliation or mediation shall continue while the panel process proceeds unless both parties agree otherwise'. ('Communication from Jordan', TN/DS/W/43, p. 2.)

4 'Communication from Haiti', TN/DS/W/37, p.4.

5 See, for example, United States – Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/R, panel Report, pp. 74–79.

6 'Communication from the European Communities', TN/DS/W/1, p. 7.

7 'Communication from the European Communities', TN/DS/W/1, p. 7.

8 The same type of issue arises in relation to bilateral compensation deals being agreed between parties to a case which have no timetable for implementation and which are not offered to other Members whose rights and obligations have also been nullified and impaired. The Australian government makes the point that if Members are forced to initiate their own complaints to acquire compensation rights, when it has already been proven that the Member concerned is in breach of its WTO obligations, this will place considerable pressure on the WTO dispute settlement system and will lead to a waste of valuable resources. ('Communication from Australia', TN/DS/W/8, p. 3. See also 'Communication from Brazil', TN/DS/W/45/Rev.1, pp. 1–3.) From the perspective of DCMs this also has the consequence that unless they monitor all cases and initiate proceedings in relevant cases where they do not automatically benefit from a bilateral compensation arrangement, then they will be excluded in effect from the trade benefits that the WTO system is supposed to offer them. As such, the following proposed Australian amendment to Article 22.2 should be supported:

'*Article 22*

Compensation and the Suspension of Concessions

...

2. If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period

of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, enter into negotiations *within 10 days of such a request* with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation. *If any party having invoked these dispute settlement procedures and the Member whose measure has been found to be inconsistent agree on acceptable compensation but such compensation is not available to third parties to a dispute, the Member whose measure has been found to be inconsistent shall, on request, agree to expedited arbitration under Article 25 to determine the right of a third party to compensation*. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.' ('Communication from Australia', TN/DS/W/49, p. 4.)

9 There is an important potential MFN exemption that may, however, allow states not to offer a benefit as part of a settlement to all WTO Member States. Under the General Agreement on Trade in Services, states have the facility of being able to make one-off MFN exemptions, and such an exemption *may* allow a state – depending on its terms – to offer another state a benefit in settlement of a dispute without having to extend it to all WTO Members.

10 'Proposals on DSU by Cuba, Honduras, India, Jamaica, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe', TN/DS/W/18, p. 2 and TN/DS/W/18/Add.1.

11 'Proposal by the African Group', TN/DS/W/15, p. 2.

12 'Proposal by the African Group', TN/DS/W/15, p. 3.

13 'Communication from Kenya on behalf of the African Group', TN/DS/W/42, p. 1.

14 'Proposal by the African Group', TN/DS/W/15, p.3. See, on this monetary compensation proposal, infra Section 6(iii)(d).

15 'Communication from European Communities', TN/DS/W/1, pp. 2–3.

16 The EC supports this argument by pointing out that in 1996 the average time for selection of panellists was 30 days, while in 2001 it had increased to 67 ('The European Communities replies to India's questions', TN/DS/W/7, 30 May 2001, p. 2.)

17 'The European Communities replies to India's questions', TN/DS/W/7, 30 May 2001, p. 3.

18 'The European Communities replies to India's questions', TN/DS/W/7, 30 May 2001, p. 3.

19 'India's Questions to the EC and its Member States on their Proposal relating to improvements of the DSU', TN/DS/W/5, 7 May 2002, p. 3.

20 'The European Communities replies to India's questions', TN/DS/W/7, 30 May 2001, p. 4.

21 'Proposal by the African Group', TN/DS/W/15, p. 6.

22 'Communication from the European Communities', TN/DS/W/38, pp. 3–4.

23 'Communication from Canada', TN/DS/W/41, pp.15-17.

24 'Proposal by the LDC Group', TN/DS/W/17, p.2.

25 'Communication from Jordan', TN/DS/W/53, p.3.

26 'Communication from Haiti', TN/DS/W/37, pp. 1–2. Haiti also proposes that Article 8.10 should be further amended by renaming the current provision as paragraph (a) – as amended – and adding the following paragraph (b): '*10.(b) When a dispute is between a least-developed country Member and a developing or developed country Member, the panel shall include at least one panelist from a least-developed country Member and if the least-developed country Member so requests, there shall be a second panellist from a least-developed country Member.*' ('Communication from Haiti', TN/DS/W/37, p. 2.)

27 'Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia', TN/DS/W/47, p. 2. Jordan agrees with the substance of this proposal: 'Communication from Jordan', TN/DS/W/43, p. 9.

28 'Communication from Thailand', TN/DS/W/2, 20 March 2002.

29 'Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia', TN/DS/W/47, p. 1; 'Communication from Cuba, Honduras, India, Jamaica, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe', TN/DS/W/18, p. 6 and TN/DS/W/18/Add.1; and 'Communication from the European Communities', TN/DS/W/38, p. 5.

30 'Communication from the European Communities', TN/DS/W/1, p. 7. The USA initially proposed that it may be helpful to adopt guideline procedures for handling amicus curiae submissions to address procedural concerns that have been raised by Members, panels, and the Appellate Body. ('Contribution of the US to the Improvement of the DSU of the WTO related to transparency', TN/DS/W/13, p. 3.)

31 'India's Questions to the EC and its Member States on their Proposal relating to improvements of the DSU', TN/DS/W/5, 7 May 2002, p. 5.

32 'Contribution of the EC and its Member States to the Improvement of the WTO DSU', 13 March 2002, TN/DS/W/1, p. 7.
33 Similarly, the African Group states that the use of the expression '*amicus curiae*' in the context of Article 13 is inappropriate, since this Article is concerned with the right to seek information while *amicus curiae* refers to 'friends of the court' to whom a court may turn to request additional advice and guidance on issues of law and interpretation and issues requiring expert knowledge. The African Group state that the 'term is not ordinarily used in reference to the adducing of factual evidence in support of a party's case.' ('Proposal by the African Group', TN/DS/W/15, p. 5.)
34 'India's Questions to the EC and its Member States on their Proposal relating to improvements of the DSU', TN/DS/W/5, 7 May 2002, p. 5.
35 'Proposals on DSU by Cuba, Honduras, India, Jamaica, Malaysia, Pakistan, Sri Lanka, Tanzania, and Zimbabwe, TN/DS/W/18, p.4 and TN/DS/W/18/Add.1. See the similar proposal against *amicus* briefs made by the Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu: 'Communication from Separate Customs Territory of Taiwan, Penghu, Kinmen, and Matsu', TN/DS/W/25, p. 1.
36 'Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia', TN/DS/W/47, p. 1.
37 'Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia', TN/DS/W/47, p. 2.
38 'Communication from the United States', TN/DS/W/46, p. 3.
39 'Communication from Jordan', TN/DS/W/53, p. 2.
40 'Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia', TN/DS/W/47, p.3. See also the virtually identical following proposal: 'Proposals on DSU by Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania, and Zimbabwe', p. 3.
41 'Proposal by the LDC Group', TN/DS/W/17, p. 1.
42 'Proposal by the LDC Group', TN/DS/W/17, pp. 1–2.
43 'Communication from Haiti', TN/DS/W/37, p. 1.
44 'Communication from Kenya on behalf of the Africa Group', TN/DS/W/42, p. 2. Haiti makes an identical proposal to that contained in paragraph 4 of the African Group proposal except that the Haitian proposal refers generically to DCMs as including LDCMs: 'Communication from Haiti', TN/DS/W/37, p. 1.
45 'Proposal by the African Group', TN/DS/W/15, p .4. A similar proposal is made by the LDC Group, TN/DS/W/17, p. 4.
46 'Proposal by the African Group', TN/DS/W/15, p. 4. A similar proposal is made by the LDC Group, TN/DS/W/17, p. 4.
47 'Proposal by the LDC Group', TN/DS/W/17, p. 2.
48 'Proposal by the LDC Group', TN/DS/W/17, p. 3.
49 'Communication from Haiti', TN/DS/W/37, p. 2.
50 Bhagirath Lal Das, 'Strengthening Developing Country Members in the WTO', *Trade and Development Series No* 8, Third World Online Network.
51 Bhagirath Lal Das, 'Strengthening Developing Country Members in the WTO', *Trade and Development Series No* 8, Third World Online Network.
53 Article 3(1) of the Statute of the International Court of Justice provides: 'The Court shall consist of fifteen members, no two of whom may be nationals of the same state'.
54 See an acknowledgment of this by the EC: 'Communication from the EC: Developing Country Members and the WTO Dispute Settlement Mechanism', WT/GC/W/148, 24 February 1998.
55 'Proposal by the African Group', TN/DS/W/15, p. 2.
56 'Proposal by the African Group', TN/DS/W/15, p. 2. The establishment of such a fund will likely require amendment of the institutional provisions of the DSU, such as Article 2.
57 Jamaica, moreover, argues that the cost of membership of the WTO Advisory Law Centre still prohibits some developing countries from accessing its facilities, and that additional independent mechanisms need to be developed to ensure that DCMs not only obtain general legal advice, but can also obtain assistance in arguing their case before a panel at a cost which these countries can afford. ('Communication from Jamaica', TN/DS/W/21, p. 2.)
58 'Communication from Kenya on behalf of the Africa Group', TN/DS/W/42, p. 5.
59 Cf., however, the African Group, which has put forward some more immediately realisable proposals relating to their participation in the DSS. Their proposal is that assistance is provided in the form of a pool of experts and lawyers in the preparation and conduct of cases, the payment of fees and expenses entailed, compilation by the WTO Secretariat of all applicable law including past decisions to be fully availed to and usable by both the parties

and the panels/Appellate Body in each individual case. ('Proposal by the African Group', TN/DS/W/15, p. 4.)
60 'Proposals on DSU by Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe', p. 3.
61 'Communication from Jamaica', TN/DS/W/21, p. 4.
62 H. Horn and P. Mavroidis, *Remedies in the WTO Dispute Settlement System and Developing Country Interests*, Institute for International Economic Studies, Stockholm University Centre for Economic Policy Research, 11 April 1999 (paper on file with author).
63 'Proposal by Mexico', TN/DS/W/23, p. 4.
64 'Communication from Mexico', TN/DS/W/40, p. 6.
65 For a critique more generally of such counter-measures, see S. Charnovitz, 'Rethinking Trade Sanctions', *AJIL*, 95 (2001), p.792.
66 'Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia', TN/DS/W/47, pp. 3–4.
67 Cf. Article 22.3(a) which provides that in general a State should first seek to suspend concessions with respect to the same sector as that in which the panel or Appellate Body has found a violation.
68 Cf. Article 22.3(b).
69 Cf. Article 22.3(c).
70 S. Charnovitz, 'Rethinking Trade Sanctions', *AJIL*, 95 (2001), p. 792 at p. 822.
71 'Communication from India on behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia', TN/DS/W/47, p. 2.
72 See generally on this approach: J. Pauwelyn, 'Enforcement and Counter-measures in the WTO: Rules are Rules – Toward a More Collective Approach', *AJIL*, 94 (2000), p.335.
73 Cf. Article 22.4.
74 See also the similar proposals in substance made by the government of Mexico, 'Communication from Mexico, TN/DS/W/40, pp. 1, 6; 'Proposal by the African Group', TN/DS/W/15, p. 3; and 'Communication from Kenya on behalf of the African Group', TN/DS/W/15, p. 4. Cf., however, the LDC Group who propose that collective measures in relation to the enforcement of a decision in favour of DCMs should be automatic as a matter of Special and Differential Treatment: TN/DS/W/17, p. 4.
75 'Communication from Haiti', TN/DS/W/37, pp. 4–5.
76 'Communication from Ecuador', TN/DS/W/9, p. 2.
77 'Communication from Ecuador', TN/DS/W/9, p. 3.
78 'Communication from Ecuador', TN/DS/W/9, p. 4.
79 'Communication from Ecuador', TN/DS/W/9, p. 5. See also the same substantive proposal made by LDCMs: 'Proposal by the LDC Group', TN/DS/W/17, p. 4. Cf. the proposal by Haiti that Article 21.8 should be amended to require monetary compensation only in relation to LDCMs: 'Communication from Haiti', TN/DS/W/37, p. 3. This approach has academic support: see, for example, J. Pauwelyn, 'Enforcement and Counter-measures in the WTO: Rules are Rules – Toward a More Collective Approach', *AJIL*, 94 (2000), p. 335 at pp. 345–346.
80 'Communication from Kenya on behalf of the Africa Group', TN/DS/W/42, p. 3.
81 In fact the EC in one of its proposals expressly noted the proposal of Ecuador and states that it is 'ready therefore to work constructively with Ecuador and other WTO Members with a view to establish a generally acceptable text on this issue.' ('Communication from the European Communities', TN/DS/W/38, p. 9.)
82 'Contribution of the EC and its Member States to the Improvement of the WTO DSU', 13 March 2002, TN/DS/W/1, p. 5.
83 'Contribution of the EC and its Member States to the Improvement of the WTO DSU', 13 March 2002, TN/DS/W/1, p. 5.
84 M. Footer, 'Developing Country Practice in the Matter of WTO Dispute Settlement' *Journal of World Trade*, 35 (1), (2001), p. 55 at p. 93.
85 European Communities – Regime for the Importation, Sale and Distribution of Bananas, complaints by Ecuador (WT/DS27/R/ECU), Guatemala and Honduras (WT/DS27/R/GTM and WT/DS27/R/HND), Mexico (WT/DS27/R/MEX), and the United States (WT/DS27/R/USA), panel Report, 22 May 1997.
86 Footer, supra n. 84, pp. 93–94.
87 'Communication from Kenya on behalf of the Africa Group', TN/DS/W/42, p. 2.
88 'Communication from Kenya on behalf of the Africa Group', TN/DS/W/42, p. 2.
89 'Proposal by the African Group', TN/DS/W/15, p.5.
90 'Communication from the European Communities', TN/DS/W/1, p. 8; and see also, e.g., 'Communication from the Separate Customs Territory of Taiwan.

7

Transparency in Government Procurement

Peter Williams

1 Background

Government procurement policies can be used to provide protection for a significant share of a country's economy but have been effectively excluded from the scope of the multilateral trade rules, including its basic national treatment and most favoured nation provisions, first under the GATT[1] and then under the WTO.[2]

Efforts were made at a relatively early stage in the GATT's existence to reduce barriers to trade created by government procurement laws and practices as part of an effort to reduce non-tariff measures in general. The results of these efforts were embodied in a series of separate agreements, commonly referred to as the Tokyo Round Codes, one of which was the GATT Government Procurement Agreement (GPA). This agreement did not oblige its signatories to liberalise their government procurement across the board, but only procurement by a negotiated list of entities. However, it attracted fewer signatories than any of the other codes and all of these were either developed countries or high-income developing countries.

Opposition to the incorporation of the GPA in WTO when it was created in 1994 was so great that it remains a plurilateral agreement outside the WTO's single undertaking.[3]

There are a number of different reasons for this opposition. Government procurement practices provide one of the most effective and, under present multilateral rules, legitimate ways of providing protection to local producers. Many countries seem to have concluded that they would have difficulty in taking advantage of the export opportunities created. Many governments look for reciprocal benefits when negotiating trade agreements – or, in the case of developing countries, expect to give less than full reciprocity. In a stand-alone agreement such as the GPA, this balance has to be found within the agreement itself. India applied to accede to the GPA in 1981 but decided not to pursue its application when the very short list of entities it offered was considered insufficient by the members of the GPA. Yet another problem that governments see is the heavy administrative burden created by the GPA's procedural requirements and the difficulty of ensuring that listed entities at different levels of government conform to the detailed requirements laid down by the GPA.

Opposition among non-signatories to the GPA to continued attempts by both the USA and the European Communities to get the liberalisation of government procurement onto the agenda of the WTO led them to lower their sights and aim, if not for

liberalisation, at least for transparency in government procurement. They therefore sought a mandate at the first WTO ministerial conference, held in Singapore in December 1996, to launch a negotiation on procurement among all WTO Members 'to develop an interim arrangement on transparency, openness and due process in procurement of goods and services'.[4] For both, this was very much second best, but for the USA transparency was an important goal since they saw it as a way to deal with 'problems of bribery and corruption and the lack of transparency in government procurement'.[5] Negotiations in Singapore took place in an informal group of about 30 countries. Many of these supported work on transparency in government procurement, Malaysia and India contributing actively to the development of a compromise decision on the subject that does not mention an 'interim' agreement, 'openness and due process', or bribery and corruption, and recognises the need to take into account participants' development priorities. Many more delegations were prepared to go along with this text.

So, in 1996 paragraph 26 of the Singapore Ministerial Declaration established a working group:

> *... to conduct a study on transparency in government procurement practices, taking into account national policies, and, based on this study, to develop elements for inclusion in an appropriate agreement.*

Transparency in government procurement was one of four issues added to the WTO agenda at that meeting. The others were: the relation between trade and investment; the interaction between trade and competition policy; and trade facilitation (often referred to as the four Singapore issues).

2 Discussions on the Working Group

The working group has done a large amount of technical work in the six years since it was established at Singapore.

One of its first tasks was to review the provisions in existing international instruments and national procedures and practices on the basis of a WTO Secretariat document on this subject, issued as far back as 1997.[6]

By 1999, its study of transparency in government procurement had enabled the chairman of the working group to identify 12 elements that might be included in a WTO transparency agreement and the WTO Secretariat to summarise the discussions that had already taken place on each of these.[7] These 12 elements are:

I. Publication of Information on National Legislation and Procedures;
II. Procurement Methods;
III. Publication of Information on National Legislation and Procedures;
IV. Information on Procurement Opportunities, Tendering and Qualification Procedures;
V. Time-Periods;

VI. Transparency of Decisions on Qualification;
VII. Transparency of Decisions on Contract Awards;
VIII. Domestic Review Procedures;
IX. Other Matters Related to Transparency (including maintenance of records of proceedings, information technology, language, and fight against bribery and corruption);
X. Information Provided to other Governments (Notification);
XI. WTO Dispute Settlement Procedures; and
XII. Technical Co-operation and Special and Differential Treatment for Developing Countries.

Discussions on these elements in the working group were given a new impetus in November 2001 by the adoption of the Doha Declaration by the fourth WTO ministerial conference, paragraph 26 of which reads:

> *Recognising the case for a multilateral agreement on transparency in government procurement and the need for enhanced technical assistance and capacity-building in this area, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference* [now scheduled to be held in Cancún on 10–14 September 2003] *on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations. These negotiations will build on the progress made in the Working Group on Transparency in Government Procurement by that time and take into account participants' development priorities, especially those of least developed country participants. Negotiations shall be limited to the transparency aspects and therefore will not restrict the scope for countries to give preferences to domestic supplies and suppliers. We commit ourselves to ensuring adequate technical assistance and support for capacity-building both during the negotiations and after their conclusion.*

In Doha, the chairman also made a final statement declaring that this wording would, in his view,

> *give each Member the right to take a position on modalities that would prevent negotiations from proceeding after the Fifth Ministerial Conference, until that member is prepared to join in an explicit consensus.*

The latest official summaries of the discussions that have taken place in the working group on each of the possible elements that might be included in a WTO transparency agreement are contained in two documents, circulated by WTO Secretariat in May and October.[8]

These summaries reveal widely different views on the content of an agreement, which bear on most of the individual elements discussed in the group. One of the main reasons for this is that participants have widely different interpretations of the Doha

mandate, in which the Ministers recognised the case for a multilateral agreement on transparency in government procurement without specifying which elements should be dealt with in an agreement.

The US aim has been stated as: 'to forge a consensus on the elements of an agreement that establishes a common set of procedures to ensure that governments' purchasing decisions are done in an open, transparent fashion'.[9] The European Communities have been the other main proponent from the outset. Other delegations supporting this approach include Australia, Canada, Chile, Hungary, Korea, Japan and Switzerland, which had given its support while taking its own situation into account. A number of other governments, such as Brazil, Costa Rica, Mexico and Sri Lanka, have demonstrated a readiness to follow this general approach.

At the present time, government procurement laws, regulations and practices can give protection to domestic supplies and suppliers in two different ways. First, procuring entities may simply have wide discretionary powers that can be used to favour certain supplies or suppliers. Second, governmental procurement policies may be embodied in laws and regulations laying down requirements designed to achieve their socio-economic goals, which may include protection of domestic supplies or suppliers, small and medium-sized enterprises, enterprises run by ethnic and minority groups, or the promotion of employment in labour surplus areas. These can take different forms, including domestic content requirements, licensing of technology requirements, investment requirements or counter-trade requirements. Other requirements may function through the price mechanism, for instance by giving domestic suppliers a specified preferential price margin.

Distortions caused by the use of discretionary powers are very much more opaque than those caused by laws and regulations. The proposals for a WTO agreement made in the Working Party on Transparency in Government Procurement are designed to limit the discretionary power of purchasing entities to distort conditions of competition, both among domestic suppliers and among domestic and foreign suppliers. However, in line with paragraph 26 of the Doha Declaration, these proposals would not limit the freedom of governments to protect domestic suppliers either by using offsets or price preferences.

At the other end of the spectrum of opinion stands a group of participants, of which Egypt and India are the most categorical, with Indonesia, Malaysia, Pakistan and Philippines adopting a similar stance. These participants (the opponents) would argue that, within the limits set by their own laws and procedures, their governments and their government entities have been able to pretty much decide for themselves how their purchases of goods and services, which account for a sizeable part of gross domestic product, are made and that this discretion provides them with one of their most effective tools to support national socio-economic policy objectives, such as protecting domestic producers (including small companies and ethnic groups), reduc-

ing outflow of foreign exchange and transferring technology to local industries. These participants apparently fear that a transparency agreement could be used as a stepping stone to an agreement providing for full market access. They take the view that the intention of paragraph 26 of the Doha decision was that the primacy of these rights should be maintained and that an agreement should simply ensure that governments provide transparency on their laws, regulations and practices as they exist, but should not oblige governments to change these. They would be prepared to accept an agreement that follows the approach embodied in transparency provisions already in WTO, such as Article X of GATT 1994, but argue that a transparency agreement should not go beyond this and object to suggestions which they consider would have the effect of improving conditions of access to their markets.[10]

The basic differences of approach outlined above have not been openly discussed as such in the working group, since it has avoided a philosophical debate on the meaning of transparency and has concentrated on individual elements of a possible agreement. However, the differences come out clearly in the discussions on these elements.

Under the first approach, the aim is necessarily an agreement covering all phases of member governments' procurement from the decision on the procurement method to be used to the award of the contract and any domestic procedures to review decisions on contract awards. Its proponents argue, for example, that entities' purchasing decisions will be transparent and predictable only if discretion is limited: if, for instance, *ex post* information is given on the use made of limited tendering; if time periods are long enough to ensure that sufficiently detailed, readily available information is given sufficiently in advance to enable interested suppliers to assess their interest in a particular procurement; if the evaluation of tenders is made on the basis of pre-published criteria; if any changes to these criteria are made known to all suppliers; if proper records are kept of decisions and actions during the procurement process; and if decisions are subject to domestic review procedures to introduce accountability into the process.[11]

Delegations adopting the second approach recall that the Doha mandate makes clear that 'the negotiations shall be limited to the transparency aspects …' and argue against obligations which, in their view, relate to market access and not to transparency. Under this approach, an agreement would not deal with all the points in the chairman's check-list. These delegations argue that procurement opportunities open only to domestic suppliers can be of no interest to other WTO Members and should not be covered by a transparency agreement. In the discussions that have taken place on the individual elements in that list, they have taken the view that no justification should be given for the choice of procurement methods; that procurement entities should be given discretion to establish time periods on a case-by-case basis; that there should be no provisions on the design of domestic review procedures; and that there should be no provisions stating explicitly the form of records or for how long they should be kept.[12]

Another basic point on which the positions of the active delegations diverge is whether an agreement should be a legally binding agreement or whether it should take the form of guidelines or a code. Proponents of a prescriptive approach to an agreement understandably argue for a legally binding agreement, since they consider that provisions would be needed to enforce the obligations which it laid down. They therefore support the inclusion of provisions making the agreement's obligations subject to the WTO dispute settlement procedures in the same way as existing clauses on transparency in WTO Agreements. Delegations that support only a minimal agreement doubt whether WTO dispute settlement procedures could apply with significant results to an agreement that dealt only with transparency. Some question how dispute settlement procedures would work in practice in this area and some fear that a legally-binding transparency agreement with dispute settlement provisions would provide another excuse to introduce sanctions against their exports. Some would prefer that an agreement take the form of guidelines without dispute settlement provisions or a code, membership of which is voluntary.

The US delegation has recently gone some way to allay the concerns expressed about the application of WTO dispute settlement procedures in this area by proposing that a transparency agreement should provide explicitly that resort to these procedures would not be available to challenge a specific procurement and thus could not be used to overturn a contract award, and that there could be transitional periods for the application of dispute settlement procedures to certain provisions.[13]

There are also differences of view regarding the scope of an agreement. Some governments of federal states, such as Australia, Brazil and Canada, seem hesitant to accept suggestions that a transparency agreement should apply to government procurement at the state and local levels.

It has been argued in the working group that a transparency agreement along the lines suggested by the proponents would be 'a critical element of good economic governance'[14] and a contribution to reducing the incidence of bribery and corruption, but it has been stressed that the issue itself was not within the mandate of the working group and that the objective of fighting against bribery and corruption should not be stated in a WTO agreement.

It is common ground that technical co-operation would be important for ensuring the successful implementation of an agreement and a number of areas in which technical assistance for capacity-building would be beneficial have been suggested.

It has also been suggested that the issue of special and differential treatment and transitional periods might be addressed once the elements of a possible agreement were more clearly defined. A suggestion from the USA that the acceptance of obligations should be linked to technical assistance has not been developed in the working group.

The discussions summarised above have taken place among a dozen or so active

delegations and the great majority of WTO Members have not expressed their views, mainly because they have small administrations that do not have the resources to take part in all the many activities on the Doha agenda that concern them and because government procurement is not a priority for them in that context.

3 Discussion of Modalities in the General Council

Paragraph 26 of the Doha Declaration indicates that negotiations will take place after the fifth session of the ministerial conference at Cancún 'on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations [for a multilateral agreement on transparency in government procurement]'.

It is unclear what the word 'modalities' means in this context.

Proponents of a transparency agreement stress that, when agreeing to paragraph 26, Members committed themselves to reaching a consensus and entering into negotiations after Cancún. Some go on to argue that, since ministers have already agreed that negotiations would take place, a decision on modalities would only deal with matters of procedure, such as the timeline for the negotiations, the number of meetings, etc.

On the other hand, some delegations of developing countries refer to the statement from the chairman in Doha on this subject and stress that negotiations will only take place if an explicit consensus is reached on modalities. They conclude that any single WTO Member can therefore block a decision. Some of these delegations go on to say that lack of resources has prevented them from developing a position on all of the elements being discussed in the working group and that they therefore need to undertake further studies before any explicit consensus can be reached. It is, for instance, reported that when European Trade Commissioner, Pascal Lamy, and his Indian counterpart, Minister Arun Jaitley, discussed the current Doha Round trade negotiations in India on 13–14 March 2003, they disagreed on whether negotiations on transparency in government procurement and the three other Singapore issues should proceed after Cancún, with Jaitley saying that India opposes negotiations and that the issues should be further studied by a panel of developing country representatives.[15]

The European Communities has recently recognised that if a consensus is to be found, the decision will need to deal with more than purely procedural matters. It has recently put forward a proposal on modalities for all four Singapore issues,[16] stating that all four constitute a priority for the EC and their Member States and suggesting that the modalities for each could deal with the following three matters:

- ***Procedural issues:*** Number of meetings, timing, internal deadlines for tabling proposals, legal texts, etc.;
- ***Scope and coverage of the negotiating agenda:*** Concrete issues that should be the object of negotiation and structure of obligations in an eventual agreement;

- ***Special and differential treatment:*** Differentiation in commitments between WTO Members; differentiation in implementation periods; provision of trade-related assistance.

With regard to the concrete issues that should be the subject of negotiations in the area of government procurement, the EU proposes that 'negotiations on a multilateral transparency agreement should comprise as a starting point the key issues in the Chairman's checklist of issues', and with regard to the structure of obligations in this area, that 'the issue of thresholds could be examined with a view to allowing for a pragmatic and little burdensome approach towards the application of transparency issues'.

The question of modalities is not being dealt with in the Working Party on Transparency in Government Procurement but in the WTO General Council which supervises the Doha work programme as a whole. Important target dates set in the Doha Declaration relating to subjects of key interest to developing countries, such as implementation issues and concerns, special and differential treatment for developing countries, agriculture, market access for non-agricultural products, and the TRIPs Agreement and access to medicines, have been missed. The work programme may not have come to a complete standstill but little forward movement can be discerned. In each area, participants are tending to reiterate already well-known positions and to push important decisions into the future.

This situation is inevitably having an impact on the discussions on modalities for the negotiations on the four Singapore subjects, including transparency in government procurement, and little can be expected to move in this area unless there is movement on the key subjects.

4 Comments and Suggestions

The need for transparency and good governance in government procurement is not, in itself, a North–South issue. Most countries, including most developing countries, have adopted, or are in the process of adopting, procurement laws, regulations and institutional reforms under pressure to use public funds more efficiently and under pressure created by increased awareness for the adoption of transparent good governance policies. These new policies have often been based on the World Bank Guidelines[17] or the UNCITRAL Model Law.[18]

The question is, however, not whether transparency in government procurement is a good thing in itself, but whether an agreement on the subject should be negotiated in WTO and, if so, what the content of such an agreement should be. Even this is not a purely North–South issue. The main challenge now faced by many developing countries is to implement their government procurement policies effectively. Some, for example Sri Lanka to name only one, take the view that, given the problems that they face in this area and the nature of these problems, a suitable binding WTO trans-

parency agreement would not only be compatible with their policies but would reinforce their own domestic objectives.

The government of each developing country will consider the arguments for and against a transparency agreement as proposed:

- ***Arguments for:*** Procedures of the sort suggested by the proponents are essential to a predictable and efficient government procurement process and would contribute to obtaining value for money. An agreement restricted to the transparency aspects would promote good governance, reinforce reform measures adopted at the national level, and help combat bribery and corruption. It would not limit the right of governments to use government procurement policies to achieve their socio-economic goals, including protection of domestic producers (including small companies and ethnic groups), reducing outflow of foreign exchange and transferring technology to local industries but would, on the contrary, help to ensure that these aims are in fact achieved. It would do this by limiting the use of discretion by purchasing entities by obliging these entities to be transparent in their operations, thus reducing administrative obstacles to competition both on the domestic market and between domestic and imported goods and services, but it would not limit the ability of governments to protect domestic producers by using policy instruments such as offsets and price preferences. Its acceptance by all WTO Members would make government procurement in export markets more transparent and predictable.

- ***Arguments against:*** An agreement on transparency in government procurement should be resisted because it would inevitably lead to proposals for an agreement to liberalise access to government procurement markets. An agreement of the sort suggested by the proponents would go beyond the limits agreed in the Singapore and Doha Declarations because it would contain provisions not only relating to transparency aspects but also to market access. A legally binding agreement would be used as another excuse to impose sanctions on exports of developing countries. An agreement would require unnecessary government bureaucracy and involve a heavy administrative burden for procuring entities. Each additional WTO Agreement adds to the already heavy administrative burden of participation in the organisation.

The government of each developing country will make its decision on the subject in the light of its own individual situation and its own national priorities. For example, small developing countries that produce a very limited range of products and services may place less weight on the need to protect domestic production than countries with a more broad-based economy. Some developing countries may consider that they have less need to combat bribery and corruption than others. Each developing country may come down on one side of the debate or the other.

However, the fact remains that the main industrialised participants, with the USA and EU in the lead, have proposed the negotiation of an agreement on transparency in government procurement and the subject is on the WTO's work programme because they wanted it there. Developing countries are not the *demandeurs* in this area. The developing countries can, therefore, legitimately expect to receive benefits in other areas of the negotiations for any contribution that they make on transparency in government procurement.

It is also almost certainly true that even those governments of developing countries that actively favour the negotiation of an agreement on transparency in government procurement have a greater interest in other areas on the WTO agenda, such as agriculture, access to markets for non-agricultural goods, services, implementation issues, special and differential treatment, or the work programme on small economies.

It is therefore likely that all developing countries will wish to use their negotiating leverage to put forward proposals on the modalities of negotiations on transparency in government procurement designed to improve their negotiating position on other items on the Doha Agenda which of more interest to them.[19]

The Indian delegation has already suggested that developing countries need to study these four issues further and are, therefore, not in a position to agree to begin negotiations on them. The draft negotiating position of least developed countries for the Doha Round submitted to the Second LDC Trade Ministers' Meeting which took place 31 May–2 June 2003 in Dhaka, Bangladesh also suggested that 'studies need to be undertaken to understand the depth and breadth of any possible agreement [on transparency in government procurement] and how it would affect LDCs'.

It is therefore suggested that developing countries might propose in the General Council that the work done to date on the issue of transparency in government procurement has not yet provided an adequate basis for them to develop proposals for a decision on modalities of negotiations, and that the WTO fifth ministerial conference in Cancún should therefore instruct the working group to continue its work. If proponents of an agreement on transparency in government procurement point out that ministers agreed in Doha that WTO Members are committed to take a decision on modalities at Cancún, developing countries may recall that other target dates laid down in the Doha Declaration have been missed.

It is therefore suggested that all developing countries share an interest in making this proposal, but that they also need to prepare a fall-back position on modalities, to be used if and when horse-trading on the various elements of the work programme gets underway. If they do not do this they will not influence developments and risk being overtaken by events.

It is suggested that the modalities for the four Singapore subjects should not simply be considered together and accorded the same treatment, as at Doha, because they each have different implications for developing countries. This is the position taken

by a broad coalition of developing countries and China which, in a communication to the WTO of 6 June 2003, concluded that 'progress varies significantly across the four Singapore Subjects. Each issue should be treated on its own merits.'[20]

The EU proposal suggests that modalities on each of the Singapore subjects be considered under three main headings: procedural issues; scope and coverage of the negotiating agenda; and special and differential treatment – differentiation in commitments between WTO Members and differentiation in implementation periods, and provision of trade-related assistance. This is a step in the right direction in so far as it provides headings under which modalities for each of these subjects can be considered on their own merits. Another welcome feature is that it recognises that modalities should not only deal with procedural matters such as the number of meetings, timing and target dates for tabling proposals. This said, the discussions are likely to be difficult.

Most developing countries do not have the leverage necessary to participate actively and fully enough in the negotiations to influence their course once these are launched, or to stand in the way of a final agreement once this has been reached by the main participants. It is therefore necessary for them to protect their interests by building the necessary safeguards into the modalities from the outset of the negotiations. On the other hand, the proponents may be expected to argue that developing countries should not attempt to use the modalities for negotiations to determine the results of the negotiations themselves.

Developing countries will need to respond to the EU suggestion and to make suggestions of their own. These should be designed to safeguard their main interests. The following paragraphs make some suggestions in relation to each of the three headings in the EU's paper.

Procedural Issues

It is suggested that that the modalities should provide for a timetable for meetings and the tabling of proposals that is acceptable to delegations of developing countries.

Negotiating Agenda

It is suggested that the modalities should provide more explicitly than the Doha Declaration that a transparency agreement will not establish any disciplines on preferences embodied in laws and regulations, including offsets and price preferences. Offsets might be defined comprehensively as in footnote 1 to Article XVI:1 of the WTO Plurilateral Agreement on Government Procurement (which forbids their use by developed members of the agreement) as 'measures used to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements'.

The EU suggestion that thresholds should be examined is a move to be welcomed by governments concerned with the administrative burden created by an agreement as proposed by the proponents, particularly since some of the proponents have argued that a transparency agreement would not result in burdens warranting the use of thresholds such as already used in the Government Procurement Agreement.[21] Developing countries might therefore suggest that the provisions of an agreement relating to individual procurements should not apply to procurements below threshold values to be specified in the agreement.

The EU suggests that 'negotiations on a multilateral transparency agreement could comprise as a starting point the key issues elaborated in a comprehensive manner during the seven-year-long study phase of the working group and compiled in the chairman's check-list of issues'. This suggestion is open-ended since it calls for negotiations on the 12 issues 'as a starting point'. It is suggested that developing countries will need to argue that the modalities should not be open-ended but should define the issues to be negotiated in this area.

Not all developing countries will have the same position on this question.

The discussions in the working party have made it very clear that some developing countries do not consider that a WTO transparency agreement would be in their interest and would use discussions on the modalities of negotiation to reduce the scope of an agreement as far as possible. The main way of achieving this aim might be for them to propose that the modalities specify that the aim of the negotiations would be a non-binding agreement relating to goods (but not services) that placed obligations on central government bodies (but not state and local government bodies). They might, in addition, propose, for instance, that an agreement would not contain obligations on the use of limited tendering, the publication of decisions on qualification and tendering, and domestic review procedures.

Other developing countries have indicated that a suitable agreement would reinforce their own national transparency policies. It is suggested that the main concern of these countries might be to ensure that the modalities mandate negotiations of an agreement that would contribute effectively to these objectives without creating unacceptable administrative burdens. It is also suggested that they might seek an agreement that would provide additional benefits in the area of technical assistance and capacity-building. The following suggestions are made in this respect.

If an agreement is to achieve these aims, it is suggested that the modalities might provide that:

- An agreement would cover goods and services and at least procurement by central government entities and entities at the highest level of sub-central government. It is, however, suggested that in order to limit the administrative burden, local government procurement would not be covered;

- All phases of the procurement process for contracts above the agreed thresholds, including records of procurement proceedings, would need to be covered.[22] The modalities might specify that existing independent domestic administrative or judicial tribunals and review procedures would be accommodated;
- The notification provisions would be limited to notification of a list of procurement laws and regulations;
- An agreement would be legally-binding but resort to WTO dispute settlement would not be available to challenge a specific procurement and thus could not be used to overturn a contract award.[23]

Special and Differential Treatment for Developing Countries.

Three types of special and differential treatment might be proposed for inclusion in the modalities.

Differentiation of substantive commitments of developing countries and least developed countries

It is welcome that the EU suggestions on modalities,[24] unlike those of the USA,[25] recognise that provisions on special and differential treatment in a transparency agreement might not be limited to transitional periods, but that the substantive commitments of developing countries might also need differentiated from those of other WTO Members.

Any modalities might state that the substantive commitments of developing countries and least developed countries would, where appropriate, be differentiated from those of other WTO Members and that this point would be further developed when the content of the general rules becomes clearer. It is therefore suggested that at the present stage developing countries should aim to ensure that their interests are fully safeguarded under the general rules.

Differentiation in implementation periods

It is suggested that the modalities might lay down that provisions of a transparency agreement would come into force for developing countries and least developed countries after a transitional period, the length of which would be negotiated when the content of the general rules becomes clearer.

Technical Co-operation

It is suggested that the modalities might provide that obligations on the provision of relevant technical assistance to developing and least developed countries would be an integral part of any agreement.

The modalities might, in addition, state that an agreement would contain provisions under which individual developing and least developed Members would be entitled to an extension of the transitional period if an independent evaluation concludes that they require additional technical assistance to build the capacity to implement their obligations under an agreement and/or the capacity of suppliers in these countries to take advantage of the transparency provided by the agreement at home and abroad.

Examples of possible technical co-operation activities, based on suggestions made by delegations in the working group, are listed in an Annex to this paper.[26]

The modalities might also provide that an agreement would contain provisions ensuring that all relevant multilateral, regional and bilateral technical co-operation activities are co-ordinated to ensure maximum effectiveness and that information on these activities is made available to all interested parties.

Annex

Areas in which technical co-operation and support for capacity-building might be beneficial.

Development and improvement of national legislation and procedures

- Preparation and/or revision of national laws, regulations and procedures;
- Preparation of administrative guidelines, including procedures for the publication of tender notices and tender decisions, etc.;
- Identification of practical steps to make procurement user-friendly by developing standard forms for tender documentation.

Institution building

- Establishment of procurement agencies;
- Establishment and implementation of domestic review systems.

Training

- Training of officials responsible for implementing new legislation, procedures and/or practices;
- Training of officials in charge of enforcement including those of domestic review bodies;
- Training local trainers in, for example, business schools or colleges of public administration;
- Study tours.

Application of information technology

- Development of information technology tools (hardware, software and the expertise) which could be used to disseminate information about procurement opportunities and practices, and/or to establish full electronic tendering, as well as to facilitate the collection of relevant economic data and statistics;
- Provision of office information technology and/or other equipment necessary for the implementation and enforcement of legislation, procedures and/or practices.

Access to information, including establishment of enquiry points

- Establishment of enquiry points, including the means to provide information on national legislation and procedures to developing country suppliers;
- Establishment of internet websites, search engines and databases to help provide information about opportunities to do business with governments at home and abroad.
- Identification of ways in which suppliers in developing countries and small and medium-sized enterprises could benefit from transparency of procurement by government entities, including entities in developed countries;
- Technical advice and other experience-sharing activities, such as twinning between developed and developing country agencies.

Notes

1 GATT 1947, Articles III:8(a) and XVII:2.
2 GATT 1994, Articles III:8(a) and XVII:2. GATS, Article XIII.
3 Counting EU as one, still today only 13 out of the WTO's 145 Members are signatories to the GPA. It is nevertheless an important instrument. Its Members account for about 75 per cent of the total world trade and its coverage was increased ten-fold in negotiations among its Members held in parallel with the Uruguay Round.
4 USTR Annual Report on Discrimination in Procurement, Section III, 30 April 1996. See Google.com, cache of http://www.usembassy-israel.org.il/publish/press/trade/archive/may/et2_5-2.htm.
5 Ibid.
6 WTO document WT/WGTGP/W/6 of 14 October 1997: Synthesis of Information Available on Transparency-Related Provisions in Existing International Instruments on Government Procurement Procedures and on National Practices.
7 WTO document Job(99)/6728 of 12 November 1999: List of Issues Raised and Points Made.
8 WTO document WT/WGTGP/W/32 of 23 May 2002: Work of the Working Party on the Matters Related to Items I–V of the List of the Issues Raised and Points Made; and WTO document WT/WGTGP/W/33 of 3 October 2002: Work of the Working Party on the Matters Related to Items VI–XII of the List of Issues Raised and Points Made.
9 USTR, 2002 Trade Policy Agenda and 2001 Annual Report of the President of the United States on the Trade Agreement Programme, p. 4.
10 For an articulation of this fear see Martin Khor, *Government Procurement, the Real Aim of the Majors*, Third World Network.
11 WTO document WT/WGTGP/W/32.
12 Ibid.
13 WTO document WT/WGTGP/W/38
14 WTO document WT/WGTPG/W/35, paras 3 and 4.
15 International Centre for Trade and Sustainable Development (ICTSD), *BRIDGES Weekly Trade News Digest*, Vol. 7, No. 10.
16 'Singapore Issues, the Question of Modalities', Communication from the European Communities. WTO document WT/GC/W/491 of 27 February 2003.
17 Procurement under IBRD Loans and IDA Credits, worldbank.org/html/opr/procure/guideline.html
18 United Nations Commission on International Trade Law, Model Law on Procurement and Construction 1993, adopted by the United Nations General Assembly at its 49th Session, uncitral.org/english/texts/procurement/proc93.htm
19 The same logic applies with greater or lesser force to the three other subjects added to the WTO agenda at the Singapore Ministerial conference: the relation between trade and investment; the interaction between trade and competition policy; and trade facilitation.
20 Communication from Argentina, Bolivia, Botswana, Brazil, Chile, China, Colombia, Cuba, Dominican Republic, Ecuador, El Salvador, Gabon, Guatemala, Honduras, India, Malaysia, Mexico, Morocco, Nicaragua, Pakistan, Paraguay, Peru, Thailand, Uruguay, Venezuela and Zimbabwe. WTO document TN/C/W/13 of 6 June 2003.
21 WTO document WT/WGTGP/W/32, para. 18.
22 Items I to IX in the Chairman's list of points – I. Procurement Methods; II. Procurement Methods; III. Publication of Information on National Legislation and Procedures; IV. Information on Procurement Opportunities, Tendering and Qualification Procedures; V. Time-Periods; VI. Transparency of Decisions on Qualification; VII. Transparency of Decisions on Contract Awards; VIII. Domestic Review Procedures; IX. Other Matters Related to Transparency (defined as maintenance of records of proceedings, information technology and language).
23 As suggested by the USA in response to concerns expressed by developing countries such as Brazil in WTO document WT/WGTPG/W/38 of 31 January 2003, next to last paragraph.
24 WTO document WT/GC/W/491 of 27 February 2003, section 4.
25 WTO document WT/WGTPG/W/38 of 31 January 2003, next to last paragraph.
26 WTO documents Job(99)6782 of 12 November 1999 and WT/WGTGP/W/33 of 3 October 2002, para. 111.

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Investment on the WTO Agenda: A Developing Country Perspective and the Way Forward for the Cancún Ministerial Conference*

Nagesh Kumar

1 Introduction

Investment has emerged as the most contentious issue in the WTO negotiations. At the fourth ministerial conference of the WTO at Doha, the finalisation of the draft declaration was held up because of differences between the developed and developing countries on the investment issue, among others. The declaration was only adopted following the clarification by the Chairman of the ministerial council of the fact that the decision to launch it will be taken at the fifth ministerial meeting, subject to an explicit consensus on the desirability of the negotiations and not merely on the modalities of negotiations. In the light of this, the fifth ministerial meeting, scheduled to take place in September 2003 in Cancún, Mexico, will be of critical importance. The developed countries will seek a negotiating mandate at the conference. The developing countries will need to examine the various pros and cons of a multilateral framework of the type that the developed countries are seeking to put in place through multilateral trade negotiations for their process of development. They will also need to think about the form and content of a possible multilateral framework on investment, should a negotiating mandate be given by the ministerial conference.

Against this backdrop, this paper examines the relevance of a multilateral framework on investment from a developing country perspective in the light of the evidence available on the role of foreign direct investment in development. It also suggests policy options that developing countries might consider at the Cancún ministerial conference on the issues of trade and investment. It reflects on approaches which would make different elements of a possible multilateral framework on investment more pro-development and balanced, in case a negotiating mandate is unavoidable at Cancún.

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The structure of the paper is as follows: Section 2 summarises the broad trends and patterns in global FDI inflows and highlights the nature of the North–South dimension of this. Section 3 presents a brief review of the literature on the developmental impact of FDI on host economies and the role of host government policy. Section 4 examines the relevance of the multilateral framework on investment. Section 5 discusses the possible positions that developing countries could adopt at the Cancún ministerial conference, including a possible compromise of negotiating a multilateral framework outside the Single Undertaking of the GATT/WTO. Section 6 discusses the issues involved in incorporating the development dimension in different elements of a possible multilateral framework on investment negotiated outside or within the Single Undertaking of the GATT. Finally, Section 7 makes a few concluding remarks.

2 Trends and Patterns in FDI Inflows and the North–South Divide

FDI flows have expanded at an unprecedented rate during the 1990s, becoming the most visible and prominent manifestation of the increasing global integration of economic activity. Compared to the average annual growth of trade in goods and services of about 6–7 per cent in the 1990s, FDI inflows grew at an average annual rate of 20 per cent in 1991–95 and 32 per cent in 1996–2000 despite the economic crisis in some important regions of the world. As a result, the magnitude of global FDI inflows increased from US$159 billion in 1991 to US$1.27 trillion in 2000 (see Table 8.1).

Table 8.1: Global FDI Inflows by Broad Host Groups, 1991–2000 (US$ million)

Host region	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
World	158936	173761	218094	255988	331844	377516	473052	680082	865487	1270764
Industrialised Countries	114792	119692	138762	145135	205693	219789	275229	480638	636449	1005178
Developing Countries	41696	49625	73045	104920	111884	145030	178789	179481	207619	240167
% Share of Developing Countries	26.23	28.55	33.49	40.98	33.71	38.41	37.79	26.39	23.98	23.89
% Share of Developing Countries excl. China	24.15	23.65	23.89	32.01	25.68	31.08	31.37	21.33	20.26	16.21
Least Developed Countries	1830	1459	1743	1168	2001	2394	2524	3715	4527	4414
% Share of LDCs	1.15	0.83	0.79	0.45	0.60	0.63	0.53	0.54	0.52	0.34

Source: UNCTAD data

To a large extent, the recent growth of FDI flows has been fuelled by cross-border mergers and acquisitions in North America and Europe as part of ongoing wave of

industrial restructuring and consolidation. However, FDI has become an increasingly important channel of market servicing as a part of the trend of globalisation. Table 8.2 shows that sales of foreign affiliates of corporations were roughly of the same order ($2 trillion) as world exports in 1982. By 2000, sales of affiliates had grown to more than twice the volume of world exports at $ 15.7 trillion, compared to world exports of $7 trillion.

Table 8.2: Relative Importance of FDI and Exports as Means of Market Servicing (US$ billion)

	1982	1990	2000
Sales of Foreign Affiliates	2465	5467	15680
Exports of Goods and Non-factor Services	2124	4381	7036

Source: UNCTAD, World Investment Reports

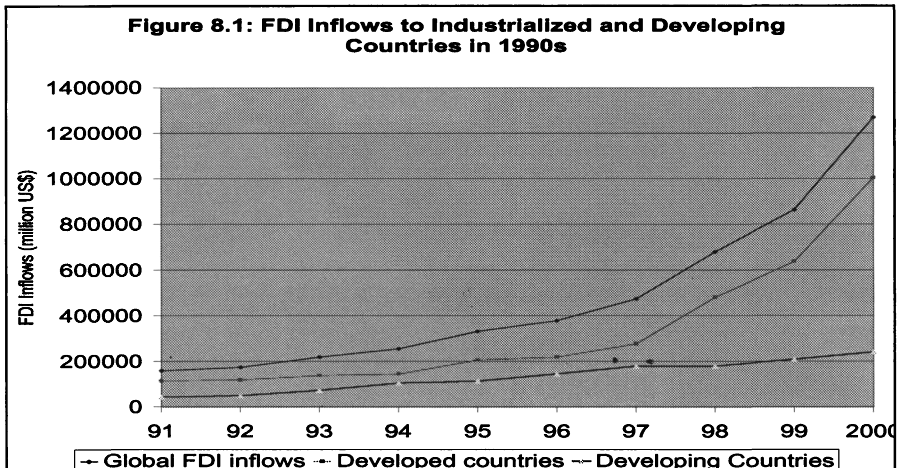
The bulk of FDI flows originate in developed countries and developing countries are on the receiving end most of the time. The top ten industrially and technologically most advanced countries account for as much as 74 per cent of FDI outflows (Kumar, 1998b). So the North–South divide is quite prominent in the case of investment.

The North–South divide is apparent in the positions adopted by developed countries at international negotiations concerning investment. Keeping in mind the increasing importance of FDI as a channel for servicing markets, a favourable international framework for FDI is seen by developed countries as furthering their commercial interests and national competitiveness. Therefore, developed country governments identify themselves with the investors and have tended to protect their interests at these negotiations. As a part of this, in the 1980s developed countries resisted initiatives of the UN system to promote codes of conduct which would be binding on corporations and have, on the other hand, been seeking to evolve an international regime guaranteeing unfettered movement for their corporations through multilateral trade negotiations.

FDI Inflows in Developing Countries

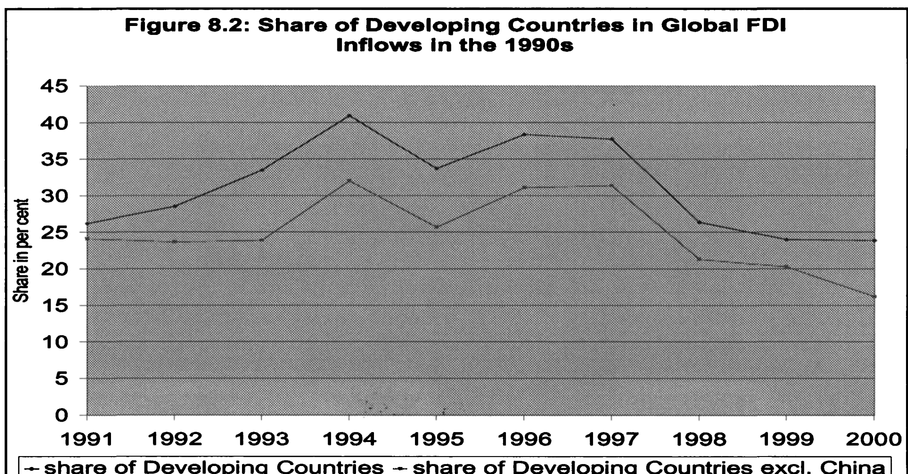
FDI inflows are expected to be less volatile and non-debt creating. They are also expected to be accompanied by a number of other assets that are valuable for development, such as technology, organisational skills and sometimes even market access, among others. Hence, most countries – developed as well as developing – compete among themselves to attract FDI inflows with increasingly liberal policy regimes and incentive packages. However, the expansion of the magnitude of FDI over the 1990s has benefited only a handful of developing countries, as is clear from the following summary of emerging trends and patterns.

FDI inflows received by developing countries expanded from less than US$42 billion in 1991 to $240 billion in 2000. The growth of FDI inflows in developing countries seems to have been slower than that of global inflows, especially in the late 1990s (see Figure 8.1).



Source: based on Table 8.1

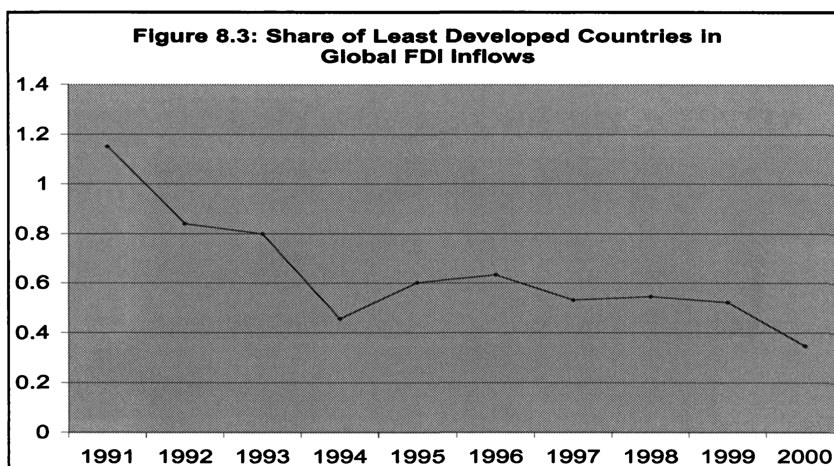
The share of developing countries in FDI inflows rose sharply during the early 1990s from 26 per cent in 1991 to over 40 per cent in 1994. Since then it has steadily declined to below 24 per cent in 2000 (see Figure 8.2). The sharp rise in the share of developing countries in the early 1990s was largely owing to the emergence of China as the most important host of FDI in the developing world.



Source: based on Table 8.1

Growing Marginalisation of Poorer Countries

The shares of different regions also tend to mask the inter-country variations in relative importance as hosts of FDI. FDI inflows are highly concentrated in a handful of high and middle-income countries. Low-income and least developed countries remain marginalised in the distribution of FDI inflows. The share of 45 least developed countries as a group in global FDI inflows is negligible at 0.35 per cent and shows a declining trend over the 1991–2000 period (see Figure 8.3). Just ten most important hosts of FDI among developing countries account for over 80 per cent of all inflows received by developing countries in 1999. The concentration in the top ten recipients has increased from 66 per cent in the mid-1980s to over 80 per cent in the late 1990s.



Source: based on Table 8.1

The findings of empirical studies of the determinants of FDI inflows across countries suggest that these flows are driven by factors like country size, level of income or development, extent of urbanisation and availability of infrastructure, together with geographical and cultural proximity to home countries. Hence, relatively smaller, poorer and agrarian countries have limitations in tapping the resources of multinational enterprises (MNEs) for their industrialisation with policy liberalisation or through investment agreements as will be seen later (Kumar, 2002).

3 Developmental Impact of FDI on the Host Economies: A Selective Review of the Literature

FDI usually flows as a bundle of resources including, besides capital, production technology, organisational and managerial skills, marketing know-how and even market access through the marketing networks of multinational enterprises who undertake FDI. These skills tend to spill over to domestic enterprises in the host country.

Therefore, FDI can be expected to make a more than proportionate contribution to growth compared to domestic investment in the host country. There is now a body of literature that has analysed the effect of FDI on growth in an inter-country framework and another analysing knowledge spill-overs to domestic enterprises from MNEs (see, for example, De Melo, 1997; Kumar and Siddharthan, 1997; and Saggi, 2000 for recent reviews of the literature). However, the mixed findings reached by these studies on the role of FDI inflows in host country growth and on knowledge spill-overs from MNEs suggest that these relationships are not unequivocal. The primary consideration for expecting a more favourable effect of FDI on growth is externalities of MNE entry for domestic firms. The externalities, such as spill-overs, may not take place in some cases because of poor linkages with domestic enterprises or poor absorptive capacity. FDI projects vary in terms of generation of linkages for domestic enterprises. There is also a possibility of MNE entry affecting domestic enterprises adversely, given the market power of their proprietary assets such as superior technology, appeal of brand names and aggressive marketing techniques. Therefore, FDI may crowd out domestic investment and may thus be immiserising. Fry (1992), for instance, found FDI to have a significant negative effect on domestic investment and to be crowding it out. This effect varies across countries; in the Pacific basin countries FDI seems to have crowded-in domestic investment. Similarly, Agosin and Mayer (2000), analysing the effect of FDI inflows on investment rates in host countries over the period 1970–95, found that FDI crowds in domestic investment in Asian countries, crowds it out in Latin American countries, while in Africa the relationship is neutral. Evidence is also available on the adverse effect of foreign ownership on the productivity of domestic enterprises in developing countries.[1] A recent G-24 Working Paper by Gordon Hanson published by UNCTAD has also highlighted cases where FDI may have lowered host country welfare. A recent study by Maria Carkovic and Ross Levin of the University of Minnesota has found that FDI has no independent influence on the economic growth of host countries. Kumar and Pradhan (2002), in a recent quantitative study covering a sample of 107 developing countries in the 1980–99 period, corroborate that FDI appears to crowd out domestic investments in net terms in general, although some countries have experienced a favourable effect of FDI on domestic investments in net terms, suggesting a role for host country policies. They inferred, therefore, that policy flexibility is important for developing countries in benefiting from FDI.

Role of Government Policy and Performance Requirements: Experiences and Evidence

It is clear that the effect of FDI on domestic investments and growth depends very much on the nature or quality of the FDI. Certain types of FDI tend to have more favourable developmental externalities than others. In this context attention needs to paid by host countries to the quality of FDI inflows as well as to attracting greater

magnitudes of FDI. Recent work has shown that host country policies have an important bearing on the quality of FDI inflows received (Kumar, 2002). Governments have employed various measures to improve the overall quality of FDI inflows, including selective policies to target more desirable FDI inflows. East Asian countries like South Korea have, in the past, pushed FDI into high technology and export-oriented sectors with various policy instruments.

Many governments, in developed as well as developing countries, have imposed performance regulations to improve FDI quality. These include local content requirements on MNEs to intensify generation of local linkages or export obligations for expanding the contribution of FDI to expansion of manufactured exports of developing countries. The evidence available shows that developed countries used these performance requirements extensively until recently and continue to use them in different forms even now. The evidence suggests that these requirements have been generally effective in achieving their goals (see Kumar, 2003, for evidence from developed and developing countries). Different host governments have also used protectionist policies to encourage the tariff-jumping type of FDI inflows (see Caves, 1996 for a review of evidence). More recently, industrialised countries in the EU, for example, have used protectionist measures such as voluntary export restraints (VERs), quotas, screwdriver regulations, rules of origin and various anti-dumping measures to encourage foreign-based MNEs, especially from Japan, to increase the domestic content in their sales (Belderbos, 1997; Moran, 1998). Stringent rules of origin have also been adopted as a part of the North American Free Trade Agreement (NAFTA) to increase the domestic content of foreign enterprises' sales in the trade bloc. Some have employed incentives such as pioneer industry programmes to attract FDI in industries that have the potential to generate more favourable externalities for domestic investment (see UNCTAD, 1999, 2001, for examples). Similarly, because MNE entry through acquisition of domestic enterprises is likely to generate less favourable externalities for domestic investment than greenfield investments, some governments discourage acquisitions by foreign enterprises (Agosin and Mayer, 2000).

Another sphere where government intervention may be required to maximise gains from globalisation is in diffusion of knowledge brought in by foreign enterprises. An important channel of diffusion of knowledge brought in by MNEs in the host economy is vertical inter-firm linkages with domestic enterprises. The host governments could consider employing proactive measures that encourage foreign and local firms to deepen their local content as a number of countries, for example Singapore, Taiwan, Korea and Ireland, have done successfully (Battat *et al.*, 1996). The knowledge diffusion could also be accomplished by creating sub-national or sub-regional clusters of inter-related activities which facilitate spill-overs of knowledge through informal and social contacts among employees besides traditional buyer-seller links.

To sum up, FDI inflows may have widely diverging developmental effects on their

host countries, ranging from a highly favourable impact by bringing and diffusing new technologies and market access, besides the creation of output and jobs, to crowding out domestic investments and hence immiserising host economies. The literature emphasises the critical role played by host government policies, such as screening mechanisms and performance requirements, in maximising the contribution of FDI to their development and minimising negative effects. It follows from this that any attempt to curtail the policy space available to host governments for regulation of FDI is likely to have a bearing on the quality of the FDI.

4 Relevance of a Multilateral Framework on Investment: A Developing Country Perspective

As observed earlier, developed countries have constantly strived to secure more favourable conditions for investment by their enterprises worldwide by seeking liberalisation of investment regimes through bilateral and multilateral negotiations, given the North–South divide on the investment issue. They have resisted the attempts of developing countries to evolve binding codes of conduct for MNEs within the UNCTC and UNCTAD framework. Furthermore, they have strategically used multilateral trade negotiations to create a more favourable framework for FDI worldwide even though investment is more a development than a trade issue. Thus, despite the resistance of developing countries, the Final Act of the Uruguay Round included an Agreement on Trade Related Investment Measures. The TRIMs Agreement requires member countries to phase out performance requirements relating to trade, such as local content requirements and foreign exchange neutrality. The GATS provided a framework for liberalisation of trade in services including through cross-border commercial presence which is akin to FDI.

The TRIMs Agreement also provided for a review within five years of the operation of the Agreement and to 'consider whether the Agreement should be complemented with provisions on investment policy and competition policy'. However, without waiting for the mandated review of TRIMs, developed countries attempted to widen the scope of the multilateral regime on investment beyond what is covered in the agreements on TRIMs and GATS. One such attempt was the initiative to establish a Multilateral Agreement (MAI) under the aegis of OECD which was launched in 1995. The OECD negotiations on the MAI, however, could not be successfully concluded and were abandoned in 1998. The MAI negotiations failed because of the failure of OECD members to reach a consensus on the issue. However, even before the experience of MAI negotiations in OECD, an attempt was made to put the investment issue onto the WTO agenda at the first ministerial conference in Singapore, where the EU and Canada proposed the creation of a possible Multilateral Framework on Investment (MFI) under the auspices of the WTO. However, given the resistance of developing countries, a negotiating mandate could not be obtained; instead, a Working

Group on Trade and Investment was set up within the WTO to study the issue without a negotiating mandate.[2] Before the WGTI's study process could conclude its work and recommend the desirability, if any, of a MFI within WTO's ambit, the EU, with the support of other industrialised countries, pushed the investment issue for negotiation at the fourth ministerial conference of WTO held in Doha in November 2001. Despite the resistance of developing countries, who wanted to first complete the study process at the WGTI before agreeing to a negotiating mandate, the Doha Declaration provided for launch of negotiations on trade and investment after the fifth ministerial conference 'on the basis of a decision taken, by explicit consensus, at that session on the modalities of negotiations'.[3]

There is some ambiguity in the Doha mandate as to whether an explicit consensus will be needed to decide whether or not to launch the negotiations or whether explicit consensus is only required for deciding the modalities of negotiations, as discussed in the following section. A basic question before entering into any negotiation on an MFI is to determine to what extent there is a need for a new multilateral instrument on investment, and what its costs and benefits may be for developing country members. Against that backdrop, this paper assesses the relevance of MFI from a developing country perspective.

A GATT-type Framework on Investment Has No Conceptual Relevance

The attempt of developed countries to extend a GATT-type regime to investment based on national treatment and MFN is clearly misconceived conceptually, as well as in practice. There is a conceptual basis for trade liberalisation on the principle of comparative advantage where countries with different comparative advantages benefit from trading mutually. So developing countries trade their labour and raw material intensive goods with more knowledge and capital intensive goods produced by developed countries. On the other hand, FDI flows emerge because of differences in the levels of development and bundles of created assets. Indeed, international firm theory explains the evolution of a national firm into an international corporation in terms of monopolistic ownership of intangible assets that have revenue productivity abroad and which more than offsets the disadvantages of operating in an alien environment. These advantages include proprietary technology, globally known brand names, access to cheaper sources of capital and accumulated experience of organising complex tasks.[4] From the start, therefore, MNE entrants enjoy an edge over local enterprises, if there are any, because of their monopolistic ownership advantages. The margin of the edge enjoyed by them is inversely related to the extent of development of local industrial capabilities and hence the level of development. It is particularly wide in low-income countries. It is no accident that 90 per cent of the global FDI stock is owned by the industrialised countries, with developing countries nearly always playing the role of host country for FDI flows.

Therefore, in contrast to the argument of the proponents of MFI, the *playing field is*

already tilted in favour of MNEs. When they enter a country MNEs are already far ahead of domestic enterprises in the potential host country; this is especially so in developing countries because of MNEs' monopolistic ownership of unique assets. Offering national treatment to foreign enterprises and domestic enterprises would amount to discriminating against the latter. In most developing countries, the little local entrepreneurship that exists runs the risk of vanishing altogether if it is forced to compete with mighty global corporations under 'national treatment'.[5]

WTO Lacks Competence in Handling Investment

The inclusion of investment on the WTO agenda has also been justified on the grounds of the trade relatedness of investment. However, the trade-investment link, other than what is covered under TRIMs, is by no means straightforward. The bulk of FDI flows continue to be of a market-seeking (or tariff-jumping) type and actually substitute for trade. Therefore, after taking care of possible trade-distorting investment policies under the TRIMs Agreement, there is very little justification for including a full-fledged investment agreement in the multilateral 'trade' negotiations. FDI, like domestic investment, is a development and industrialisation issue rather than a trade issue. Bringing it onto the WTO agenda would unnecessarily divert the attention of the WTO from its main purpose, i.e. trade liberalisation. The WTO also does not have competence to deal with the investment and development issue. This is clear from the fact that the Working Group on Trade and Investment set up as by the Singapore Meeting in 1996 has so far been unable to complete its work.

FDI Policy Needs to be Tuned to the Level of Development

It has been shown in the literature that countries at different levels of development receive different types of FDI (Porter, 1990; Ozawa, 1992). For instance, a country at the beginning of the factor-driven stage will attract resource-seeking or labour-seeking inward FDI and investments in capital and intermediate goods industries in subsequent stages. Naturally, the need for a policy framework dealing with FDI depends upon the level of development. The one-size-fits-all approach to FDI policy inherent in the idea of the MFI in the WTO cannot serve the best interests of countries which are at different levels of development.

The Developmental Impact of FDI Depends on Host Country Policies

The evidence presented in Section 3 has shown that host government policies have played an important role in extracting benefits from FDI in developed and developing countries. The countries that pursued selective policies with respect to FDI, for instance, South Korea, Taiwan and China, among other south-east Asian nations – for instance, in channelling FDI into export-oriented and high-technology activities – have had a greater success in achieving their developmental objectives with FDI

inflow than those which pursued more open policies, such as some Latin American countries. A multilateral regime takes away the ability of host governments to direct FDI in accordance with their development policy objectives and the overall 'quality' of any FDI inflows received is likely to suffer.

MFI is Unlikely to Expand the Magnitude of FDI Inflows

Proponents of a GATT-type MFI argue that such a framework would help developing countries to increase their attractiveness to foreign investors. However, as numerous empirical studies have shown, FDI inflows are largely driven by gravity factors such as market size, income levels, the extent of urbanisation, geographical and cultural proximity to the major source countries of FDI and the quality of infrastructure. Policy factors play a relatively minor role at the margin, holding gravity factors constant (Contractor, 1990; Wheeler and Mody, 1992; Kumar, 2000a). After harmonisation of policy regimes across the world as proposed, the concentration of FDI in the industrialised countries may increase further. The irrelevance of government policy regimes as a determinant of FDI inflows is clear from the fact that many African countries that have liberalised their FDI policy as a part of structural adjustment programmes administered by the IMF and the World Bank during the 1980s have failed to receive any significant FDI inflows. As observed earlier, the share of the 45 least developed countries in the global distribution of FDI inflows has actually declined from 0.8 per cent in the early 1990s to 0.34 per cent in 2000. On the other hand, some countries which have a much more restrictive policy framework are able to attract sizeable inflows, for example China, which attracts over $40 billion worth of FDI inflows every year. Despite the fact that the USA and China do not even have a bilateral investment treaty, the USA is the most important source of FDI in China. The same is the case in Brazil. Therefore an MFI is unlikely to make any difference to the level of FDI inflows, while it has the potential to affect their quality.

No Symmetry between the Rights and Responsibilities of Foreign Investors is Proposed

Proponents of an MFI seek to protect only the rights of investors or corporations. Nothing is being proposed in terms of their obligations and responsibilities, and there are no provisions concerning protection of host country interests. FDI flows are generally undertaken by MNEs that command enormous resources and power as as a result of their gigantic and global scales of operation which are larger than the economies of many of the countries they operate in and which are growing faster than the size of many of these economies, as shown by UNCTAD's 2000 *World Investment Report*. This enormous power can be misused to pursue restrictive business practices.[6] Recognition of concerns about possible misuse of this power in private hands led the international community to launch several initiatives at the international level to curb it, such as

the United Nations Code of Conduct on TNCs in the 1970s that was also resisted by developed countries (Correa and Kumar, 2003). The glaring lack of a binding international regulation of the activities of international corporations has often been noted in the past decade. The Bhopal tragedy, where the MNC concerned sought to shirk the liability arising from the actions of its majority-owned subsidiary is a case in point. The practice of manipulation of transfer prices to shift funds across countries to evade taxes is also well-known. Furthermore, while there are attempts to curb the ability of host governments to impose performance obligations, the ability of corporations to impose restrictive clauses on their subsidiaries that are often trade distorting goes unregulated. According to Bergsten and Graham (1992), an 'ideal accord would grant specific rights to, and simultaneously place certain obligations on, three sets of actors: (a) governments of nations that are host to FDI (including sub-national governmental entities); (b) governments of nations that are home to international corporations; and (c) international corporations themselves'.

Adequate Frameworks for Investment Protection and Dispute Settlement Exist

A general impression that is created by the protagonists is that an adequate framework for protection of investment and dispute settlement does not exist. This impression is completely flawed. There exists an elaborate framework for investment protection and dispute settlement at the bilateral as well as at multilateral levels. There is an extensive network of bilateral investment promotion and protection agreements or treaties (BIPAs or BITs) between different pairs of countries. By the end of 2001, 2096 such treaties had been signed by 174 countries. The bulk of these treaties were signed during the 1990s following the rapid growth of FDI flows. As many as 31 per cent of the treaties have been concluded between developed and developing countries and 45 per cent between developing countries.[7] Typically, these BITs provide protection and national treatment for investments that have been established in tune with the existing national regulations and policies. Hence, they provide flexibility to host countries to pursue their development policy, while at the same time giving a sense of security to foreign investors. It is much easier to conclude BITs than to establish a multilateral framework, as is clear from the fact that the OECD's negotiations for an MAI could not be concluded even though all the negotiating parties were developed countries.

Furthermore, multilateral instruments for protection and guarantee of international investments do exist. They include the Multilateral Investment Guarantee Agency (MIGA) under the World Bank which came into being in 1988. The International Convention of Settlement of Investment Disputes (ICSID) also falls under the aegis of the World Bank and has provided a framework for dispute settlement since the mid-1960s. Other such bodies are the UN Committee on International Trade Law (UNCITRAL) and the International Chamber of Commerce (ICC) (Correa and Kumar, 2003).

Finally, contrary to the general impression created by the proponents of an MFI, bilateral investment treaties would still be needed, even with a multilateral agreement, just as the presence of GATT in trade in goods has not removed the need for bilateral trade agreements.

No Reciprocity with Labour Mobility

Capital and labour are two mobile factors of production. The proposed framework on investment proposes to liberalise capital movements without providing for labour mobility and hence would create asymmetry. The economic arguments for free movement of labour are no weaker than those for free movement of capital (Hoekman and Saggi, 2000). As Panagariya (2000) argues, 'symmetry dictates that alongside investment agreement, there also be an agreement on the movement of natural persons. Since the current ethos is unlikely to permit the inclusion of such proposals into the negotiating agenda, there is no reason for inclusion of investment into the agenda either.' Regional blocs such as the EU and NAFTA that provide for free capital movement between member states generally also provide for labour mobility.

Evidence of the reluctance of developed countries to liberalise labour mobility is clear from the lack of commitments made by them in respect of Mode 4 in the GATS that covers movement of natural persons. Almost all of the market access commitments made by developed countries are subject to limitations such as an economic needs test or restricted to a specified proportion of the work force. Similarly, 83 per cent of commitments in respect of national treatment made by developed countries are also subject to limitations such as tax treatment or other discriminating treatment that is sometimes non-transparent. This situation prevails notwithstanding Article IV.1(c) of GATS, which covers 'the liberalisation of market access in sectors and modes of supply of export interest' to developing countries' (RIS, 2002). The restrictions on movement of natural persons across regions impose a cost on developed and developing economies far exceeding that of trade restrictions on goods. Winters *et al.* (2002) have estimated in the framework of a CGE model that an increase in developed countries' quotas for both skilled and unskilled temporary workers equivalent to just 3 per cent of their labour force would lead to over US$150 billion of welfare gains for developed and developing economies.

5 The Way forward for the Cancún Ministerial Conference

We have reviewed above the merit of various arguments in favour of a GATT-type multilateral framework on investment. It is clear that an MFI is justified on neither conceptual or policy grounds. The reduced flexibility to regulate FDI inflows in tune with their development policy objectives resulting from agreeing to a multilateral framework could lead to considerable loss of welfare in developing countries. While

the proposed MFI would reduce the policy space available to developing countries, it does not offer them anything in return. Neither they can expect more inflows of FDI nor any reciprocity in other sectors such as labour mobility. In view of this, developing countries resisted a negotiating mandate on investment at the Doha ministerial conference. However, developed countries, and especially the European Union, strongly pushed for a negotiating mandate. The final Doha Declaration provides as –follows:

> Relationship between trade and investment
> 20. Recognising the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade, and the need for enhanced technical assistance and capacity-building in this area as referred to in paragraph 21, *we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations*[8] (emphasis added).

Although the language of the Declaration talks of the need for a consensus on the modalities of negotiations, the Chairman's understanding and clarification that enabled the adoption of the Declaration at the Doha Ministerial suggests that the negotiating mandate would itself be subject to an explicit consensus:

> I would like to note that some delegations have requested clarification concerning paragraphs 20 ... of the draft declaration. Let me say that *with respect to the reference to an 'explicit consensus'* being needed, in these paragraphs, for a decision to be taken at the Fifth Session of the Ministerial Conference, *my understanding is that, at that session, a decision would indeed need to be taken by explicit consensus, before negotiations on trade and investment ... could proceed.*
>
> In my view, this would also give *each member the right to take a position on modalities that would prevent negotiations from proceeding after the Fifth Session* of the Ministerial Conference until that member is prepared to join in an explicit consensus (emphasis added).
>
> H. E. Youssef Hussain Kamal, Qatari Finance, Economy and Trade Minister, Chairman of Doha Ministerial Conference at the closing plenary session, 14 November 2001[9]

Going by the Chairman's understanding, the negotiating mandate on investment is yet to be obtained at the fifth ministerial conference scheduled to be held in Cancún in September 2003. In light of that, this section reviews the various options that developing countries can consider at the Cancún Ministerial in September 2003.

In the context of the Doha Mandate, developing countries have four possible options:

Most Preferred Option: Resist a Negotiating Mandate at Cancún

Keeping in mind the Chairman's clarification, it is still possible to resist a negotiating mandate on investment. For this to happen, a coalition of developing countries would be of critical importance. Developing countries will have to argue their case effectively. They could also draw attention to the practical problems involved in arriving at a consensus on the subject in the light of the OECD's MAI experience when a relatively homogeneous group of 29 OECD Member States failed to arrive at a consensus even after negotiations lasting over three years. Another attempt to evolve a multilateral framework on investment, the UN Code of Conduct on TNCs, similarly could not be concluded successfully, despite protracted negotiations lasting from 1977 to 1992. In a forum like the WTO, whose membership covers the entire spectrum of high-income, middle-income, low-income and least developed countries, the possibility of arriving at a consensus would appear to be abysmally low. The potential cost in terms of world development and welfare could be substantial, while the promise of gains is negligible. Instead, developing countries could seek a review of the reasons for the failure of the OECD's MAI and the lessons learnt from that experience as a part of the ongoing study process launched at the Singapore ministerial conference in the form of WGTI. This option would be by far the most desirable from a developing country point of view. But it would also be the most challenging to achieve given the developed countries' serious pursuit of an MFI. Yet it could be feasible, depending on the ability of developing countries to form a coalition on the issue.[10]

A Compromise Solution: A Multilateral Treaty on Investment Negotiated Outside the WTO

If developed countries persist with their demand for an MFI, a compromise solution could be a multilateral treaty on investment negotiated outside the Single Undertaking of the WTO. The objective of proponents of an MFI is 'to secure transparent, stable and predictable conditions' for cross-border investments, particularly FDI, that can be well served by a free-standing independent multilateral treaty on investment negotiated within the UN framework like many other international treaties, such as a the Law of the Sea, that have served their purpose well. An independent Multilateral Investment Treaty (MIT) could be modelled in large part on the Bilateral Investment Promotion and Protection Treaties (BIPAs) that provide protection for investments approved under the existing policies. It could also contain provisions on the obligations of investors among other provisions that are considered necessary. It could link itself with the existing institutional infrastructure on investment protection and settlement of investment disputes in the framework of ICSID, UNCITRAL, ICC and MIGA. Developing countries could argue that the WTO does not have the necessary expertise to deal with investment, which is a subject dealt by finance or industry ministries, rather than by trade diplomats. UNCTAD would probably be a more appropri-

ate forum, as it has inherited the UN Commission on TNCs. UNCTAD is also well placed to put a development dimension at the core of an MIT.

If there is an agreement to negotiate a treaty on investment outside the WTO, one alternative could be to resurrect the draft UN Code of Conduct on TNCs which could be adopted with minor amendments. The draft UN Code was negotiated in protracted negotiations over the 1977–1992 period. The draft code represents a balanced approach to a multilateral framework, setting out rights and obligations of investors and host governments (Correa and Kumar, 2003). The draft Code could not be adopted because of differences between developed and developing countries on its legal status and was abandoned in 1992. In view of the fact that considerable negotiating effort was spent in refining its different elements, its balanced treatment of host country, home country and investor interests, and its ability to provide a stable, predictable and transparent framework for FDI, it would serve the objective of both developed and developing countries very ably. It was negotiated within the negotiating platform of the UN Commission on TNCs which is currently serviced by UNCTAD. UNCTAD has the capability to provide a Secretariat for the Code and to service its implementation, given its work on investment.

The Last Resort: Negotiating a Development-friendly Multilateral Framework in the WTO

If a negotiating mandate on investment is unavoidable at the Cancún ministerial conference, then developing countries have to ensure that the framework contains adequate development provisions so that their development process is not disrupted and sufficient flexibility to pursue their developmental policy objectives is retained. This will be a big challenge and must be responded to by proactive preparation by the developing country negotiators in evolving a development-friendly MFI draft. In such a draft each and every element will have to be defined in such a manner that the concerns of developing countries are kept in mind. Some reflections on this are discussed in the following section.

6 Incorporating a 'Development Dimension' in a Possible MFI

If it is decided to negotiate a multilateral framework on investment within or outside the Single Undertaking, developing countries would have to reflect on different elements of such a framework from their perspective, including scope and definition, transparency, non-discrimination (national treatment and MFN) and development provisions. A basic consideration in the analysis that follows is the incorporation throughout a possible MFI of a 'developmental dimension'. Under this concept, the effects on development of various obligations should be systematically assessed in order to ensure that the overall impact of a possible agreement on development is pos-

itive, and that obligations with a likely negative effect are excluded or minimised. The Doha Declaration places heavy emphasis on the development provisions in Para 22 as follows:

> 22. In the period until the Fifth Session, further work in the Working Group on the Relationship Between Trade and Investment will focus on the clarification of: scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-*type, positive list approach; development provisions; exceptions and balance-of-payments safeguards*; consultation and the settlement of disputes between members. Any framework should reflect *in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to* regulate in the public interest. The special development, trade and financial needs of developing and least developed countries should be taken into account as an integral part of any framework, which should enable members to undertake obligations and commitments commensurate with their individual needs and circumstances. ... (emphasis added).[11]

The challenge, therefore, before developing countries is to define different elements of an MFI in such a manner that their developmental concerns are taken care of. Given the different impact that an MFI may have on developed and developing countries, an MFI should allow for differential treatment with regard to developing countries (and LDCs), as generally permitted under GATT/WTO Agreements.

A crucial point in the negotiation of an MFI is how to achieve a balance between rights and obligations. In other words, a MFI should not only contain a set of restrictions on Members' policies, but it should also spell out clearly the obligations of investors. Most importantly, developing countries should retain flexibility in pursuing selective policies in tune with their development policy objectives and impose performance requirements on foreign investors.

Some considerations for designing a development-friendly framework are as follows:

Scope and Definition

It is important to clarify the implications of different criteria adopted for scope and definition from the perspective of host and home countries. Adoption of a broad scope and definition has obvious problems. For instance, a broad assets-based definition and all-encompassing sectoral coverage would limit governments' ability to regulate financial flows and manage financial crises. Given the frequency of crises in various parts of the world, international financial institutions such as the World Bank are advising caution on the part of the governments with respect to capital account liberalisation.[12]

Past experience suggests that if investment agreements have a broad and general scope, they are not able to keep in mind the specific conditions and interests of different countries. Hence there is need for exceptions. The experience of OECD's Multilateral Agreement on Investment is illustrative in this context as it had to be annexed with several hundred exceptions, despite the fact that the contracting parties were all highly developed OECD member countries. Although bilateral investment treaties adopt broad assets-based definitions, their scope is limited to investments undertaken in accordance with national laws and policies and their purpose is essentially protection. Similarly, investment treaties negotiated within regional integration arrangements (RIAs) such as EU and NAFTA are also generally broad in their coverage. However, the treatment accorded under these treaties is given on a discriminatory basis to the member states in the RIA only and these RIAs invariably cover mobility of all the goods and factors of production such as labour and capital.

Considerations for defining the Scope and Coverage of the Framework from a Development Perspective:

i) Restrict the Scope to FDI

In the present context, it is important to keep in mind the mandate of the Doha Declaration that suggests, in paragraph 20, that the focus is on 'long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade'. Thus the mandate clearly limits the scope of the possible MFI to 'long-term cross-border investments particularly foreign direct investments'. It is important to focus on FDI because these are essentially long-term in nature. In the WGTI meetings, Japan was one of the countries that argued for the need to restrict the scope of MFI to FDI.[13]

ii) Majority Ownership is the Only Objective Criteria for Defining FDI

FDI is distinguished from foreign portfolio investments in that ownership is accompanied by management control. Therefore, there is a need to define a threshold of equity ownership that ensures management control and hence can be used to distinguish FDI from all other types of foreign investment. Different levels of equity ownership are used in different countries for defining a controlling stake. For example, the IMF considers 10 per cent equity ownership to be adequate for exercising control, some institutions (for example the Reserve Bank of India) use 25 per cent ownership as sufficient and in some countries the figure is set at 33 per cent. However, all these criteria are arbitrary in nature. Indeed, the proportion of ownership necessary for exercising effective control over an enterprise depends on how the rest of the share holding is dispersed. Majority ownership is the only objectively defined threshold because only the majority shareholder is able to take all the important decisions. Hence, majority ownership could be employed to define FDI. GATS, CARICOM and the

Statute of a 'European Company' have adopted the majority ownership rule in their definitions of a controlling stake.[14]

iii) Limit the Coverage to Export-oriented FDI that Contributes to Trade Expansion
Furthermore, the Doha Declaration focuses on 'foreign direct investment that will contribute to the expansion of trade'. Clearly, the focus is on investments that contribute to the expansion of trade and eventually to development, rather than on all cross-border investments. There are certain types of foreign direct investments that contribute to trade expansion more than other investments. While the bulk of foreign direct investment flows continues essentially to be seeking the domestic markets in the host countries and generally substitute trade, export-platform investments undertaken by multinational enterprises as a part of their restructuring of production according to international differences in factor costs have contributed significantly to the expansion of world trade over the past three decades. Export-oriented foreign direct investments have helped the east and south-east Asian countries to rapidly build their manufacturing export capabilities. Therefore, these investments can contribute to the expansion of trade as well as expediting the development of the host countries. The literature suggests that export-oriented foreign direct investment is a special type of foreign direct investment and is determined by different factors (Kumar, 1994; 1998). Therefore, in view of the language of paragraph 22 of the Doha Declaration, it is worthwhile to argue a case for limiting the scope of possible MFI to export-oriented FDI and not all cross-border investments.

iv) Limit the Coverage to Greenfield Investments that contribute to growth
FDI's developmental impact on the host country also depends on whether it takes the form of a greenfield investment or acquisition of an existing enterprise (Brownfield). UNCTAD's studies suggest that 'the potential of an adverse effect is greater in the case or M & As than in the case of greenfield investment'.[15] It may be argued that greenfield investment has a greater potential for contributing to the expansion of trade by making a contribution to manufacturing and export capabilities than through acquisition of existing enterprises. Therefore, developing countries may wish to exclude acquisitions of existing enterprises from the scope of a possible MFI.

Transparency: Seeking a Symmetric Framework

In an effort to attract FDI, developing countries are themselves moving towards making their investment policy regimes more transparent. It is not clear whether binding rules on transparency are necessary. APEC's approach to Non-binding Investment Principles may be adequate. Keeping in mind the generally life-long relationship that they entail, governments are more cautious in dealing with investments, and especially with FDI, than trade. The WTO Secretariat has observed that transparency provisions in existing bilateral and regional investment treaties – where they exist – are

generally less detailed and prescriptive than similar requirements in the WTO'.[16] While transparency with respect to an FDI policy framework might be unexceptional, some of the procedures for processing and evaluating proposals might not be made transparent in the public interest. The exceptions of where keeping information confidential is in the public interest need to be provided.

In dealing with foreign investors, governments of developing and least developed countries often experience an information asymmetry, i.e. availability of little information about the background and track record of the investors in other countries with respect to corporate social responsibility, their involvement in bribery and corruption and restrictive business practices. The recent cases of Enron, Anderson and Xerox are cases in point. In this context, the MFI should provide for transparency on the background and track record of corporations and other investors. Investors and home governments must accept obligations to share information on their involvement in questionable dealings. The MFI could also provide for the creation of a centralised online database recording cases of fraud, bribery and corruption, transfer pricing manipulations and questionable dealings, and other cases of violation of national laws from different host countries in respect of foreign investors. Such a database will be particularly useful for governments, especially in smaller and poorer countries with limited resources to verify the credentials of foreign investors.

National Treatment in Post-establishment Phase: Retaining the Policy Flexibility

As argued earlier, MNC affiliates enjoy several monopolistic advantages such as globally known brand names, proprietary superior technology, captive access to resources and talent; they face different opportunities and pursue different objective functions compared to national enterprises. The margin of the edge enjoyed by them may be particularly wide in poorer developing countries. In low-income countries, because of a wide technology gap, not only may knowledge spill-overs fail to take place, but the foreign entry may sometimes crowd domestic enterprises out and hence lower host country welfare (Correa and Kumar, 2003).

Therefore, in contrast to the argument of the proponents of MFI, the *playing field is already tilted in favour of* MNCs. When they enter a country, MNCs are already far ahead of domestic enterprises in the potential host country, especially if it is a developing county, because of their monopolistic ownership of unique assets. Offering national treatment to foreign enterprises and domestic enterprises would amount to discriminating against the latter. In most developing countries, the little local entrepreneurship that exists runs the risk of vanishing altogether if forced to compete with mighty global corporations under 'national treatment'.

Given the differences in corporate strategy and decision-making, and the special advantages of MNCs, host governments in developing countries often need to adopt

policies supporting and nurturing domestic 'infant enterprises' or small and medium enterprises from foreign competition, either through selective policies towards FDI or through measures favouring domestic enterprises. Given the scarcity of public funds that may be committed through tax exemptions or subsidies to promote development-related activities (such as research and development, employment and adding local value), governments in developing countries may need to limit the granting of incentives to national firms or to a certain category thereof, for instance, small and medium enterprises. Discriminatory support measures favouring domestic enterprises in strategic industries are quite common even in the developed world. A well-known example is SEMATECH, a consortium of computer chip manufacturers that has excluded foreign participation and has received substantial subsidies from the US government.[17]

The recognition of national treatment as a general principle in an MFI would prevent any future change in legislation aimed at providing advantages to nationals, which are not available to foreign investors. The Doha Declaration indicates that any framework should '*take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest* ...' (emphasis added).[18]

To protect flexibility for developing countries, granting of national treatment in the post-establishment phase may be structured on the basis of a GATS-type positive list approach which is more development friendly and could be subject to such limitations as were considered necessary. The GATS-type approach leaves to the Members the possibility of determining in which sectors the national treatment standard will be applicable. National treatment, therefore, is not unconditionally and automatically applicable (as in other WTO Agreements) but is subject to the prior decision of the respective Member who prepares its own 'positive list' of sectors where it is ready to give concessions.

d) National Treatment in Pre-establishment Phase: Exclude any Commitments

Currently, WTO Member States can apply measures aiming at screening FDI inflows, either in particular sectors or across the board, in order to admit those projects that are consistent with their development needs. Since the objectives sought by host countries (such as the building up of domestic industrial and technological capabilities, the development of SMEs, the protection of the environment and the development of particular regions) may vary significantly, the criteria to assess investment proposals are also likely to differ among countries.

In view of the great variation in the quality or developmental impact of different FDI proposals on the host country's economy and in the light of possible adverse impact on domestic enterprises and host country welfare, as observed earlier, host governments may wish to protect domestic 'infant enterprises' or small and medium enterprises from foreign competition through selective policies towards FDI. Host

governments may also impose, subject to the TRIMS Agreement, performance requirements on foreign entrants to regulate their operations in tune with their development policy objectives. The policy flexibility of governments of developing countries to pursue a selective policy towards FDI and impose performance requirements is very crucial and needs to be retained in any multilateral framework. The Doha Declaration provides for such flexibility and suggests due regard for development policy; it preserves their right to '... take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest'.[19]

The application of the national treatment principle for pre-establishment would limit host countries' freedom to exclude or restrict foreign investment in specified sectors or activities, stipulate domestic ownership requirements and adopt other permissible performance measures at the entry of FDI. Pre-establishment national treatment is not provided under bilateral investment treaties, except for a few treaties signed by the USA. Investment agreements as a part of regional integration arrangements (RIA) agreements like NAFTA provide for pre-establishment national treatment. But these are limited to partners on a reciprocal basis and also include full labour mobility alongside capital mobility. MFI, on the other hand, is limited to only capital mobility and not labour mobility.

Therefore, developing countries should resist the national treatment obligation for pre-establishment stage to retain the policy flexibility.

The proponents of MFI argue that a GATS-type approach to pre-establishment national treatment commitment allow adequate policy space to developing countries.[20] In principle, the GATS approach provides the flexibility. However, the experience of GATS suggests that developed countries bring pressure on developing countries to make commitments in the sectors that are of particular interest to them.

(e) Most-Favoured-Nation: Building Exceptions for Ethnic Investors

The extension of the MFN treatment to investment may be seen as a logical requirement in a multilateral system. It may affect, however, the special treatment conferred by many developing countries to 'ethnic overseas investors', in spite of their being permanent residents in or citizens of other countries. Therefore, exceptions for a differential treatment for ethnic overseas investors may be retained in a possible MFI.

(f) Development Provisions

Developing countries seek FDI as a resource for their industrialisation and development. FDI is supposed to bring to its host country a number of valuable resources for development, such as capital, technology, managerial and marketing skills, and sometimes market access in the case of export-oriented FDI. The knowledge and technologies brought in may be diffused through the host economy and hence be more productive. However, not all FDI brings with it such resources and as is evident from the literature cited in Section 3, FDI may even reduce host country welfare by crowding

out FDI. The evidence also shows the critical importance of host government policies such as performance requirements in maximising the benefits of FDI and minimising possible adverse effects. Hence, host governments – developed as well as developing – have generally employed policies that bring the operations of MNCs into consonance with the host country's developmental goals.

i) Flexibility to Impose Performance Requirements

Under special and differential treatment provisions, developing countries should seek flexibility to pursue policies that help them in exploiting the resources of MNCs for their development more effectively. These include policies such as performance requirements. Performance requirements may be employed to increase the depth of the involvement of MNCs' operations with the host economy and enhance their vertical linkages (such as local content requirements), to moderate the adverse effect of FDI on the balance of payments of the host country (such as export performance requirements or foreign exchange neutrality requirements), and to put in place domestic equity or joint venture requirements to facilitate absorption of technology transferred by MNCs, and training and transfer of technology requirements. The evidence available has shown that developed and developing countries have extensively employed these performance requirements and they have helped the host governments in achieving their development policy objectives (Kumar, 2003).

Some of these performance requirements, such as local content requirements and foreign exchange neutrality requirements, have been phased out as per the obligations of TRIMs Agreements . Others can still be applied. A number of developing countries have sought extensions to the phase-out period for implementation of commitments under TRIMs.[21] In cases where developing countries agree to negotiate an MFI, they can seek an abrogation of the TRIMs Agreement as the MFI will subsume all the necessary elements for dealing with investment.

ii) Exceptions in Government Procurement

Government procurement has been extensively used, in developed and developing countries, to promote the development of local industries by means of preferential treatment in terms of prices or other conditions of supply. From a developmental perspective, a possible MFI should be flexible enough to permit the use of public purchasing power as an instrument to promote the development of local firms.[22]

iii) Balance of Payments Safeguards

Safeguards should be built into the possible MFI for periods of balance of payments difficulties faced by developing countries. BIPAs have sometimes incorporated provisions for temporary suspension of remittances of profits and dividends and repatriation of disinvestments proceeds by companies in periods of balance of payments difficulties faced by host countries. Such provisions could be built into an MFI as well.

iv) A Special and Differential Treatment based on Objectively Defined Criterion for Development

The special and differential provisions for developing countries should be based on the level of development rather than additional transition years. For example, the provisions and policy flexibility could be linked to developing countries reaching a threshold of per capita manufacturing value added (MVA per capita). In this way the concept of graduation is built into as countries crossing the development threshold will cease to enjoy special and differential treatment. As in the case of the Agreement on Subsidies and Countervailing Measures (SCM), a threshold level could be defined, of MVA per capita, keeping in mind the world average of per capita MVA of US$1000 (MVA accounting for roughly 20 per cent of GDP and with an average per capita income for the world of US$5000 in 2000). A country should retain the policy flexibility that it deems desirable to pursue its development policy objectives so long as it has not crossed the threshold of US$1000 of MVA per capita. In this way the SDT will be based on an objective criteria will also introduce a concept of graduation. The countries below the MVA threshold should have complete freedom to apply performance requirements and other policies to maximise the contribution of FDI to their development.

(g) Balancing the Host Country and Home Country Interests

The Doha Declaration indicates the need to balance the interests of host and home countries. However, no indication has been made on how to balance the interests of developed and developing countries. A balancing of interest between all the stakeholders could be ensured with rights and obligations of all the stakeholders and by ensuring a symmetry between capital and labour mobility. China, Cuba, India, Kenya, Pakistan and Zimbabwe have made a joint submission to the WGTI on Investors' and Home Governments' Obligations.[23]

i) Seeking Binding Investors' Obligations

The proponents of the MFI have been seeking rights of foreign investors which the host country governments should commit to provide. However, nothing has been said about the obligations of the investors or the home countries. Any multilateral framework on investment has to be a balanced one defining the rights and responsibilities of all the actors involved. The Doha Declaration indicates the need for a balanced framework covering host and home country interests.

FDI is generally undertaken by TNCs. Given the massive economic power and resources that they command and their operations spreading around the globe, it is difficult for host governments to regulate their conduct. In view of their objective of global profit maximisation, there could be conflict of interests between their objectives and the development policy objectives of host countries and they could indulge in restrictive business practices, manipulation of transfer prices and other anti-competitive or corrupt practices. A number of cases of corporate misconduct have

been reported from different parts of the world involving some of the largest TNCs. National regulations have obvious limitations in regulating the operations of TNCs which cover the globe, although countries like the USA have adopted regulations covering operations conducted outside their national boundaries such as the Foreign Corrupt Practices Act and anti-trust regulations.[24]

Recognising the limitations of host governments in regulating the activities of TNCs, the international community has made several attempts to establish international norms of conduct for TNCs. These include the OECD's Guidelines of 1976, the ILO's Tripartite Declaration, UNCTAD's Multilaterally Agreed Set of Principles on Restrictive Business Practices and Draft Code of Conduct on International Transfer of Technology, among others (Correa and Kumar, 2003). The most ambitious and comprehensive of such attempts was the initiative to try to establish a UN Code of Conduct on TNCs, a draft of which was developed in lengthy negotiations during 1977–1992. The draft TNCs Code (abandoned in 1992) provided for a number of obligations to be complied with by foreign investors. During the period since the late 1990s, there has been a big trend towards consolidation and restructuring in the corporate world through mergers and acquisitions. These mergers and acquisitions have further increased concentration in larger corporations and, hence, their market and political power.

Some of these obligations and others that could be appropriately considered for incorporation in a possible MFI include:

- In terms of general principles, foreign investors would respect the national sovereignty of host governments and the right of each state to regulate, monitor and determine the role such corporations may play in economic and social development and to limit the extent of their involvement in specific sectors; agree not to interfere in the internal affairs of the host country and intergovernmental relations; adhere to economic goals and development objectives, policies and priorities, and work seriously towards making a positive contribution to the achievement of broad developmental objectives; adhere to socio-cultural objectives and values, and avoid practices, products or services that may have detrimental effects; and abstain from corrupt practices.

- Making a contribution to the strengthening of the scientific and technological capacities of developing countries

- Contributing to the technical and managerial training of nationals of host states and giving priority to the employment of local personnel at all levels;

- Refraining from imposing restrictive clauses in technology transfer contracts with their affiliates and licensees that prevent absorption and assimilation of technology transferred;[25]

- Refraining from imposing conditions on their overseas affiliates that restrict the sourcing of equipment, spares, raw material and services to affiliates' sources;
- Contributing to the promotion and diversification of exports and to increased utilisation of goods, services and other resources available locally;
- Not imposing restrictions on overseas affiliates regarding their exports either by limiting their quantity or destination;
- Co-operating with host governments in periods of balance of payments crisis by delaying remittances of profits and by phasing out divestment proceeds;
- Desisting from engaging in short-term financial operations or intra-corporate transfers in a manner that would increase currency instability and balance of payments difficulties;
- Prohibiting the imposition of restrictions on affiliates regarding the sourcing of their purchases and on their exports;
- Applying fair pricing policies in intra-corporate trade and curbing transfer pricing manipulations;
- Paying due regard to international standards of consumer protection;[26]
- Adopting fair employment practices, providing a safe and healthy working environment, paying remuneration to workers that provides them with an adequate standard of living and recognising their right to join organisations of their own choice without previous authorisation, eliminating discrimination unrelated to individual's ability to perform his/her job and protecting children from economic exploitation;[27]
- Taking steps to protect environment and rehabilitate it when there is damage;
- Accepting that they should disclose financial as well as non-financial information on the structure, policies and activities of the TNC as a whole, as well as that of the local affiliate.[28]

ii) Seeking Provisions for Transfer of Technology by Investors

For developing countries and LDCs, access to foreign technology is a critical issue which has not so far been adequately addressed in WTO Agreements. There are limitations in national regulations in effecting technology transfer from MNCs, as is clear from the evidence that is available.[29] As mentioned, an attempt was made in the 1980s to establish an International Code of Conduct on Transfer of Technology under the auspices of UNCTAD, but these negotiations have failed.

If an MFI is to be negotiated, an important target for developing countries may be

to include provisions relating to transfer of technology, so as to ensure that foreign investment effectively contributes to the technological development of the host country. Issues to be considered in this framework include:

- Requirements of transfer of technology as a condition for entry or operation of a foreign investment;
- Obligations to train and employ local personnel;
- Performance requirements related to a given level or value of research and development;
- Restraints on the TNCs from imposing restrictions on their overseas affiliates that adversely affect the process of absorption of technology and diversify sources of capital equipment and services;
- Measures to attract FDI in research and development activities;
- Grant of subsidies and tax benefits in developed countries to promote the transfer of technology (including associated equipment) to developing countries and LDCs.[30]

iii) Dealing with Market Power and Restrictive Business Practices of MNEs

Concern about the market power of MNEs and possible abuse of it has attracted the attention of the international community. MNEs have been found to have engaged in a number of anti-competitive arrangements with other firms. These include horizontal international marketing and price-fixing cartels, vertical international distribution systems established by MNEs for the sale of their products and the use of joint ventures with other firms.[31] National competition policy may have limitations in dealing with the abuse of market power by MNE affiliates which have operations crossing national boundaries. As observed earlier, these concerns led to the adoption of the Set of Multilaterally Agreed Equitable Principles and Rules for Control of Restrictive Business Practices drawn up under the auspices of UNCTAD in 1980. The set provides for collaboration between governments and puts in place an international mechanism to facilitate control of RBPs. Enterprises are obliged to refrain from RBPs defined to include price fixing, collusive tendering, market or customer allocation arrangements, allocation of sales or production quota, concerted refusal to deal or supplies to potential importers and collective denial of access to an arrangement. The enterprises are also required to refrain from abuse of market power in the form of predatory behaviour, discriminatory pricing or terms, joint ventures, mergers and acquisitions, and refusal to deal. It also facilitates appropriate action at multilateral level. However, the set is not a binding instrument. Effective regulation of RBPs and other anti-competitive practices through binding provisions should form an integral part of the MFI if it is negotiated.

iv) Seeking Binding Home Country Obligations

In a balanced framework, the home governments should also accept some obligations. Home governments' policies do influence the behaviour of TNCs originating in their territories. Some home governments, for example the USA, have asserted their power to restrict exports of goods by the overseas subsidiaries of US enterprises. Home governments must accept an obligation not to impose such trade or investment-related restrictions on the overseas affiliates of corporations based in their territories. They should also undertake to provide information regarding the involvement of TNCs in any questionable dealings and other information on their background that may be useful for the host government at the time of approval. The home governments should also co-operate with host governments in controlling restrictive business practices, transfer-pricing manipulation and in recovery of the liabilities of TNCs resulting from their misconduct in host countries.

v) Seeking Commitment on Labour Mobility

MFI is a framework for liberalisation of capital flows and will benefit developed countries. Developing countries could seek a reciprocity in the form of a multilateral framework for the liberalisation of labour flows. This would make it a balanced framework. As observed earlier, the restrictions on the movement of natural persons are imposing substantial costs in terms of world welfare. Facilitation of labour mobility would yield substantial efficiency gains benefiting both home, as well as host, countries.[32]

vi) An International Discipline on Incentives

A number of investment incentives are granted by developed and some developing countries as a part of their industrial, technological and other policies. It has been demonstrated that these incentives distort investment patterns in favour of developed countries, as developing countries are at a disadvantage in trying to provide matching incentives. Because of the prisoners' dilemma inherent in investment incentives competition, an international discipline to limit investment-distorting incentives would maximise the collective welfare of the participating countries. Such a discipline should form a part of an MFI. However, exceptions allowing developing countries and LDCs to use such incentives to promote such policy objectives as industrial development and regional development of backward regions have to be built into such a discipline.

vii) A Cautious Approach to Investor Protection

Standards relating to investor protection, such as general treatment, compensation in cases of expropriation, protection from strife, free transfer of payments and subrogation are generally contained in bilateral investment treaties and regional agreements on investment. Those standards are by and large accepted and established in bilateral and regional treaties. The implications of a possible inclusion of those standards in an

MFI will largely depend upon the scope of the adopted definition (particularly important with regard to the free transfer of payments) and on the extent to which protection would be an absolute standard, or subject to a 'contractual approach' as suggested above, that is, to compliance by the concerned investor with the host country's laws and regulations.

The right to initiate a dispute should be limited to Member States as currently provided under applicable rules for dispute settlement. Investor-to-state disputes would not acceptable in an MFI negotiated in the WTO framework.

Furthermore, there is a need to adopt a cautious and restrictive definition of expropriation or takings in the light of evidence on litigation brought by affiliates of US corporations against the Canadian government under Chapter 11 of NAFTA seeking compensation for government regulations and actions affecting the business prospects of companies as amounting to regulatory takings. For instance, the United Parcel Service (UPS) has sued the Canadian government under Chapter 11 of NAFTA for $230 million over what it alleges is unfair cross-subsidisation by Canada Post of its Xpresspost and Priority Courier operations.[33] Regulatory actions of host governments taken in pursuit of their development policy goals and of environmental and social objectives which are in the broad public interest should be specifically excluded from the scope of expropriation or regulatory takings.

7 Concluding Remarks

This paper has reviewed the options open to developing countries on investment at the Cancún ministerial conference of the WTO which will decide whether or not to launch negotiations on a multilateral framework for investment. Given the high opportunity cost of policy flexibility in the process of development and no reciprocity or gains even in the form of higher inflows of FDI, the most prudent option for developing countries would be to resist a negotiating mandate on investment at Cancún. In view of the clarificatory statement by the Chairman of the Doha ministerial conference that led to the adoption of the Declaration, this may still be possible. However, it will require effective co-ordination among developing countries and their ability to put up a strong coalition against the negotiating mandate.

A compromise solution could be to negotiate a multilateral treaty on investment on the lines of bilateral treaties outside the WTO. Better still would be to resurrect the UN Code of Conduct on TNCs, a draft of which still exists and which could be adopted as a binding UN instrument. The draft UN Code provides a multilateral framework balancing host country, investor and home country interests and could serve the purpose of the protagonists of the MFI very well.

If a negotiating mandate at the fifth meeting is unavoidable, then efforts should be made to ensure that developing countries' concerns are built into each element of the

proposed framework. This paper has outlined different elements of a possible MFI which captures the development dimension to aid the preparations of developing countries for negotiations. This is to be secured by limiting the scope of the MFI to trade-oriented FDI, resisting commitments on pre-establishment national treatment and adopting a GATS-type approach for post-establishment commitments, providing for flexibility to pursue selective policy and impose performance requirements by developing countries, incorporating investors' obligations and home country obligations, providing for transfer of technology, control of RBPs and competition policy, in order to balance the interests of the host and home countries. In this way, developing countries will be able to minimise the damage that an MFI has the potential to cause in terms of its effects on their development.

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Notes

1 See Brian Aitken and Ann E. Harrison (1999), pp. 605–18.
2 See Singapore Ministerial Declaration, WT/MIN((96)/DEC dated 18 December 1996.
3 See Doha Ministerial Declaration adopted on 14 November 2001, WT/MIN(01)/DEC/1.
4 See Dunning (1993) and Caves (1996) for expositions of theoretical approaches to FDI.
5 See Kumar (2001).
6 There have been several revelations of 'sensational abuses of international corporate power. The most prominent of these is the involvement of ITT in US plans to overthrow the government of Salvador Allende in Chile and the efforts of US copper companies, nationalised by his government, to hinder Chile's economic planning through a campaign of economic disruption. The Chilean case was closely examined by the US Senate Sub-Committee on Multinationals. Its investigations confirmed the fears of those who believed that US corporations were a threat to the sovereignty of host states. The Chilean investigations were followed by hearings concerning alleged corruption on the part of US firms operating abroad, particularly in the arms industry. The findings of these hearings reinforced the view that US business abroad was a power that had to be controlled, and that the USA itself had a duty to check abuses by its own corporations. This resulted in the passage of the Foreign Corrupt Business Practices Act in 1977 (quoted from in Peter Muchlinsky (1999), pp. 6–7).
7 UNCTAD (2002), TD/COM.2/EM.11/2 8 May 2002.
8 http://www.wto.org/english/tratop_e/dda_e/dohaexplained_e.htm#investment. Emphasis added.
9 http://www.wto.org/english/thewto_e/minist_e/min01_e/min01_chair_speaking_e.htm#clarification
10 Several developing countries continue to resist a negotiating mandate on investment at the Fifth Ministerial. For instance, ambassadors from Kenya, Uganda and India at a Seminar on the Nature and Implications of a WTO Investment Agreement held in Geneva on 20 March 2003, clearly argued against a WTO framework on investment besides representatives of over 40 NGOs. For more details see: http://www.tradeobservatory.org/library/uploadedfiles/No_Investment_Negotiations_at_the_WTO.pdf
11 http://www.wto.org/english/tratop_e/dda_e/dohaexplained_e.htm#investment
12 See, for instance, World Bank, 1999: 146.
13 See Paper submitted by Japan at WGTI, WT/WGTI/W/111, April 2002.
14 See UNCTAD/ITE/IIT/11; 1999a: 41–3.
15 UNCTAD, 1999, 2000: 171.
16 WTO, Working Group on Trade and Investment Transparency, WT/WGTI/W/109, 2002, A Note by the Secretariat.
17 Moran (1996: 431).
18 Para 22 of the Doha Declaration.
19 Doha Ministerial Declaration, para. 22.
20 See Concept Paper on Policy Space for Development by EC and its Member States, WT/WGTI/W/154, 7 April 2003.
21 See Correa and Kumar (2003) for details.
22 In contrast, the draft MAI did not affect the right of a state to establish or maintain state (or private) monopolies, but prevented discrimination against foreign investors with regard to the sale of goods and services made by a monopoly, as well as with respect to its purchase of goods and services from third parties, except to the extent that the purchase were not made with a view to commercial resale or for use in the production of goods and services for commercial sale.
23 See WT/WGTI/W/152, 19 November 2003.
24 See Muchlinsky (1999, chapter 6) for an analysis of the limitations of national regulation on TNCs given their operations transcending the national boundaries.
25 See Kumar (1985) for evidence on restrictive clauses included in technology transfer contracts signed by TNCs.
26 The Working Group on Transnational Corporations of the UN Sub-Commission on Human Rights is deliberating on the Responsibilities of Transnational Corporations to Human Rights. A significant part of the obligation of TNCs being discussed relates to consumer protection. TNCs are required to ensure the safety and quality of the goods and services they provide and not to produce, market or advertise potentially harmful products. The enforcement mechanisms and appropriate sanctions in case of non-observance of obligations by TNCs is also being debated. See http://www.unhchr.ch/html/menu2/2/sc.htmas for more details. Also *Times of India*, 4 August 2002.
27 Such obligations are being debated by the TNCs Working Group of the UN Sub-Commission on Human Rights, op.cit.

28 The European Commission already has Directives on the reporting and disclosure requirements requiring consolidated accounts. See Muchlinsky (1999, chapter 10).

29 See Muchlinsky (1999), p. 447, describing Nigerian experience with transfer technology regulation that has been largely ignored by foreign and local investors when entering into technology licensing contracts.

30 The establishment of this type of incentives may require appropriate adjustments to the Agreement on Subsidies and Countervailing Measures. It should also be noted that under article 66.2 of the TRIPs Agreement, developed countries are bound to provide incentives domestically to promote the transfer of technology to LDCs.

31 See Muchlinsky (1999: p. 387).

32 See Winters *et al.*, 2002.

9

A Multilateral Competition Agreement and the Developing Countries

Michael Davenport*

1 Executive Summary

The argument for introducing competition policy as a 'new' WTO issue – and for setting up a WTO working group to examine it – is that improved market access achieved by lower trade barriers is put at risk by anti-competitive practices. Of course competition policy has a wider remit than simply contributing to market access for exporters. It focuses on protection for consumers against the abuse of market power by dominant firms, cartels or other collusive practices. But the focus of competition policy as a WTO issue is – or at least should be – the trade and market access implications of certain types of anti-competitive behaviour. While increasing numbers of developing countries are choosing to put competition laws in place, these laws are generally useless against the effects of the abuse of market power in other jurisdictions. Indeed, although a number of developed countries proscribe cartels and other forms of anti-competitive action, export cartels are often exempted on self-serving mercantilist grounds.

There are a number of bilateral and regional agreements on competition, largely concerned with the sharing of case-specific information and co-operation. While these are useful in coping with particular instances of anti-competitive behaviour, they do not deal with the systemic problems of hard core cartels, dominant mergers and the willful obstruction of market access. Nor has the traditional Bretton Woods approach on eliminating anti-competitive behaviour by liberalising market access been found adequate, particularly as services are so often outside the tradeable sector.

Competition Law and WTO Principles and Related Policies

Competition rules are already embedded in a number of WTO Agreements, most importantly the GATT, the GATS and TRIPs. There have also been a number of non-binding codes, particularly on restrictive business practices. But for the proponents of an international agreement on competition these are piecemeal and/or non-

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actionable. What they – and in particular the EU which, together with Japan and South Korea, is a principle advocate of a Multilateral Competition Agreement – have argued is that the core WTO principles, in particular transparency and non-discrimination, should underlie the adoption by all WTO Members of a set of minimum legal standards for domestic competition laws and regulations, and minimal requirements as regards international co-operation between competition authorities. In December 1996, at the Singapore ministerial meeting of the WTO, a Working Group on the Interaction between Trade and Competition Policy (WGTCP) was established, though only 'on the understanding that the work undertaken shall not prejudge whether negotiations will be initiated in the future' while its mandate for continued 'educative' work was renewed for 1999 and 2000.

In the working group, to the extent that the developed and developing countries disagree, it is mainly over the scope of the so-called development dimension. For example, many developing countries would argue that the principle of non-discrimination, which includes both national treatment and most favoured nation treatment, is not inconsistent with sectoral exceptions, exemptions and exclusions from national competition regimes, provided that these provisions are applied in a totally transparent way and discrimination between foreign enterprises is avoided. After all, even in developed countries, competition rules are used with discretion in order to avoid damaging, or in order even to positively contribute to, the international competitiveness of the sector. Some, mainly developing, countries continue to argue that the case for a multilateral competition policy has not been made, particularly since opportunities for increasing co-operation between jurisdictions remain largely unexploited.

The paper identifies the main forms of anti-competitive behaviour, concentrating on those with clear transborder implications. The clearest of these are export cartels. Research by the World Bank and the OECD has shown that these have imposed massive costs on developing country imports and, by implication, the distortion of resources and economic growth. Horizontal agreements are both easier to define, and so prohibit *de facto*, than are vertical agreements, abuses of dominance and publicly sanctioned monopolies.

A Multilateral Competition Agreement would have implications for other policies, most obviously consumer protection, which may or may not be subsumed into competition law, but where it is clearly necessary that legislative inconsistencies and conflicts are avoided. In the case of policy with regard to foreign investment, or more precisely foreign investment policy, there is a parallel WTO working group. As in the discussions about a possible MCA, the emphasis of the developing countries is on ensuring that under an Multilateral Investment Agreement there are substantive and binding provisions to ensure that individual countries, while subjected to certain disciplines, nevertheless be allowed sufficient policy discretion to protect their developmental goals and policies. It is likely that the MIA will be based on the GATS model,

with national treatment (NT) only applying to the sectors listed in the schedule of commitments and even then is subject to conditions and qualifications. As far as TRIPs are concerned, there have been many allegations of instances of the exploitation of intellectual property rights for anti-competitive purposes. The TRIPs agreement does include some protection against that but it is clearly inadequate. Opening up the TRIPs agreement to re-examination could take many years, but it is argued that this is something that could be entrusted to the proposed World Competition Forum (WCF) rather than making an MCA hostage to the reform of that agreement. The same approach is recommended as regards anti-dumping. Anti-dumping laws are widely made use of as a trade barrier for anti-competitive purposes. Certainly in principle competition laws could replace AD laws and this abuse could be prevented, though initially it might necessitate a plurilateral agreement between Members who accepted each others' laws against export predation and the relevant legal processes.

Developing Country Concerns

The concerns of the developing countries about an MCA are firstly that it would significantly reduce their 'policy space' as regards development policy: in particular, they may wish to emphasise what as been called 'dynamic efficiency' as opposed to allocative efficiency. For example, the high level of profit and of investment that may be required for the rapid development of a particular sector might imply that certain key public or private enterprises, in return for ensuring a high level of investment, should be protected at least temporarily from the full rigours of competition, for example through licensing.

Another major concern is that national firms would be at a competitive disadvantage vis-à-vis the larger and lower cost transnational companies, and that the TNCs might even exploit the competition rules to place themselves in a dominant market position. The developing countries are worried about their right to prevent foreign take-overs of domestic firms. Competition rules, arguably, should allow this in certain circumstances while not inhibiting mergers of domestic firms. Indeed, given that by international standards developing country firms are usually small or at most medium-sized, the merger of existing national firms may be the only way to provide competition for some TNCs.

On the other hand this paper comes firmly down against Special and Differential Treatment for developing countries in an MCA. Demands for SDT have become major sources of resentment in multilateral trade negotiations. Since the Uruguay Round was completed in 1995, disputes about whether the SDT has been implemented and whether SDT has been eroded through case law created by the disputes mechanism procedures have contributed to a major loss of confidence in WTO procedures on the part of developing countries. In general accommodating the concerns of the developing countries within the MCA itself rather than in SDT clauses

would be vastly preferable.

The developing countries are generally opposed to giving responsibility for the implementation of the rules agreed under an MCA to the WTO dispute resolution process. It is the case that the experience of the DSU has been limited to inter-government disputes concerning the implementation of the WTO Agreements and it would be appropriate to maintain that principle. In other words Members could bring to the WTO cases about the non-implementation of the MCA, if, for example, one Member does not enact the agreed laws on market access or refuses systematically to co-operate in transborder competition cases. But individual cases between state and private enterprises would remain the sole responsibility of national courts and authorities.

Not the least concern among the developing countries is the cost, both directly financial and in terms of resources of legal and other skills, that would be imposed on them by an MCA which required them to establish an extensive corpus of competition law and the necessary institutions for its implementation. Insofar as there is a role for an agreement under the auspices of the WTO, it is because there is a strong link between market access and anti-competitive behaviour, and an MCA should be limited to this facet of competition policy. Developing countries would be the major beneficiaries if an MCA meant that market access for their exports is not blocked by anti-competitive practices of international cartels, abuses of dominance by multinational firms and large mergers intended to create situations of such dominance, and other restrictive practices by private firms, since most of those firms are based in developed countries. Similarly they would gain disproportionately from lower import prices where hard-core cartels are broken up. Bilateral and regional agreements are inadequate for this task. However, beyond an agreement to outlaw anti-competitive practices which effect trade in goods and services and ensure international co-operation in prosecuting such behaviour, the scope and details of the competition law and the competition agencies should be for the individual country to decide without obligations imposed by a WTO or other international agreement.

Regional Approaches

Some of the burden of complying with an MCA might be shared among countries who are members of a regional grouping. They could join together to develop an appropriate set of competition laws and even share a competition authority, though even within such a group there may be problems of a 'one-size-fits-all' nature. There is also the need to police trade within a free trade area or common market, and several free trade areas, including the Caribbean Community (CARICOM), the Union Économique et Monétaire Ouest Africaine (UEMOA) and the Common Market for Eastern and Southern Africa (COMESA), have either established an authority for preventing anti-competitive practices in regional trade or are planning to do so.

With the establishment of Economic Partnership Agreements (EPAs) between groups of developing countries and the European Union, the co-ordination, not of competition policies, but of the negotiating stances within each of these groups, is needed. The EU negotiators are likely to insist that competition law requirements be included in any FTA or customs union (CU). The African, Caribbean and Pacific states, in negotiating EPAs with the EU, may find themselves constrained to accept certain rules over specific competition issues while any exceptions to NT rules for EU firms are disallowed. Pre-empting such pressures by pressing for an Multilateral Competition Agreement in Geneva may be advantageous to the ACP countries in their Brussels negotiations.

A Minimalist MCA

The World Bank, in association with the OECD and, separately, UNCTAD, have produced model competition laws. The EU has proposed the universal adoption of a set of minimum legal standards and 'core principles' for domestic competition laws and regulations, and minimal requirements as regards international co-operation between competition authorities. The EU proposals are less broad-ranging than their earlier proposals which appeared to put a lot of emphasis on opening up developing countries markets to developed country exporters. Perhaps as a result of their dilution they are now rather vague.

These model laws and the EU proposals serve as useful starting points. But the role of the WTO should be limited to issues closely related to market access. Secondly, it is important to minimise the costs of competition policy to the developing countries and to avoid requiring developing countries to adopt a legal and administrative structure for competition policy greatly in excess of what the level of development implies or what they could effectively manage. Thirdly, it is important to avoid imposing on the developing countries an uncertain but escalating commitment such as has emerged from other WTO Agreements, for example the TRIPs, while avoiding exemptions and exceptions from commitments for developing countries that are time-limited or subject to periodic review.

This paper proposes an MCA under WTO auspices. This would require of all Members:

- That all anti-competitive practices that significantly impair the access for foreign exporters of goods or services to a country's markets through private or public restraints be prohibited;
- That hard-core cartels be outlawed in all Member countries;
- That Members should agree to consider the interests of third countries in their merger authorisation procedures;
- That to assist in enforcement actions in partner countries, Members practice positive and negative comity, international notification and consultation;

- That fair and equitable legal procedures – modelled on those in the TRIPs Agreement – would be agreed, including equal application of competition law enforcement to foreign and domestic persons (natural and legal), the right of appeal and the availability of remedy measures, and the avoidance of undue delays in the proceedings.

The Proposed World Competition Forum

The competition issue goes beyond the formal competence and practical expertise of the WTO. In order that WTO Members can continue to share experiences in the competition field, with the more experienced offering the others technical assistance with capacity-building in the area, a more mutually supportive organisation is needed. This report proposes the establishment of a World Competition Forum, which would bring WTO Members and other countries together voluntarily in a non-confrontational grouping for the promotion of the 'culture of competition', for sharing experience and for mutual assistance in the establishment of best practice law and procedures.

The WCF would engage in exchanges of experience and discussions on competition policy issues. For example, it would organise conferences on global competition issues that affect international trade and global economy. It would engage Members in debate and negotiation with a view to improving and expanding the MCA in appropriate directions. These include the prohibition of various types of vertical agreement or abuses of dominance, in the private or public sectors, which are not prohibited initially in the MCA because of difficulties in the precise identification and definition of the anti-competitive activities, the replacement of the existing much abused anti-dumping measures by competition law and the improvement of the TRIPs Agreement to prevent it being used to justify anti-competitive behaviour, including the prohibition of action to stop parallel imports.

Voluntary peer reviews of each member's competition laws, policies and perhaps even their enforcement record would be undertaken under the WCF umbrella. Perhaps the ultimate proof of the success of a WCF would be the establishment, under its auspices, of an international authority for the investigation of proposed mergers and acquisitions.

The WCF would also serve as the focal point for the co-ordination and monitoring of technical assistance, especially to developing countries. Capacity-building is required if countries are to fully benefit from competition laws in general and international co-operation in particular. This not only applies to countries about to institute a system of competition laws with the necessary agencies to make them work, but also to the roughly 90 WTO Members who currently have competition laws on their books. Even the most sophisticated exponents of competition law can benefit in various respects from the experiences of others.

1 Introduction

The interaction between trade and competition law is one of the 'new trade-related issues' proposed as a subject to be included in the Doha round of multilateral trade negotiations. Trade law and competition law most clearly intersect where market access is blocked by anti-competitive restraints. At this point trade law and competition law are two sides of the same coin.[1] Rules that require countries to open their doors to trade may be rendered meaningless by commercial constraints – on the part of national or foreign firms – which block access.

However there is a major difference between trade policy and competition policy. The former focuses on liberalising the access of enterprises to markets; the latter, traditionally, on the protection of consumers against the abuse of market power. Competition policy goes beyond market access issues to protect consumers' interests threatened by cartels, where, for example, groups of firms from the same or different countries conspire to force up prices on international markets. Another threat to consumers arises from mergers and acquisitions where large firms combine to achieve a dominant position in international markets.

At the last known count, about 90 WTO Member countries, including some 50 developing and transition countries, have adopted competition laws, also known as 'anti-trust' or 'anti-monopoly' laws. Generally these laws are aimed at such anti-competitive practices as price fixing, market sharing and other cartel arrangements, abuses of a dominant position, mergers that limit competition and agreements between suppliers and distributors that seek to exclude new competitors from the market. Under the heading of competition 'policy', it is sometimes useful to include other such goals as the promotion of competition in the national economy, through sectoral regulations and privatisation and even liberalising imports.[2] In this chapter, however, competition 'policy' is defined *in senso stricto* to refer to strategies for the enacting of legislation to prohibit behaviour that interferes with the contestability of markets and establishing the institutions necessary for the implementation and policing of these laws.

The heightened interest in competition policy shown by a number of developing countries is to some extent associated with the wave of privatisation in so many countries. Privatisation may be indicative of disenchantment with the effectiveness of public ownership from an economic efficiency standard or with evidence that public ownership creates problems of accountability and corruption. However transforming a state-owned enterprise (SOE) monopoly to a private firm or firms operating under competitive market conditions is a complex process, particular in a situation of so-called natural monopoly. Competition policy is no panacea but may be of some value though sectoral regulatory institutions may also be necessary. Another factor encouraging the adoption of competition laws is the lack of progress in dealing with the

restrictive business practices (RBPs) of TNCs despite a number of initiatives by multilateral organisations in this area.

As regards the developed countries, the renewed interest in issues relating to competition may have been aroused by a number of large-scale mergers and frustrated merger plans between US and/or European TNCs which has put stress on the 'comity' arrangements between US and European regulatory bodies.[3] Clearly there are limits to the effectiveness of bilateral and regional agreements on competition policy and this raises questions about whether such problems might be better resolved through a Multilateral Competition Agreement.

Market opening as an instrument for achieving competitive markets was until lately the orthodoxy preached by the Bretton Woods institutions, which used the conditionality associated with structural adjustment programmes to insist on the reduction of trade barriers without any requirement as regards competition policy.[4] More recently there has been a realisation that market opening through reducing trade barriers is in itself an inadequate instrument for ensuring the contestability of markets. This is partly because services are largely outside the traded sector and so an increasing share of the economy is denied the benefits of competition from imports.[5] Another reason is that imports themselves can be subject to anti-competitive pricing, either because of export cartels or because of mergers between foreign and domestic suppliers.

Indeed, the consensus has swung towards the view that the existence of competitive markets is itself the *sine qua non* for the successful use of market opening and other liberalisation policies as instruments for bringing about integration into the world economy and, more generally, raising the trend rate of economic growth. This view has informed the attitude of the developed countries towards an MCA within the WTO structure. To a large extent the interest of the developed countries is in using competition policy to lever open new markets for their exports. That rationale seems to have informed the EU's original proposals for a multilateral agreement.[6] But within the developed countries many policy-makers now claim to be convinced that the developing countries specifically would gain from the domestic impact of competition policy.

Historical Perspectives

In, fact the link between trade and competition policy is by no means a new issue. The importance of competition law as a back-up to trade liberalisation was recognised in the Havana Charter of 1950. The original International Trade Organization (ITO) was to proscribe 'business practices which restrain competition, limit access to markets or foster monopolistic control ...' in breach of the basic notions of free competition.[7] However, the ITO was stillborn and the GATT included no such clause on competition.

Since then there have been a number of initiatives to limit anti-competitive prac-

tices, directed primarily at multinational companies. In particular, efforts to codify unacceptable TNC practices have resulted in the non-binding OECD Guidelines for Multinational Enterprise (1976, revised 2000); the UN Centre for Transnational Corporations Draft Code of Conduct for Transnational Corporations, promulgated in 1977 and intended to be binding but abandoned in 1992; and the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy of 1977.[8] In 1980 the UN General Assembly adopted the voluntary 'Set of Principles and Rules on Competition'. A binding code remains elusive though the 1999 Global Compact project of the UN Secretary-General to link the activities of TNCs with the Universal Declaration of Human Rights, the ILO Declaration and the Rio Declaration on Environment and Development are still alive. One of these initiatives could still result in the comprehensive and actionable agreement sought by the developing countries but the slow progress in that direction has encouraged some developing countries to pursue the idea of an MCA.

The developing countries would like to see binding rules on such matters as corporate disclosure, accountability through corporate governance structures to different stakeholder groups, responsibility over such matters as illicit payments, advertising and product safety and quality, transparency in transfer pricing, restrictive and unfair business practices, labour and environmental standards, technology transfer, and commitments to respect national laws for the promotion of local entrepreneurship.[9] Some of these issues might be better addressed in other existing or proposed WTO Agreements such as the MIA currently under discussion by a WTO working group but some, such as on RBPs, could find their way into an agreement on competition policy.

Today, despite the continuing concerns of the developing countries, the emphasis is less on anti-competitive practices by TNCs, and more on an MCA as a means to eliminate, or at least limit, both private and public practices that restrict international trade. In December 1996, at the Singapore Ministerial Meeting of the WTO, a Working Group on the Interaction between Trade and Competition Policy was established though only 'on the understanding that the work undertaken shall not prejudge whether negotiations will be initiated in the future', while its mandate for continued 'educative' work was renewed for 1999 and 2000. The establishment of this working group, together with the Working Group on Trade and Investment, emerged as part of the built-in agenda under the Agreement on Trade-Related Investment Measures (TRIMs) and the interrelatedness of any reforms of the TRIMs agreement and proposals for new agreements in trade and investment and in trade and competition policy will be of importance as these issues develop.

The WGTCP has had a number of discussions on, for example, the relevance of the WTO principles of national treatment, transparency and the MFN rule to competition policy and on the contribution that a competition policy agreement might make to the objectives of the WTO, including the promotion of trade. The group has not

sought to define a consensus, let alone the contents of such an agreement, but has adumbrated certain core principles and providing a forum for the ventilation of the concerns of the developing countries.

Competition Policy in Existing WTO Agreements

Considerations of anti-competitive practices are not new within the WTO. Competition-related provisions already feature in existing WTO Agreements. The abuse of a monopoly position and other anti-competitive practices is dealt with in Articles VIII and IX of the GATS, which explicitly raises the use of comity, though without using that word. In particular, Article VIII deals with monopoly and exclusive service suppliers and the possible abuse of monopoly power, while Article IX deals with constraints on competition arising from other business practices. The latter article states that '[e]ach Member shall, at the request of any other Member, enter into consultations with a view to eliminating practices [which may restrain competition]. The Member addressed shall accord full and sympathetic consideration to such a request and shall co-operate through the supply of publicly available non-confidential information of relevance to the matter in question.'

In TRIPs, members are given the right to take measures in the event of abuse of property rights (Articles 8.2, 31 and 40). Licensing agreements among competitors can readily serve as vehicles for establishing cartels. Article 8.2 allows Members to take action against holders of intellectual property rights who use these in unreasonable restraint of trade. Article 31 recognises such anti-competitive practices as constituting grounds for 'use without authorisation of the right-holder', i.e. compulsory licensing, while Article 40 authorises Members to outlaw anti-competitive practices that constitute an abuse of IPRs.

Article 9 of TRIMs requires the Council for Trade in Goods to consider whether there need be complementary provisions on investment policy and competition policy. This is indeed the justification of the two working parties. There are other references to anti-competitive practices, and remedies prescribed, in the Safeguards, the Technical Barriers to Trade (TBT) and the Sanitary and Phyto-sanitary (SPS) Agreements and in Article XVII of GATT 1994 concerning state trading enterprises. Any new MCA would clearly have to be designed to dovetail with existing provisions. But it is also clear that the piecemeal set of existing WTO rules against anti-competitive behaviour is inadequate to counteract the proliferation of widespread anti-competitive activities.

Competition Law and WTO Principles

A considerable amount of the WGTCP's time has been devoted to the examination of the relevance of WTO principles to the formulation of a strategy of competition

policy. However, an absence of consensus as to what these principles consist in, let alone their interpretation, has meant that the discussion has hardly justified the many hours spent thereon, let alone in the preparation of the background documents.[10] Nevertheless, such principles have served as useful hooks on which various Members have hung their particular ideas about the development of competition policy.

One particular strand of argument that has garnered much support among the developing country Members is that traditional WTO principles such as non-discrimination (including both national treatment and MFN treatment), transparency and flexibility (though not everyone would include the last as a fundamental WTO principle rather than an acknowledgement of *real politik*) do not imply a one-size-fits-all or harmonised approach.[11] In particular, within a multilateral approach, there is scope for the inclusion of a strong development dimension.[12] In addition, the principle of non-discrimination when applied to the scope of competition law and/or policy embodied in a multilateral framework does not stretch to wider issues of industrial or development-related policy. In other words, sectoral exceptions, exemptions and exclusions from national competition regimes are not inconsistent with non-discrimination, provided that these provisions are applied in a totally transparent way and discrimination between foreign enterprises is avoided. As Woolcock points out, 'national competition rules whether in developed or developing countries have been used with discretion in order to allow concentration/rationalisation of the domestic industry in the hope that this will contribute to the international competitiveness of the sector'.[13]

Against this view that there are benefits to be gained from a multilateral agreement with the appropriate scope for exceptions and exemptions, some Members have reacted against the idea of such an *à la carte* view of competition policy by coining a new WTO principle, that of comprehensiveness. Others, in particular certain developing countries, have argued that the case for any multilateral agreement has not been convincingly made. But a broad view among Members appears to be that insistence on the principle of transparency will, in effect, guard against many of the problems that worry some developing countries about a multilateral agreement, in particular excessive intrusiveness and standardisation, as well as contributing to compliance and credible enforcement procedures.[14]

2 Forms of Anti-competitive Behaviour

The role of national competition rules in improving resource allocation and raising consumer welfare is well-known. The gains may take the form of higher productivity and lower prices for consumers, better choice, a clearer operating environment for business and even reduced compliance costs. Here we look more specifically at the anti-competitive practices that are particular transborder threats to free trade and/or

consumer interests. They are horizontal and vertical agreements (to collude), the abuse of market dominance and publicly sanctioned restrictive practices.

Horizontal Agreements

The clearest examples of this type of arrangement affecting transborder trade and competition are export cartels. In this case, a number of producers from one country may enter into an agreement which sets prices or output levels for foreign markets. Governments have often 'turned a blind eye' towards, or even encouraged, cartels which have helped their exports.[15] Transborder mergers and acquisitions may be attempts to create monopoly positions which are not under the jurisdiction of any one competition authority, while international cartels are joint actions by corporations from more than one country, under which they agree to divide markets, set prices or divide up bids for projects. Import cartels may be a defensive response by companies that purchase the goods of export cartels, or could be simply an attempt to force down import prices from foreign suppliers.

Currently some 25 investigations of export cartels are underway. Recently revealed cartels include: a) the vitamins case, in which collusion between European and Japanese firms resulted in 70 per cent higher prices for consumers; b) the Archer Daniels Midlands case which involved international co-operation between American, Japanese and European firms to fix prices in the worldwide food and feed additives industries; and c) the UCAR International Inc. case in which that firm pleaded guilty in participating in an international cartel which agreed to fix prices and allocate market share in the US$ 500 million graphite electrodes market.

A World Bank study found that '[i]n 1997, the latest year for which we have trade data, developing countries imported $81.1 billion of goods from industries which had seen a price-fixing conspiracy during the 1990s. These imports represented 6.7% of imports and 1.2% of GDP in developing countries. They represented an even larger fraction of trade for the poorest developing countries, for whom these sixteen products represent 8.8% of imports.'[16] The prevalence of hard core cartels, both domestic and international – the OECD investigated over 120 cases between 1996 and 2000 – and the magnitude of the welfare losses that they have caused is probably the single greatest justification for international action on competition policy.

Vertical Agreements

These arrangements describe special and sometimes exclusive relationships along the production-distribution chain, such as those between manufacturers and retailers or material providers and assemblers. They include tied selling where a seller forces a buyer to purchase more of a product than the buyer wants, exclusive dealing where two or more sellers create local monopolies by agreeing to divide markets into regions (by product or geographically) and refusals to deal where a supplier forces a purchaser *into*

restraint of trade under threat of withdrawal of products or services. Such agreements have anti-competitive effects if they restrict market entry by domestic or foreign products and/or result in artificial price maintenance.

The best known of the vertical agreement cases is the Kodak-Fuji case. This was brought to the WTO as a so-called 'non-violation' complaint under Article XXIII of the GATT which allows members to challenge government measures that 'nullify or impair' trade liberalisation commitments even though the measures themselves are not subject to WTO rules. 'The US claimed that because Fuji controlled the distribution system, this allowed it to exclude Kodak from access to film wholesaling networks, obliging it to sell directly to retailers, a much less efficient method of market penetration. The key allegation was thus of an anti-competitive vertical relationship between Fuji and its primary distributors. Japan responded that the control by Fuji of wholesale networks was irrelevant since most of the retailers they served also bought imported film and that Kodak's own distribution system amounted to the creation of a wholesale system of its own, the exclusion from the Fuji system, such as it was, therefore being irrelevant.'[17] The WTO dispute panel found that US access rights were not impaired on the grounds that importers were not disproportionately affected by Fuji's marketing strategy, that there was nothing in the distribution systems in Japan that excluded foreigners and that Fuji's marketing strategy was the norm for photographic film, even in the US.

Abuse of Dominant Positions

A major concern in national competition policy is the actual (or potential) abuse of market power by dominant enterprises. For example, a large company may use predatory pricing to drive its smaller competitors out of a particular market. The potential for abuse is a significant consideration in the scrutiny of mergers to determine whether they could result in excessive market power or its exercise. The interpretation of what constitutes a dominant position, or a particular abuse of such a position, can be a matter of considerable complexity in a domestic market. The issue is even more complicated if the alleged abuse involves foreign or international markets.

Concentration levels are typically higher in developing countries than in industrialised countries.[18] Often a few large enterprises dominate a sector, accounting for the greater part of output. Such a situation serves to facilitate collusion. Secondly, privatisation has often led to the transfer of the monopoly from the public to the private sector, whether there may be little restraint on the exploitation of monopoly power. Competition laws may help prevent the dominant firm from exercising market power and to enable competitors to enter and survive whereas in the case of natural monopolies, regulation in the form of setting of prices, profits and possibly quality standards is generally necessary.

Pakistan's privatisation policy provides some useful examples of the inherent diffi-

culties.[19] In particular, the evidence on growth of output and change in prices in the activities so far privatised shows that the producers have been able to exercise their monopoly power at the expense of consumers. Interestingly, the weakness of the regulatory framework in Pakistan has led the government to adopt a policy of reducing import duties in order to expose the industries to competition from abroad.

Publicly Sanctioned Restrictive Practices

These might include public or regulated private monopolies, the granting of favourable conditions to state-owned companies, provision of subsidies and other state aid to local private companies and preferential consideration for government procurement. The *World Bank Development Report* for 2001 states that in developing countries 'the main institutional barriers to domestic competition are government regulations on exit and entry of firms. Even in the tradeable sector, international competition may not lead to domestic competition, partly because institutional barriers to competition, such as government regulations in product and factor markets that deter firm entry, exit, and growth. Excessive and costly government regulations also facilitate corruption and lead to adverse distributional consequences by inducing workers and firms to escape into the informal sector.'[20] This is one aspect of the problem of contestability. Another is market segmentation. A market may be so fragmented, possibly as a result of ownership or control by a multiplicity of different local governments, that it is of little interest as a target for other enterprises.

There are problems both with regard to the commitment to reform in many countries where there are powerful vested interests in favour of the *status quo* and, even where that commitment is present, with respect to the capacity to implement reforms. Often government enterprises are kept going – and competition from the private sector prohibited – in order to sustain employment even where resources are being used inefficiently and the social costs of closure could be more productively offset by fiscal transfers and retraining. Furthermore, 'poor infrastructure, underdeveloped financial markets and overly complex administrative arrangements may provide formidable obstacles, not just to the entry prospects of new enterprises, but to the growth prospects for smaller existing enterprises'.[21]

3 Competition Law and Other Related Policies

A number of references have already been made to the conflicts that may arise between industrial policy and competition policy. In particular, deepening diversification and the achievement of economies of scale in the manufacturing sector may be constrained by competition policy. A liberal trade policy in the form of low barriers to imports increases market contestability. These are the fundamental 'development dimensions' of competition policy and the question of where any potential MCA

draws the line will be crucial in getting the developing countries on board. But there are other significant overlaps between competition policy *per se* and other policies that bear critically on competition.

Consumer Protection, Privatisation and Price Liberalisation

Competition policy may include a section devoted to consumer protection through, for example, the outlawing of tied selling. Alternatively, there may be separate laws to protect consumers but in that case they should be carefully worded to avoid duplication or inconsistency.[22] The same is true as far as the regulation of privatised companies is concerned. In the event of a natural monopoly, competition law may never replace direct regulation but they both serve a distinct and complementary role. However, it is important that the regulatory and competition agencies avoid overlapping or contradictory judgments.

Investment Policy

The momentum towards an MIA is being maintained primarily by the developed countries. Clearly, most foreign investment between the developed and the developing worlds moves from the former to the latter. Multinational firms want 'an appropriate stable, predictable and transparent foreign investment framework' and freedom from threats of appropriation, nationalisation or restrictions on the repatriation of profits or capital. The governments of the developed countries broadly share the interests of their multinationals. They also see an MIA as of value to the developing countries in that through creating an investor-friendly environment foreign investment flows would expand to the benefit of the host countries.[23]

As in the discussions about a possible MCA, the emphasis of the developing countries in the trade and investment working group (WGTI) is on safeguarding the 'development dimension', that is, ensuring that under an MIA there are substantive and binding provisions to ensure that individual countries, while subjected to certain disciplines, nevertheless be allowed sufficient policy discretion to protect their developmental goals and policies. But it is generally accepted that these provisions need not involve discrimination among foreign investment inflows on the basis of country of origin.

An MIA might embrace non-discrimination between foreign and domestic enterprises both at the pre-establishment stage and at the post-establishment stage or only at the latter. In the former case, the appropriate standard is most favoured nation: in the latter, it is national treatment (NT). The former ensures that no country receives any more favourable treatment than any other – without affecting the policy of the host country as regards, say, the sectors to liberalise. Non-discrimination at the post-establishment stage requires NT, i.e. equal – or as this is sometimes impractical, *no less favourable* – treatment for all foreign investors to that given to domestic investors.

However, in the GATS model NT only applies to the sectors listed in the schedule of commitments, and even then it is subject to conditions and qualifications detailed in the schedule.[24] This could well be copied in an MIA.

There are clearly a number of interfaces between investment policy and competition policy. The latter would not normally come into play – although the competition authority might be asked to give an opinion – until after a foreign company has established itself. At this point, as far as competition policy is concerned, NT is the touchstone. But if a proposed acquisition of a national firm by a foreign firm is suspected of leading to a dominant position, the competition authority may assume an appropriate role in preventing such an acquisition, though it should be subject to the same scrutiny and criteria as would have applied had the proposed acquisition been by another national firm. Again, it is important that the rules are clear and transparent and all inconsistencies between investment and competition laws are avoided.

In addition, competition law would not impinge on any exclusions and exceptions to foreign investment in national markets provided that they were clear in a country's 'offer' under a MAI. Similarly, even where foreign investment was welcomed in a particular sector, the government still has the prerogative of supporting national enterprises in a discriminatory way – allowing market-sharing for example – but here the exceptions would have to be made transparent as a qualification in the MAI as well as in the competition law. The problem of discrimination between foreign enterprises would be less likely to arise in the context of competition policy than through a MAI. One such situation might arise if one foreign investor was favoured over others because of a bilateral or regional preferential trade agreement with the country from where that enterprise had come. Again, where such agreements might include special treatment, say, over mergers, it would be important that such rules were transparent to all potential investors.

Intellectual Property Rights

There is a view prevalent among developing countries that the protections provided by the TRIPs Agreement against the exploitation of intellectual property rights for anti-competitive purposes are inadequate. In particular, there have been allegations that certain firms have engaged in 'patent pooling' to establish cartels. This has led to the suggestion that the implementation of an MCA should be held hostage to the reform of that agreement although there is a counter-argument to the effect that competition rules should in fact outlaw the misuse of IPRs and enable firms who have suffered to find redress through the courts, either in their own or a foreign jurisdiction.

Anti-dumping Rules

Another possible gain from a multilateral agreement on competition is in limiting the abuse of anti-dumping laws. Developing countries are concerned about the frequency

of predatory pricing, dumping, cross-subsidisation and similar practices on the part of TNCs and increasingly have joined the developed countries in adopting and resorting to AD measures. But they are also concerned about the use, and abuse, of AD measures against their own exports.[25] It would appear that an MCA could lead to the elimination of existing AD laws which are often exploited simply as protective devices or another form of RBP. If the MCA outlawed dumping as anti-competitive behaviour and laid down in some detail the criteria for judging the existence of dumping and the appropriate penalties, aggrieved domestic suppliers could take their case to the relevant courts in either their own or the exporting firms' jurisdiction. However it has been suggested that the attraction of AD measures as a way of giving domestic companies relief from highly competitive imports will be too great for the developed countries to sacrifice.[26] On the other hand certain free trade areas, including the EU and ANZCERTA, the free trade agreement between Australia and New Zealand, have replaced AD procedures with competition rules.[27]

4 Developing Country Concerns

The submissions made to the WGTCP by developing countries show a wide range of views about the possible role of the WTO in competition policy. For example, there is disagreement at the most fundamental level, with some countries arguing that networks of bilateral competition agreements are adequate to deal with the issues at stake, while others support some sort of role for the WTO. Some would allow that all Members should sign up to multilateral undertakings, but there are major differences about the content and the degree of harmonisation. Many developing countries are emphatic about the importance of retaining flexibility and believe that the level and nature of commitments in any multilateral agreements must be subject to that priority.

The Development Dimension

By flexibility, the developing countries usually mean the so-called development dimension. They argue that the same rules are not suitable for countries at different levels of economic and institutional development or with different cultural and legal traditions. In particular, it is argued that it would be inappropriate for the developed countries to insist that their model of competition policy be adopted wholesale by the developing countries. In any event, in economic theory the gains from competition policy are allocative efficiency and achieving that efficiency, for example realising the output and prices of a competitive market rather than a monopoly, would bring a once-and-for-all gain. What the developing countries need is dynamic efficiency where some of the potential gain from the optimal static market structure may be worth sacrificing in favour of maximising economic growth, reducing poverty or focusing on whatever objective function the policy makers adopt.

For example, the high level of profit and of investment that may be required for the rapid development of a particular sector might imply that certain key public or private enterprises, in return for ensuring a high level of investment, should be protected at least temporarily from the full rigours of competition, for example through licensing. Thus, it is argued, the optimal level, rather than the maximum level of competition, should be the goal.[28] Secondly, it is argued that there is 'an optimal combination of competition and co-operation' between enterprises. Thirdly, there must be coherence between industrial policies – including protection for infant industries – and competition policy. This implies that competition policy should not restrict a developing country's ability to prevent foreign take-overs of domestic firms or inhibit it from encouraging mergers of domestic firms. Indeed, given that by international standards developing country firms are usually small or at most medium-sized, the merger of existing national firms may be the only way that will provide competition to some TNCs. Allowing national firms to merge, while preventing mergers involving TNCs, may represent a reasonable exception to the principle of national treatment. As the 2002 summary of the WGTCP proceedings puts it, '... in a sense a discriminatory competition policy could be a concomitant to a non-discriminatory trade policy'.[29]

A country may also have certain essentially non-economic goals that perhaps should be protected from competition law. A good example is the South African Competition Act which contains provisions 'to extend and promote control of those historically disadvantaged' which were designed to advance the interests of small and medium-sized and, in particular, black-owned enterprises.[30]

There is a more general worry to the effect that, if an MCA is reached through the WTO, it may be too 'pro-trade' at the expense of consumer interests.[31] On the other hand, it can be argued that, insofar as there is a role for an agreement under the auspices of the WTO, it is because there is a strong link between market access and anti-competitive behaviour, and that the role of the WTO should be limited to this facet of competition policy. But there is a danger that the role of a WTO agreement on competition will be pushed beyond this point with market access becoming the be-all-and-end-all at the expense of any sovereignty issues or developmental concerns. This could happen if the process of reaching an agreement were 'captured' by Members whose primary concern was the opening of markets in developing countries.

Another aspect of the development dimension is Special and Differential Treatment. Demands for SDT, generally in the form of longer transition periods for developing countries to implement a particular regime and/or exceptions and derogations from global rules, are typically hornets' nests in multilateral trade negotiations. Since the Uruguay Round was completed in 1995 they have led to disputes about whether SDT has been implemented, in particular 'the best endeavours' clauses supposedly binding the developed countries, and whether SDT has been eroded through case law created by the disputes mechanism procedures or through subsequent

agreements. In general, it would be preferable to find ways in which the concerns of the developing countries can be accommodated within the MCA itself rather than in SDT clauses.

The TNC Threat

One of the major concerns about an MCA among developing countries is whether big TNCs will use the competition rules to reach a dominant position in the economy, putting domestic firms out of business through price competition or taking them over. It is because of concern over the competitive threat to national firms from TNCs that a number of developing countries accept that competition policy agreements at the bilateral or plurilateral level could be valuable but are not in favour of a multilateral agreement. In other words, NT would be reserved for firms from countries where bilateral or plurilateral agreements had been negotiated. On the other hand, negotiating such agreements with larger countries may be difficult for a small developing country with little to offer in return.

In their presentations to the WGTCP, many developing countries have focused on this issue, their concerns stemming from the small size of their enterprises compared with most TNCs and the fact that they already face anti-competitive practices from TNCs in their markets. There are clear suspicions about the extent to which an MCA could deal with these problems. For example, Egypt has said there should be a studies of the extent to which national competition laws can effectively deal with RBPs of TNCs at international level, and how to control the international mergers that create monopolies or dominant positions in the national market, of how international co-operation could enable countries to deal effectively with TNCs and of the possible scope of a multilateral framework.[32] International co-operation to deal with anti-competitive practices clearly needs to be strengthened. At the same time, where they have not yet done so, developing countries could often make some headway against such behaviour in their own markets by developing appropriate competition laws and authorities. We will return to these issues in Section 7.

Judicial Processes

There is a general concern about whether the WTO DSU is the appropriate process for adjudicating on competition cases. These cases must be judged in terms of national law, even though that national law might have to meet various criteria established in the MCA. The WTO disputes settlement process is not an appropriate forum for the arbitration of specific competition cases, typically involving governments on the one hand and private companies on the other, even where there are transborder elements as, for example, in cases dealing with export cartels. Nor could it easily take on the role of international authority responsible for vetting mergers and acquisitions.

The WTO has had no experience of these matters. It has not had to protect the

confidentiality of documents in the past. Its experience has been confined to questions of the implementation of international agreements by governments. If it were to take a role in individual cases, it would be necessary to broaden the WTO dispute settlement process to allow private firms and individuals to claim that countries have not properly implemented the agreed competition rules, or, arguably even more radical, to allow appeals against judicial decisions by national courts. The latter may be seen as a threat to national sovereignty. Moreover, among many developing countries there is a concern that the rules and procedures of the DSU are stacked against them.[33]

The WTO would, however, be the appropriate judicial forum for issues concerning whether or not a country has respected an agreement on competition signed within the WTO structure, such as the proposed MCA. Thus the DSU should only be used to challenge whether a country has abided by the MCA – to be established through a WTO agreement – and in no circumstances whether an individual firm is in violation of national law. Even then, the EU is reluctant to bring in the DSU. 'As regards dispute settlement, any review of individual decisions should be ruled out. Issues relating to the way in which the law is being applied (or not applied) could only be considered within the framework of 'peer review' and outside the context of any possible dispute settlement mechanism. Any dispute settlement case would therefore be strictly limited to the consideration of any possible lack of conformity of domestic legislation with multilateral commitments.'[34]

The OECD Competition Committee already has a system of peer review (known as 'regulatory reform review') and UNCTAD has suggested that the system could be adapted for use in the WTO. It would be analogous to the existing Trade Policy Review System.[35] The problem is that it would be onerous in resource costs, particularly the time spent by lawyers and officials.

When there is a disagreement over one country's implementation of competition law, for example its interpretation of hard-core cartels may be particularly strict or excessively easy-going but still arguably consistent with the agreement, moral suasion through peer review is likely to be more practicable than judicial rulings. Such peer reviews on a regular basis could best be undertaken by the proposed World Competition Forum to be discussed in Section 6.4.

Costs

The developing countries are clearly and justifiably concerned about the costs of establishing and implementing fully-fledged competition laws. Anti-competitive practices are closely related to the existence of and opportunities for collusion. Thus, competition policy must largely involve an assessment of the potential for collusion, whether in the form of a proposed merger or existing cartel structures. The number of firms involved, and the share of output they supply, are both important factors but neither is paramount. High levels of concentration do not necessarily mean the

absence of intense competition, nor do large numbers of firms mean that there is intense competition when there are ways of dividing the market through geographical or informational barriers, or because the local infrastructure is so lacking.[36] These are particular problems in developing countries as may be participation in collusion by local officials, or, when that is suppressed, even with the regulators themselves. In any event a commitment to the proactive investigation of collusion is perhaps the *sine qua non* for all competition policy and competition agencies. This is inevitably costly. Lack of financial resources could, in the extreme, make a mockery of the whole competition policy.

Some developing countries have suggested that the cost of legislating and implementing a comprehensive competition policy would exceed the benefits that this would bring. True, a Western-style competition policy does imply a high level of investment, particularly in trained lawyers and judges. Many developing countries would argue that that sort of level of legal sophistication is not appropriate.

5 Competition Law and the Developing Countries

Gains from Internal Competition Law

The most obvious beneficiaries from competition laws are the consumers. They will benefit from the regulation of anti-competitive behaviour within developing countries. Consumers – and industrial users of domestically produced goods – will benefit from lower prices and increased output. In addition, the increased transparency and more competitive markets will enhance the attractiveness of an economy to foreign investors, as well as increasing the benefits of that investment to the host country. Competition policy may also have a specific role in the process of privatisation and deregulation. Both privatisation and deregulation are likely to lead to greater economic efficiency and lower prices where there are competition rules.

However, these gains from establishing a corpus of competition law, with the necessary legal and administrative institutions to make it effective, are primarily internal to the country. A developing country may well need technical and financial assistance to put in place such a legal framework and this paper will argue for a wide-ranging international capacity-building exercise. But, with one important exception, the scope and details of the competition law and the competition agencies should be for the individual country to decide without obligations imposed by a WTO or any other international agreement.

The exception arises where access to one country's markets is being obstructed by anti-competitive activities. Then a national competition law is required to realise the positive goals of trade liberalisation – in particular reductions in tariff and non-tariff barriers. It will make foreign goods and services available or, where they have previously been available, cheaper, and this could be critical for economic diversification

and industrialisation. Small developing countries are particularly dependent on exports. They will benefit from unimpaired access to foreign markets. But their exports usually require imported inputs or capital equipment and these will be cheaper and the choice will be greater in the absence of anti-competitive behaviour on the part of importers.[37]

Gains from International Co-operation

International anti-competitive practices can be particularly damaging in small countries. 'Developing countries are mostly price takers on world markets; outside of certain natural resources, their firms generally have no market power.'[38] The available evidence points to the presence of international cartels, abuses of dominance by multinational firms and large mergers intended to create situations of such dominance, and other restrictive practices by private firms operating in international markets, all designed to limit competition in international trade and maintain high prices. These arrangements can be quite durable and detrimental to economic development, particularly for developing countries that rely heavily on imports given their own restricted industrial base. Efforts to build a competitive industrial or services sector may be stifled by the excess prices charged by international cartels. Again, as mentioned in the previous section, developing countries tend to have small, narrowly based domestic markets, which means that exporting is necessary if they are to enjoy the economies of scale available to producers in larger countries. But even where their costs suggest that they can be competitive, they may find access to export markets blocked by anti-competitive practices.

National competition laws are restricted to operating within national boundaries. An international framework agreement is needed to deal with international abuses of competition. Moreover, a country whose exports are boosted by export cartels operating within its borders, or whose enterprises may be involved in cartel arrangements with foreign companies, may have little incentive to attack such practices. A domestic competition law may not be totally ineffective against export cartels but many jurisdictions with domestic competition laws specifically exclude export cartels, including Canada, Japan, Mexico, Portugal, Sweden and the United States.[39] Even the broad EU-US bilateral co-operation agreements do not deal with anti-competitive behaviour by export cartels.[40]

It is easier to identify and prohibit horizontal agreements – usually collusion among suppliers of similar products or services – than vertical agreements where market power is used to distort relationships up and down the supply chain. When it comes to defining the types of anti-competitive behaviour that are to be prohibited as obstacles to market access, the horizontal agreements can be generally banned *de facto*, whereas vertical agreements – the Kodak-Fuji case is a good example – are legally more complex and may only be judged *de jure*. This implies that the MCA will inevitably

concentrate on horizontal agreements. However, where market access is impaired by anti-competitive practices, these arise very largely because of horizontal agreements.

A multilateral agreement is required if such anti-competitive practices as hard-core cartels are to be effectively policed and prosecuted. An agreement is also necessary if international co-operation is to be effective in the pursuit of other anti-competitive behaviour with transborder elements. A number of states have adopted bilateral co-operation agreements, either state-to-state or agency-to-agency. For example, Canada currently has two state-to-state type agreements relating to competition law enforcement, one with the United States and the other with the European Communities.[41] But Canada believes that bilateral co-operation can never be enough.

> *The growing network of bilateral competition co-operation agreements is demonstrable evidence of the recognition of the value and necessity of anti-trust cooperation in an interconnected global marketplace … . However, Canada sees the need for a more ambitious vision for cooperation. To achieve true efficiency in international competition law enforcement, cooperation must go beyond the bilateral front. There is a need to establish a nexus between countries in the enforcement of competition law. A commitment towards cooperation in the context of a WTO framework agreement on competition policy would provide the cohesion and stability necessary for the establishment and development of international anti-trust cooperative relationships…. The central theme in Canada's efforts to engage in anti-trust cooperation has been to promote a level of compatibility in the application and enforcement of the basic objectives and rules, without compromising a country's fundamental jurisdiction over conduct affecting its own territory. A similar theme should be at the core of anti-trust cooperation in a WTO setting.*

As regards case specific co-operation, provision should be made for the notification by authorities that are currently investigating and prosecuting such cartels to promptly alert competent authorities in other countries where these cartels could be operating, together with regular information on progress in the investigation. The second element would be a consultation whereby governments that are investigating an alleged cartel would engage in discussions with other Member countries whose interests could be affected. The third element would be assistance in the enforcement process through positive and negative comity.

Furthermore, there has to be a commonly agreed means whereby the government, firms or individuals in one jurisdiction can pursue, in their own courts, anti-competitive practices practiced in foreign jurisdictions, or the former can request that the authorities in the foreign jurisdiction take action to pursue the anti-competitive behaviour. This implies some general understanding and acceptance of the 'effects doctrine'.[42] The MCA should provide for the minimum required extra-territorial

reach among all Members though this minimum, together with rules on co-operation over evidence, the exact interpretation of the 'effects doctrine' and so on, could be enhanced through co-operation agreements among different states or regional groupings. In due course the World Competition Forum proposed below might, after extensive debate, agree the extension of the international consultation commitments of Members through later amendments to the MCA.

The TRIPs agreement is a good example of how 'fair and equitable' procedures for implementation of a WTO agreement in domestic courts can be safeguarded. If that model is followed the MCA would require that:

- All processes pertaining to competition law enforcement should apply equally to foreign and domestic persons (natural and legal) in a fair and transparent manner;
- All parties have the right to appeal against an unfavourable decision made by a competition authority or court;
- Both domestic and foreign individuals or firms should be guaranteed the right to appeal to and to request remedy measures from competition authorities or courts against anti-competitive practices;
- The proceedings must proceed in a timely fashion in order to ensure prompt measures to protect rights and prevent uncertainty or excess costs resulting from undue delays.[43]

International co-operation, together with the 'effects doctrine', can only be fully effective if the notion of 'positive comity' is accepted, and indeed pressed, within the MCA. The OECD Recommendation defines investigatory assistance (or 'negative' comity) as 'co-operation with another country's law enforcement proceeding. Such assistance may include gathering information on behalf of the requesting country, sharing information with the requesting country, and discussing relevant facts and legal theories' while 'positive comity may be described as the principle that a country should (1) give full and sympathetic consideration to another country's request that it open or expand a law enforcement proceeding in order to remedy conduct in its territory that is substantially and adversely affecting another country's interest, and (2) take whatever remedial action it deems appropriate on a voluntary basis and in considering its legitimate interests.'[44]

Comity must include the sharing of confidential information if it is to be effective. It must be voluntary. Some countries may not have the capacity to respond to all requests for information or legal action. There may be situations where a country's own interests are put at risk. But there needs to be the assumption that co-operation will take place and disputes proceedings within the WTO must be available in the event that a country clearly and systematically refuses to co-operate.

One issue over which divergent views have been expressed in the WGTCP is whether a obligation to participate in comity, both negative and positive, does imply that a country must have a competition authority.[45] Some argue that a Member without any kind of domestic enforcement capacity could not be involved in case-specific co-operation. The alternative view was that co-operation was possible even if the participating countries had different systems of competition law, and even if a particular country did not have a comprehensive competition law or did not incorporate all the WTO principles in its national legislation. This report takes the view that a multilateral agreement on competition policy without an obligation to adopt a fully-fledged domestic competition law – though it does argue for a minimal mandatory law – or set up a competition authority would still facilitate co-operation and the efforts to stop anti-competitive behaviour. It would also be a useful source of assistance for countries in the process of developing or implementing a law.

The threats of mergers and acquisitions within or between one or two jurisdictions on markets in third countries need to be acknowledged. The main criterion in consideration in a merger review is whether the proposed merger – or that already consummated if reviews are undertaken *post facto* which is a second-best alternative – will substantially prevent or lessen competition. Where it is found that competition is likely to suffer, other criteria can be considered, such as technological or efficiency (including economies of scale) gains, and other public interest concerns, such as employment or the development of small businesses.[46]

The criteria for deciding whether a particular merger is likely to create a position of dominance, and thus a threat to the contestability of markets, are by no means harmonised, even between the US and the EU. It will be a long time before an international body takes over the role of vetting proposed mergers on behalf of all jurisdictions, though this is a worthy goal for the medium term.

Mergers by two or more large firms, within or across borders, may give rise to concerns about global dominance – even in markets where neither firm is currently operating. The regulation of mergers and acquisitions has become a major issue within large developed countries. In particular the EU and the USA have both developed institutional capacities, through the Competition Directorate of the European Commission and through the Commerce Department respectively, to examine mergers and acquisitions involving firms trading, though not necessarily headquartered, within their jurisdictions. These two jurisdictions view the authorisation of mergers and acquisitions rather differently, with the EU emphasising size in itself as a potential threat. In any event, decisions to allow a merger by these institutions may have a major impact on the global market in a particular sector and this will have spill-over effects in countries which presently have no say in the issue. Even if third country jurisdictions had the resources to determine whether such a merger could lead to a serious reduction in competition within its borders, it is not at all clear what impact it

would have. If a merger has been 'passed' by the EU and the USA, the companies would in most cases go ahead, regardless of the decisions of other jurisdictions.

But as Hoekman and Holmes stress, it is by no means clear that these large jurisdictions would willingly relinquish their powers to determine whether a proposed merger was in the public interest – which they point out may be construed as the interest of competing companies in their own jurisdiction. 'For an international agreement to have prevented a similar dispute [to the Boeing-Macdonald Douglas merger] or the eventual negotiated outcome, it would have to impose clear standards for examination and review of mergers. The EU and the US already co-operate on anti-trust matters under the auspices of a bilateral agreement that includes positive comity language. This was not sufficient to prevent the dispute. One can question whether international rules could be devised that would be effective in requiring any one jurisdiction to back off [given that] efforts to put competition-related issues on the WTO agenda are largely driven by classic producer interests in major OECD countries, with governments pursuing a traditional "export promotion" objective. The primary concern is not welfare or efficiency – the major focus of many national anti-trust regimes.'[47] It is also unlikely that many developing countries would accept a national treatment clause which treated all proposed mergers identically. The ambition that national firms should grow, combine and eventually compete with the TNCs is perfectly acceptable.

However, Singh and Dhumale argue that, on balance, the boom in mergers and acquisitions has led to a significant reduction in competition which is likely to be welfare-reducing.[48] Whether an international competition authority to prevent anti-competitive practices by international companies, and pronounce on the acceptability of mergers, would be practicable in the near future is doubtful – though we argue that that should be the ultimate aim through a newly-formed World Competition Forum. What can be required is that competition or other authorities in all Member countries, when then are investigating proposed mergers, consider the possible anti-competitive impacts of those on third countries. This may not appear as a proposal with significant teeth. It should be remembered, however, that failure to do so could be cause for a complaint through the disputes settlement procedures of the WTO. Moreover, key pieces of information which one authority may need in order to complete a review could lie in jurisdictions outside a country's set of bilateral or regional arrangements.[49] As the practice of comity becomes more established, it will become normal for authorities to exchange confidential information, including the impact of a proposed merger on third country markets.[50] Indeed, authorities in third countries who feared the results of a merger could request that the merger not be approved.

International co-operation on competition policy can take many forms, including the establishment of channels of communication between competition authorities, the exchange of information and mutual assistance in the implementation of competi-

tion law. It should go further than these proposals for the content of an MCA. In Section 7.2 below the establishment of an international body, outside the scope of the WTO, to vet mergers and acquisitions is proposed.

Thirdly, 'competition policy should use multiple factors to determine whether a firm has a dominant market position rather than simply looking at size'.[51] Generally, competition law should not restrict the growth of firms where competition from either foreign or domestic firms is present and there is no identifiable threat of collusion. In general, though criteria based on size or market shares in the event, say, of a merger or other threat to market dominance may have some role to play, it is conduct, rather than structure, that is critical in determining whether firms are acting anti-competitively.[52]

Fourthly, there must be a clear role for competition law in the stemming of the abuse of IPRs. Clearly the relationships between IPRs and competition laws are complex and these give rise to difficult cases even in countries with many years of experience. The rules covering the granting of IPRs, whether in the form of patents, trademarks or copyrights, need to be tightly drawn up and the role of competition laws in preventing the abuse of the temporary exclusivities that these rights provide has to be made clear.[53]

Competition Law and RTAs

Co-operation between countries can be facilitated by working within a regional grouping. Such co-operation may also be particularly valuable in avoiding problems of cross-country collusion, anti-competitive mergers and RBPs that could be damaging throughout a free trade area or other trade grouping. But membership of a regional trading bloc, particularly with a preferential or free trade arrangement, implies the desirability not only of regional co-operation but also regional co-ordination of competition rules. Otherwise, firms proposing mergers or export cartel arrangements may 'shop around' for the most lenient jurisdiction. In addition, competition policy at the regional level could be a way forward for small states that would find the implementation of a national competition policy both expensive and superfluous. A regional approach may imply significant resource savings, particularly in terms of qualified personnel.

Already a number of regional organisations, including CARICOM, UEMOA and COMESA, have established or are examining regional competition frameworks.[54] CARICOM, however, is a good example of the institutional problems that arise in the development of a regional approach to competition policy. A strong governmental commitment throughout the region for the creation of a CARICOM competition commission has been lacking. Similarly, there have been lengthy wrangles about the powers of and the appropriate mechanism for financing the proposed Caribbean Court of Justice. COMESA, on the other hand, has displayed a greater degree of unity and resolution. This is seen in the rapid progress to a customs union within the COMESA

free trade area, as well as in matters of competition law and the establishment of a regional court. There are already nine countries within this customs union while a further two have announced timetables for joining. A draft competition law and draft competition regulations have been under discussion by the COMESA Member States since August 2002. The 1993 COMESA agreement 'includes a provision, in Article 55 (similar to Article 81 EEC), which prohibits RBPs that distort trade within the future common market. There is scope for exceptions to this provided the COMESA Council agrees. Work is underway on studies of how to apply this provision and develop a common competition policy within the region. It is expected that the COMESA Court would play a role in interpreting the competition as well as other provisions of the agreement.'[55]

Article 55 of the draft treaty constitutes a general prohibition on agreements between undertakings, decisions by associations of undertakings and concerted practices that may distort competition within the common market.[56] To trigger the jurisdiction of a regional competition authority the conduct in question must have, or be likely to have, an appreciable negative competitive impact on trade between Member States. 'Trade' encompasses all activity that results in a profit, and also covers services as well as goods. The definitions are closely based on EU competition rules. For example, Article 55(1) of the COMESA Treaty prohibits 'any agreement between undertakings or concerted practice which has as its objective or effect the prevention, restriction or distortion of competition within the Common Market'. This is taken almost verbatim from Article 81 of the European Community's Treaty of Rome. Horizontal agreements are *per se* illegal. Vertical agreements are analysed from a 'rule of reason' perspective. What constitutes abuse of a dominant position is carefully spelt out. A subsidy is also outlawed 'in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the member states'.[57] Mergers above a certain size will require pre-notification and will only be authorised by the COMESA Competition Commission in the event of positive net benefits. The proposed law will also specifically address consumer protection.

But it is worth emphasising that in COMESA, and in the future in CARICOM, anti-competitive practices that do not impinge on intra-member trade are left for the Member State to deal with – four of the COMESA members have already legislated a corpus of competition law and established competition authorities. But where there is a regional trade organisation, a single competition law may suffice for all Member States. A single law could be both cost-effective and avoid some of the problems that might arise through discrepancies in different laws. While the question of whether one size fits all may also arise in this context, there is room for national adjustments and qualifications to a common regional competition law intended to deal with anti-competitive practices whether or not they have transborder effects.

With the establishment of Economic Partnership Agreements between groups of developing countries and the EU, the co-ordination, not of competition policies, but of the negotiating stances within each of these groups is needed. The EU negotiators are likely to insist that competition law requirements be included in any free trade agreement or customs union, whether with individual ACP states or regional groupings of ACP states. Indeed, it is significant that the EU–South Africa Agreement goes significantly further than the Cotonou Agreement as regards competition policy. That could become a model that the EU tries to impose on future FTAs with ACP states.

In Article 35, the EU–South Africa Agreement states that

> *... the following are incompatible with the proper functioning of this Agreement ... (a) agreements and concerted practices between firms in horizontal relationships, decisions by associations of firms, and agreements between firms in vertical relationships, which have the effect of substantially preventing or lessening competition ... (b) abuse by one or more firms of market power ...*

There is nothing exceptional about that; it does not go far beyond the Cotonou Agreement and a case could be made that the benefits to a developing country from legislating to implement that article could be significant. But then in Article 38, under the title 'comity':

> [t]*he Parties agree that, whenever the Commission or the South African Competition Authority has reason to believe that anti-competitive practices, defined under Article 35, are taking place within the territory of the other authority and are substantially affecting important interests of the Parties, it may request the other Party's competition authority to take appropriate remedial action in terms of that authority's rules governing competition ....*

Thus it is entirely possible that the ACP states, in negotiating EPAs with the EU, will find themselves constrained to accept certain rules about close co-operation with the EU over specific competition issues, including comity, as well as to adopt rules which preclude any exceptions to NT rules, at least as regards EU firms. In general, it would be preferable to pre-empt such pressures by reaching agreement within the WTO rather than to face pressures in the Brussels negotiations where the ACP countries are arguably in a weaker negotiating position. An MCA might also pre-empt pressures for more extensive competition rules in bilateral or regional negotiations with other developed economies.

6 Possible Ways Forward

The World Bank-OECD, UNCTAD and Canadian Models

While this paper argues that an MCA should require only that Members outlaw anti-competitive practices which have clear transborder effects, as countries continue to

adopt new or amend existing competition laws they will reflect the experiences of those countries, as well as perhaps their political biases. The report on the CUTS 7-Up project draws attention to the differences in emphasis in the seven countries under examination.[58] Some competition laws specify the control of inflation, even the encouragement of innovation, some even the fair distribution of income or the reduction in unemployment.

The World Bank, in association with the OECD and, separately, UNCTAD, have produced templates for competition laws in developing countries; these models differ in some important ways.[59] They are summarised in Annex 1. The principal differences between the model laws are the omission of extra-territoriality and any prohibitions on unfair trade practices in the UNCTAD model. The World Bank-OECD model does not include the compulsory pre-notification of mergers and acquisitions. It is broader as regards the justifications for preventing mergers and acquisitions while throughout it shows a greater concern for consumer interests relative to opening markets as the underlying principle. In both cases government activities are totally excluded though mixed public-private enterprises would be covered by the World Bank-OECD model if they were intended to be profit-making.

Within the WGTCP over the last year Canada has proposed a framework agreement on competition policy that includes:

- Countries' adoption of a 'sound' competition law;
- A commitment to the principles of transparency, non-discrimination and procedural fairness, including private right of action or procedures to petition the competition authority;
- An advocacy role for the competition authority;
- Common substantive approaches to international cartels;
- Mechanisms to facilitate and foster co-operation between competition authorities;
- Undertakings on technical assistance to developing countries, for example, via World Bank programmes, to reinforce their ability to negotiate and implement a competition agreement.

But though it favours a broad MCA under the WTO, Canada's view is that it would not be appropriate for WTO dispute settlement procedures to apply to countries' commitments on competition policy. Competition decisions must reflect specific economic and legal considerations which WTO panels are not in a good position to evaluate. Rather, it argues that a process of 'peer review' is the only constructive option relevant to general undertakings on competition policy.

The EU Proposals

The European Union is the major proponent of an MCA. It has proposed the universal adoption of a set of minimum legal standards and 'core principles' for domestic competition laws and regulations, and minimal requirements as regards international co-operation between competition authorities. It calls for:

- Agreement on core principles to be reflected in domestic competition laws; the EU argues that WTO Members should negotiate a binding framework agreement which would set out a set of core principles to serve as the basis for domestic competition laws within each Member. The legislative framework would be based on the principles of non-discrimination and transparency, guarantees of 'due process' in competition investigations (including protection of confidential information) and the right of petition to competition authorities and/or judicial review;
- Agreement on a ban on hard-core cartels;
- Establishment of a flexible framework for international co-operation; this could include the establishment of an international 'clearing house' for the exchange of information on domestic laws, practices and developments; co-operation between investigatory organisation on particular cases; and discussions on issues of concern with regard to policy and its developments in different jurisdictions.

The EU supports the recently launched International Competition Network (ICN), which includes, besides the EU itself, Israel, Japan, Korea, Mexico, South Africa, the United States and Zambia. It is intended to provide competition authorities with a stronger and broader network for addressing practical competition enforcement and policy issues. It will encourage the dissemination of experience and best practices to facilitate international co-operation building on the work of other international organisations such as the OECD, the WTO and UNCTAD. Initially, the ICN will focus on the merger control process as it applies to multinational mergers and on the competition advocacy role of anti-trust agencies, particularly in developing and emerging economies.[60]

As regards the role of the WTO, under the EU proposals, an MCA would not limit the independence of domestic competition authorities in the exercise of their enforcement responsibilities, nor allow the WTO to overrule their decisions.[61] 'However, it is likely that Members of the WTO could challenge the compatibility of another Member's national law with the Agreement if the law is not based on the principles of non-discrimination and transparency.'

7 A Minimalist Approach

The model laws and the EU proposals serve as useful starting points. But it can be argued that the model laws incorporating, for example, rules for mergers and acquisi-

tions, would be superfluous in a country where there was no industrial base. The EU proposals remain rather vague as to what would be included in the minimum set of rules. In any event it is likely that a multilateral agreement on a comprehensive set of competition rules involving many obligations would be impossible to reach, given the divergences between the practice and philosophy of different countries. Many developing countries now feel that they made mistakes in agreeing to the TRIPs and TRIMs agreements which had much more far-reaching implications as regards their discretion to make policy than they had envisaged at the time.

This paper has raised some strong arguments in favour of a minimum set of rules agreed in an MCA. Clearly, however, that should not be seen as the end of the story. There is a strong rationale for moving much further towards a harmonised set of best practices as regards competition policy – always bearing in mind that what is most appropriate is not identical for all countries. History, domestic economic conditions, developmental objectives and the capacity to implement mean that, in some respects, the optimal laws and the structure of the institutions for their implementation will not be the same in all countries.

Content of a Multilateral Competition Agreement

The argument in favour of a minimum set of rules is that it could enable the developing countries to benefit further from trade liberalisation while not involving them in major, resource-intensive and ultimately uncertain international commitments. They broadly accept that domestic anti-competitive practices, whether through cartels, vertical restraints or government-sanctioned monopoly situations defeat the very purpose of free trade. The developed countries broadly agree that the special needs of the developing countries need to be recognised. They accept a certain flexibility in the implementation of the core principles and the needs of these countries as regards co-ordinated technical assistance and help in capacity-building. Excessive demands on the developing countries through pressing for a comprehensive competition policy including both a far-reaching set of statutes and the appropriate agencies to put them into practice could be counter-productive. The commitments, both as regards domestic legislation and international co-operation, agreed in a MCA should be manageable from the point of view of the capacity of all the WTO members to legislate and enforce those laws and to establish the necessary structures for international co-operation, including the allocation of responsibilities among competition agencies and/or government departments.

Another general concern among developing countries is that exemptions and exceptions from commitments are typically time-limited or subject to periodic reviews. In the former case, simply the passage of time, rather than any economic criteria, will mean that these derogations will be disallowed or in the latter there will be constant pressure from developed countries for their removal. To some extent this

process is already evident in the ongoing negotiations on services. An important advantage of minimising the set of agreed competition rules and practices under the WTO umbrella would be the avoidance of the problems associated with exemptions and exceptions.

Fox proposes a law, agreed multilaterally, to prohibit the impairment of market access through private or public restraints, including exclusions by dominant firms, cartels with boycotts or exclusive dealings by a few dominant firms.[62] The law would require no international negotiation or new bureaucracy. It would not be a bonanza for lawyers. It would be transparent and non-discriminatory. It would only come to a WTO disputes panel in a dispute as to whether the international agreement was being implemented. It would limit the occasions for extraterritorial applications of anti-competitive action and reduce anti-dumping cases, the latter because domestic firms would be less able to price-discriminate in the domestic and foreign markets.

This minimal competition law is consistent with the Canadian and EU proposals. Of course, many developing countries have gone, or will want to go, beyond these minimal requirements to develop more wide-ranging anti-trust legislation. They will want to curb anti-competitive behaviour whether on the part of national firms or TNCs. Many of the large new national companies are privatised utilities and often natural monopolies. The market power of TNCs and their scope for anti-competitive practices depend more on the economies associated with bulk buying of inputs, finance and marketing than with technological economies of scale – which are typically exhausted at a smaller size – but this market power can be disastrous for local producers.[63] However the competition laws and regulatory mechanisms appropriate for developed countries may appear both too expensive and unnecessarily sophisticated for many developing countries. There is much to be said for leaving the choice of going beyond, and if so how far beyond, a simple mandatory law against access impairment to the individual countries concerned. However, as far as the transborder dimensions of a MCA are concerned, we would want to go considerably further.

Under these proposals the MCA would require of all Members:

- That all anti-competitive practices that significantly impair the access for foreign exporters of goods or services to a country's markets through private or public restraints be prohibited;
- That hard core cartels are outlawed in all Member countries;
- That Members should agree to consider the interests of third countries in their merger authorisation procedures, even though taking into account issues beyond simply those of dominance will lead to some difficult judgments;
- That, in order to deal with the problem intensive information-sharing by competition authorities (or the appropriate branches of government), enforcement actions

in partner countries, the practice of positive and negative comity, international notification and consultation are all required;

- That fair and equitable legal procedures, modelled on those in the TRIPs Agreement, would be agreed, including equal application of competition law enforcement to foreign and domestic persons (natural and legal), the right of appeal and the availability of remedy measures and the avoidance of undue delays in the proceedings.

Towards a World Competition Forum

Clearly establishing the basic commitment to an international competition authority would be a lengthy process. It is also clear that it would be valuable to bring along the entire WTO membership in the process. Many of the issues that have been raised in the debate within the WGTCP are not directly related to the dismantling of trade barriers or more broadly to questions of market access. The question of market access – and competition by way of unimpaired market access – is *the* purview of the WTO and this chapter has proposed an agreement that covers national legislation and international co-operation to deal specifically with the market access issue.

The competition issue – and arguably other new issues currently being mooted for inclusion in trade negotiations such as labour standards – go beyond the formal competence and practical expertise of the WTO. For intense international co-operation and capacity-building in the area of competition policy, a more mutually supportive body is needed and one that can readily embrace non-governmental players such as bar associations and chambers of commerce. All states, particularly perhaps the developing countries, could benefit from further engagement in dialogue and the exchange of views across the full range of competition policy issues. Through the OECD there is already co-operation which promotes the adoption of 'best practices' and, ultimately, the convergence of approaches, rather than strict harmonisation, towards competition law and institutions.[64] What is required is a body that includes both developed and developing countries, a World Competition Forum, which would bring WTO Members and other countries together voluntarily in a non-confrontational grouping for the promotion of the 'culture of competition', for sharing experience and for mutual assistance in the establishment of best practice law and procedures.

The International Competition Network (ICN) is a forum in which national competition authorities are addressing competition issues; it already is considered as a promising forum for co-operation and the promotion of best practices. It is plausible that the ICN could form the nucleus of the new WCF proposed here. The WCF would be the principal locus for the general exchange of experiences, views and advice among competition authorities and their officials, while the more specific forms of mutual assistance that would take place between competition authorities in regard to

individual cases would be the function of the comity provisions of the MCA. The WCF would engage in exchanges of experience and discussions on competition policy issues. For example, it would organise conferences on global competition issues which affect international trade and global economy. It would be the forum for developing a long-term vision of enhanced co-operation, in particular by discussing issues relating to procedural and substantive convergence An important activity that would be undertaken within the WCF would be voluntary peer reviews of each member's competition laws, policies and perhaps even their enforcement record. It would also serve as the focal point for the co-ordination and monitoring of technical assistance, especially to the developing countries. Perhaps the ultimate proof of the success of a WCF would be the establishment, under its auspices, of an international authority for the investigation of proposed mergers and acquisitions.[65]

In particular the WCF should engage the Members in debate and negotiation with a view to improving and expanding the MCA in appropriate directions. These include:

- Since horizontal agreements are both easier to define and thus prohibit *de facto* and are responsible for the greater part of anti-competitive action which impairs market access, it is proposed that they be singled out for immediate prohibition through the MCA. Any clearly definable vertical agreements which also impair market access should also be outlawed. However, other types of vertical agreement or abuses of dominance, in the private or public sectors, need to be carefully examined in order that appropriate definitions can be derived and such abuses added to the list of agreements outlawed through the MCA;
- The replacement of the existing much abused anti-dumping measures by competition law. As countries develop laws against predation and their legal processes are open for foreign individuals or firms to take legal action against predatory behaviour, those countries may associate under a plurilateral agreement to eliminate AD procedures against one another;
- Whether it is practicable to agree on a list of prohibited and actionable RBPs, and whether such a list could be enacted throughout all Members as part of an extended MCA;
- The improvement of the TRIPs Agreement to prevent abuse of the agreement to justify anti-competitive behaviour, including the prohibition of action to stop parallel imports, i.e. imports of branded goods bought in markets where they are cheaper to avoid costly official marketing channels.

The existing TRIPs agreement makes clear that IPRs are 'exhausted' once the right holder releases the intellectual property, but certain jurisdictions, including the EU, have nevertheless sought to restrict certain parallel imports. Both the EU and the US have protested about laws permitting parallel imports in other developed economies,

the latter against a law in New Zealand based on the principle of international exhaustion. Both the EU and the US accept national exhaustion, under which traders have the right to move goods across internal borders after the initial sale has occurred and sell those goods at whatever price the traders may decide, but have not accepted that that is legal where the movement is into a foreign market. In addition, the abuse of IPRs should lead in appropriate cases to 'compulsory licensing', that is the required licensing of the IP to third parties, and rules governing this should be made explicit in the competition law.[66]

8 The Need for Financial Support and Technical Assistance

The Doha Ministerial explicitly recognised the need for enhanced technical assistance and capacity-building in this area, 'including policy analysis and development so that they (the developing countries) may better evaluate the implications of closer multilateral co-operation for their development policies and objectives, and human and institutional development. To this end, we shall work in co-operation with other relevant intergovernmental organisations, including UNCTAD, and through appropriate regional and bilateral channels, to provide strengthened and adequately resourced assistance to respond to these needs. In the period until the Fifth Session, further work in the Working Group on the Interaction between Trade and Competition Policy will focus on support for the progressive reinforcement of competition institutions in developing countries through capacity-building.'[67]

Capacity-building is required if countries are to fully benefit from competition laws in general and international co-operation in particular. This not only applies to countries about to institute a system of competition laws, with the necessary agencies to make them work, but also to the roughly 90 WTO Members who currently have competition laws on their books. Even the most sophisticated exponents of competition law can benefit in various respects from the experiences of others.

Many developing countries clearly lack trained lawyers and other experts in the implementation of competition law. In this regard, scholarships for academic and professional training, internships at competition authorities abroad, visiting staff from experienced agencies in other countries, financial assistance for workshops and help with international databases of competition law and cases are all areas where assistance would be valuable. 'For example, in relation to long-term secondment programmes, apart from the obvious benefits of having an experienced anti-trust official on site, it ensured that the 'capacity builder' developed an understanding of the country which he or she was assisting and that a long-standing connection developed between competition authorities in the respective countries which, in turn, meant that assistance could continue to be sought long after the capacity builder had returned to his or her home country.'[68]

Assistance in drafting legislation would often be valuable. The developed countries could also help with establishing a network, both of individuals and computers, for the exchange of opinions, experience and information and with a detailed and ongoing comparison of competition law in different countries matched to the experiences of implementing different laws. It is clear from the CUTS 7-Up project that financial constraints are a significant handicap to the work of some of the competition authorities examined, particularly given that some of their legal opponents were employed by large corporations, sometimes TNCs, with resources able to command the finest legal skills. This is hardly surprising given that the authorities are not yet an integral part of government and, indeed, are more likely to stand on the toes of aspiring politicians or businessmen than to be enthusiastically embraced by them.[69] It is clear from the CUTS interim report that competition authorities need both financial support and long-term help with training and development. They need the support of strong advocacy of their contribution to economic development.

With respect to the development dimension, Canada has argued that developing and emerging economies will gain particular advantage from a multilateral agreement on competition law and policy, notably from co-operation with more experienced competition authorities, but only if they are in a position to participate as full and equal partners. The WTO would need to seek the co-operation of UNCTAD, the World Bank and other international institutions to ensure the delivery of a coherent program of technical assistance in the competition policy field as a means of enhancing the capacities of developing countries in the implementation and enforcement of competition law and policy. However, the WTO was not envisaged as a major provider of technical assistance and currently has neither the structure or funds for that role. In addition, it lacks the full confidence of the developing countries.

The proposed World Competition Forum could serve better as the main source of capacity-building and co-ordinator of the technical assistance currently offered by the WTO, other existing international organisations (UNCTAD, the World Bank and the OECD are already involved) and national governments. In this respect the peer review system could serve, not only to enforce international obligations, but also to foster understanding and the adoption of best practices among countries adopting or reforming their competition laws.

9 Conclusions

Many developing countries are pressing ahead with fully-fledged competition laws and agencies. The goal of an active competition policy is reliance on market forces to determinate allocation of productive resources, subject to the constraint of ensuring that certain social objectives – including distributional goals – are not compromised. Progress towards this goal will be advantageous both to consumers who will gain from

lower prices and greater choice, and to economic growth which will benefit from improved economic efficiency. But what is important is that the international community ensures the availability of financial and technical assistance to the countries that are embarking on this path – and indeed to those who have already made some headway but where further progress is being pursued.

A number of WTO Agreements – in particular the GATS and the agreements on TRIPs and TRIMs – already embody a number of competition rules, but competition issues are dealt with piecemeal and inadequately. If anti-competitive practices are not to frustrate the access to international markets that the WTO was intended to safeguard, a much more thoroughgoing approach is needed. Moreover such a comprehensive approach could have major, often beneficial, implications for the implementation of other WTO Agreements where there would be a fair measure of overlap – in particular, the agreements on TRIMs, TRIPs and anti-dumping. In any event, the piecemeal nature of the treatment of competition issues in the Uruguay Round Agreements has resulted in the setting up of the WTO Working Group on the Interaction of Trade and Competition Policy.

The WGTCP has spent many hours discussing the relevance of WTP principles – what these are is a matter of varying interpretation – to competition rules and, in particular, to a Multilateral Agreement on Competition. There seems to be a general consensus that non-discrimination, transparency and flexibility – a code word for the 'development dimension' – are critical. But there has been little debate about what an MCA should cover and the role of the WTO in its implementation.

This chapter has addressed the question of whether the WTO has a role in establishing competition laws and agencies among all its Members and developing a system of international co-operation:

- At the case-specific level for mutual assistance in the prosecution of anti-competitive behaviour by national authorities;
- Through providing a judicial forum for the prosecution of anti-competitive behaviour of a transborder nature, for example export cartels, and/or an international authority for the vetting of merges and acquisitions where there are transborder implications;
- At the more general level helping Members to pursue best practice in the establishment of laws or agencies and, in so doing, advancing the gradual process of harmonisation of the formulation and implementation of competition law among Members.

The analysis has come down in favour of a minimal corpus of domestic competition law to be agreed in a Multilateral Competition Agreement and implemented by all Members. These laws would be designed to prevent the impairment of market access

by anti-competitive actions. A number of clearly identified anti-competitive practices which restrict exporters' access to markets would be proscribed.

The extent to which Members wish to institute more sophisticated or comprehensive competition rules to limit anti-competitive behaviour which essentially affects only their own markets is a question for them, not for the WTO, whose mandate is one of preventing obstacles to trade rather than looking to improve economic structures willy-nilly.

As far as international co-operation is concerned the MCA should require considerably more. In particular the MCA would include three principal elements:

- All Members would agree to wide-ranging information-sharing and intensive co-operation through both negative and positive comity to assist in the elimination of threats to competition;
- Outlawing of hard-core cartels in all Member countries. Clearly a definition would be required and the broad outline of that could be included in the Agreement.[70] There should also be a mechanism for allowing countries to grant exclusions to purely domestic cartels while ensuring appropriate transparency regarding such exclusions;[71]
- An agreement that in the examination of the threat to competition of new mergers or proposals for new mergers (or acquisitions) in any Member, the interests and arguments of other Members, particular in respect of the potential dominance in their individual markets, would be taken into account.

The reasons for rejecting a more extensive prescription for domestic competition law within the proposed MCA, using for example the World Bank-OECD or the UNCTAD codes, are mainly that concern to protect their development interests will make many developing countries reluctant to participate in such an agreement. Consideration of the development dimension raises the question of whether the necessary policy scope and required institutional backing is the same for a small economy as a big one: whether in short 'one size fits all'.

There are also major resource concerns not only with regard to the financial implications of setting up the necessary institutions to make competition law effective but in the lack of qualified lawyers and other needed personnel. In this respect there is much to be said in favour of a regional approach, particularly where there are already existing regional institutions.

In addition, there is an understandable suspicion of entering into multilateral agreements under WTO auspices on the part of the developing countries, who feel that they have had their fingers burnt in both the TRIMs and the TRIPs agreements. They fear that the details of the agreement are liable to be 'captured' by the developed countries, in particular the USA and/or the EU.

There is no need to wait for all countries to adopt competition law before an MCA is agreed at the international level. Such an international agreement will be likely to encourage countries to act more rapidly on the domestic arena, in some cases proving helpful in overcoming domestic opposition to the implementation of pro-competitive policies.[72]

However, this chapter proposes a new instrument to serve as an international forum for discussion on experience in competition policy – dubbed the World Competition Forum – which would be open to all WTO Members and ideally attract most of them to join. It would be an intergovernmental body but would be run informally with major participation from academics and lawyers. To some extent the International Competition Network is already serving as such forum and could serve as the nucleus of the WCF.

The WCF would have a major role in technical assistance and capacity-building in the developing world. It would run peer reviews – along the lines of the OECD peer reviews of competition policy in the OECD states – to examine competition law and agencies in all its member countries and encourage the best practice and thereby a useful, but not slavish, harmonisation. It could ultimately be the focal point for a world mergers and acquisitions authority.

Annex

Table 9.1: Comparison of the UNCTAD and World Bank-OECD Models of Competition Law

	UNCTAD model law	World Bank-OECD Model Law
Objectives	To limit restrictive agreements between enterprises or M & A or abuse of market power, which limit access to markets or otherwise unduly restrain competition	To maintain and enhance competition in order ultimately to enhance consumer welfare
Coverage	All enterprises in regards to commercial agreements and transactions regarding goods, services or IPRs All natural persons, who in capacity as owner, manager or employee, authorise or engage in restrictive practices prohibited by law Does not apply to sovereign acts of the state	All areas of commercial economic activity Does not derogate the privileges and protection conferred by laws to protect IPRs, but it does apply to the use of such property in such a manner as to cause the anti-competitive effects prohibited by competition law
Extra-territorial jurisdiction	Not explicit	The law is applicable to all matters specified in having substantial effects, including from acts done outside the country
Dominance	Prohibition on acts or behaviour involving an abuse of a dominant position of market power: – where an enterprise, either by itself or acting together with others, is in a position to control a relevant market; – where the acts of a dominant enterprises limit access to a market or otherwise unduly constrain competition – having adverse effects on trade or development – acts or behaviour considered abusive – predatory or discriminatory pricing – resale price maintenance – restrictions on parallel imports	A firm has a dominant position if it can restrain competition for a significant period and has 35 or more per cent of the market. Abuse of dominance is prohibited including creating obstacles to entry, or to expansion of competitors or eliminating competing firms, other than by increasing efficiency. Where no other remedy is available, the competition authority could reorganise and break up the abusing firm, provided the results would be economically viable

	UNCTAD model law	World Bank-OECD Model Law
Restrictive trade practices	Agreements prohibited are those which – fix prices or other terms of sale – collusive tendering – market allocation – restraints on production or sale – concerted refusal to purchase or supply – concerted denials of access to an arrangement crucial to competition	Agreements prohibited are those meant – to fix prices, tariffs, discounts etc. – to fix the quantity of output – to divide the market by any means – to eliminate actual or potential sellers or purchasers – to refuse to deal and any agreement significantly limiting competition
Mergers and acquisitions	Mergers, takeovers, joint ventures, horizontal, vertical or conglomerate should be *notified* when – at least one of the enterprises is established within the country and – the resultant market share is likely to create market power, especially when there is a high degree of concentration, barriers to entry or lack of substitutes It should be *prohibited* when – the ability to exercise market power is substantially increased – a dominant firm or significant reduction in competition will result	Concentration will be deemed to arise when two or more firms or parts of firms merge; or one or more natural or legal persons controlling one firm acquire control of the whole or parts of other firm(s) Concentrations that will probably lead to a significant limitation of competition are prohibited
Unfair trade practices	No specific suggestions	These include the distribution of false information capable of harming another firm or false or misleading comparisons of goods
Enforcement agency	No specific suggestions	– an independent, autonomous, accountable competition agency – specialised court with procedures and rules of evidence suited to competition cases with appropriate composition
Status, powers and functions	– inquiries, investigations upon complaints – taking necessary decisions, including sanctions, or recommending them to minister – studies, reports and information for public – making regulations – assisting in the making or review of legislation on RBPs or related areas – exchange of information with other states	– independent from any government department, receiving budget from and reporting directly to president/legislature – the right to make submissions to state authorities on legislation or regulations that could affect competition. When hearings on proposed laws are held, the competition authorities should have right to intervene and publish such interventions

	UNCTAD model law	World Bank-OECD Model Law
Sanctions and relief	The imposition of sanctions for – violations of the law – failure to comply with decisions of the competition authority or judicial authority – failure to supply information on time – false or misleading information. Sanctions could include – fines, imprisonment – interim orders or injections, cease and desist etc. – divestiture or recession (mergers and acquisitions or restrictive contracts) – restitution to injured parties	Orders to prohibit firms carrying on the anti-competitive practices, and actions to eliminate the harmful effects, and ensure against recurrence – fines for cartel or restrictive agreements, abuse of dominance, unfair competition and to ensure unfair competition and to ensure mergers and acquisition notification compliance – interim injunctions when necessary – parties may apply for an advance ruling, which would be binding on the competition agency. Advance ruling is for a limited period but can be renewed or modified or revoked under certain conditions

Sources: UNCTAD (2000), World Bank/OECD (1999), Basant (2002)

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Notes

1 Fox (1999), p. 665.
2 WTO (2003), *Trade and Competition*, background information, available at http://www.wto.org/english/tratop_e/comp_e/comp_e.htm#top
3 Paul Cook (2002), *Competition Policy, Market Power and Collusion in Developing Countries*, University of Manchester.
4 Tybout (1992).
5 Even in Hong Kong anti-competitive practices in the services sectors have shown the need for competition policy: '[c]ost pressures felt in Hong Kong have highlighted the need for improved competitiveness and cost effectiveness throughout the economy. While free and open competition has long been the case in the traded sectors of the Hong Kong economy, this has not been the case in some non-traded sectors. Since they do not face direct competition, it is important to ensure that the monopolies and oligopolies found in Hong Kong operate at maximum efficiency'. Vision 2047 Foundation (July 1996), p. 6. This is apparently not yet the case in Singapore.
6 EU Commission (1995).
7 WorldTradeLaw.net (2002).
8 CUTS (2002).
9 Ibid.
10 A good overview of the proceedings of the WGTCP is available in the yearly reports; see WTO (2000, 2001a, 2002).
11 WTO (2001a), para. 15 f.
12 In a number of submissions to the WGTCP, 'progressivity' is cited as a WTO principle: in these it appears to refer to the acceptance of a gradualist and time-differentiated approach to the introduction of multilaterally-agreed laws and institutions.
13 Woolcock (2003), p. 4.
14 It is important not to underestimate the complexity of – and costs attached to – a commitment to transparency. It involves much more than the provision of information of competition law. It includes, for example, implementing procedures and the decisions and guidelines of courts and competition authorities. See Woolcock (2003).
15 For example, in the US in 1982 export cartel exemptions to anti-trust laws were enacted with a view to promoting exports.
16 Levenstein and Suslow (2001). See also Evenett, Levenstein and. Suslow (2001) for further evidence from World Bank research on the topic.
17 Hoekman and Holmes (1999), pp. 7–8.,
18 Cook (2002) p. 20.
18 Kemal, Bilquees and Malik, (2002).
19 World Bank (2001), p. 135.
20 Cook (2002), p. 19.
21 CUTS (2001).
22 See, for example, WTO (2002a),
23 The GATS also has elements of a negative list approach. In sectors where market-access commitments are undertaken, there are a number of qualifications that are not permitted, including limitations on the number of service providers or on the value of transactions or employment or restrictions on the participation of foreign capital. See GATS, Article XVI.
24 Basant (2002), p. 8, notes the extensive use of AD measures by India, Pakistan and Zambia in recent years.
25 Hoekman and Holmes (1999).
26 WTO (2002b).
27 For the development of these arguments, see in particular Singh and Dhumale (1999).
28 WTO (2002), para. 26.
29 WTO (2002), para. 44.
30 Fox (1999).
31 Raghavan (2000).
32 Even then the EU is reluctant to bring in the DSU. 'As regards dispute settlement, any review of individual decisions should be ruled out. Issues relating to the way in which the law is being applied (or not applied) could only be considered within the framework of 'peer review' and outside the context of any possible dispute settlement mechanism. Any possible dispute settlement case would therefore be strictly limited to the consideration of any possible lack of conformity of domestic legislation with multilateral commitments.' European Commission (2000).

33 Commonwealth Secretariat (2001).
34 WTO (2002b).
35 WTO (2002b).
36 Cook (2002), p. 20.
37 The ratio of trade (exports plus imports) to GDP is highly correlated with size. The average ratio for the Commonwealth Secretariat-World Bank set of small states was 1.25 in 1986, for least developed countries 0.54 and for other developing countries 0.72.
38 Hoekman and Holmes (1999), p. 10.
39 Evenett et al. (2001), Table 3.
40 CUTS (2000), p. 7.
41 See WTO (2000a) for a description of Canada's experience and its reasons for favouring a multilateral agreement on competition.
42 The 'effects doctrine' deals with any behaviour taking place abroad which adversely affects competition in the home country. There might be disagreement, inter alia, over the extent where intent has to be established.
43 WTO (2002c).
44 WTO (2000a).
45 WTO (2002), para. 78.
46 See, for example, the discussion of the South Africa Competition Law in WTO (2002), para. 44.
47 Hoekman and Holmes (1999), p. 9.
48 Singh and Dhumale (1999), p. 5.
49 WTO (2000), para. 46.
50 It is important not to minimise the dangers from the exchange of information. These have been brought out by the International Chamber of Commerce, see ICC (1999).
51 CUTS (2001), p. 2.
52 Basant (2002), p.18.
53 CUTS (2001), p. 2.
54 DFID (2001).
55 Woolcock (2003).
56 For details see COMESA (2002, 2002a and 2002b).
57 COMESA (2002b), p. 13.
58 CUTS (2000).
59 World Bank/OECD (1999); UNCTAD (2000); also see CUTS (2001) for an alternative overview of the scope of the competition law which might be mandatory under an MCA.
60 ICN (2002).
61 Department of Trade and Industry (2001).
62 Fox (1999).
63 Singh and Dhumale (1999), p. 6.
64 This is largely through two OECD Recommendations: the 1995 Recommendation on Co-operation and the 1998 Recommendation on Hard-Core Cartels. For an update on the latter, see OECD (2002).
65 The ICN already has a Merger Review Working Group though this focuses on best practice rather than on the challenges of an international authority. 'The mission of the ICN Merger Review Working Group is to promote the adoption of best practices in the design and operation of merger review regimes in order to: (i) enhance the effectiveness of each jurisdiction's merger review mechanisms; (ii) facilitate procedural and substantive convergence; and (iii) reduce the public and private time and cost of multijurisdictional merger reviews.' See ICN (2002).
66 Hoekman and Holmes (1999), p. 8.
67 WTO (2001).
68 WTO (2002a), para. 90.
69 Basant (2002), p. 33.
70 The process of defining hard-core cartels would not be easy. The OECD has defined them in terms of certain behaviour: price-fixing, bid-rigging, market allocation and output restrictions. But arguably this should constitute only a 'starting-point'. The 2002 WGTCP discussion also raised the question as to whether the definition of hard core cartels would include a *per se* or rule-of-reason approach. WTO (2002), para. 55 ff.
71 WTO (2000), para. 53.
72 Hoekman and Holmes (1999), p. 16.

10

The State of Trade and Environment Negotiations within the WTO

Beatrice Chaytor*

1 Introduction

The Doha Ministerial Declaration (DMD), adopted at the fourth ministerial conference of the World Trade Organisation in 2001, set a four-year target for completion of negotiations on its various mandates.[1] Paragraphs 31–33 of the DMD explicitly recognised the link between WTO Agreements and multilateral environmental agreements (MEAs) and set terms of reference for 'without prejudice' negotiations to commence in this area.[2] Regard for the special needs of developing and least developed countries was to underpin the negotiations, as indicated by the wording of paragraphs 32 and 33.

The Committee on Trade and Environment (CTE) is the primary forum in which the negotiations are held and meets regularly for debate and consensus building. The fifth WTO ministerial conference to be held in September 2003 presents an opportunity, at the halfway point to the 1 January 2005 deadline for completion of negotiations, for a review and assessment of progress. This paper starts with a short assessment of the current state of play in the negotiations on key mandated issues on trade and the environment in the DMD, providing an insight into the respective positions of key developing and developed countries. Section 2 analyses the likely outcomes of the current negotiations and Section 3 puts forward some ideas on how to break deadlocks in a somewhat polarised negotiating environment and how to move forward to positive outcomes, highlighting issues at stake for developing countries. Finally, Section 4 provides some indicative conclusions.

2 Current State of Play in Trade and Environment Negotiations

Negotiations on trade and environment are divided between special sessions of the CTE (CTESS), which has a specific negotiating mandate on certain subjects such as the relationship between WTO rules and MEAs and the usual sessions of the CTE which continue discussion and debate on a number of other issues already in its original mandate, such as eco-labelling, TRIPs and the Convention on Bio-Diversity (CBD),

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and market access and environmental measures. However, issues such as environmental goods and services are taken up in other WTO bodies.[3]

The Relationship between WTO rules and MEAs (Paragraph 31(i))

Paragraph 31 (i) of the DMD provides the negotiating mandate on the relationship between WTO rules and provisions under multilateral environmental agreements:

> *With a view to enhancing the mutual supportiveness of trade and environment, we agree to negotiations, without prejudging their outcome, on: (i) the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements. The negotiations shall be limited in scope to the applicability of such existing WTO rules as among parties to the MEA in question. The negotiations shall not prejudice the WTO rights of any Member that is not a party to the MEA in question.*

According to the language in the paragraph, the negotiations appear limited to *existing* WTO rules and *specific trade obligations* set out in MEAs, and to the application of such measures between Members that are also *Parties* to the MEAs. Despite, or perhaps as a result of, its restrictive wording, paragraph 31(i) has attracted detailed proposals to the CTE special sessions on a multiplicity of issues touching on both process and substance.[4] The process debate has been distilled into two distinct lines of discussion. The first is a conceptual approach aimed at defining the substantive meaning of the terms used in sub-section (i) and the second focuses on developing a framework within which negotiations can take place. The substantive debate has focused on analyses of the trade measures contained in the various MEAs, identifying those qualifying as 'specific trade obligations', contained either in MEAs in force or those MEAs not yet in force.

The Process

(a) The conceptual approach

The conceptual approach is particularly advocated by countries such as Argentina, Switzerland and the European Community, which take the view that the scope of paragraph 31(i) cannot be determined until the meaning of its terms is agreed. Terms which are of primary interest are 'multilateral environmental agreement', 'specific trade obligation' (STO) and 'existing WTO rules'.

(b) The structural approach

Some Members were particularly anxious to progress negotiations beyond establishing definitions and other conceptual issues towards a more tangible result. A proposal spearheaded by Australia was accepted by Members at the November 2002 meeting of the Council for Trade in Services (CTESS) as a reasonable way forward. This suggested a three-phased approach to structuring the negotiations.[5] First, Members should identify: (a) the '*specific trade obligations* in multilateral environmental agreements'

that are to be discussed; and (b) the WTO *rules* that are relevant to these obligations. Second, once WTO Members have identified the specific trade obligations and the particular WTO rules at issue, *information sessions with relevant* MEA *Secretariats* can be used to seek information from these secretariats, and from WTO Members' own experiences, concerning these provisions. The third phase would involve discussion of matters arising from the work undertaken in phases one and two, and focus on the *outcome of the negotiations*. It was further agreed that adoption of the so-called structural approach did not preclude the inclusion of any conceptual discussions as and when they arise.

The Substantive Debate

Members effectively arrived at a compromise at the fifth meeting of the CTESS in February 2003[6] by agreeing to use a revised document by the Secretariat, *Matrix on Trade Measures Pursuant to Selected* MEAs, as a starting point for substantive discussions.[7] This document has formed the basis for a more thorough analysis by Members of the terms used in sub-paragraph (i), and their significance to WTO rights and obligations.

(a) Specific Trade Obligation

A distinction is being drawn between MEA provisions containing explicit trade obligations (mandated by MEA) and those leaving a degree of discretion to states as to the selection of measures to be taken to achieve the established environmental objectives sought by the particular MEA. While India, Argentina and the USA propose that the term STO should be limited to MEA measures that are mandatory and specific in nature,[8] the EC, Switzerland and Canada advocate a definition of STO that also includes trade measures that are relevant or necessary to achieve an MEA objective, particularly where the MEA mandates a particular environmental outcome.[9] Other developing countries, such as Korea and Chinese Taipei, support the more restrictive interpretation of STO suggested by the USA and India.[10]

(b) Multilateral Environmental Agreement

Members differ on the meaning of an MEA. There appears to be consensus on the fact that it should be an environmental agreement negotiated under the auspices of the UN, its specialised agencies or UNEP, and that it should be open to participation/accession by all countries. From this basic premise some Members, such as India, have various qualifications, including that the agreement in question should not only be open to all countries but should have the effective participation of countries of all geographical regions, as well as those at different stages of economic and social development.[11] India, Chinese Taipei and the EC agree that the agreement should be open to accession by other countries on the same equitable terms as the original signatories.[12] However, India and Argentina would prefer the category to be restricted to

agreements already in force, while the USA, Japan and Canada wish to broaden this to include agreements not yet in force.[13] Examples of these include the Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade, the Stockholm Convention on Persistent Organic Pollutants and the Cartagena Protocol on Biosafety.

(c) Relationship between Specific Trade Obligations in MEAs and Existing WTO Rules

In essence, this aspect of the negotiations turns on the extent to which specific trade obligations may be assumed to comply with WTO rules. Members have expressed general sentiments about the legal status of the environment and trade regimes and the meaning of terms, and have proposed principles to guide the relationship between WTO rules and trade measures in MEAs. The EC and Switzerland have been prominent supporters of the need to clarify the relationship. In their view, the relationship raises fundamental governance issues touching on the security and certainty of international legal systems (laws and institutions). They are of the opinion that the reconciliation of the relationship between MEA measures and WTO rules should not be left to the dispute settlement system of the WTO (from which substantive jurisprudence has emerged on this issue) but should be settled through political consensus based on negotiation. They have proposed sets of principles to be used to decide the extent to which STOs may be deemed to be automatically in conformity with WTO rules.[14] Most developing countries, including Chinese Taipei, assert that a STO should not automatically be presumed to be in conformity with WTO rules.[15] Unlike the EC and Switzerland, the USA takes the view that the MEA/WTO relationship is working very well and needs no new rules to give it legal clarity. It declares that WTO rules have not interfered with the use of MEA trade provisions and that MEA negotiators have taken WTO implications into account in designing MEA trade provisions. The route to the rationalisation of the MEA/WTO relationship preferred by the USA is coordination at the national level between MEA and WTO policy-makers and negotiators.[16]

(d) Party/Non-Party

On this issue, the lines are clearly drawn between those Members seeking to keep strictly to the limits of the mandate in sub-paragraph (i) dealing with trade obligations among *parties to the* MEA, and those wishing to consider the possibility that the mandate could be flexible enough to extend to non-parties. In the first camp are the USA, Norway and some developing countries.[17] The EC and Switzerland have raised the question whether 'among parties to the MEA' means that both parties which have acceded to an MEA must be parties to the MEA and its annexes in exactly the same way or whether it is enough that they should be parties to a framework convention without taking the annexes into consideration.[18] They have expressed the opinion that any specific trade obligation in an MEA is negotiated and agreed by consensus in

a multilateral context and challenges between Parties are, therefore, highly unlikely. Accordingly, if parties to an MEA have a dispute over a specific trade obligation, they should endeavour to solve the issue through the MEA dispute settlement mechanism.

Analysis of Positions

The European Community has been the most consistent advocate in the WTO of reconciling MEA measures with WTO rules through either an amendment to the existing exception provisions (GATT Article XX) or a separate WTO agreement dealing with measures taken pursuant to MEAs. This stance stems from the EC's internal policy agenda, where environment has increasingly assumed a prominent role among Member States. Since 1999, the legal agreements that provide the basis for European political and economic integration (the Amsterdam Treaty) have required that Community action must aim at a high level of protection of human health, consumers and the environment and that these objectives must be integrated into the European Community's policies and action. The EC, supported by Switzerland, as a major actor in several MEAs, is therefore seeking to assure the coherence of its Community laws with international trade law. A case in point is the EC's approach to the use of precaution in meeting environmental or human health objectives. As early as the Seattle ministerial conference in 1999, the EC sought to include operational elements of the precautionary principle into the new round of negotiations, but was strongly opposed by the majority of the WTO Members including the USA.

For its part, the USA has taken a cautious approach to the idea that new WTO rules are needed to accommodate MEA measures. In recent years, its trade-related environmental measures have been the target of complaints submitted to the WTO dispute settlement system and through the jurisprudence of the Appellate Body it has more or less achieved the result that it wanted, leading it to conclude that no obvious problem remains to be solved on the relationship between MEA measures and WTO rules. It should also be noted that the USA is not a party to some key MEAs such as the Convention on Biological Diversity, the Kyoto Protocol and the Biosafety Protocol, even though it played a key role in their negotiation, seeking to mitigate the impact of any trade-related measures in these MEAs on WTO commitments. Thus the USA is effectively the most powerful MEA non-party in the WTO and as such its strong interest lies in preventing any attempt to prejudice the WTO rights of any Member that is not a party to an MEA. In particular, it would seek to limit any attempt by the EC to enshrine the precautionary principle in WTO rules, since it has huge economic interests at stake, and because it believes that the ideas about the precautionary principle mask a deeper debate about fundamental differences in societal perceptions of risk: witness the most recent US complaint to the WTO dispute settlement system over the EC ban on GM products.[19]

Developing countries have traditionally been suspicious of the relationship

between trade-related environmental measures and the multilateral trading system, due to the fact that the relationship has usually been described in terms of trade restrictions on products of key interest to them (so-called green protectionism). They have taken a more proactive stance in the debates in the CTE and other fora, and better perceive where their strategic interests lie in the trade and environment relationship, but some of their suspicions remain. In their view, reconciling the MEA/WTO relationship is not an immediate priority; they prefer to focus on negotiation of issues such as the impact of environmental standards and requirements on market access for their products, to assure themselves better integration within the multilateral trading system. In the negotiations on paragraph 31 (i), India has been a key Commonwealth developing country voice, as has Singapore, Kenya, Malaysia and Pakistan. Developing countries in Asia and Africa, in particular, will be seeking to ensure that the mandate in paragraph 31 (i) is strictly interpreted to avoid any circumstances where their products could be the target of unilateral trade-related measures. They and other developing countries will be anxious to avoid any discretion on the part of countries in using trade measures under MEAs to restrict trade, hence India's insistence that the definition of a STO is limited to measures that are specifically mandated and prescribed by the MEA. At the same time, developing countries will be relieved that there are differences between the EC and the USA on this issue.

Information Exchange and Observer Status (Paragraph 31(ii))

Paragraph 31(ii) declares that negotiations should also cover *'the procedures for regular information exchange between the MEA Secretariats and the relevant WTO committees and the criteria for granting observer status …'* The importance of co-operation and information exchange has been acknowledged among Members and recent discussion on this issue has been described as 'constructive', if not conclusive.[20]

Information Exchange

Proposals for procedural arrangements for MEA-WTO information exchange have been made that closely resemble existing informal processes. These include:

i. Co-operation arrangements between the WTO and UNEP Secretariats;

ii. MEA Information Sessions held by the CTE;

iii. WTO Trade and Environment Regional Seminars;

iv. Technical assistance workshops in parallel to main WTO meetings.[21]

Overall, information exchange is considered to be fairly advanced, although the importance of formal procedures to assure efficient information dissemination has been emphasised. Most Members have noted that regional seminars and parallel workshops at main meetings are an important means of helping developing countries to

keep abreast of current trends and progress in the CTE debates. The pre-existence of information exchange among the WTO and MEA Secretariats suggests that this is not a contentious issue and so the prospects for an agreement on this aspect are good. The EC and USA are supported by New Zealand, Australia and Japan in calling for early action on this part of the trade and environment negotiation mandate. Australia and Canada agree with the EC and US suggestions that it would be useful to develop a more formal structure for the information sessions, and that value could be added by clustering the sessions around specific issues.[22] However, the EC's proposal to involve NGOs and other non-governmental experts in the information sessions has caused concern among some countries including Australia and Kenya, which believe that this is outside the current mandate. Malaysia is supported by Brazil and Nigeria in calling for three issues on information exchange to be explored: (1) the nature of the information being exchanged; (2) the procedures involved in the exchange; and (3) the frequency of the exchange.

Observer Status

In contrast, the question of granting observer status to MEA Secretariats and UNEP in the CTESS is more controversial and has been linked to the question of general observer status being considered in the Trade Negotiations Committee (TNC)/ General Council. In both fora the issue remains unresolved. The question has also arisen as to which other WTO bodies and MEA Secretariats should participate, given that paragraph 31(ii) refers to 'relevant WTO Committees'. Both the EC and USA, supported by Nigeria, Canada and Chinese Taipei, propose that a core set of MEA Secretariats that have been participants in the regular CTE should be given *ad hoc* observer status in the CTESS, without prejudicing the General Council's ultimate decision on comprehensive observer status. Australia, while in principle supportive of the idea of observer status for MEA Secretariats, appears wary of creating a subcategory of privileged MEA Secretariats. Other countries, such as Cuba and Argentina, wish to see prior resolution of the issue of observer status in the TNC/ General Council.

In the meantime, Members have agreed a provisional, *ad hoc* solution to allow existing CTESS observers and those with pending requests for observership at the CTESS to be qualified as observers.[23] Under this arrangement, UNEP and six MEA Secretariats have been granted observer status.[24] Some Members, including Egypt and Malaysia, stress that this is without prejudice to ongoing discussions within the CTESS and the TNC/General Council. Discussions will continue in the CTESS about the criteria for observer status at the CTE level and on the relevant WTO Committees concerned by the mandate. A factual document on the observer question and applications by UNEP and MEA Secretariats for observer status in different WTO committees has been prepared.[25]

Analysis of Positions

Where the EC is concerned, observer status for MEA Secretariats and UNEP is a crucial aspect of the legal certainty and security it seeks to achieve between the trade and environment regimes. It forms part of its strategy to ensure improved governance and policy coherence at the international level. It is broadly supported in this latter aspect by New Zealand and Japan. For the USA, paragraph 31(ii) is one of the more innocuous aspects of the trade and environment mandate in the DMD. It coincides with its emphasis on trade and environment policy co-ordination at the national level and underlines its approach to transparency in environment and trade policy-making.

The impasse over observer status stems from the tension in the General Council where the approval of observer status for the Arab League has been blocked by the USA and Israel (because the Arab League maintains a trade ban on Israel). All other applications for observer status are now on a waiting list for approval.[26]

Most developing countries welcome interaction between MEA and WTO Secretariats through regular information sessions because this provides them with valuable information on the complex inter-connecting issues in the negotiations. Since developing countries are better represented in MEA negotiations, they are in a stronger position than they are in the WTO to influence the direction and nature of MEA Secretariat interaction with the WTO. Any discomfort they have about observer status for MEA Secretariats may arise due to the fact that they view the WTO as a forum primarily for governments. Their hostility to the potential involvement of NGOs in the WTO/MEA information sessions also stems from this emphasis on the intergovernmental nature of WTO and because developing countries themselves struggle with effective participation in the CTE and CTESS. Moreover, they view permanent observer status for environmental bodies as gradually enshrining environment within the institutional framework of the WTO, given that many acknowledge that the WTO should not become involved in environment policy-making.

Environmental Goods and Services (Paragraph 31(iii))

Paragraph 31(iii) mandates negotiations on '*... the reduction, or as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services*'. The DMD further states that the elimination of trade barriers would lead to 'win–win' situations as it would have beneficial effects on trade, the environment and development.

Definitional and classification issues are crucial to the negotiations on environmental goods and services, since there is no agreed definition, nor are there internationally agreed criteria to classify environmental goods and services and, therefore, it is not clear which goods or services would automatically qualify for liberalisation.[27] Some Members have argued that negotiations on reduction or elimination of tariff/non-tariff barriers cannot proceed to completion until definitional issues have been resolved. Negotiations on environmental goods have been assigned to the Nego-

tiating Group on Market Access for Non-Agricultural Products (NGMA), while the negotiations on environmental services are under the auspices of the special sessions of the Council for Trade in Services (CTSSS). However, the CTESS has been given a monitoring role on progress in the negotiations and will contribute to these negotiations by examining the definitional aspects and the scope of environmental goods and services.

Environmental Services

The negotiations on environmental services have progressed to consideration of liberalisation requests across a broad range of services, as part of the request-offer process. WTO already had a benchmark for the classification of environmental services; a 1991 GATT Services Sectoral Classification List contains four categories of environmental services – sewage systems, refuse disposal, sanitation and 'other' services.[28] The OECD and the Statistical Office of the European Communities (Eurostat) have developed a broader classification of environmental services. First, relevant industry activities are defined and then a preliminary and indicative list is developed. Industry activities are classified under three broad headings: pollution management group;[29] cleaner technologies and products group;[30] and resource management group.[31]

The broader OECD definition/classification has found favour with some developed countries, such as the EC, USA, Canada, Japan, Switzerland and Australia. In their view, the current WTO classification system (W/120) is too narrow and fails to reflect the market realities of the industry. Adopting a core listing approach, the USA is in favour of a new classification that incorporates a list of environmental sectors that are significant in the provision of environmental services, e.g. construction, engineering and consulting.[32] The USA also mentions the need to focus the classification on pollution prevention rather than 'end-of-pipe' clean up services, i.e. goods that are used to clean the environment or to contain or prevent pollution. The EC has suggested an advanced definition that offers more categories than the W/120 classification, based on what it considers 'pure' environmental services.[33] Such services would be the subject of a cluster negotiation so that they would fall within other sections of the GATS (avoiding the mutual exclusivity pitfall). Australia and Switzerland are broadly in favour of the EC's approach.[34] Switzerland takes the view that there are several fields of activities that would accommodate the gradual integration of environmental services, including professional services relating to the environment, research and development relating to the environment, consultancy, sub-contracting and engineering relating to the environment and construction relating to the environment.[35] Canada also proposes the use of clusters in the negotiations as a check-list,[36] noting that there are relevant services available elsewhere in the W/120 that are important for the delivery of environmental services, such as technical testing and analysis services, scientific and technical consulting services, engineering services and construc-

tion services. Developing countries have not made explicit proposals on environmental services, apart from Colombia which emphasised pollution control and waste management. It accepts the EC classification as a working basis but would add three further services: (i) the implementation and auditing of environmental management systems; (ii) the evaluation and mitigation of environmental impact; and (iii) advice in the design and implementation of clean technologies.[37] Cuba has proposed that developed countries should commit themselves to exporting services from developing countries in the modes of supply that are of key developing country interest.[38] It calls for differential treatment in order to enhance the competitiveness of developing countries. For the moment, environmental services are being negotiated in the Committee on Specific Commitments on a bilateral basis as Members respond to each other's requests, and thus it is likely that in the short term Members will use a variety of different classifications as environmental services. Meanwhile, the CTESS has not yet played the guiding role it has been given on the definitional issues. However, it is likely that the Quad will continue to push strongly for a broadening of the W/120 classification.

Analysis of Positions

Developed countries are market leaders in the conception and delivery of environmental services. The USA is the world's largest producer and consumer of these goods and services, apart from being the second largest net exporter after Germany. The USA, Japan and the EC combined control 85 per cent of the trade in this industry. Most developing countries are net importers of such services. On the other hand, with increasing environmental awareness and the imposition of stricter environmental standards and regulations, markets in developing countries are catching up fast. With the faster rate of growth of demand in developing countries and the over-capacity of supply in developed countries, the latter are looking vigorously to penetrate emerging developing country markets. The further liberalisation of a broader range of services classified as 'environmental' will clearly help them achieve this objective. Meanwhile, the response from developing countries on environmental services will vary depending on the domestic demand for such services which in turn is driven by increasingly strict environmental standards and regulations.[39]

Environmental Goods

Members of the CTESS have broadly supported a proposal by New Zealand[40] for classification based on lists compiled by the Asia Pacific Economic Cooperation (APEC) forum, which in turn is based on the definitions developed by the OECD:

> *... the goods and services used to measure, prevent, limit or correct environmental damage to water, air and soil, as well as problems related to waste, noise and ecosystems, and may also include clean technologies, processes, products and services which reduce environmental risk and minimise pollution and material use.*

New Zealand also produced an annex listing all products it considered 'environmental goods' together with examples for each category.[41] The classification focuses on end use rather than production characteristics. The list is considered 'open' and subject to further elaboration and discussion.

Proposals for the composition of the final list show a clear split among WTO Members. The EC is a major proponent of using process-based criteria (so-called process and production methods (PPMs)) to include goods produced in an environmentally friendly way. It considers that there is a particular need to 'pay attention to goods whose sustainable materials or production characteristics mean that increased trade in such products would also be environmentally supportive'.[42] This view is firmly resisted not only by developing countries, such as Korea[43] and Singapore,[44] but also by the USA[45] and Switzerland.[46] Most developing countries prefer the focus to remain on an 'end-use' approach that focuses on goods that can be used to remedy environmental problems. This position is supported by several Members from across the economic spectrum including Australia, New Zealand, India,[47] Argentina, Chile[48] and Canada.[49]

Analysis of Positions

In the negotiations on environmental goods, PPMs are the proverbial 'elephant in the room'. It is difficult to imagine how substantial liberalisation can take place without addressing this issue. Developing countries are in a difficult position vis-à-vis PPMs. They are understandably anxious to exclude PPMs from the negotiations because of their potential to undermine market access or the competitiveness of their products. At the same time, in some key product sectors, such as organic products, developing countries may find comparative advantage through the differentiation inherent in the consideration of PPMs. Yet how can such goods be distinguished from other products without considering the way in which they have been produced?

Developed countries are not in such a quandary because the products for which they have a competitive advantage are more or less recognised in their own right as technologically-enhanced (environmental) goods (for example catalytic converters and water purifiers). They therefore have less to gain from an insistence on consideration of PPMs in the definition of environmental goods.

To avoid consideration of PPMs, it could be argued that organic products (for instance) are different from other goods because they are inherently environmentally friendly (through their impact on human health, etc). However, this means that such goods must have different customs codes assigned under the international customs system known as the Harmonised System (HS), which is maintained by the World Customs Organisation (WCO). The six-digit codes, which are regularly updated by the WCO to take account of changes in technology or patterns of international trade, are based on national customs codes. In the latest amendments to the HS codes in January 2002, the WCO for the first time included social and environmental fields,

particularly relating to products under certain MEAs including CITES, the International Convention on the Conservation of Atlantic Tunas (ICCAT) and the Basle Convention.[50]

Amendments to the HS codes in order to differentiate between products based on their environmental characteristics are arrived at through fairly protracted deliberations in the WCO. As a start, such customs codes may need to be developed at the national level and then gradually be harmonised. This issue may also provide an opportunity for developing countries to play a more proactive role in the WCO to ensure that their trade interests are taken into account in the development of customs codes.

The Effect of Environmental Measures on Market Access and Win–Win Opportunities (Paragraph 32(i))

Paragraph 32(i) negotiations have focused on two elements: the effect of environmental measures on market access and opportunities for sector-based 'win–win–win' improvements for trade-environment-development by reducing or eliminating trade restrictions or distortions.

The Effect of Environmental Measures on Market Access

Paragraph 32(i) instructs the CTE to give particular attention to the effect of environmental measures on market access, especially in relation to developing and less developed countries.[51] India and other developing countries have consistently attempted to raise the profile of this issue in the CTE. The following issues, *inter alia*, have been highlighted:

i. Developing countries are more vulnerable to adverse side effects of environmental measures because of, *inter alia*, lack of infrastructure and inadequate access to technology, environmentally-friendly raw materials and information;

ii. Environmental standards should take account of the uniqueness of the environmental conditions in each country;

iii. Different environmental measures may be applied in different countries to achieve the same environmental objective and exceptions should be made for these;

iv. Foreign producers should be given the opportunity to participate at an early stage in the development of standards and developing countries in particular should be given more time to adjust.[52]

These concerns have not garnered general consensus in the CTE and although developed countries have expressed themselves willing to discuss these issues, they have warned that some of the recommendations may not be achievable.

Win–Win–Win Opportunities

Paragraph 32(i) instructs members to give particular attention to 'those situations in which the elimination or reduction of trade restrictions and distortions would benefit trade, the environment and development', which are commonly referred to as 'win–win–win' opportunities.[53] Discussions have centred on four sectors: fisheries, agriculture, forests and energy.

i. Fisheries: Some members have argued for the elimination of fisheries subsidies in order to combat over-fishing and stock depletion, while other members, particularly Japan, suggest that some subsidies are not environmentally harmful, and that such problems are compounded by factors such as poor fisheries management.[54] Other countries suggest that the Negotiating Committee on Rules is a more appropriate forum for such a debate.[55]

ii. Agriculture: A number of countries believe that eliminating trade and production-distorting subsidies would allow international commodity prices to reach market levels, thereby increasing returns from agriculture and encouraging investment and production in developing countries.[56]

iii. Forests: Reference has been made to WSSD efforts to combat illegal logging. Some countries have suggested that the United Nations Forum on Forests (UNFF) was a more appropriate body to address such concerns.[57]

iv. Energy: Issues on coal subsidies and a carbon tax have been raised, while some members believe that there are more appropriate fora for such discussions.[58]

The Agreement on Trade-related Aspects of Intellectual Property Rights (Paragraph 32(ii))

Consensus is yet to be achieved on whether clarification of the TRIPs Agreement to reflect its relation to biodiversity conservation and the environment in general is required. This is an area where the differing priorities of developing and developed countries are most obvious. The rift between developing and developed countries lies primarily in three issues:

i. Clarification of the link between the TRIPs Agreement, the CBD and traditional knowledge;

ii. Whether the TRIPs agreement should be modified to provide intellectual property protection for traditional knowledge relating to biodiversity conservation;

iii. The appropriate forum for these discussions.

Developing countries led by India, Pakistan and Brazil are pushing for clarification of the relationship between TRIPs and the CBD and for such clarification to take place

under the work programme of the TRIPs Council. The most vocal developed countries – the USA, Canada and Switzerland – oppose any such moves in the TRIPs Council. In their view there is no conflict between the TRIPs Agreement and the CBD, and they consider the two instruments to be mutually supportive. Further, they reject any effort to restrict trade in patented goods. Widely diverse nations believe that the mechanism of access to genetic resources and traditional knowledge should ensure the conservation and sustainable use of biological diversity in the countries of origin, with their peoples – and particularly local and indigenous communities – reaping the benefits, including monetary benefits, transfer of technology, development of value-added products and improvement in their economies.[59]

Labelling requirements for environmental purposes (Paragraph 32(iii))

Eco–labelling and packaging requirements are also a prime concern for developing countries due to the fact that they are faced with the proliferation of both voluntary and mandatory eco-labelling schemes, which may act as another potential barrier to market access. The issue has remained unresolved for some time within the CTE. The EC[60] and Switzerland[61] have both made submissions suggesting ways of moving forward the discussions on the interpretation of the Agreement on Technical Barriers to Trade or the development of guidelines on the application of its provisions. Suggestions have also been made on combining meetings of the CTE with those of the TBT Committee to discuss this issue; however, these proposals have not progressed further in the CTE. The EC is likely to seek a negotiation mandate for eco-labelling, i.e. moving discussions from the regular CTE to the CTESS. Developing countries are wary of this move since they believe they already have many complex issues to handle in the existing negotiations under paragraph 31(i)–(iii).

2 Likely Outcomes from Trade and Environment Negotiations

The trade and environment negotiations are likely to be affected by the slow pace of progress in Geneva on the entire negotiations under the DMD. Trade-offs will be made depending on the developments in other crucial aspects of the trade negotiations, such as agriculture or textiles. The apparent apathy over the agriculture negotiations will affect the likelihood that trade and environment will produce concrete outcomes at the Cancún ministerial conference in September. In the longer term, progress depends on the political will and changing strategic interests of Members, as well as developments at the bilateral and regional levels.

Short-term Outcomes (Cancún Ministerial Conference)

From the current atmosphere in the CTESS, two possible outcomes seem the most likely.

Political Declaration on Information Exchange between WTO and MEA Secretariats

The negotiations on this issue are the most advanced in the CTESS mandate, and the general atmosphere of co-operation makes this one of the most viable outcomes from the Geneva talks. WTO Members may conclude a political declaration establishing a formal process for information exchange between WTO and MEA Secretariats that seeks to improve information dissemination and achieve policy coherence between environment and trade regimes. The Declaration is likely to contain references to the WSSD Plan of Implementation which advocates mutual supportiveness between the multilateral trading system and MEAs. It may also emphasise the need for national policy co-ordination between environment and trade ministries. However, the Declaration is likely to be silent on the issue of formal observer status for MEA Secretariats and UNEP in WTO Committees. WTO Members may decide to monitor the way the informal ad hoc observer status in the CTESS works, as well as awaiting the TNC/General Council decision on observer status for the whole of WTO.

Recommendation to Advance Market Access (paragraph 32 (i)) and Eco-labelling (paragraph 32 (iii)) Discussions to Negotiation Mode

This would be a simple trade-off between the different proponents of these issues – the EC and Switzerland, on the one hand, and India and other developing countries on the other, and can be viewed as quite likely with a bit of flexibility from both sides. It is likely that the EC will seek to move eco-labelling from discussion to negotiation. Developing countries should be prepared for this and as a counterpart to this effort, they should actively work towards advancing market access to negotiation and be prepared to concede on eco-labelling as the trade-off. Each side can then claim a substantive result from the negotiations.

Longer-Term Outcomes (Post-Cancún and beyond)

There are a number of outcomes from the current negotiation mandate which will take time to emerge.

Classification of Environmental Goods and Services

Consensus is unlikely over a final list of environmental goods at Cancún, and while progress continues to be made on a bilateral basis on environmental services, classification issues also remain problematic in this area. Since there is a clearer benchmark for environmental services, it seems clear that the classification in this sector will be divided into 'core' (those contained in W/120) and 'related' (e.g. engineering, construction or education) services. For environmental goods, the position is not so clear, although the consensus on using the APEC classification as a starting point is useful. This increases the chances of reaching an agreed definition or classification of

environmental goods which reflects a broad range of developing and developed country interests. One major issue that would need resolution in this area is, of course, the issue of PPMs. Developing countries will need to look past their wariness on this issue to the potential trade gains they can make in the sector. The question of how to distinguish environmental products and services from others is central to classification. This necessitates not only developing a methodology in order to establish the distinction, but assigning different customs (HS) codes to these products and services.

Interpretative Decision on the Relationship between Specific Trade Obligations in MEAs and WTO rules

Although the negotiations on the relationship between specific trade obligations in MEAs and WTO rules remains controversial, it may be possible for WTO Members to develop an interpretative decision that keeps within the letter and spirit of the mandate in paragraph 31(i). In the Decision, Members may outline principles and criteria that they have used to determine the definition of: (a) specific trade obligations; and (b) multilateral environmental agreements in the context of the relationship to the WTO and as between Parties to a given MEA. The Decision is certain to start with a preambular statement that environmental and trade regimes have equal status in international law and are to be seen as complementary to each other. It may then identify the STOs already contained in the WTO Secretariat's *Matrix* and go on to establish that they are a privileged category that would be shielded from the application of WTO rules and WTO procedures when these STOs are applied between Parties to the relevant MEAs. In essence, such a Decision would simply be endorsing an application of the law of treaties that recognises that the Parties to these MEAs have, by ratifying these agreements, waived certain rights under the WTO.

3 Ideas for Positive Outcomes from the Trade and Environment Negotiations

The initial debate on environment in the WTO has shifted from a focus on 'trade and environment' towards 'trade and sustainable development'. This change reflects greater participation in the debates at international and regional level by developing countries and a gradual realisation by them that the issues may present more opportunities than threats to their economic interests. It also reflects the perception by developed countries that the trade and environment relationship includes many development issues. This convergence of opinion on the core sustainable development issues of the relationship means that it is important that developing countries do not lose the momentum in engaging their developed country counterparts on the key issues in order that the trade and environment agenda stays focused on real sustainable outcomes. The following are three ideas for avoiding the pitfalls of polarisation in the

current negotiations. At the heart of each of these ideas are the core elements of market access and capacity-building, which are critical for advancing the negotiations.

Defining Environmental Goods and Services to Support the Export Interests of Developing Countries

Forecasts by the OECD indicate that the average growth in the environment-related industry in the next few years in the developing countries of Asia and Latin America will be 5–7 per cent, against the overall annual rate of growth of 3–4 per cent in the Western industrial countries and Japan.[62] Therefore the mandate to liberalise environmental goods and services offers a unique chance to bring together developed and developing countries in a common understanding of the benefits of the environment for trade and vice versa (the so-called win–win scenario). Thus, a comprehensive approach to product and service coverage in these two sectors would demonstrate the strong comparative advantage of developing countries. In particular, the broadening of the environmental goods classification to include products derived from sustainable agriculture, fisheries, forestry or mining may provide opportunities for specific trade interests from developing countries that the current WTO classification does not provide.

However, the benefits of liberalisation in environmental goods and services may not be realised unless WTO members can find viable trade interests and environmental strategic objectives within the framework of the negotiations. Two issues therefore arise:

(a) The extent to which trade liberalisation may enhance the availability of environmental goods and services used to address national environmental problems;

(b) The necessary conditions for trade liberalisation to open markets for environmental goods and services from both developed and developing countries.

Thus, when WTO Members are negotiating commitments in their respective Schedules, the aim should be two-fold: (a) to liberalise market access in sectors and modes of supply of export interest to developing countries;[63] and (b) to strengthen developing countries' capacity in domestic services (including access to technology) and improve developing country access to information networks.

An important factor for developing countries to consider in the negotiations is that the environmental industry in developed countries is extremely well-organised and competitive, particularly for environmental services where capital technologies and large-scale engineering services provide them with considerable comparative advantage. However, although firms from developed countries presently meet most of the emerging demand for environmental goods and services in developing countries, firms from other developing countries may be able to enter these markets too. Trade liberalisation in environmental goods and services as between countries in different develop-

ing country regions could create export opportunities for firms with acquired technologies for addressing similar environmental problems.[64] Firms from developing countries may be in a better position to address environmental problems peculiar to developing regions. Moreover, they may be able to offer a range of products and services that are not only price competitive with those from developed countries, but also based on appropriate technology for the developing country market. For example, in Malaysia, a private company operating privatised waste-water plants is following the example of British and French water companies by providing integrated water services domestically and to other countries in the Asia Pacific region.[65] Another Malaysian company has expanded into manufacturing in order to complement its design of licensed and proprietary water-treatment systems, enabling it to serve markets in Indonesia and Thailand.

It is important to note, though, that developing countries are not a homogeneous group. Most are in the first phases of addressing environmental problems through command and control instruments. This is likely to generate demand for a broad spectrum of environmental goods and services relating to health and sanitation. Others are introducing market instruments to complement regulation, which generate differentiated demand for goods and services in cleaner technologies and resource management. Growth of the industry in developing countries will also depend on the ability of potential producers and consumers, particularly SMEs, to be aware of export opportunities for, and be able to access information on, environmental goods and services.[66] This may come in the form of partnerships or joint ventures between developed and developing country service suppliers, whereby environmental expertise is imported and used with indigenous capacity, making it possible to increase the adoption and operation of new technologies and generate knowledge and skills which can contribute to improving the environment. Even where this is successful, reliable and substantial supply of environmental goods from SMEs is a key factor. It is a fact that many developing country producers of environmental goods, particularly natural-based products may only appeal to niche markets. However, markets are expected to expand in the future for products such as organic foods or sustainable forest products. For example, in Tanzania, trade in honey and other bee products such as beeswax and royal jelly is a larger contributor to the country's GDP than all other forest products combined.[67]

While trade liberalisation in environmental goods and services sectors may be a potential 'win–win', there are multiple factors which may present challenges to WTO Members in the negotiations. Much will turn on the nature of the industry itself, the factors affecting availability and diffusion of goods and services, the preconditions for technology co-operation and innovation, local capabilities, and the nature of domestic environmental and economic conditions.[68] At the same time, these are sectors that cut across a range of other sectors and issues that are currently the subject of the DMD

negotiations, such as agriculture, energy, forestry and textiles. Moreover, negotiations on environmental goods and services will also touch on other issues at the heart of the trade and environment relationship, such as eco-labelling, PPMs, technology transfer and compliance with environmental agreements. Developing countries should use environmental goods and services as a way of mainstreaming some of their core interests in the multilateral trading system.

Technology Transfer Side Agreements

The importance of technology transfer for sustainable development and for environmental protection, especially in the present context of international liberalised trade, cannot be over-emphasised. Access to appropriate technology is often a prerequisite for market access, particularly when access depends on compliance with environmental regulations. Developing countries' main concern here is the facilitation of access to, and transfer of, technology, including environmentally sound technologies (ESTs). Recognition of the role of technology transfer for sustainable development has found expression in many international treaties and instruments, including Agenda 21, the Rio Declaration, the Montreal Protocol, the CBD and the TRIPs Agreement. Yet enforcement of these technology transfer provisions remains patchy, ranging from reasonably adequate as in the case of the Montreal Protocol to non-existent in case of the CBD. Moreover, the entry into force of the TRIPs Agreement has witnessed a situation where patents and patent protection is steadily increasing and widening its scope of application to genetic resources, plant varieties and even living organisms.

Thus far, international law has focused on states and international organisations in attempting to improve EST transfer. However, it is important to recall that technology is possessed by, and technology transfer takes place between, private actors (enterprises) whose standing in international law is much less clear.[69] The rise of the influence of private actors, particularly business, in international law-making calls for a perceptibly different approach to this group in international law. It may be time to expressly recognise their implicit power by including them in certain international agreements through specific side agreements on technology transfer, which impose binding obligations on these multinational enterprises. For instance, a technology transfer side agreement could be negotiated to the TRIPs Agreement which provides for the technology transfer of ESTs which is vital for the compliance of several MEAs, such as the Framework Convention on Climate Change or the Kyoto Protocol, the CBD or the Biosafety Protocol, or the POPs and PIC Conventions. Such a technology transfer side agreement could also include technology elements which assist developing countries in addressing the issue of domestically prohibited goods (DPGs) or the trade in hazardous wastes. A technology transfer side agreement could also be built into the negotiations of future MEAs, or the further development of current MEAs, which more or less require technology transfer for their effective implementation.

At the same time, it will be important that various capacity-building initiatives are developed parallel to a binding side agreement, which enable developing countries (the *demandeurs* of the technology transfer) to exploit technology once it is transferred, and to distinguish technology appropriate to their economic and social conditions.

4 Conclusions

Developing countries now constitute the majority of the membership of the WTO and their voice in the organisation has become progressively authoritative, as their participation in WTO decision-making increases. Through their influence in the CTE and CTESS process, the debate has gradually shifted from a focus on trade and environment to an emphasis on trade and sustainable development. This proactive stance by developing countries must continue in the WTO. Far from shying away from discussion of trade and environment issues, developing countries should ensure that the discussion is oriented towards support for accelerated liberalisation of trade in goods of special interest to them. To do this, developing countries should decisively indicate their priorities and interests, and ensure that the necessary links are made between issues emerging in the CTE and those in other WTO committees. For instance, to ensure better market access for their agricultural goods, developing countries should take positions on organic food products in the environmental goods negotiations in the NGMA; classification of such goods under the CTESS; labelling either affecting or improving trade in such goods in the Committee on Technical Barriers to Trade; requirements for notifications of subsidies which distort trade in such goods in the Committee on Subsidies and Countervailing Measures; and on high tariffs and tariff escalation affecting such goods in the Committee on Agriculture. The same series of issues could be taken up in bilateral trade agreements or regional trade agreements on a consistent basis, backed up with requests for technical assistance and capacity-building to improve trade facilitation.

Developing countries should not be wary of seeking trade-offs as long as the trade-offs serve their strategic interests. At the same time, it is important that developed countries enter into partnerships with developing countries to ensure that the Doha Development Round exists not merely in name but in fact. Some of the anomalies in the trade and environment relationship could be easily addressed by measures from developed countries, such as the elimination or reduction of perverse subsidies in agriculture and fisheries that distort trade and harm ecosystems. Traditional, low-impact community farming may be covered under the notion of sustainable agriculture (one of the OECD environmental goods classifications), and may be properly distinguished from large-scale mechanised agriculture with capital inputs such as pesticides. Through the negotiations in the NGMA, the CTE and the Committee on Agricul-

ture, developing countries could explore differentiation between products derived from sustainable agriculture and similar products from large-scale intensive agricultural practices in developed countries. Trade-offs may be made not only among the issues covered by the trade and environment negotiations but also across issues and sectors in the WTO. For instance, developed countries may be persuaded of the merits of faster and fuller implementation of their obligations under the Agreement on Textiles and Clothing to enable improved market access for developing countries products, if developing countries were minded to reconsider upgrading the issue of labelling for environmental purposes to negotiation mode. Obviously, such trade-offs should be explored within regional groupings of developing countries to test out hypotheses and assumptions before any attempts are made. However, the underlying premise of the proactive stance remains.

To increase their influence in the WTO and to improve the chances for successful trade-offs, developing countries should co-operate more effectively within their regional groupings. Many developing countries have limited resources to devote to maintaining missions in Geneva or to ensure the essential participation of capital-based policy makers in the WTO negotiations. Since 1999, African countries in particular have attempted to surmount technical and logistical difficulties associated with participation through regional seminars hosted by the (then) OAU to update capitals on progress in Geneva. Developing countries need to share information and exchange experiences at the regional level, developing common or co-ordinated positions where appropriate in order to be more effective in both WTO and MEAs processes. Where possible, various countries could be selected to take the lead on certain issues to advance developing country interests in the negotiations. It is interesting to note that developing countries are also co-ordinating positions across geographical regions. For instance, the Like Minded group of countries includes countries from Asia, Africa and Latin America. These developments are welcome and should be built upon to ensure the continued integration of developing countries into the multilateral trading system.

Annex 1. Doha Declaration paragraphs 31–33

Trade and environment

31. With a view to enhancing the mutual supportiveness of trade and environment, we agree to negotiations, without prejudging their outcome, on:

(i) the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements (MEAs). The negotiations shall be limited in scope to the applicability of such existing WTO rules as among parties to the MEA in question. The negotiations shall not prejudice the WTO rights of any Member that is not a party to the MEA in question;

(ii) procedures for regular information exchange between MEA Secretariats and the relevant WTO committees, and the criteria for the granting of observer status;

(iii) the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services.

We note that fisheries subsidies form part of the negotiations provided for in paragraph 28.

32. We instruct the Committee on Trade and Environment, in pursuing work on all items on its agenda within its current terms of reference, to give particular attention to:

(i) the effect of environmental measures on market access, especially in relation to developing countries, in particular the least developed among them, and those situations in which the elimination or reduction of trade restrictions and distortions would benefit trade, the environment and development;

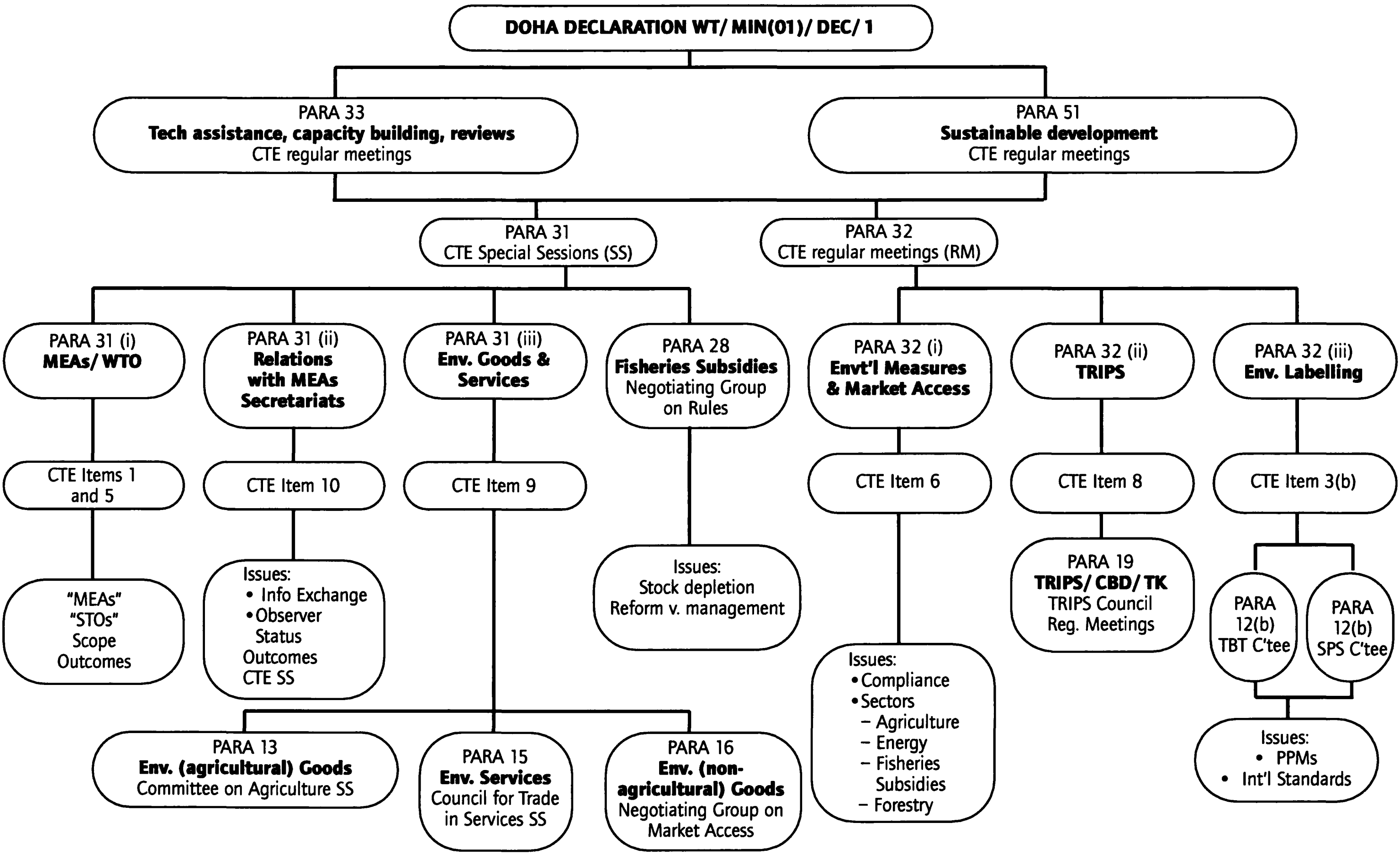
(ii) the relevant provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights; and

(iii) labelling requirements for environmental purposes.

Work on these issues should include the identification of any need to clarify relevant WTO rules. The Committee shall report to the fifth session of the ministerial conference, and make recommendations, where appropriate, with respect to future action, including the desirability of negotiations. The outcome of this work as well as the negotiations carried out under paragraph 31(i) and (ii) shall be compatible with the open and non-discriminatory nature of the multilateral trading system, shall not add to or diminish the rights and obligations of members under existing jmWTO Agreements, in particular the Agreement on the Application of Sanitary and Phyto-sanitary Measures, nor alter the balance of these rights and obligations, and will take into account the needs of developing and least developed countries.

33. We recognise the importance of technical assistance and capacity-building in the field of trade and environment to developing countries, in particular the least developed among them. We also encourage that expertise and experience be shared with members wishing to perform environmental reviews at the national level. A report shall be prepared on these activities for the Fifth Session.

Annex 2. Doha Negotiations on Trade and Environment



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Notes

1 Doha Ministerial Declaration, WT/MIN (01)/DEC1, 20 November 2001.
2 The full text of paragraphs 31–33 is set out in Annex 1 of this paper.
3 See Annex 2 of this paper.
4 See Compilation of Submissions under paragraph 31(i) of the Doha Declaration, TN/TE/S/3/Rev.1, 24 April 2003.
5 Committee on Trade and Environment – Special Session – Suggested Procedure for the Negotiations under Paragraph 31(i) of the Doha Declaration – Submission by Australia – Paragraph 31(i), TN/TE/W/7, 7 June 2002.
6 See Report by the Chairperson of the Special Session of the Committee on Trade and Environment to the Negotiations Committee, TN/TE/5, 28 February 2003.
7 See *Matrix on Trade Measures Pursuant to Selected Multilateral Environmental Agreements*, Note by the Secretariat, WT/CTE/160/Rev.1, 14 June 2002.
8 See Argentina: TN/TE/W/2; India: TN/TE/W/23; US: TN/TE/W/20.
9 See EC: TN/TE/W/1; Canada: TN/TE/W22; Switzerland: TN/TE/W4; TN/TE/W/16; TN/TE/W/21.
10 See Korea: TN/TE/W/13; Chinese Taipei: TN/TE/W/11.
11 See India: TN/TE/W/23.
12 See India: TN/TE/W/23; Chinese Taipei: TN/TE/W/11; EC: TN/TE/W/1.
13 See India: TN/TE/W/23; Argentina: TN/TE/W/2; US: TN/TE/W/20; Japan: TN/TE/W/10; Canada: TN/TE/W/22.
14 See EC: TN/TE/W/1; Switzerland: TN/TE/W/4, TN/TE/W/16, TN/TE/W/21.
15 See Chinese Taipei: TN/TE/W/11.
16 See US: TN/TE/W/20.
17 See US: TN/TE/W/20; Norway: TN/TE/W/25; Argentina: TN/TE/W/2; Chinese Taipei: TN/TE/W/11.
18 See EC: TN/TE/W/1; Switzerland: TN/TE/W/4.
19 http://europa.eu.int/rapid/start/cgi/guesten.ksh?reslist
20 See Report by the Chairperson of the Special Session of the Committee on Trade and Environment to the Negotiations Committee,TN/TE/5, 28 February 2003.
21 For a more detailed list see Summary Report of the MEA Information Session on paragraph 31(ii) of the Doha Declaration, TN/TE/R/4, 21 January 2003; Committee on Trade and Environment – Special Session – Report by the Chairperson of the Special Session of the Committee on Trade and Environment to the Trade Negotiations Committee; TN/TE/4, 2 December 2002.
22 See EC: TN/TE/W/15; US: TN/TE/W/5.
23 *Bridges Weekly Trade News Digest*, Vol. 7, No. 6, 19 February 2003, http://www.ictsd.org/weekly/03-02-19/story4.htm
24 They are the Basle Convention on Transboundary Movement of Hazardous Waste; The Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES); The Convention on Biological Diversity (CBD); The Montreal Protocol on Ozone-depleting Substances; The International Tropical Timber Organisation (ITTO); UN Framework Convention on Climate Change (UNFCCC).
25 Not yet publicly available.
26 See Doha Round Briefing Series, Vol. 1 No. 9 of 13, February 2003, IISD, ICTSD.
27 See *Environmental Goods and Services: The Benefits of Further Global Trade Liberalisation*, OECD 2001 [OECD (2001)].
28 Group on Negotiations on Services. MTN.GNS/W/120, July 1991.
29 The pollution management group, which is the most developed environmental sphere, consists of activities that produce equipment, technology or services to treat or remove environmental effects. This usually includes end-of-pipe treatment that is intended solely for environmental purposes, and is statistically identifiable. The following activities fall into this category: air pollution control; wastewater management; solid waste management; remediation/clean up of soil and water; noise/vibration abatement; monitoring, analysis and assessment. Of these, wastewater management is of crucial importance to many countries.
30 The cleaner technology and products group includes any activity that continually improves, reduces or eliminates the environmental impact of technologies, processes or products, but which may be supplied other than for environmental purposes. Methods of classification and assessment are still under discussion in this group. This group comprises cleaner or resource efficient technology or products such as those that reduce energy consumption, recover valuable by-products, reduce emissions or minimise waste disposal problems.
31 Within the resource management group are activities that prevent environmental damage to air, water and/or

soil. These include activities that produce equipment, technology or specific materials, design, construct or install, manage or provide other services for recycling new materials or products; for the generation of renewable energy (such as biomass, solar, wind, tidal or geothermal sources); for reducing climate change, for sustainable agriculture and fisheries (such as biotechnology applied to agriculture and fisheries activities); for sustainable forest management; for natural disaster risk management; or related to eco-tourism.

32 Communication from the United States to the Council for Trade in Services, S/CSS/W/25, 18 December 2000.

33 Communication from the European Communities and their member states to the Council for Trade in Services, S/CSS/W/38, 22 December 2000. The proposal also covers all sectors and sub-sectors of the environmental services 'cluster' or 'checklist' described in the EC Communication S/CSC/W/25 as modified on 28 November 2000.

34 Communication from Australia to the Council for Trade in Services S/CSS/W/112, 1 October 2001). Australia supported the EC communication on classification of environmental services (S/CSC/W/25, 28 September 1999), i.e. to schedule commitments according to a revised classification which preserves the mutually exclusive nature of W/120 while addressing most of its recognised problems.

35 Communication from Switzerland to the Council for Trade in Services, S/CSS/W/76, 4 May 2001.

36 Communication from Canada to the Council for Trade in Services, S/CSS/W/51, 14 March 2001.

37 Communication from Colombia to the Council for Trade in Services, S/CSS/W/121, 27 November 2001. According to Colombia, the commercial presence of foreign enterprise in the provision of environmental services may be beneficial for developing countries through: (i) increased investment and contribution to capital formation; (ii) technology transfer; (iii) wider coverage; (iv) an improvement in environmental and sanitary conditions.

38 Communication from Cuba to the Council for Trade in Services, S/CSS/W/142, 22 March 2002.

39 Jolita Butkeviciene, 'Gats Negotiations and Issues for Consideration in the Area of Environmental Services from a Development Perspective', Workshop on Post-Doha Negotiating Issues on Trade and Environment in Paragraph 31 (Singapore, May 16, 2002) <http://www.unep-unctad.org/cbtf/meetings/singapore.htm>

40 Communication to the Committee on Trade and Environment, TN/TE/W/6, 6 June 2002. See particularly Section III, paragraphs 5–8. Annex III.1 and Annex III.2

41 New Zealand's Communication includes some examples of environmental goods: (i) Air pollution control includes soot removers for boilers, scrubbers/precipitators, catalytic converters, waste gas incinerators; (ii) Water pollution control includes pumps, equipment for filtering/purifying water or other liquid industrial discharge; (iii) Solid/hazardous waste management: waste incinerators. (iv) Remediation/clean-up of soil and water: absorbent material used in booms or socks used for containing oil spills, inflatable spill recovery barges, pollution protection booms; (v) Noise /vibration abatement includes industrial mufflers; (vi) Monitoring/analysis and assessment includes pH meters, gas or smoke analysis apparatus (vi) Potable water treatment includes water treatment systems, (vi) Other recycling system includes metal recycling equipment, machinery for cleaning or drying bottles or other containers, asphalt recycling equipment; (vii) Renewable energy plant includes wind turbine pumps, solar panels; (viii) Heat/energy management includes heat exchangers, economisers for boilers; (ix) other – soil conversion, erosion control matter, environmental protection cloth. Annex III.2 of the Communication includes some additional product specifications.

42 Communication to Negotiating Group on Market Access, TN/MA/W/1, 24 June 2002). See paragraphs 6, 11 and 21. Second Communication TN/MA/W/11, 21 October 2002 deals with Post Doha developed-developing countries market access issues.

43 Communication made to negotiating Group on Market Access, TN/MA/W/6, 5 August 2002. In Paragraph 5, Korea makes the point that 'environmental goods to be included in the list should be determined in terms of their end-use, but not in terms of their production and process methods'.

44 Communication made to the Negotiating Group on Market Access, TN/MA/W/8, 10 September 2002. Para. 16 adds that OECD and APEC's list should be the starting point to define environmental goods.

45 Communication to the Negotiations Group on Market Access, TN/MA/W/3, 3 July 2002. Second communication, TN/MA/W/18 was made on 5 December 2002.

46 Communication made to the Negotiating Group on Market Access, TN/MA/W/16, 28 November 2002. In paragraph 13, Switzerland notes that there is a lack of internationally recognised standards in the application of PPM. Secondly, the application of such a criterion may prove to be difficult at the border.

47 Communications made to the Negotiating Group on Market Access, TN/MA/W/10, 22 October 2002. See paragraph 9, where India notes that environmental goods need to be defined in the light of the need of developing countries and LDCs and may include environmentally friendly products. See also TN/MA/W/10/Add.1, 8 January 2003.

48 Communication made to the Negotiating Group on Market Access, TN/MA/W/17, 2 December 2002.
49 See Summary Report on the Third Meeting of the Committee on Trade and Environment Special Session, TN/TE/R/3, 31 October 2002.
50 See http://:www.wcoomd.org
51 Paragraphs 32 and 33 contain the non-negotiation mandate given to the regular CTE.
52 See 'The Effects of Environmental Measures on Market Access, especially in relation to Developing Countries, in particular the Least Developed among them', WT/CTE/W/207, 21 May 2002.
53 See Annex 1.
54 See Committee on Trade and Environment – Report of the Meeting Held on 14 February 2003 – Note by the Secretariat; WT/CTE/M/32, para.37.
55 See Committee on Trade and Environment – Report of the Meeting Held on 29 April 2003 – Note by the Secretariat; WT/CTE/M/33, para. 24.
56 See Committee on Trade and Environment – Report of the Meeting Held on 13 – 14 June 2002 – Note by the Secretariat; WT/CTE/M/30, paras 66–67.
57 See Committee on Trade and Environment – Report of the Meeting Held on 8 October 2002 – Note by the Secretariat, WT/CTE/M/31, 2 December 2002, paras 70–72.
58 Ibid. WT/CTE/M/31, 2 December 2002, paras 61–68.
59 See *Cusco Declaration on Access to Genetic Resources, Traditional Knowledge and Intellectual Property Rights of Like-minded Megadiverse Countries*, http://www.comunidadandina.org/ingles/document/cusco29-11-02.htm (Presented at Committee on Trade and Environment – Report of the Meeting Held on 14 February 2003 – Note by the Secretariat; WT/CTE/M/32). These widely diverse nations include Bolivia, Brazil, China, Colombia, Costa Rica, Ecuador, the Philippines, India, Indonesia, Kenya, Malaysia, Mexico, Peru, South Africa and Venezuela, representing 70 per cent of the biological diversity of the planet.
60 See Committee on Technical Barriers to Trade – Committee on Trade and Environment – Labelling – Submission by the European Communities, WT/CTE/W212, 12 June 2002.
61 See Committee on Trade and Environment – Labelling for Environment Purposes – Submission by Switzerland, WT/CTE/W/ 219, 14 October 2002.
62 In 1996, the global environment industry was estimated US$453 billion. Basic infrastructure services of waste treatment, water treatment and water supply account for more than half, while equipment accounts for nearly quarter of the total. Future Liberalisation of Trade in Environmental Goods and Services, OECD COM/TD/ ENV (98)37/FINAL, p. 7.
63 For instance, pulp and paper processing, steel smelting and refining, energy, coal, textiles and footwear. See *Cleaner Production and Waste Minimisation in OECD and Dynamic Non-Member Countries*, OECD, Paris 1998.
64 'Strengthening Capacities in Developing Countries to develop their Environmental Services Sector', Background Note by the UNCTAD Secretariat, TD/B/COM.1/EM.7/2, 12 May 1998 [UNCTAD (1998)], para. 16.
65 Ibid, para. 52
66 Environmental Benefits of Removing Trade Restrictions and Distortions. Note by the Secretariat, Addendum. Committee on Trade and Environment. WT/CTE/W/67/Add.1, 13 March 1998, para. 10.
67 See 'Environmentally Preferable Products (EPPs) as a Trade Opportunity for Developing Countries', Report by the UNCTAD Secretariat, UNCTAD/COM/70, 19 December 1995, p. 24.
68 See Beatrice Chaytor, *Negotiating Further Liberalisation in Environmental Goods and Services: An Exploration of the Terms of Art*, RECIEL 11.3.
69 More than 90 per cent of existing ESTs involve proprietary knowledge, often developed and belonging to TNCs. See 'Factors affecting Transfer of Environmentally Sound Technology', Note by the Secretariat. WT/CTE/W/22, 1996.

11

Small Vulnerable Economy Issues and the WTO

Roman Grynberg and Jan Yves Remy*

1 Introduction

Since the second Ministerial Conference of the WTO[1] held in Geneva in 1998 there has been an attempt by small vulnerable economies[2] to achieve some measure of recognition of the particular problems that confront them in the process of globalisation. At the failed Seattle Ministerial Conference the establishment of a work programme for small economies was agreed to by members,[3] but as the draft text was not accepted it was left until the fourth session in Doha before a small economies work programme was agreed.[4]

This paper addresses several issues pertaining to the apparent contradiction in the wording of the work programme agreed to at Doha, which on the one hand mandates Members to frame responses to trade concerns of small, vulnerable economies, but on the other prohibits the creation of a sub-category of states. The relevant paragraph of the Ministerial Declaration was a political compromise between the small economy proponents of the WTO work programme and developed countries, which insisted on the definitional caveat. It has created a conundrum of sorts for negotiators, as it seems impossible to target responses to the concerns of a group that is yet to be defined or recognised because WTO Members have consistently refused to recognise SVEs as a distinct category. While the creation of a WTO sub-category of members is explicitly prohibited in the work programme, this does not nullify the right of any WTO member or group of members to make a proposal during negotiations that includes such a group of countries.

The paper seeks to review the concerns and specificities of small states, thereby highlighting the peculiarities and natural disadvantages that inhibit the ability of SVEs to thrive, and at times survive, in the multilateral trading context. It then considers the implicit definitions and other sub-categorisations relating to smallness already existing in various WTO Agreements, as well as in its administrative practice. The paper argues that small states have many characteristics that are similar to, but sufficiently distinct from, that of least developed countries (the only formally recognised sub-group in the WTO) which warrants special treatment of them in the WTO.[5]

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However, the paper argues that such special treatment can begin only with a definition, which it goes some way to advance. Lastly, the authors briefly examine the discussions currently taking place in WTO sessions pursuant to the work programme, which underscores the intense discomfort that some WTO members may feel with the creation of new categories. Irrespective of this stated uneasiness, the paper argues that they have already created such categories during the Uruguay Round and must do so implicitly or explicitly if they are to address the legitimate trade concerns of small vulnerable sates.

2 Small States, Globalisation and the WTO

Prior to any discussion of the definitional issue, the first question that must be answered is why SVEs require particular attention in the WTO. SVEs comprise small states and small island states which in particular suffer from a combination of inherited and inherent characteristics that impede their ability to integrate into the global economy. These characteristics include smallness, physical isolation from markets, dispersion of small pockets of populations and a small and high specialised human and physical resource base. These together raise the operating cost structure of small economies and render market adjustment more difficult. The high-cost structure that has traditionally been associated with these economies has meant that many have predicated their export trade upon products or services where the export price includes either market or institutionalised quasi-rents, as few other activities have proven viable for these very small producers. These market-based quasi-rents have been based either on short temporary booms which have facilitated resource extractive activities and created transitory rents, or on short-term niche markets. The institutional sources of quasi-rent have stemmed from trade preferences, tax concessions or sovereignty-based activities.

Historically, SVEs have become dependent upon these forms of export-oriented activities primarily because few other exports ever developed. Merchandise exports in particular have been based on high rates of trade preference resulting from high MFN tariffs, or preference donors have created quota based systems such as the Sugar and Banana Protocols. It is these particularly distorting trade measures that are most beneficial to SVEs because they offer guaranteed access under quota for what are often small volumes that would otherwise not be traded. In so doing these measures have addressed the marketing constraints faced by SVEs.

Over the seven years since the creation of the WTO, these high rates of trade preference along with the tariff quotas have been diminished by a series of disputes and ongoing negotiations that have shaken the foundation of small vulnerable economies. These include:

i) The Banana Dispute which has not only caused a major restructuring in the

Caribbean and parts of Africa but is forcing a complete realignment of trade regimes throughout the ACP regions and necessitating reciprocity in the ACP-EU trade relationship;

ii) The Sugar Dispute between Brazil/Australia/Thailand and the EU over subsidies in the EU sugar regime will force similar adjustment in at least 12 small ACP states that have been substantial beneficiaries of the Sugar Protocol of the Cotonou Agreement;

iii) The Thailand-Philippines/EU mediation over margins of preference for canned tuna has further eroded the competitive position of a number of small states including Mauritius, Papua New Guinea, Fiji and Seychelles;

iv) The Fisheries Subsidies negotiations threaten to undermine the revenue of small coastal developing states which are highly dependent upon fisheries access arrangements;

v) The full implementation of the provisions of the Agreement on Subsidies and Countervailing Measures (ASCM) will by 2008 undermine the ability of many small developing countries to use their current range of export incentives in the Export Processing Zones.

Nonetheless, the economic adjustments and loss of quasi-rents in export-oriented activities brought by these changes in the WTO are not the only cause for concern. In addition, the OECD's Harmful Tax Initiative has served to undermine the development of offshore finance centres located predominantly in small states which have used this sector to diversify away from the high trade preference dependent activities. Thus the international trade policy shift that has occurred in recent years has served to thoroughly undermine the export sector of small states.

In fact, no other group of developing countries, including LDCs, has been obliged to undertake such wide-ranging adjustments necessitated by the last decade of globalisation. This is the reason for the particular problems of small states which, in the WTO context, include:

i) Loss of trade preferences stemming from MFN liberalisation and WTO disputes.

ii) Application of rules, including those of the ASCM, in a manner that does not recognise the inherent economic characteristics of small states.

iii) Implementation of complex and burdensome WTO obligations which are beyond the scope of small states with very small administrations.

3 WTO Precedents on Sub-categorisation of Members, including Small Economies

WTO provisions have created a number of sub-categories of Members and in the process have set precedents that may be useful for present purposes. These usually constitute provisions on special and differential treatment for small Members or small suppliers, although it is noteworthy that preferential treatment is not true in all cases. For instance, small Members pay proportionately higher contributions to the WTO budget than larger Members. This has been justified from the earliest days of the GATT 1947 by the cost to the organisation of providing services to Members.

MFN treatment and non-discrimination among its Members are among the most basic principles of the WTO. However, there is an increasing amount of trade being carried out on the basis of exceptions to these basic rules and which allow for differentiation among Members. For instance, there are provisions permitting free-trade areas and customs unions or preferences for developing countries and LDCs. Tulloch has also drawn attention to the fact that special characteristics, interests and concerns of various groups of countries, other than developing countries or least developed countries, are recognised and accommodated in some of the WTO Agreements.[6]

LDCs constitute the only sub-category of WTO Members that is clearly agreed and defined. The WTO has agreed that the LDCs are those countries designated as such by the United Nations and which are Members of the WTO. As this grouping is clearly defined, LDCs are specifically referred to and granted special and differential treatment in many WTO Agreements, including the Decision on Measures in Favour of Least Developed Countries appended to the Final Act of the Uruguay Round.

Apart from these references to LDCs, the WTO also recognises other sub-groupings within the broader category of developing countries. This has often been done either explicitly or implicitly through the creation of *de minimis* thresholds that in effect distinguish small states and often entitles them to special and or preferential treatment. This is reflected in the following WTO Agreements and practices:

(a) The Agreement on Agriculture and its related Decision contain special provisions for net food-importing developing countries.[7] Article 6:2 also contains special provisions for low-income or resource-poor producers in developing countries, which are aimed at encouraging diversification from growing illicit narcotic crops.[8]

(b) The ASCM also grants developing countries with a per capita GNP below US$1,000 the same treatment as least developed countries in respect of export subsidies.[9] Other developing countries are granted a transitional period to phase out their export subsidies on non-agricultural products, unless they have reached export competitiveness in particular products. Furthermore, the Agreement

defines export competitiveness to exist if a developing country Member's exports of the product in question have reached a share of at least 3.25 per cent in world trade in the relevant period.[10] The agreement also provides for the termination of any countervailing duty investigations as soon as the authorities determine that the volume of subsidised imports represents less than 4 per cent of the total imports of the like product in the importing Member concerned.[11] Significantly, at the Doha Ministerial Conference, while explicitly rejecting the creation of new category of small states, another *de minimis* threshold was established for defining the conditions under which developing country members may obtain an extension of the rights to use prohibited export subsidies.[12]

(c) The Agreement on Implementation of Article VI of GATT 1994 provides that the volume of dumped imports shall normally be regarded as negligible if the volume of dumped imports from a particular country is found to account for less than 3 per cent of imports of the like product in the importing Member, unless the countries which individually account for less than 3 per cent of the imports of the like product in the importing Member collectively account for more than 7 per cent of imports of the like product in the importing Member.[13] The Agreement also provides that due account shall be taken of any difficulties experienced by interested parties, in particular small companies, in supplying information.[14]

(d) The Agreement on Safeguards lays down that safeguard measures shall not be applied against a product originating in a developing country Member as long as its share of imports of the product concerned in the importing Member does not exceed 3 per cent, provided that the developing country Members with less than 3 per cent import share collectively account for no more than 9 per cent of the total imports of the product concerned.[15]

(e) The Agreement on Textiles and Clothing lays down that meaningful improvement in access for exports of Members are subject to restriction and must account for 1.2 per cent or less of the total volume of restrictions applied by the importing Member concerned.[16] Special and differential treatment provisions under the agreement provide for Members whose total volume of textile and clothing exports is small in comparison with the total volume of exports of other Members and who account for a small percentage of total imports of that product into the importing Members.[17] Furthermore, special consideration is to be given to wool products from wool-producing country Members whose economy and textiles and clothing trade are dependent on the wool sector, whose total textile and clothing exports consist almost exclusively of wool products, and whose volume of textile and clothing trade is comparatively small in the markets of the importing Member.[18]

(f) In the Doha Declaration dealing with Technical Co-operation and Capacity-Building, Ministers agreed that priority shall be accorded to small, vulnerable, and transitional economies, as well as Members and observers without representation in Geneva.[19] Members with a relatively small share of world trade are subject to less frequent review of their trade regime under the Trade Policy Review Mechanism.[20]

(g) The rules setting contributions to the WTO budget, drawn up under Article VII of the Agreement establishing the organisation, provide that each Member's contribution is a function of its share of world trade. However, these rules provide that Members with less than 0.015 per cent of world trade should pay a minimum contribution of 0.015 per cent of the budget (this figure has been modified on a number of occasions in the past and was reduced from 0.03 per cent from the budget year 2000).

4 A Small Matter of Definition

While WTO members have been emphatic in their opposition to the creation of a separate category of SVEs and have frequently restated their support for the principles of non-discrimination, they have nonetheless systematically created at least seven *de minimis* thresholds in various agreements and administrative arrangements, which reveals a preference for rules dependent upon the size of the particular member. As mentioned above, the difficulty arises because the mandate undertaken by WTO members is to '... frame responses to the trade-related issues identified for the fuller integration of small, vulnerable economies into the multilateral trading system ...' Clearly such responses, if they are to involve any derogation from or alteration of existing WTO rules, will by definition require WTO Members to differentiate between those members to which the derogation or alteration of obligations applies and those outside that group. However, because WTO members went on to say that they would not create a new sub-category of WTO Members, the Doha mandate creates an impossible conundrum for policy makers and negotiators

In fact, should WTO Members desire it, the task of defining SVEs is far from impossible. Quite inadvertently, WTO Members may have in fact, created a defined, albeit imperfect, category of 'vulnerable' states. The ECOSOC definition of an LDC, the only category of WTO members officially recognised, is defined by resort to three criteria, one of which is the UN Economic Vulnerability Index (EVI). If a country's rating on the EVI is greater than 31 then it is deemed to be vulnerable. If it is greater than 36, then a country is deemed to be highly vulnerable. In order to be an LDC, a country must rank above 36. Unfortunately only 128 UN Members have been classified on the EVI. The first 96 countries on the list in Annex 2 of this paper would qualify as 'vulnerable' using this criterion. However, one limitation of the list is that,

while EVIs have been calculated for 128 countries, the list does not include all WTO Members and acceding countries, notably transition economies.

For expository purposes, one could use a trade criterion of 0.05 per cent of world trade for measuring 'smallness'. This threshold would categorise some 86 WTO Members as small. In total these 86 states account for 1.5 per cent of world trade and if the trade of least developed countries is subtracted then the total amount of world trade potentially affected by the WTO recognising small economies, as a group, is a mere 1.1 per cent.(See Annex 2.)

Unfortunately, if individual thresholds are chosen some anomalies would be created. This is because at least five countries, namely Cyprus, Malta, Iceland, Singapore and Lichtenstein are either small or vulnerable economies. This could be resolved, however, if EU members are excluded on the basis that any criteria would be restricted to developing countries. In this way, Cyprus, Malta and Lichtenstein would be excluded. In addition, if one uses both filters, i.e. 'small' and 'vulnerable', Iceland and Singapore would also be excluded.[21] Notably, the Doha Ministerial mandate uses both these terms in its language.

This raises the question of the choice of thresholds for the definition of small. There is little doubt that the threshold chosen for expository purposes is *ad hoc* in nature. There is and can be no legitimate theoretical explanation for the choice of 0.05 per cent as a threshold except for the purely practical consideration that it excludes the most egregious anomalies, something that that would be necessary in order to satisfy WTO Members that a trade advantage was not being offered to high-income developed countries. In defence of such an *ad hoc* approach to the definition of small, one need look no further than WTO practice itself, as WTO Members in the past have never provided a justification for the particular choice of *de minimis* thresholds in any of the WTO Agreements

For the moment, this definitional debate could be largely academic because, as will be seen below, the demands currently being made by SVEs in WTO negotiations may not as yet require a formal definition *per se*. However, the emerging situation and debate suggests that it may soon be necessary for proponents of a definition to develop at least the contours of a working definition in order to address more specifically the economic and trade concerns of Members. Significantly, given the above precedents, there are a host of possible definitions and approaches to the issue that can be employed depending upon the circumstances.

5 Small Economy Issues in the Dedicated Sessions of the WTO

Discussions concerning small economies in the WTO have taken place in four dedicated sessions of the Committee on Trade and Development (CTD). This Committee was entrusted with the task of ensuring compliance with and completion of the Doha mandate regarding small economies.[22]

The dedicated sessions have shown the small economies representatives to be the agenda-setters, as they have taken the lead in initiating and steering discussions thus far. In particular, a grouping of SVEs[23] has submitted papers and tabled various proposals specific to their circumstances. In their first paper, the SVEs underscore the characteristics that make them vulnerable, and the implications that these characteristics have on their trade and development.[24] In sessions of the CTD, SVE representatives have also recounted their day-to-day hardships in trying to operate in a multilateral trading context. Although the developed countries have been generally supportive of these papers and have encouraged the sharing of individual experiences, they have at times raised the definitional issue, with the wearying precaution that the mandate clearly restricts sub-categorisation of the kind that SVEs appear interested.[25]

The actual proposals tabled by SVEs thus far address concerns of smaller economies generally and are relatively modest in scope.[26] They are expressly intended to complement others submitted in specific negotiating groups (see Annex 1). Their coverage is both procedural and substantive in nature, and they are generally aimed at improving administrative procedures for SVEs, as well as attempting to refashion current rules to better suit and accommodate their needs. Developed countries have in general been amenable to the former, but as regards the rule-based proposals, they have indicated discomfort with the idea of changing rules to address the need of a sub-category of WTO Members.[27] Many SVEs have however indicated their intention to present, and have proposals accepted, as a packaged and all-inclusive deal.

Not surprisingly, one of the proposals seeks to retain the margins of preferences for small economy exports. However, this has led to some contention within the small economies camp, and in particular to concern from some Latin American countries, who self-define as small economies, and who would want existing preferences extended to all small economies. A number of the proponents of the proposal, however, feel that such a blanket application to all self-professed small economies would have the effect of diluting any advantage or benefit to SVEs. This would be an area where a definition could be helpful.

Less contentious were proposals on Article XXIV and Regional Trading Arrangements, which seek to ensure non-reciprocity in regional trade agreements between developed and small economies. Small economies have proposed that sufficient space for policy development specific to their needs should be retained in the WTO, and that developed countries do not require concessions in negotiations that are inconsistent with the developmental, financial and trade needs of smaller economies.

Most proposals are aimed at improving the way in which the rules of various WTO Agreements work and affect small economies. One such proposal regarding the ASCM seeks to ensure that small economies are not made subject to the provisions of paragraph 1(a) of Article 3 of the ASCM requiring phasing out of fiscal incentives. The proposal further provides that the rules and procedures of the Agreement be

modified for small economies. However, developed countries have generally not seen the need for such special treatment of smaller economies, arguing that current procedures are working well, and that any special consideration would encourage subcategorisation of the kind prohibited under the mandate. Other more administrative proposals which call for the explicit recognition of the right of small economies to designate regional bodies as their 'competent authorities' for the purposes of that Agreement, have been more generally supported by developed countries, with some instances of voluntary pledges for the provision of technical assistance. A similar proposal in the context of the SPS and TBT Agreements, has likewise been welcomed, and developed countries have been generally supportive of any requests for technical assistance in the establishment of joint and shared missions for current non-resident Members.

Proposals for the revision of some rules in the Safeguard Agreement for small economies, including those relating to the definition of domestic industry, serious injury, investigations, reporting requirements, the causation and non-attribution principle, and the right of compensation and/or retaliation were not embraced by developed countries who drew attention to the fact that Article XIX of the Agreement already catered for developing countries. The proponents have, however, responded that the rules of the Safeguards Agreement entail cumbersome administrative procedures, which would need to be simplified for smaller economies.

There have also been proposals for developed countries to assist small economies in complying with their obligations under the SPS and TBT Agreements through: (1) the use of the former's technology and technical facilities on preferential and noncommercial terms, preferably free of costs; and (2) appropriate flexibility for small economies in dealing with time-frames and notifications requirements. Again, developed countries have reacted to these proposals negatively by suggesting that technical regulation was also a problem for them, and smaller economies could focus instead on the notification requirements of these Agreements. Some developed countries have even suggested the increased use of electronic technology, for example, in accessing such notifications. According to smaller economies, however, the plight of the developed countries was not comparable to that of smaller developing ones, and flexibility needed to be incorporated into the time-frame and notification requirements.

Proposals on the dispute settlement body were met with comments from developed countries that many of the issues raised were already being discussed in the context of special and differential treatment in DSU negotiations. The proponents expressed their awareness and intention to participate concurrently in these discussions as well. On issues of graduation and accession of small economies from LDC status, there is general agreement that these issues would have to be considered to develop acceptable guidelines and procedure for small economies.

The proponents of all of these proposals have attempted to make them the basis of

recommendations to the General Council,[28] as required under the mandate. However, lack of consensus, particularly by developed countries, on the suitability and workability of some proposals and on the issue of how to prevent the creation of a two-tier system of rights and obligations within the WTO, has prevented the forwarding of the proposals.

Conclusion

The present discussions in the WTO underscore the discomfort among developed countries with the idea of explicitly recognising a sub-category of smaller economies and further SVEs. However, it is hard to surmise how execution of the mandate in paragraph 35, requiring the framing of trade-related responses to the problems of smaller vulnerable economies, can occur without the logical first step of defining and clarifying what a small vulnerable economy is. The existence of clear precedents in the text and practice of the WTO exposes the possibility, and indeed desirability, of doing so once the requisite political will exists. In order for small states within the WTO to gain any measure of success in current trade negotiations, they must first and foremost achieve recognition as a separate sub-grouping within the Membership of the WTO.

Annex 1

Table of Other Negotiating Proposals Made or to be Made in Favour of Small Developing States in the WTO

Subject Area/ Relevant WTO Agreement	Background	Content of Proposal
Fisheries Subsidies (ASCM, including Article XVI GATT GATT 1994: GATT Agreement on Subsidies and Countervailing Measures Article 1, Article 3.1, Article 27, Article 6, Annex VII)	SVEs have relatively high dependence on domestic and export fisheries. Large exporting countries seeking negotiations of fisheries subsidies on basis that subsidies have harmful effect on sustainable fish catches. SVEs fisheries' interests extend to the following main areas: revenue generation from access fees: domestic and foreign fishers operating for export in the EEZ and territorial sea, artisan fisheries within their territorial sea	Ensure that Article 1 of the ASCM is clarified to explicitly exclude certain types of assistance from definition of subsidy: (including, access fees and development assistance, fiscal incentives to domestication and fisheries development, artisanal fisheries)
TRIPs (Article 67)	Due to limited capacity many SVEs are unable to implement complex rules and procedures in TRIPs. Article 67 of TRIPs makes provision for developed countries to assist with such implementation, upon request. However, SVES often have problems even identifying their needs to make such requests, nor do they have the ability to implement this agreement.	Explicit recognition that SVEs may designate regional body as competent authority for implementation of the TRIPs Agreement. This should be assisted by developed countries through the provision of technical and financial assistance
Regional Trade Arrangements (RTAs) (in particular, Article XXIV and Enabling Clause, para.3 Understanding on the Interpretation of Article XXIV GATT 1994)		Provisions in Article XXIV to be interpreted to incorporate incomplete reciprocity for SVEs as contained in Enabling Clause. In particular, to incorporate notion of flexibility in 'substantially all trade' in Article XXIV:8 – to accommodate asymmetric liberalisation between developing countries with less than average of 0.05% of world merchandise export (in last five years) and developed countries, suitable to the circumstances of SVEs.

Subject Area/ Relevant WTO Agreement	Background	Content of Proposal
Regional Trade Arrangements (contin.)		Flexibility to entail: 1) Asymetry in timetabling of tariff reduction and elimination during transitional periods. 2) Any FTAs involving SVEs and Developed countries (as referred to above) should be 'exceptional' case and 'reasonable length of time' to be 25 years.
Trade Preferences – Part IV of GA TT 1994 and Enabling Clause	SVEs are particularly trade preference dependent. The erosion of trade preferences jeopardises the future of small vulnerable economies in critical areas such as agriculture and manufacturing. Current WTO negotiations and rules threaten these arrangements.	'Grand fathering' of existing margins of trade preferences for products and small economies accounting for less than 3.25% of world trade.
Agreement on Subsidies and Countervailing Measures (ASCM): Article XVI GATT 1994, ASCM Article 27, Annex VII, Doha Ministerial Declaration (c)	SVEs suffer from the combined effect of diseconomies of scale caused by their small size and physical isolation which together necessitate compensatory measure to offset these inherent cost disadvantages. Moreover without these compensatory measures SVEs will be unable to attract investment. WTO provisions 'recognize that subsidies may play an important role in economic development programmes of developing country members' and provide flexibility for certain developing countries in the application of subsidies. The agreement does not grant the necessary flexibility to small vulnerable economies. Moreover, existing fiscal incentives are required to be phased out under current WTO rules.	SVEs **shall be granted** a **permanent** exemption from the provisions of paragraph 1 (a) of Article 3, (ASCM) SVEs should be allowed the provision of subsidies to reduce the cost of marketing exports of non-agricultural products, (including export promotion and advisory services) including handling, upgrading and other processing costs of international transport and freight. SVEs should be allowed to provide internal transport and freight charges on export shipment, provided or mandated by governments on terms more favourable than for domestic shipments for non-agricultural products.

Subject Area/ Relevant WTO Agreement	Background	Content of Proposal
Agreement on Agriculture (Article 9)	SVEs suffer from the combined effect of diseconomies of scale caused by their small size and physical isolation which together necessitate compensatory measures to offset these inherent cost disadvantages. Moreover without these compensatory measures SVEs will be unable to attract investment. WTO provisions 'recognise that subsidies may play an important role in economic development programmes of developing country members' and flexibility for certain developing countries in the application of subsidies. The agreement does not grant the necessary flexibility to small vulnerable economies. Existing fiscal incentives are required to be phased out under current WTO rules.	Permanent exemption from the reduction commitments in Article 9 in the Agreement

Annex 2

Total Trade in Goods and Services Sorted by average percentage share, 1998–2000

Country	1998 (US$ m)	1999 (US$ m)	2000 (US$ m)	Average	Average share 1998–2000 (%)
1 United States	1,995,459	2,140,380	2,472,460	2,202,766.33	15.42
2 Germany	1,218,840	1,234,558	1,254,113	1,235,837.33	8.65
3 Japan	798,199	858,549	986,299	881,015.50	6.17
4 United Kingdom	768,695	785,237	825,536	793,155.93	5.55
5 France	731,704	727,349	732,608	730,553.77	5.11
6 Italy	579,021	562,534	582,028	574,527.63	4.02
7 Canada	495,867	542,234	611,711	549,937.23	3.85
8 Netherlands	470,123	478,530	498,210	482,287.47	3.38
9 Hong Kong, China	421,225	414,030	480,701	438,651.93	3.07
10 China	370,790	410,582	529,792	437,054.73	3.06
11 Belgium	348,938	350,891	369,704	356,511.06	2.50
12 Spain	320,745	338,836	351,379	336,986.63	2.36
13 Korea, Rep. of	271,556	314,496	397,768	327,940.23	2.30
14 Mexico	266,941	304,037	371,196	314,058.00	2.20
15 Taipei, Chinese	249,946	267,659	326,699	281,434.67	1.97
16 Singapore	242,905	262,601	314,723	273,409.57	1.91
17 Switzerland	227,374	224,514	227,770	226,552.40	1.59
18 Sweden	192,021	201,625	203,029	198,891.60	1.39
19 Austria	186,779	192,644	192,737	190,719.97	1.34
20 Malaysia	150,633	171,972	206,268	176,291.13	1.23
21 Ireland	177,698	154,761	166,780	166,412.80	1.16
22 Russian Fed.	161,701	137,624	178,007	159,110.67	1.11
23 Australia	149,809	156,840	168,397	158,348.67	1.11
24 Denmark	122,920	132,072	141,222	132,071.20	0.92
25 Thailand	114,216	127,543	153,201	131,653.27	0.92
26 Brazil	131,701	117,513	135,585	128,266.33	0.90
27 India	104,162	113,484	135,728	117,791.47	0.82
28 Norway	107,252	109,576	124,058	113,628.80	0.80
29 Indonesia	98,397	97,629	125,587	107,204.33	0.75
30 Turkey	109,261	93,734	112,557	105,184.00	0.74
31 Saudi Arabia	79,745	91,292	121,052	97,363.37	0.68
32 Poland	95,059	90,360	103,368	96,262.33	0.67
33 Finland	88,571	86,083	92,189	88,947.67	0.62
34 Portugal	78,805	79,802	79,092	79,233.00	0.55
35 Israel	67,768	76,919	91,433	78,706.37	0.55
36 Philippines	76,572	75,732	77,673	76,658.87	0.54
37 United Arab Emirates	67,950	70,100	79,701	72,583.77	0.51
38 Czech Rep.	67,449	66,978	73,113	69,179.83	0.48
39 South Africa	66,972	63,614	69,247	66,610.93	0.47
40 Argentina	69,339	60,067	63,246	64,217.40	0.45
41 Hungary	53,811	55,677	63,849	57,778.93	0.40

Country	1998 (US$ m)	1999 (US$ m)	2000 (US$ m)	Average	Average share 1998–2000 (%)
42 Greece	41,026	60,336	70,741	57,367.60	0.40
43 Luxembourg	43,203	48,099	52,062	47,787.95	0.33
44 Venezuela	38,898	38,720	53,649	43,755.67	0.31
45 Chile	40,285	37,228	43,059	40,190.67	0.28
46 Egypt	32,738	35,636	39,291	35,888.33	0.25
47 Ukraine	36,449	32,295	37,055	35,266.33	0.25
48 New Zealand	31,701	34,354	35,050	33,702.00	0.24
49 Colombia	30,648	27,180	29,941	29,256.17	0.20
50 Viet Nam	25,473	27,641	34,475	29,196.33	0.20
51 Nigeria	23,120	25,754	37,125	28,666.10	0.20
52 Slovak Rep.	28,338	25,210	28,685	27,410.77	0.19
53 Algeria	22,114	24,781	34,119	27,004.43	0.19
54 Kuwait	23,071	24,148	31,619	26,279.33	0.18
55 Romania	22,259	21,197	26,132	23,196.00	0.16
56 Slovenia	22,516	21,906	22,071	22,164.27	0.16
57 Morocco	20,646	21,806	22,438	21,629.77	0.15
58 Pakistan	21,031	20,351	22,030	21,137.33	0.15
59 Croatia	19,210	17,909	18,262	18,460.07	0.13
60 Dominican Republic	16,298	17,169	19,697	17,721.50	0.12
61 Tunisia	17,327	17,763	17,624	17,571.50	0.12
62 Peru	17,949	16,477	18,048	17,491.33	0.12
63 Kazakhstan	14,601	13,670	19,259	15,843.43	0.11
64 Panama	16,947	14,785	15,767	15,832.93	0.11
65 Bangladesh	13,273	14,578	16,259	14,703.23	0.10
66 Costa Rica	13,903	15,342	14,732	14,659.10	0.10
67 Belarus	15,203	13,039	15,721	14,654.10	0.10
68 Oman	12,645	13,273	17,696	14,538.07	0.10
69 Sri Lanka	12,341	12,290	14,430	13,020.10	0.09
70 Bulgaria	11,932	12,321	14,614	12,955.50	0.00
71 Libyan Arab Jamahiriya	13,137	11,624	13,607	12,789.10	0.09
72 Qatar	8,823	10,360	13,687	10,956.77	0.08
73 Angola	8,141	10,614	13,652	10,802.10	0.08
74 Ecuador	11,624	9,441	10,885	10,649.97	0.07
75 Lithuania	11,354	9,528	10,912	10,598.03	0.07
76 Syrian Arab Republic	9,183	10,227	11,818	10,409.33	0.07
77 Cuba	8,982	9,589	10,495	9,688.67	0.07
78 Bahrain	7,946	9,005	11,587	9,512.27	0.07
79 Estonia	8,786	8,098	9,735	8,872.87	0.06
80 Côte d'Ivoire	9,434	9,293	7,649	8,791.87	0.06
81 Guatemala	8,442	8,419	9,361	8,740.87	0.06
82 Jordan	8,605	8,298	9,037	8,646.33	0.06
83 Macau, China	7,995	8,158	9,453	8,535.37	0.06
84 Lebanon	8,946	8,119	8,369	8,478.00	0.06
85 Cyprus	8,323	8,333	8,575	8,410.37	0.06

	1998 (US$ m)	1999 (US$ m)	2000 (US$ m)	Average	Average share 1998–2000 (%)
86 El Salvador	7,524	7,822	9,242	8,195.80	0.06
87 Uruguay	8,571	7,472	7,877	7,973.07	0.06
88 Jamaica	7,358	7,420	7,851	7,543.13	0.05
89 Paraguay	8,645	6,732	6,241	7,205.97	0.05
90 Uzbekistan	6,817	6,347	7,594	6,919.10	0.05
91 Latvia	6,973	6,454	7,077	6,834.67	0.05
92 Malta	6,165	6,611	7,507	6,760.77	0.05
93 Trinidad and Tobago	6,066	6,414	7,506	6,661.73	0.05
94 Iceland	5,993	6,174	6,368	6,178.40	0.04
95 Zimbabwe	5,679	5,896	6,644	6,073.07	0.04
96 Kenya	6,309	5,706	6,184	6,066.20	0.04
97 Ghana	5,963	6,264	5,657	5,961.17	0.04
98 Yemen	4,574	5,411	7,510	5,831.80	0.04
99 Honduras	5,187	5,227	5,714	5,376.13	0.04
100 Mauritius	5,219	5,446	5,312	5,325.63	0.04
101 Brunei Darussalam	4,748	5,383	5,740	5,290.57	0.04
102 Bosnia & Herzegovina	4,979	5,467	5,412	5,285.87	0.04
103 Botswana	4,801	5,525	5,435	5,253.37	0.04
104 Bahamas	4,556	4,881	5,613	5,016.50	0.04
105 Gabon	4,245	4,511	5,066	4,607.20	0.03
106 Cameroon	4,154	4,727	4,889	4,589.97	0.03
107 Myanmar	4,477	4,206	4,762	4,481.87	0.03
108 Papua New Guinea	3,963	3,975	4,669	4,202.50	0.03
109 Namibia	3,493	3,625	4,087	3,735.00	0.03
110 Azerbaijan	3,414	3,171	4,107	3,564.03	0.02
111 Congo	2,656	3,384	4,576	3,538.60	0.02
112 TFYR Macedonia	3,433	3,337	3,824	3,531.33	0.02
113 Bolivia	3,522	3,269	3,498	3,429.53	0.02
114 Tanzania, United Rep.	3,373	3,298	3,290	3,320.53	0.02
115 Senegal	3,047	3,171	2,982	3,066.60	0.02
116 Sudan	2,542	2,387	3,829	2,919.47	0.02
117 Nicaragua	2,447	2,819	2,888	2,718.13	0.02
118 Barbados	2,595	2,695	2,832	2,707.17	0.02
119 Nepal	2,343	2,763	2,967	2,690.87	0.02
120 Cambodia	2,243	2,511	3,248	2,667.20	0.02
121 Uganda	2,581	2,524	2,574	2,559.67	0.02
122 Congo, Dem. Rep. of	2,609	2,176	2,053	2,279.33	0.02
123 Swaziland	2,387	2,197	1,973	2,185.93	0.02
124 Zambia	2,173	2,046	2,177	2,132.03	0.01
125 Fiji Islands	1,846	2,060	2,405	2,103.83	0.01
126 Madagascar	1,821	1,953	2,530	2,101.40	0.01
127 Mozambique	1,663	2,061	2,174	1,965.73	0.01
128 Georgia	1,983	1,634	1,852	1,823.13	0.01
129 Albania	1,222	1,618	2,168	1,669.20	0.01
130 Moldova, Rep. of	2,013	1,383	1,602	1,666.10	0.01
131 Haiti	1,488	1,650	1,692	1,609.93	0.01

	1998 (US$ m)	1999 (US$ m)	2000 (US$ m)	Average	Average share 1998–2000 (%)
132 Guinea	1,605	1,533	1,568	1,568.80	0.01
133 Tajikistan	1,392	1,429	1,879	1,566.90	0.01
134 Mali	1,512	1,630	1,546	1,562.93	0.01
135 Guyana	1,485	1,414	1,471	1,456.80	0.01
136 Armenia	1,344	1,281	1,484	1,369.67	0.01
137 Kyrgyz Rep.	1,521	1,222	1,215	1,319.33	0.01
138 Benin	1,305	1,425	1,215	1,314.90	0.01
139 Mongolia	1,204	1,178	1,410	1,264.13	0.01
140 Togo	1,188	1,065	1,361	1,204.77	0.01
141 Malawi	1,238	1,267	1,083	1,195.87	0.01
142 Lao People's Dem. Rep.	1,057	1,016	1,217	1,096.63	0.01
143 Lesotho	1,156	1,035	1,016	1,069.00	0.01
144 Burkina Faso	1,150	1,009	883	1,014.07	0.01
145 Antigua and Barbuda	952	997	947	965.47	0.01
146 Seychelles	880	977	994	950.00	0.01
147 Suriname	968	849	907	907.97	0.01
148 Maldives	833	892	904	876.40	0.01
149 St Lucia	799	821	782	800.43	0.01
150 Belize	693	791	882	788.53	0.01
151 Mauritania	831	748	781	786.77	0.01
152 Chad	800	752	765	772.17	0.01
153 Niger	768	656	639	687.80	0.00
154 Gambia	558	524	550	544.13	0.00
155 Grenada	409	478	530	471.90	0.00
156 Djibouti	434	464	495	464.10	0.00
157 Cape Verde	411	469	447	442.30	0.00
158 Rwanda	430	455	434	440.03	0.00
159 Central African Republic	443	398	411	417.23	0.00
160 St Vincent and the Grenadines	400	412	375	395.63	0.00
161 Bhutan	332	371	436	379.50	0.00
162 Solomon Islands	407	411	273	363.97	0.00
163 St Kitts and Nevis	336	358	391	361.70	0.00
164 Dominica	300	326	312	312.93	0.00
165 Vanuatu	261	255	294	270.30	0.00
166 Burundi	230	178	193	200.40	0.00
167 Samoa	204	200	187	196.83	0.00
168 Sierra Leone	166	150	238	184.70	0.00
169 Guinea-Bissau	92	135	171	132.83	0.00
170 Tonga	123	124	145	130.73	0.00
171 Federal Rep. of Yugoslavia	..	..	..	–	–
172 Andorra	..	..	..	–	–
173 Liechtenstein	..	..	..	–	–
Total	13,441,042	13,905,731	15,511,380	14,286,051.25	100.0000

Source: World Trade Organisation, statistics used for calculation of budget contributions.

Annex 3

United Nations Economic Vulnerability Index, sorted by vulnerability

S. No.	Country	EVI
1	Kiribati	74.32
2	Tuvalu	73.68
3	Chad	64.41
4	Liberia	63.62
5	Gambia	61.83
6	Cambodia	61.00
7	Saudi Arabia	60.01
8	Sao Tome and Principe	59.07
9	Niger	58.98
10	Benin	58.68
11	Tonga	58.63
12	Nigeria	58.41
13	Somalia	58.04
14	Seychelles	57.02
15	St Lucia	56.99
16	Cape Verde	56.98
17	Uganda	56.52
18	Dominica	56.05
19	Guinea-Bissau	55.91
20	Rwanda	55.85
21	Qatar	55.84
22	Equatorial Guinea	55.81
23	United Arab Emirates	55.55
24	Comoros	55.36
25	Angola	55.19
26	Libyan Arab Jamahiriya	54.01
27	Solomon Islands	53.93
28	Lesotho	53.11
29	Samoa	52.45
30	Dem. Rep. of the Congo	51.89
31	Zambia	51.82
32	St Vincent and the Grenadines	51.65
33	Burundi	51.55
34	Guyana	51.41
35	Brunei Darussalam	51.07
36	Syrian Arab Republic	51.04
37	St Kitts and Nevis	50.26
38	Iran (Islamic Rep. of)	50.00
39	Gabon	49.96
40	Myanmar	49.82
41	Mongolia	49.73
42	Yemen	49.54
43	Oman	49.05
44	Mali	48.41
45	Bahrain	48.15

S. No.	Country	EVI
46	Congo (Republic of)	46.90
47	Djibouti	46.60
48	Sierra Leone	46.30
49	Guinea	45.77
50	Laos	45.65
51	Haiti	45.61
52	Dominican Republic	45.54
53	Bahamas	45.37
54	Togo	45.30
55	Afghanistan	44.89
56	Burkina Faso	44.58
57	Ethiopia	44.58
58	Sudan	44.45
59	Suriname	44.28
60	Grenada	43.67
61	Nicaragua	43.16
62	Ghana	43.13
63	Paraguay	43.05
64	Central African Republic	42.43
65	Bhutan	42.27
66	Lebanon	41.90
67	Malawi	41.57
68	Cuba	41.50
69	Mauritania	41.42
70	Papua New Guinea	41.40
71	Vanuatu	41.31
72	Algeria	41.30
73	Antigua and Barbuda	41.20
74	Tunisia	41.08
75	Zimbabwe	40.94
76	Senegal	40.86
77	Belize	40.47
78	Trinidad and Tobago	39.03
79	Malta	38.98
80	Fiji Islands	37.39
81	Mozambique	37.36
82	Barbados	36.54
83	Nepal	36.37
84	Tanzania (United Republic of)	36.23
85	Honduras	35.73
86	Mauritius	35.21
87	Swaziland	35.02
88	Morocco	33.82
89	Venezuela	33.79
90	Côte d'Ivoire	32.81
91	Democratic People's Republic of Korea	32.31
92	Maldives	32.18
93	Cameroon	31.59

S. No.	Country	EVI
94	Jamaica	31.18
95	Singapore	31.02
96	Viet Nam	31.02
97	Cyprus	29.87
98	Ecuador	29.40
99	Panama	28.89
100	El Salvador	28.36
101	Kenya	27.75
102	Jordan	27.70
103	Bolivia	27.24
104	Eritrea	27.06
105	Madagascar	26.75
106	Sri Lanka	26.18
107	Peru	26.13
108	Guatemala	25.99
109	Chile	25.09
110	Philippines	25.00
111	Egypt	24.85
112	Colombia	24.28
113	Uruguay	24.09
114	Costa Rica	23.99
115	Bangladesh	23.77
116	Israel	23.35
117	South Africa	22.43
118	Pakistan	22.21
119	Turkey	19.33
120	Thailand	17.92
121	Indonesia	17.38
122	Malaysia	16.55
123	Korea (Republic of)	16.09
124	Mexico	15.47
125	Argentina	15.22
126	Brazil	15.20
127	India	12.20
128	China	4.18

Source: United Nations, Economic and Social Council

Notes

1 Ministerial Declaration, Second Session, Ministerial Conference of the World Trade Organization WT/MIN (98)/DEC/1, 25 May 1998,(98-2149), Geneva, 18 and 20 May 1998, adopted on 20 May 1998, para 6 :
'We remain deeply concerned over the marginalization of least-developed countries and certain small economies, and recognize the urgent need to address this issue which has been compounded by the chronic foreign debt problem facing many of them.
2 The authors are keenly aware that there is a substantial difference between small states and small economies. Small economies include the self-selected group of WTO members which includes countries as large as Sri Lanka, Cuba and Bolivia which are not necessarily small states. Small economies often do not face the constraints imposed by very small administrative capacity to implement the WTO Agreements. Employing the World Bank/ Commonwealth criteria of a population of 1.5 million would have excluded these larger countries. The WTO mandates and nomenclature refer to small economies but the problems addressed in this paper refer to the problems of small states, which are usually more vulnerable and have vastly different problems, both economically and administratively, to some of the larger 'small economies' that are members of the small economies group at the WTO. For the purposes of this paper, reference to small states, as distinct from small economies, will be to small vulnerable economies.
3 The later versions of the draft text of the Seattle Ministerial Declaration contained no square brackets in the section pertaining to small economies but the draft ministerial declaration was not endorsed by WTO Members.
4 Ministerial Declaration, Fourth Session, Ministerial Conference of the World Trade Organization, WT/MIN(01)/DEC/1, 20 November 2001, (01-5859), Doha, 9 - 14 November 2001, adopted on 14 November 2001, para. 35.
'We agree to a work programme, under the auspices of the General Council, to examine issues relating to the trade of small economies. The objective of this work is to frame responses to the trade-related issues identified for the fuller integration of small, vulnerable economies into the multilateral trading system, and not to create a sub-category of WTO Members. The General Council shall review the work programme and make recommendations for action to the Fifth Session of the Ministerial Conference.'
5 The category of least developed country is defined by the UN's Economic and Social Commission and is external to the WTO. The category of developing country is determined in the WTO by self election which has meant that until very recently high income countries such as South Korea, Israel and Singapore have chosen to define themselves as developing countries.
6 Tulloch, Peter. 'Small Economies in the WTO' in David Peretz, Rumman Faruqui and Eliawony J. Kisanga, 'Small States in the Global Economy', Commonwealth Secretariat and World Bank, 2001, p. 258.
7 Agreement on Agriculture, Article 16.
8 Agreement on Agriculture, Article 6.2.
9 Agreement on Subsidies and Countervailing Measures, Article 3 and Annex VII.
10 Agreement on Subsidies and Countervailing Measures, Article 27.6.
11 Agreement on Subsidies and Countervailing Measures, Article 27.10.
12 Procedures for extensions under Article 27.4 for certain developing country members G/SCM/39,20 November 2001. The provisions state:
Programmes eligible for extension pursuant to these procedures, and for which members shall therefore grant extensions for calendar year 2003 as referred to in 1(c), are export subsidy programmes (i) in the form of full or partial exemptions from import duties and internal taxes, (ii) which were in existence not later than 1 September 2001, and (iii) which are provided by developing country members (iv) whose share of world merchandise export trade was not greater than 0.10 per cent, (v) whose total Gross National Income ("GNI") for the year 2000 as published by the World Bank was at or below US $20 billion, (vi) and who are otherwise eligible to request an extension pursuant to Article 27.4,and (vii) in respect of which these procedures are followed.
13 Agreement on Implementation of Article VI of GATT, Article 5:8.
14 Agreement on Implementation of Article VI of GATT, Article 6.
15 Article 9, Agreement on Safeguard.s
16 Agreement on Textiles and Clothing, Article 2.
17 Article 6:6(a).
18 Article 6:6(b).
19 Ministerial Declaration WT/MIN(01)/DEC/1, 20 November 2001, paragraph 38.
20 GATT 1994, Annex 3 Trade Policy Review Mechanism, para. C(ii).
21 It should be noted that the UN has not classified Iceland on the vulnerability index and if it were included

then given its dependence on a very narrow range of exports it may also have an EVI classification above 31.

22 See the Framework and Procedures of the Work Programme given to the CTD on 1 March by the General Council, at WT/L/447. This requires the CTD inter alia to conduct these discussions in scheduled Dedicated Sessions; to report regularly to the General Council, which has overall responsibility for ensuring that responses to the trade related concerns identified in these Dedicated Sessions are arrived at; and where necessary to work with the other relevant subsidiary bodies of the WTO. The WTO Secretariat is also instructed to provide relevant information and factual analysis to inform discussions taking place in these Dedicated Sessions.

23 These include Barbados, Belize, Bolivia, Cuba, Dominican Republic, El Salvador, Fiji Islands, Guatemala, Haiti, Honduras, Jamaica, Mauritius, Nicaragua, Papua New Guinea, Paraguay, St Lucia, Solomon Islands, Sri Lanka, Trinidad and Tobago.

24 See WT/COMTD/SE//Rev 1*, dated 3 May 2002.

25 See in this regard, minutes of the Dedicated Sessions, available at WT/COMTD/SE/M/1,2,3 and 4.

26 The proponents of this submission were Barbados, Belize, Bolivia, Dominican Republic, Guatemala, Honduras, Mauritius and Sri Lanka. See WT/COMTD/SE/W/3 for entire exposition of these proposals, and the backgrounds informing them.

27 The general response to these proposals has been encouraging and supportive, with a few pointed questions being asked in particular by the developing countries in dedicated sessions. Notably, the US has tendered a written questionnaire to the proposal's proponents, in which they have sought clarification and further information on the proposals. The full version of the questions posed by the United States, and the responses received from the proponents of the proposal are available at WT/COMTD/SE/W/7.

28 This request is contained in the Communication.

12

WTO Fisheries Subsidies Negotiations: Implications for Fisheries Access Arrangements and Sustainable Management

Roman Grynberg*

Abstract

The paper considers the WTO negotiations on fisheries subsidies and the implications that envisaged disciplines will have on coastal developing countries. This is considered in relation to fisheries access agreements in the Central and Western Pacific where several least developed, but resource-rich, island states such as Kiribati and Tuvalu are highly exposed to the risks associated with new WTO fisheries subsidies disciplines that do not consider their particular vulnerabilities. The paper considers some of the issues that coastal developing countries should incorporate into their emerging negotiating positions at the WTO. State-to-state fisheries access agreements which are often highly subsidised, but where fishing vessel owners pay the equivalent of lump sum tax, are, paradoxically, the least distortionary and damaging to the environment. Strategies for managing the possible new disciplines are considered.

1 Introduction

After almost five years of discussion at the Committee on Trade and Environment, WTO members have embarked upon negotiations on fisheries subsidies as a result of the decision reached by ministers at the fourth ministerial conference of the WTO at Doha. The ministerial decision was couched in language that explicitly recognised the importance of the sector to developing countries and clearly implied the development of appropriate special and differential treatment rules.[1] Yet, despite the language, in the principal submission[2] by the 'Friends of Fish', the majority of which are developing countries,[3] there has been no substantive call for special and differential treatment from developing countries.[4]

* The author is Deputy Director, Trade and Regional Integration, Commonwealth Secretariat. The views expressed in this paper are those of the author and not necessarily those of the Commonwealth Secretariat or any of its members. The author would like to thank Ms Christina Shroeder, WTO and Mr Len Rodwell, Forum Fisheries Agency, for their invaluable comments on earlier drafts. The contents are of course the sole responsibility of the author.

This paper begins by briefly considering both the economic case for fisheries subsidies disciplines and the evidence of the magnitude of those subsidies. The analysis proceeds to consider the existing subsidies rules in the WTO, perceived weaknesses that may exist in those rules and then reviews the negotiating positions of various WTO members in the negotiating group on rules which is considering the fisheries subsidies issue. The paper attempts to explain the need for special and differential treatment of developing coastal states in the current round of WTO negotiations in terms of the particular development needs of coastal states.

Particular reference is made to the situation in the Pacific Island states, which are the source of 45 per cent of the world's tuna landings and where the fisheries subsidies issue is of vital economic importance to some of the world's most vulnerable island states. It will be argued that two of world's smallest and most vulnerable LDCs, Kiribati and Tuvalu, neither of which are conducting an unsustainable fisheries policy, are exposed to the greatest risk from the current negotiations if they should result in new fisheries access fee disciplines. The last section of the paper deals with the implications of the proposed disciplines for ACP states in a number of areas and proposes several policy options that ACP governments may wish to pursue to minimise the possibility of new fisheries disciplines adversely effecting their development and fisheries policies.

2 Existing Economic Theory and Empirical Evidence on Subsidies

The question of fisheries depletion in open access fisheries has been studied for many decades by natural resource economists. What is in large measure agreed is that in the absence of property rights fish stock depletion will occur in open access fisheries.[5] It is also widely accepted that this will occur whether there are subsidies or not.[6] The only role that subsidies play is that they will accelerate the rate of depletion. Only where there is some form of property rights arrangements can the natural tendency of depletion in the commons be arrested.[7] It is on this basis that economists have attempted to develop systems of tradable quotas as a mechanism of checking the tendency towards depletion in the open access fishery. However, where an effective and sustainable management regime exists[8] or where a system of tradable quotas is created,[9] then subsidies simply become rents that are transferred to either producers or consumers depending upon the particular market situation. This raises the key policy question of whether the current negotiations at WTO on enhanced fisheries subsidies disciplines constitutes a 'second best' approach to fisheries management where devising appropriate sustainable management policies in more appropriate fora, such as the FAO, has been more politically difficult than devising enforceable WTO rules.[10]

While there has been considerable discussion of subsidies in the marine products sector, there was no systematic attempt to quantify these subsidies until the late 1980s and 1990s when there was a flurry of research activity to attempt to determine the magnitude of the subsidies involved. The research results have indicated that these

subsidies have been of a significant order of magnitude. While the order of magnitude is in dispute, the fact they are substantial is not. The estimates originally made by the FAO suggested that in 1989 subsidies were US$22 billion when measured in terms of operating costs only, and US$54 billion when all investment costs were included.[11] This study was followed by research by APEC,[12] OECD[13] and World Bank,[14] all providing different estimates of the magnitude of subsidies. Present estimates suggest that subsidies are in the region of US$10–US$15 billion, possibly rising to as much as US$20 billion. Regrettably, neither the WTO estimates stemming from notifications nor the research undertaken by international organisations has as yet provided sufficient and accurate time series on fisheries subsidies to allow economists to determine the statistical significance to the problem of fish stock depletion.

3 Existing WTO Rules on Subsidies

During the Uruguay Round, largely as a result of the position taken by a number of WTO members, some of whom are proponents of the current disciplines, fisheries was left out of the Agreement on Agriculture. This left fisheries subject to the disciplines of the Agreement on Subsidies and Countervailing Measures (ASCM). The ASCM provides for two types of subsidies relevant to the fisheries sector – prohibited and actionable subsidies.[15] In the definition of a prohibited subsidy,[16] which is a subsidy 'contingent in fact or in law' upon exports, the article is prefixed with the proviso that certain subsidies were prohibited 'except as provided in the Agreement on Agriculture'.[17] As the fisheries sector is bound by the disciplines of the ASCM, there are adequate provisions to deal with many, but by no means all, of the subsidies that are currently found in the sector. When defining the adverse effects of actionable subsidies the ASCM states:[18]

This Article does not apply to subsidies maintained on agricultural products as provided in article 13 of the Agreement on Agriculture.

The two principal forms of subsidies discussed above, prohibited and actionable subsidies, cover various subventions that are offered by coastal states to their fisheries sector. Governmental transfers by which a benefit is conferred, are defined as existing if:[19]

There is a financial contribution by a government or any Member public body within the territory of a Member;

A government practice involves a direct transfer of funds (e.g. grants, loans and equity infusions) , potential direct transfers of funds or liabilities (e.g. loan guarantees); or

There is any form of income and price support in the sense of Article XVI of GATT 1994; and

a benefit is thereby conferred.

This definition may not include certain types of payments or subsidies for access by fishing fleets that may be 'flag-of-convenience' registered and hence defined as 'outside the territory' of the member offering the subsidy. In addition, subsidies that may be offered in the form of foreign aid in lieu of access may not be covered under the current definition of subsidy;[20] hence one of the main forms of fisheries subsidies that are under attack by environmental NGOs (WWF and Greenpeace) would not be covered by the ASCM. It is precisely this potentially extra-territorial application of fisheries subsidies disciplines to distant water fishing nation (DWFN) development assistance that should necessarily be of principal concern to developing countries.

However, the definition may be adequate to cover many of the domestic subsidies that are currently available from distant water fishing nations. These subsidies include low interest loans, tax exemptions, vessel buy-back schemes and direct payments such as income and price support schemes.

The two types of subsidies that are of principle concern in the ASCM, prohibited and actionable subsidies, are prevalent to varying degrees in the fisheries.[21] Prohibited subsidies are defined as those that are 'contingent in law or in fact ... upon export performance'.[22] Given the broad listing of prohibited export subsidies in the ASCM[23] and the broad interpretation normally given these subventions, there is no doubt that many of the provisions currently applied to the coastal fishing fleets of developed countries would be considered to fall into the category of prohibited export subsidies. The problem, as has been noted in the submissions during the current WTO negotiations by the 'Friends of Fish', is that the subsidies notifications are at a level of aggregation such that it is not possible to determine precisely which species of fish are being targeted. However, even where the existing range of subsidies are not covered under the broad definition of prohibited subsidies, there remain actionable subsidies that have 'adverse effects' upon the domestic industry of a WTO member. Adverse effects are defined to exist where:[24]

(a) There is injury to the domestic industry of another Member;

(b) There is nullification or impairment of benefits accruing directly or indirectly to other members under GATT 1994, in particular the benefits of concessions bound under Article II of GATT 1994;

(c) Serious prejudice is said to exist.

Until January 2000 there was a quantitative measure of serious prejudice which was deemed to exist, *inter alia*, when 'the total *ad valorem* subsidisation of a product exceeded 5 per cent'.[25] This definition of serious prejudice would have implied that, unless the FAO, World Bank and other estimates reviewed above were totally in error, there is *prima facie* evidence of the adverse effects of actionable subsidies. Redress for subsidies can be through the immediate application of countervailing duty measures.[26]

New Zealand has argued in a recent communication that the heterogeneity of fish stocks makes remedies including countervailing measures difficult to apply.[27] However, for fish exporting countries such Iceland, New Zealand or Australia which do not import fish from fish-subsidising countries, countervailing duties are an ineffective form of redress. This has been raised by several countries but where countervailing duties are inappropriate the ASCM also permits resort to the WTO Dispute Settlement Mechanism. Should the DSM find in favour of a complainant experiencing injury to its domestic industry or nullification and impairment or serious prejudice it would allow redress through the imposition of duties in either the affected sector or in other sectors.

This raises the obvious question of why the subsidies issue is in need of new rules when the WTO's dispute settlement mechanism could readily be employed as a means of dealing with WTO members that are employing prohibited or actionable subsidies. Clearly the now lapsed provisions of Article 6.1 provided an opportunity for litigation that was unambiguous. As argued by New Zealand, the heterogeneity of fish species makes proof of serious prejudice more difficult as any dispute may founder on appropriate definition of like products. Once again, the possibility of the use of nullification and impairment provisions in the ASCM would address the concerns of those WTO members unable to employ countervailing duties because of the structure of their fisheries sector. Second, as subsidies for fishing fleets are so pervasive among developed WTO members, negotiations are being chosen essentially for political and diplomatic reasons. In the litigious 'tit-for-tat' environment at the WTO it is difficult to find a developed WTO member with substantive trade interests in the sector that could not be accused of applying measures either in the marine products sector or in other sectors that could not be deemed as a GATT violation. Moreover, given the information requirements involved in successful litigation, a fisheries subsidies discipline based upon a methodology that forces countries to notify their subsidies in a precise manner, similar to the traffic light approach found in the Agreement on Agriculture, seems to be an architecture that would find support amongst many 'Friends of Fish'.

4 The Post-Doha Fisheries Negotiations and the Concerns of Small Developing Coastal States

The Negotiations

What then should be the concerns of small developing coastal states with regard to the negotiation of possible new disciplines in the fisheries sector? For over 200 years developed countries have provided subsidies to their fisheries sector as part of a mercantilist policy of development of fisheries, maritime transport, food security and national defence.[28] Now these subsidies, correctly or otherwise, are seen as undermining fisheries sustainability and hence are about to be subjected to possibly entirely new disci-

plines. There remains considerable disagreement in the negotiating Group on Rules on the need for new disciplines and whether or not the provisions of the ASCM are adequate.[29] New Zealand has argued that, given the heterogeneous nature of fish stocks, it is not possible to use existing ASCM disciplines to challenge the actions of WTO members offering what are viewed as illegal subsidies.[30]

The question now arises as to precisely what type of architecture, if any, will evolve in order to accommodate the perceived shortcoming of the ASCM in the area of fisheries. This depends in large measure on political as well as technical considerations. With most WTO issues it is the commercial interests that counts when issues are being traded off at the end of the round. In the case of fisheries, the proponents are a mixed collection of countries with commercial interests and those that believe that fisheries subsidies disciplines will constitute an important step towards environmental sustainability. The only two developed countries in the Friends of Fish group where a substantial and clearly demonstrable commercial interest is at stake are Iceland and New Zealand, both nations with highly efficient and competitive fishing fleets but neither of which carry significant bargaining power.[31] Iceland's fisheries account for 75 per cent of its export earnings; hence the government simply cannot compete with other WTO members on subsidies, i.e. the Icelandic economy cannot subsidise fisheries. In the case of New Zealand, which has pursued a policy of aggressive unilateral liberalisation, there is also an ideological opposition to such subsidies which, according to OECD estimates, are virtually non-existent.[32] Both countries and their fishing industry would benefit substantially from the exit of less efficient suppliers that currently rely on subsidies.

The USA is one of the key players backing the current fisheries subsidies initiative.[33] It has tabled a paper on fisheries subsidies[34] which supports enhanced subsidies but, given the very wide diversity of its own fisheries interests (its New England, Gulf, Pacific west coast and distant water fleets all have quite different interests), its long-term support may depend not so much on direct commercial interests but upon how much the current US administration wishes to demonstrate that is has a environmental agenda in multilateral trade negotiations. Similarly, Australia appears to have strong political, as opposed to strictly commercial, interests in the subject. Those developing countries which are part of the 'Friends of Fish' group all have international fisheries trade interests but are also unlikely to be willing or able to 'pay' for fisheries disciplines when the crunch comes. The real powerhouses behind public support for the fisheries subsidies negotiations in the developed countries are the environmental NGOs, Greenpeace and WWF.

During the Uruguay Round, political opposition to the inclusion of fisheries under the reduction commitment disciplines of the Agreement on Agriculture came from the EU and those countries called 'the Friends of Fisheries'.[35] However, if recent proposed changes to the EU Common Fisheries Policy (CFP) actually succeed, then the

EU will be removed as an active obstacle to fisheries subsidies reform at the WTO.[36] Thus far in the Doha Round the EU has remained uncharacteristically silent and if the CFP reform is blocked by the 'Friends of Fisheries' then the EU will certainly become a more active protagonist. The most vocal political opposition to enhanced disciplines now comes from Japan. With the possible exception of Iceland and Norway, most OECD countries view fish as just one alternative to beef or lamb, but in Japan, with its long mercantilist tradition in the fisheries and where an older generation still vividly remembers the hunger at the end of World War II, food security issues for the nation's main source of animal protein remain a high priority. It is Japan's vital fisheries interests that will create the single largest barrier to a new architecture with enhanced disciplines.

WTO members in the Negotiating Group on Rules have not yet resolved or even openly discussed the technical issues pertaining to the possible architecture of enhanced disciplines. However, the environmental NGOs and UNEP have a much clearer picture and are well ahead of most WTO members in terms of enunciating architecture for future disciplines. If there is to be a new architecture, it will employ a methodology that would be related to the one employed in the Uruguay Round negotiations on agriculture, where countries disclose their support measures to fisheries and then make appropriate reduction commitments based upon some sort of traffic light system, i.e. red, green and amber.

It is instructive to consider briefly the possible architectural arrangements for a WTO agreement on Fisheries Subsidies.[37] In 2000 three separate subsidies nomenclature were developed for categorising subsidies by the USA,[38] the OECD[39] and APEC,[40] all of which either directly or indirectly include government transfers such as access fees and tax and access fee exemptions that are of trade and commercial interest to coastal developing countries.[41] The architecture that emerges from the various proposals would almost certainly limit the capacity of developed countries to contribute to access fees and of developing countries to domesticate their fisheries. Such an architecture would require detailed notification of a variety of measures and also be likely to require commitments to reductions in support measures, as well commitments to the abolition of certain types of subsidies. If the normal type of special and differential approach provisions seen in the reduction commitments in the Agreement on Agriculture were to be extended to fisheries, then most developing coastal states would not be absolved from some level of bound reductions. Clearly, in such a case, least developed countries would be exempted from reduction commitments. It is precisely these measures that should be of concern to developing countries, as many of the measures that are discussed below are vital to the downstream processing of marine resources.

While a traffic light architecture seems to be the most likely type of framework to emerge, if fisheries management considerations are to have any influence on the disciplines then unless disciplines are imposed within the context of the fisheries manage-

ment regime and particular national context, it will make little environmental sense. To make reduction commitments where an appropriate fisheries management regime is in place would be environmentally futile and have no effect on sustainability; on the other hand, the acceptance of such an approach would imply something that WTO negotiators have long resisted, that criteria from other areas, for example environment or agriculture, can be a pre-condition for the application of disciplines. While an approach to the architecture which does not consider the fisheries management regime may be inappropriate from an environmental standpoint, it certainly does make sense from the standpoint of trade liberalisation. If negotiators ultimately agree on an architecture, it will be based solely on commercial criteria, i.e. whether a subsidy exists in a particular category, irrespective of whether or not the fisheries regime is sustainable.[42]

If WTO members are unable to agree on a new architecture, then what is likely to emerge is an annex to the ASCM which may have little commercial import and do little or nothing to protect fish stocks. Given the opposition to such an architecture from Japan and the relative weakness of its principle proponents, a new architecture is by no means a 'done deal' unless the environmental NGOs are able to successfully exert their considerable pressure on both the USA and the EU. A popular option in Geneva to increase bargaining leverage is to file a dispute, as has occurred in the case of the Australia/Brazil challenge to EU sugar subsidies and the Brazilian challenge to the US cotton regime. In the case of fisheries, such a challenge to the fisheries regimes of several larger WTO members is possible despite New Zealand protestations to the contrary.

The Concerns of Small Vulnerable Coastal States

The experience that developing countries have had with the WTO disciplines over the last eight years requires a highly precautionary approach to any new disciplines. Few small developing country missions in Geneva have had time to consider fisheries subsidies as they are widely seen by them as an issue that is peripheral to their principal trade interests. In the past, and often quite unintentionally, small developing countries have found themselves as 'by-catch' in trade disputes between larger WTO members. The experience with the *Banana* panels, the ensuing pressure on tuna margins of preference[43] and the current dispute over the EU sugar regime[44] have all resulted in developing countries experiencing the consequences of 'judicial activism' in the multilateral trading system between much larger players. It is precisely the past disciplines based on a single undertaking with MFN treatment which catch 'big fish' and 'small by-catch'. It is this, along with *ad hoc* judicial activism, that has created much of the discomfort that small developing states feel with further disciplines. The WTO's net has been cast without adequate consideration of the development, as opposed to adjustment, needs of its members.

Fisheries activities in small vulnerable coastal states fall into three separate categories:

a) Revenue generation from access fees for distant water fleets;

b) Domestic and foreign fishers operating for export in the EEZ and territorial sea to supply canneries, loining facilities and domestic processing facilities;

c) Artisanal fisheries within the territorial sea for the domestic and export market.

In the fisheries sector of many small vulnerable coastal states, governments have been attempting to localise the distant water fisheries as well as develop linkages between inshore fishery in the territorial sea and other sectors of their economies which include tourism, a substantial consumer of both domestic and imported marine products in coastal states. The section below considers the interests and concerns of small coastal states in each of these areas of fisheries activities as it pertains to the WTO negotiations.

a. Revenue generation from access fees

It is widely, though incorrectly, assumed that fish stocks are in decline in all marine environments. This is not the case and in those coastal states which have a substantial surplus fish stock in their exclusive economic zones and which have practised prudent fisheries management policies there are stocks in excess of the existing sustainable catch capacity of the domestic fleets. In these countries, many of which are least developed countries, significant government revenue has been generated from access fees from developed and developing country distant water fishing fleets.

The access fees that Pacific Island states negotiate are through state-to-state agreements and through commercial agreements between states and private companies. In the state-to-state agreements the distant water fishing nations also provide invaluable development assistance. A recent submission to the Negotiating Group on Rules (TN/RL/W/3, para 14) has served to heighten concerns amongst small vulnerable states that the intention of negotiations in this area may result, by design or default, in disciplines on fisheries access fees. The submission argues that:

> *... the fisheries sector is distinctive in that, in addition to the standard market addressed in the SCM rules, fisheries sector subsidies can also distort access to productive resources, and can have negative effects from an environmental or developmental perspective.*

b. Domestic and foreign fishers operating for export in the EEZ and territorial sea to supply canneries, loining facilities and domestic processing facilities

Access fees, while significant to some marine resource-rich small vulnerable states, have generally only been significant to the least developed and most vulnerable. A far more common concern pertaining to the current negotiations on fisheries subsidies is

the potential impact that new disciplines may have upon fisheries activities geared towards domestic processing and subsequent export. This is a far more widespread concern, as many of the small vulnerable coastal states that do not offer access to distant water fishing nations have nevertheless sought to develop domestic capacity to use their own marine resource for development purposes. Many of these domestic facilities have formed strategic partnerships with fleets from distant water fishing nations to develop and land catches from the EEZ of small vulnerable coastal states.

In order to attract local and foreign investment in the fisheries, many developing and least developed small vulnerable states have offered incentives to both local and foreign fishers to supply domestic processing facilities. These incentives are vital if small vulnerable coastal states are to develop their fisheries sector. The right of coastal states to domesticate their fisheries sector is assured under UNCLOS and any possible WTO disciplines should not undermine the fundamental principles of the Law of the Sea.

Outside the context of the WTO there has been some early discussion of the methodology to be employed in any possible fisheries subsidies negotiations. While the ASCM has considerable weaknesses as it pertains to special and differential treatment for developing countries, the need for departure from its methodology is as yet to be demonstrated.

c. Artisanal fisheries for export and domestic markets

Any new fisheries subsidy disciplines on distant water and local fleets, as suggested by the proponents of such disciplines, would impact on large numbers of coastal small vulnerable states. However, heightened subsidies disciplines, if crafted without sufficient understanding or consideration of the particular circumstances of artisanal fishers, could effect the development efforts of all small vulnerable coastal states in the fisheries sector. The artisanal fisheries sector remains central to the subsistence and monetised livelihood of coastal populations throughout the developing world in general, and in particular in small vulnerable coastal states. Those involved in artisanal fisheries in the territorial sea normally fall into low-income groups. Moreover, in many coastal developing states women dominate the subsistence component of the artisanal sector.

In many small vulnerable states governments have specific programmes to assist these groups which often include direct assistance for the purchase of monetised inputs. This type of government assistance to low-income, low-technology fishers to raise income levels by expanding into monetised activities for the domestic and speciality export market are vital to the development efforts of small vulnerable coastal states and to raise the standard of living of what are often very low-income groups. As a result, any disciplines that may be developed on fisheries subsidies must be crafted so that they exempt government programmes to raise the income levels of artisanal fishers.

All these matters can conceivably be addressed if the size of the WTO's net is cast widely enough to provide for appropriate escape for the 'by-catch'. The judicious use of appropriate *de minimis* and special and differential provisions could provide a genuine development space. The question is whether, in the rush to write yet more disciplines, the genuine and legitimate concerns of the WTO's most vulnerable members will be overlooked.

5 Fisheries Subsidies Disciplines – the Case of Pacific ACP Fisheries Access Arrangements

This section considers some of the implied disciplines that the current negotiations at the WTO appear to suggest. It will be argued that the disciplines implied by the negotiating positions suggest that possible future WTO disciplines that could endanger the position of the Pacific Island states and other coastal developing states that remain highly dependent upon revenues and development assistance stemming from access fees.[45] The analysis of possible WTO provisions will be reviewed in light of the various access provisions of the predominant regional fisheries access arrangements. These include treaty arrangements with the USA, emerging arrangements with the European Union and private bilateral access arrangements.

Fisheries Access Arrangements with the USA

The most significant access arrangement in the South Pacific is the multilateral arrangement between the Pacific Islands and the USA, the Treaty on Fisheries Between the governments of Certain Pacific Island states and the government of the United States of America (the US Treaty),[46] originally negotiated in 1987, revised in 1993 and with a further extension scheduled for June 2003. The US Treaty creates a multilateral framework to regulate access of US purse seine vessels in the EEZs of the South Pacific Island states which are members of the Forum Fisheries Agency (FFA).[47]

The financial terms of the revised US Treaty, which come into force in June 2003 (currently US$18 million per annum), fall into three categories: (a) an annual industry payment representing licence fees for a maximum of 45 purse seine vessels and technical assistance; (b) observer programme costs paid by industry; and (c) economic development assistance provided by the US government pursuant to a related agreement between the US government and the FFA.[48] Under current arrangements in the Multilateral Treaty, USAID pays approximately US$14 million of the US$18 million of annual returns to the beneficiaries.[49] This accounts for almost a third of total access fees derived by Pacific Island states, but less than 20 per cent of total DWFN catch in their EEZs.[50]

Studies by the World Bank[51] suggest that the current 4 per cent average access fee is only as high as it is because of the 10–11 per cent return received from the USA,

which is subsidising the agreement through USAID. In the past two decades two factors, both now related to events at the WTO, have pushed the US fleet into the Central and Western Pacific and away from the Eastern Pacific which was its traditional fishing ground. The first is that in the Western Pacific tuna and dolphin do not school together and hence canneries using fish caught by US purse seiners could continue to use the 'dolphin free' label and continue to use the profitable purse seine fishing technique. However, with recent amendments to the US Mammal Protection Act made necessary as a result of the second *tuna-dolphin* case, there has been a redefinition of 'dolphin friendly' which will increase the permissible dolphin by-catch and may well help to pull the US fleet back to the Eastern Pacific closer to previous bases of Pago Pago and San Diego. Finally, capacity constraints in the fisheries in the Eastern Pacific have meant that the US fleet will maintain its operations in the Central and Western Pacific region.

The second factor bringing the US fleet into the Central and Western Pacific have been the US Treaty itself, which not only provides substantial subsidies but allows purse seine operators to fish throughout the EEZs of the members of the FFA under one access agreement.[52] Should new fisheries subsidies disciplines be negotiated, then the US treaty in its present form would be likely to have to be revised. This would put further pressure on the US purse seiners to shift their operations to the Eastern Pacific. Without the US treaty the average access fee for Pacific Island countries would drop to 3 per cent.[53]

EU Fisheries Partnership Agreements

The EU has been a relatively new entrant into the resource-rich waters of the South Pacific. The first fisheries access agreement was signed between Kiribati and the EU in July 2002.[54] The three-year agreement is a bilateral access agreement which foresees six EU purse seine fishing vessels in the Kiribati EEZ in the first year along with 12 long-liners.[55] Receipts will be set at €546,000 per annum but in the second year of the agreement the benefits to Kiribati decrease to €416,000 when vessel levels will fall to four purse seine vessels, though this can increase to 11 purse seine vessels with an additional payment of €65,000 per purse seine vessel. The component paid by the industry is the highest of any previous EU access agreement and is set €35/tonne landed.[56] The method of calculating the licence fee in the EU agreement, it will be argued, compounds the fisheries management difficulties faced by policy-makers in the sector by providing a substantial and direct incentive to under-reporting. It should be noted that approximately 17 per cent of the total cost of fisheries access was met by ship owners with the balance coming from EU public funds.[57]

The relationship in fisheries between the EU and the ACP states in general has by and large been dominated by this type of 'cash for access' type arrangement with only some notable exceptions.[58] However, at the very end of 2002 the European commission launched a new policy initiative on fisheries that foresaw the development of

'fisheries partnership agreements'.[59] It is envisaged that the partnership agreements will result in the creation of a framework agreement with ACP countries in the area of fisheries. This fisheries agreement will have the overall objective of sustainability, good governance and poverty eradication[60] but have the specific objectives of protecting EU fisheries interests (including access) and fostering developing countries' capabilities to exploit their marine resource. The potential for policy conflict is apparent.

The current EU access arrangements involve substantial government transfers and because access fees are paid on the basis of reported catch, they result in incentive mechanisms that exacerbate unsustainable fisheries practices. The estimates of the extent of the government transfer in the current EU access arrangement are 83 per cent of total cost. This is very similar to that of the USA where the public contribution is 84 per cent of total payment.

Japan, Korea and Taiwan

While US, and to a lesser degree EU, fisheries access agreements are state-to-state and are largely transparent in nature, agreements with East Asian DWFN are highly opaque because they are a commercial agreements that are secret. In the case of Japan, there is a Head agreement with South Pacific nations but access is negotiated by industry associations, representing vessel operators, and individual governments. The access fee is negotiated in the subsidiary agreement which is calculated on per trip basis which decreases the incentive to under-reporting and is paid wholly by the Japanese companies.[61] Significantly, like the US arrangement, fisheries access is not dependent upon declared catch and hence is not as corrosive of good fisheries management practices as other arrangements. Japan has also successfully decoupled, in law if not entirely in fact, its access arrangements from its development assistance. where access is not subsidised but becomes, in the view of Pacific Island countries, a *conditio sine qua non* of Japanese development assistance to the fisheries sector.[62] Japan, like the USA, has a relatively good fisheries management record in the region.

Other DWFN such as Korea and Taiwan negotiate bilateral commercial agreements between individual ministries and fishing companies; these are not agreements between sovereign states. Little or nothing is publicly known about these agreements except that the access fee is normally based on a percentage of the previous year's catch. It is entirely possible that governments offer subsidies for access to the DWFNs in the home country but no information on the existence of such transfers is available. In a recent publication, FFA officials described the access formula used by Pacific Island states:[63]

> *In the FFA region, the access fees are largely determined using the previous year's catch and effort data as supplied by the DWFN, the market price and set percentage rate of return. The standard access fee formula is as follows:*

Access = Average Price of Tuna x Average Catch per Vessel x Minimum Rate of Return

This access fee formula or variants thereof have been used by Pacific Island countries as a method for calculating access fees for over a decade.[64] On the basis of current estimates US purse seine owners are paying US$120,000 for access as compared with US$250,000 paid for access by Japan, Korea and Taiwan.[65] EU purse seiners will pay an extra €65,000 (US$70,000) for access. However, what the Pacific Island state receives is approximately five times more than what the US vessel owner pays because of the contributions of USAID.

This formula contrasts sharply with the access arrangement in the US Treaty which is highly subsidised but, more importantly, is not in any way related to catch levels or declared catch and hence creates no incentive for under-reporting or misreporting. In the formula above the more a fisherman reports, the more he will pay in access fees in the following year. Scientists and policy-makers are keenly aware that there are economic incentives to under-report or to report fish caught in the EEZ as being caught on the high seas. These policy-makers and scientists are confident that they are able to build into their own catch estimates margins of error which will take into account the magnitude of the misreporting and hence assure the sustainability of the region's fisheries. Whether this confidence is justifiable will only be tested in time as more pressure is put on the resource with the entry of new DWFNs into the Pacific and as the EU's desire for enhanced access into ACP waters brings effort levels close to estimated sustainable yields. However, suffice it to say that a system of access fees that provides financial incentives to misreport only further compounds fisheries management problems in the region because biological accuracy of recruitment is notoriously poor in the tuna fisheries.

It will be argued that the differences between the nature of the agreements bears heavily on the issue of sustainability of the fisheries but in an exactly opposite way to that predicted by the opponents of fisheries subsidies disciplines. The US agreement, with its extensive subsidies, is far more conducive to sustainability because it is multilateral in nature, transparent to all parties and in large measure respects the environmental and marine standards established in the Pacific Islands. The US treaty is widely regarded in fisheries circles as a model and the US Distant Water Fishing Fleet's behaviour is considered to be exemplary in terms of sustainability and monitoring. The USA is widely seen as the DWFN that is least involved in under-reporting and misreporting. The reason for this is that the treaty is based on access fees that are decoupled from fish catches. Thus, whether the US fleet reports catches on the high seas or within the EEZs of the Pacific Island countries does not affect the amount of the access fees it will pay in the current years. The US Treaty imposes an access fee regime that is the equivalent of a lump sum tax and so does not distort behaviour.

Revenue Estimates from Pacific ACP Access Arrangements

For many years data on the economic importance and magnitude of access fees have not been publicly available in the Pacific Island states or indeed in many coastal states. National governments and regional fisheries organisations, operating under instruction from their members, have jealously guarded what they have seen as 'commercially sensitive' data on fisheries access fees and the revenues generated therefrom. Table 12.1 is the first country specific estimate of the significance of access fees to Pacific Island countries.

Table 12.1: 1999 Access Fees and Gross Domestic Product

	Access Fees (US$)	GDP (US$)	Access Fees (% of GDP)
Kiribati	20,600,000	48,123,871	42.81
Tuvalu	5,900,000	13,848,788	42.60
Federated States of Micronesia	15,400,000	229,869,864	6.70
Nauru	3,400,000	51,612,903	6.59
Marshall Islands	4,982,600	97,311,800	5.12
Niue	151,793	7,514,077	2.02
Palau	800,000	113,484,869	0.70
Cook Is	169,072	$82,371,930	0.21
Papua New Guinea	5,840,000	3,415,590,478	0.17
Tonga	152,041	157,018,257	0.10
Solomon Islands	273,458	279,593,229	0.10
Vanuatu	218,448	226,280,313	0.09
Samoa	188,616	233,506,665	0.08
Fiji Islands	212,000	1,821,334,281	0.01

Source: R. Gillet and C. Lightfoot, *The Contribution of Fisheries to the Economies of the Pacific Island Countries,* Honiara: FFA, 2001

The most significant observation regarding these data is the importance of access fees to the economies of the region. One-quarter of total Pacific access fees come from payments made by USAID under the terms of the US Treaty. What is also significant is that access fees as a percentage of GDP tend to be greatest in those countries with the least developed fisheries sector and they are very often smallest as a portion of GDP in those countries with a relatively developed fisheries export sector. For the least developed and most vulnerable states, such as Kiribati and Tuvalu, fisheries access fees constitute an overwhelming proportion of GDP. Significantly, despite high dependence on access fess, there is no scientific evidence that either Kiribati or Tuvalu have allowed fishing in their EEZs beyond sustainable levels for the main target species of tuna. In some of the more developed and more resource-endowed states exemption

from access fees has been a standard incentive offered to facilitate localisation and down stream processing. The WTO compatibility of these arrangements should be of concern to Pacific Island countries that are members of the WTO.[66]

Table 12.2 covers estimates of access fees for two groups of countries, Pacific WTO members, i.e. Papua New Guinea, Fiji and Solomon Islands, and resource-rich non-WTO members who may nonetheless be effected by WTO disciplines. In the case of those countries where there are abundant marine resources, for example Kiribati, Marshall Islands, Nauru, Federated States of Micronesia and Tuvalu, almost no fish exports pass through their territories. However, where exports are developed and substantial in value, access fees are minimal because governments that have large marine product exporting sectors have used exemption from fisheries access fess as means of providing incentives to localisation.

Table 12.2: Exports and Access Fees of Selected Pacific Countries (1999)

Country	Estimated Exports (US$)	Estimated Catch[a] (MT)	Estimated Value of Catch (US$)	Access Fees (US$)	Access Fees as % of Catch
Fiji Islands	23,000,000[b]	15,600	40,000,000	212,000	0.053
Federated States of Micronesia	4,623,000[c]	134,499	180,000,000	15,400,00	8.6
Kiribati	2,302,000[d]	138,000	139,000,000	20,600,000	14.8
Marshall Islands	473,000	33,217	50,000.000	4,984,000	9.96
Nauru	0	41,000	37,000,000	3,400,00	9.2
Papua New Guinea	48,000,000	141,000 (85,000)	140,000,000 (75,000,000)	5,840,000	4.1 (7.3)[e]
Solomon Islands	5,000,000	74,000	70,600,000	273,000	0.3
Tuvalu	4,500	40,532	37,400,000	5,900,000	15.8

Source: R. Gillet R. and C. Lightfoot, *The Contribution of Fisheries to the Economies of the Pacific Island Countries,* Honiara: FFA, 2001

a Based on total commercial (non-subsistence) catch.

b These estimates are based on official figures of the Fiji Fisheries Division. The Reserve Bank of Fiji estimates that these figures are $28,000,000. The EU estimates that these figures are closer to $40,000,000.

c These are 1997 estimates for Federated States of Micronesia.

d Kiribati exports are dominated by live aquarium fish.

e The bracketed estimates for Papua New Guinea are based on the assumption that all access fees are paid only by offshore foreign based vessels.

Cross-country comparisons of percentage access fees are always fraught with difficulty for at least two reasons. The effective rates reflect two distinct forces. First, they may reflect differences in the nominal negotiated or target rate, i.e. rates may be different from one country to another. This could be because where catch levels are below

sustainable levels, as they are in the Pacific, some coastal states will prefer to attract some possibly low level of access from a marginal DWFN than to gain nothing at all. Second, the effective rates may be different even where two countries pay the same nominal rates because the declared catch per vessel is higher for one DWFN than for another. This, in turn, could be the result of genuine differences in actual catch per vessel, stemming from differences in productivity or from differences in misreporting and under-reporting, i.e. differences in the rate of malfeasance. Differences are also a matter of development policy. as has been mentioned above. where the relatively advanced marine product-exporting countries such as Fiji, Solomon Islands and Papua New Guinea have, as a matter of development policy, developed a diversified and 'domestic' fisheries sector where no or almost no access fees are paid by local and locally-based fishers. Nevertheless, the differences in rates are so large as to require some explanation.

The estimates above are determined by dividing the known access fees paid by the DWFN by the estimated value of the catch. The numerator, i.e. the access fees, forms part of government revenue and is relatively accurate as the amount received in fees is presented to parliament in government budget estimates. It is the denominator, the volume and unit value of fish, which is the most difficult to verify as it comes from reported catch levels multiplied by estimated price. The catch estimates of the distant water fishing fleets are inaccurate if for no other reason than that the access fee formula used in bilateral agreements gives them considerable economic incentive to under-report and misreport.

It is worth considering three groups of countries from the above sample. The first group is made up of Kiribati and Tuvalu, two of the poorest and most vulnerable LDCs in the Pacific, but islands which are resource rich and overwhelmingly dependent upon access fees paid under the US Treaty. Over the last few years, the US fleet has become increasingly dependent upon the EEZs of Kiribati and Tuvalu as these countries are nearest to their traditional fishing grounds in the Eastern Pacific. In 1999, approximately 40 per cent of the tuna caught in the Kiribati EEZ was caught by US purse seiners (56,000 tonnes) and 90 per cent in Tuvalu (36,000 tonnes). The very high estimates of return to both Kiribati and Tuvalu reflect not only low reported volumes but also the predominance of the US fleet and the way in which access fees are paid under the US Treaty. Three factors help explain the high reported *ad valorem* rates which are much higher than what is known to be paid internationally. First, the US Treaty decouples access from price; second, most of the US fleet was operating in the EEZs of these countries; and third, 1999 was a low tuna price year. However, according to Pacific fisheries officials the US fleet has the best fisheries management record of all the DWFN operating in the region. Because access fess are decoupled from declared catch they also have no incentive to misreport and under-report. Furthermore, the US fleet operates a monitoring and surveillance framework which contributes to good management.

The second group of countries includes Nauru, Federated States of Micronesia (FSM) and Marshall Islands which appear to generate access fees of around 8.6–9.9 per cent of estimated catch. In this case it is not possible to easily explain such estimates. From the data available in 1999 these apparently high rates of return cannot be explained by the presence of the US tuna fleet as it was not operating in the EEZs of FSM or Marshall Islands and was only a minor player in the EEZ of Nauru (accounting for 15 per cent of total Nauru catch in 1999).

The third group of countries, the WTO members – Papua New Guinea, Solomon Islands and Fiji – have, as stated above, pursued a development policy based on the domestication of the fisheries sector and have used access fees, along with a host of other measures, to subsidise domestication of their industry. As a result, revenues from access fees have been negligible. This constitutes a significant investment in the development of a commercial advantage in marine resource exports. Papua New Guinea has earned access fees from agreements with Taipei and, to a lesser degree, USA.[67] In Fiji, the absence of government earnings from access fees is compounded by the loss of tax revenues stemming from tax incentives to the export sector. Thus a very high rent sector, such as the export of sashimi grade tuna, operates in Fiji in an almost tax free environment.[68] Moreover, there is evidence that operators in this sector are involved in the massive and systematic under-reporting of exports, as has been highlighted by the EU as well as the Reserve Bank. This absence of access fees for local fishers accounts for the relatively low percentage access fees found for Fiji and Papua New Guinea.[69] In the Fiji and Papua New Guinea canned tuna sectors no access fee is paid for tuna used in the cannery which is processed domestically; in the demersal export fisheries in Papua New Guinea, where there are only domestic fishers, there is an exemption from access fees. It should, however, be noted that since the publication of this data there have been changes in policy in both Papua New Guinea and Fiji which will assure higher access fees even for domestic fishers as the Fisheries Departments become ever more self-reliant in financing their operations.

6 Implications of WTO Disciplines on Fisheries Subsidies

The clamour for fisheries subsidies disciplines at the WTO has been strenuously supported by the NGOs and the intergovernmental organisations (IGOs), such as UNEP, FAO, APEC and the World Bank. The nexus between fisheries subsidies and stock depletion is now accepted wisdom, so that policy-makers no longer even consider the internal dynamics of the global capture fisheries. However, even if by some *deus ex machina* effective subsidies disciplines are negotiated at the WTO, the dynamics of rising global population, rapid economic growth, which has increased income and demand for fish, and the application of sophisticated technology to the last primitive hunter-gatherer activity will mean that global fisheries will not survive unless global

disciplines to limit access to sustainable levels are negotiated in the appropriate forum, i.e. the FAO or the UN. To discuss this dynamic of fisheries depletion is today profoundly unfashionable because it is to lay the blame for fish stock depletion on what are, in effect, the very pillars of our modern society – the application of advanced technology and rapid population and economic growth. Instead, the NGOs and IGOs prefer to pretend to address the issue of fish stock depletion by supporting WTO negotiations that will ultimately result in weak disciplines at the WTO. In the Pacific, the coastal states together with the DWFNs have virtually completed the negotiation of a new legal instrument[70] which will set in place a management regime that will provide genuine multilateral guarantees for sustainability. In such a fisheries management context, fisheries subsidies rules at the WTO will only serve to undermine the economies of the region and make the fisheries sector of less value to governments.

Disputing the logical veracity and factual foundations of an argument made by those who are large, rich and powerful by those who are small, poor and vulnerable may prove personally satisfying to the proponent, but it normally overlooks the inevitable outcome. It is best for coastal states to consider policy responses to the threats posed by those changes in policy. The challenges posed by these disciplines include:

- The potential loss of a substantial portion of the GDP of Kiribati and Tuvalu, two of the smallest and most environmentally and economically vulnerable LDCs in the ACP group;
- Losses of revenue by a large number of other ACP countries dependent upon revenues from subsidised access agreements;
- dismantling of economic incentives to domestication through elimination of subsidies to local fishers.

The responses by ACP countries to the challenges posed should be based upon:

- Seeking special and differential treatment in fisheries negotiations that recognise the need of developing coastal states to maintain revenues from sustainable access arrangements, and subventions to domestic and artisanal fishers;
- Developing access agreements that decouple development assistance from fisheries access arrangements, such as is found in the Japanese agreements with the Pacific ACP. In the case of the fisheries partnership agreements, development assistance to the fisheries sector should not be linked to EU access;
- Where possible, replacing access fees with income withholding taxes for DWFNs. This will permit differential rates for local and foreign fishers and avoid issues pertaining to GATT Article I and III.

There is much irony in a situation where Kiribati and Tuvalu,[71] two of the world's

smallest and most environmentally vulnerable states threatened by unsustainability and eventual physical extinction caused by global warming, are first threatened with economic collapse as a result of negotiations in the WTO, an international trade body which is being used by some of its members to protect the environment. This is even more ironic when one considers that the most powerful proponent of these fisheries subsidies disciplines, the USA, is the most important provider of government support to fisheries access in the region and at the same time has destroyed the best, albeit flawed, hope for saving these low-lying atolls from global warming through its refusal to sign the Kyoto Convention. All this may be palatable to some if it could be defended on the grounds of fisheries management, but there is no evidence of unsustainable fisheries in Kiribati and Tuvalu; the first victim of the negotiations would probably be the very access agreement that has become most closely associated with good fisheries management practice in the region, i.e. the US Treaty. The outcome becomes demonstrably inequitable and unjust when one considers that these disciplines are being negotiated in the WTO, a forum in which both Kiribati and Tuvalu were *de facto* members, a status which they lost at the end of the Uruguay Round.[72]

Notes

1 WTO Ministerial Declaration WT/MIN(01)/DEC/1, 20 November 2001, Para. 28. In the context of these negotiations, participants shall also aim to clarify and improve WTO disciplines on fisheries subsidies, taking into account the importance of this sector to developing countries.
2 Negotiating Group on Rules, TN/RL/W/3, 24 April 2002.
3 The principle proponents of enhanced fisheries subsidies rules at the WTO include Australia, Chile, Ecuador, Iceland, New Zealand, Peru, Philippines and the USA
4 China has called for Special and Differential Treatment Provisions in very broad terms without specifying the content of such provisions. Negotiating Group on Rules TN/RL/W/9, 20 June 2002.
5 Gordon, H. S., 'The Economic Theory of a Common Property Resource: The Fishery', *Journal of Political Economy*, Vol. LXII, 1954, pp. 124–42.
6 See Arnason, R., 'Ocean Fisheries management: recent international developments', *Marine Policy*, September 1993; Porter, G., 'Fisheries Subsidies and Overfishing: Towards a Structured Discussion', UNEP, Geneva, 2002, p. 11.
7 Scott, A. D., 'The Fishery: The Objectives of Sole Ownership', *Journal of Political Economy*, Vol. LXIII, 1955, pp. 116–24.
8 Flaaten, O. and Wallis, P., 'Government Financial Transfers to Fishing Industries in OECD Countries', OECD, 2000. http://oecd.org/agr/fish/publication.htm
9 Arnason, R., 'Fisheries subsidies, overcapitalization and economic losses' in *Overcapacity, Overcapitalisation, and Subsidies in European Fisheries, Proceedings of the First Workshop of the EU Concerted Action and the Common Fisheries Policy*, ed. Hatcher, A. and Robinson, C., University of Portsmouth, UK, October 1998.
10 Japan has asserted that any possible adverse effect of fisheries subsidies on stock depletion could be addressed with an appropriate management regime, WT/CTE/W/173.
11 FAO, 'Marine Fisheries and the Law of the Sea: a Decade of Change', 1992, Rome.
12 Asia-Pacific Economic Cooperation (APEC), Fisheries Working Group, *Study into the Nature and Extent of Subsidies in the Fisheries Sector in APEC Member Countries*, 2000.
13 See *Transition to Responsible Fisheries: Economic and Policy Implications*, Paris, 2000; also 'Transition to Responsible Fisheries, Government Financial Transfers and Resource Sustainability: Case Studies', (AGRI/FI), Paris 2000. It is worthy of note that the OECD does not refer to subsidies which may be construed as having WTO implications but 'government transfers'.
14 Milazzo, M., 'Subsidies in World Fisheries: A Re-examination', Washington, World Bank, 2000.
15 For a full and complete analysis of the application of existing WTO fisheries subsidies rules see Stone, C. D., 'Too Many Fishing Boats, Too Few Fish: Can Trade Laws Trim Subsidies and Restore the Balance in Global Fisheries', *Ecology Law Quarterly*, Vol. 24, 1997, pp. 505–43.
16 Article 3, ASCM.
17 There are clear exemptions from these provisions under the covered agreements which would allow least developed countries and those with a GNP per capita of less than US$1,000 to be exempted from these disciplines. See Annex VII, ASCM.
18 Article 5, ASCM.
19 Article 1, ASCM.
20 It is generally understood that development assistance is normally not covered under the subsidies code. However, there is no legal precedent on the matter and the specific case of development assistance being used to lower access fees for DWFNs is central to the advocates of greater subsidies disciplines.
21 Non-actionable subsidies ceased to exist from January 2000.
22 Footnote 4, ASCM, defines this standard as being met 'when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated export earnings.
23 See Annex 1, ASCM.
24 Article 5, ASCM.
25 Article 6(a) ASCM. Under the provisions of ASCM, Article 31.
26 ASCM, Articles 17 and 19.
27 TN/RL/W/3 and TN/RL/W12. While there is no doubt that fish stocks are heterogeneous in nature and this creates difficulties in the definition of 'like products' for the purpose of the application of countervailing measures, this is not unique to fish. More significantly, heterogeneity does not preclude the determination of injury or serious prejudice as there is no obligation in footnote 46 ASCM for the like products to be identical.

28 Indeed Adam Smith, in *The Wealth of Nations*, criticised bounties provided by Britain to its own whaling fleet but in the end recognised the key role the subsidies played in the national defence. Japan and France used subsidies in the nineteenth century to develop their own distant water fleets.
29 Japan has argued that the current rules are adequate (Negotiating Group on Rules, TN/RL/W/11, 2 July 2002) and that the matter should be addressed at the FAO which possess the fisheries expertise to address such a complex issue.
30 Negotiating Group on Rules, TN/RL/W/12, 4 July 2002.
31 Norway, which is not formally part of the group but is supportive of enhanced disciplines in the sector, does posses some bargaining power, but whether it is willing to use this on fisheries issues remains to be seen.
32 OECD, 'Transition to Responsible Fisheries – Economic and Policy Implications', Paris, 2000. New Zealand government transfers to the national fisheries are approximately 1.5 per cent of the estimated value of the New Zealand catch in 1996 (p. 145). In the case of Iceland, the comparable figure is 4.6 per cent of the value of the catch. While no comparable figures were provided by Japan, the EU, reputedly among the largest provider of subsidies, granted 639 million Euros, equal to approximately 7 per cent of the value of 1997 landings. If one includes the cost of general services under the CFP, this figure rises to 14 per cent of the value of the catch (p. 140).
33 On the basis of OECD data, op. cit p. 148, the USA is by far the most prolific provider of transfers to the fisheries sector. In 1997, the last year for which comparable OECD data were available, the USA provided transfers of $724 million in constant 1990 dollars from a catch of $3 billion, i.e. 24 per cent of the value of the catch. This makes the USA the largest user of transfers of any OECD country for which comparable data were available. (Data from Japan were not available.)
34 Negotiating Group on Rules, TN/RL/W/21, 15 October 2002.
35 This is a group of EC members who have substantial fisheries interests and includes, among others. France and Spain.
36 At the Johannesburg Earth Summit, the European Union took an active role as protagonist for the agreement to limit fish catches to sustainable levels.
37 The architectural options come from G. Porter, 'Fisheries Subsidies and Overfishing: Towards a Structured Approach', UNEP, Geneva, 2001.
38 WT/CTE/W/154.
39 OECD, 'Transition to Responsible Fisheries: Economics and Policy Implications', Paris, 2000.
40 APEC, Fisheries Working Group, 'Study into the Nature and Extent of Subsidies in the Fisheries Sector of APEC Member Economies'.
41 Access fee exemption provisions for local fishers may well constitute a *prima facie* violation of GATT 1947 National Treatment obligations.
42 Porter, G., op. cit, UNEP, 2000, pp. 34–35 The architecture proposed by Porter, which foresees a matrix that would include evaluation of whether a particular fisheries management regime imposes weak or strong output controls, would require an evaluation from experts in fisheries as a pre-condition to imposing trade rules. Irrespective of the economic or environmental virtues of such a methodology, it would certainly prove extremely unpalatable to trade negotiators.
43 Thailand and Philippines placed considerable pressure on the EU at the Doha ministerial conference to agree to lower their MFN tariff on canned tuna in response to demands from the ACP group for a waiver for the trade provisions of the Cotonou Agreement. The waiver was made necessary by the results of the various Banana disputes. Thailand and Philippines have sought mediation at the WTO over EU MFN canned tuna tariffs.
44 Australia Request for Consultation, European Communities – Export Subsidies on Sugar, WT/DS265/1, 1 October 2002; Brazil Request for Consultation, European Communities – Export Subsidies on Sugar, WT/DS266/1, 1 October 2002.
45 Kingston, T., 'The Current Status and Benefits of the Pacific Island Fisheries Industry', in Zachary, D. et.al., Towards a Prosperous Pacific: Building a Sustainable Tuna Industry in the Pacific Islands ,Maui Pacific Centre , Hawaii, 1997, pp. 73–81. The Marshall Islands obtained 25 per cent of government revenue from fisheries access fees in 1992/3. The equivalent figure for other island states was Kiribati – 45 per cent in 1991; Federated States of Micronesia 25 per cent in 1993; Tuvalu 11 per cent in 1990; and Solomon islands 5 per cent in 1993.
46 Forum Fisheries Agency, the *Treaty on Fisheries Between the Governments of Certain Pacific Island States and the Government of the United States of America* (the Multilateral Treaty on Fisheries), Honiara, 1994.
47 The parties to the Multilateral Treaty include Australia, Cook Islands, Federated Stares of Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, New Zealand, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu.
48 See Schedule 3, Multilateral Treaty, op. cit.

49 S. Tarte, 'The European Union and the Western Pacific Tuna Fishery', October, 2002, Strasbourg, France.
50 Needs source from Forum Fisheries Agency.
51 World Bank, *Pacific Island Economies: Building a Resilient Economic base for the Twenty First Century*, Report No 13803-EAP, Washington February, 1995, p. viii.
52 If the US purse seiners paid the US government the equivalent of the USAID contribution in licence fees then this would not be a subsidy.
53 This estimate is based on tuna prices existing in 1997. Given that the US estimates
54 The agreement grants access to French, Spanish and Portuguese vessels.
55 Even this initially modest agreement between the EU and Kiribati has proven to be quite controversial as there was considerable debate as to whether Kiribati provision of access for EU purse seiners violated their obligation to limit access under the Palau arrangement. (Arrangement for the Management of the Western Pacific Purse Seine Fishery, 1995). See www.spc.org.nc/OceanFish/Hmtl/SCTB/SCTB14/FT5_Opnai_Clark.pdf For a complete analysis of the Palau arrangement see T. Aquorau and A. Bergin, 'Ocean Governance in the Western Pacific purse seine fishery – the Palau Arrangement', *Marine Policy*, Vol. 21, No. 2, 1997, pp. 173–86.
56 In earlier tuna access agreements, such as the Seychelles-EU arrangement, the amount paid by the industry was set at €25/tonne
57 IFREMER, CEMARE, CEP,199. 'Evaluation of Fishing Agreements Concluded by the European Community', European Contract No. 97/S 240-152919.10.12.1197, IFREMER/CEMARE/CEP, Ref. APC02, quoted in B. Gorez and B. O'Roidan, 'A report on the Future of European Union-ACP Fisheries Relations', Commonwealth Secretariat, February 2002, p. 17.
58 This type of 'first generation agreement' was followed by 'second generation agreements', e.g. that between the EU and Argentina which saw the creation of joint ventures. In Mozambique the EU has also pursued fisheries joint ventures.
59 'Communication from the Commission on an Integrated Framework for Fisheries Partnership Agreements with Third Countries', Brussels, 23 December 2002, COM (2002)637 final.
60 Ibid p. 5.
61 Japan has fisheries agreements with FSM, Kiribati, Marshall Islands, Nauru, Palau, Solomon Islands and Tuvalu. There is also a fisheries agreement with Fiji but Japanese fishing vessels do not fish in Fiji waters
62 The government of Japan normally denies that there is any link between its fisheries technical assistance and access agreements. The US government also denies that the Multilateral Treaty has any subsidy component.
63 Tamate, J. and Joseph, G., 'The Experience in the Pacific on Negotiating Fishing Agreements' in Lankester, K., Diouf, P, and Khandy, S.(eds), 'Proceedings of two Workshops held in Senegal and Mauritania on Fisheries Access in West Africa', WWF, 2002, p. 94.
64 See Grynberg, R. and Powell, M., 'Taxation in the Island Nations of the South Pacific', Australian National University, NCDS, Canberra, 1994, Vol. I.
65 See Tarte supra, p. 6.
66 The differences in access fees can be seen as a possible GATT Article I (MFN) and III(National treatment) violation as well as a possible violation of existing subsidies rules. These concerns, especially possibly Articles I and III violations, should be considered by developing countries irrespective of the outcome of the Fisheries subsidies negotiations.
67 It is reported that PNG tuna caught by Philippino and PNG vessels bound for the Madang tuna cannery and export to the EU have been free of access fees. This accounts for approximately 50 per cent of PNG exports in 1999.
68 Fiji has a long tradition of offering tax-free status to marginal garment factories as well as high rent earning sectors such as gold mining and sashimi grade tuna.
69 This exemption from access fees in Fiji has in the past extended to foreign fishers operating under licence to domestic fishers.
70 Pursuant of the UN Fish Stocks Agreement (the agreement for the Implementation of the Provisions of the United Nations Convention on the Law of the Sea of 10 December 1982 relating to the Conservation and management of Straddling Fish Stocks and Highly Migratory Fish Stocks) has negotiated a multilateral agreement for management of fish stocks the Central and Western Pacific region.
71 Kiribati and Tuvalu are small atolls with their highest points approximately two meters above sea level.
72 Kiribati and Tuvalu were GATT *de facto* members until the end of the Uruguay Round. As they did not seek accession prior to the creation of the WTO they would now have to accede like all other countries. Countries such as Solomon Islands, which were also GATT *de facto* members, obtained WTO membership easily at the end of the Uruguay Round because they submitted their offers within the stipulated period.

13

Trade, Debt and Finance: A Complex Agenda for the WTO

Pradeep Metha

1 Introduction

At the close of the last millennium, the international community succeeded in achieving two goals: firstly, in 1995, a long desired ambition of having a rules-based international trade body called the World Trade Organisation was set up; secondly, in 1996, a new debt relief initiative for the heavily-indebted poor countries (the HIPC Initiative) was launched by the International Monetary Fund and the World Bank. The progress on these two fronts is crucial in the fight against poverty.

Earlier, worldwide events in the 1970s and 1980s – particularly the oil price shocks, high interest rates and recessions in industrial countries, and then weak commodity prices – were major contributors to the debt build-up in the HIPC countries. After rising by 12 per cent per year from 1970 to 1980, commodity prices dropped sharply in the early 1980s. Countries partly compensated for declining terms of trade with increased foreign borrowing.

The external debt of all HIPCs combined was some $200 billion at the end of 1998. Although small in nominal amount compared with the more than $2 trillion owed by developing countries overall, the debt of the HIPC countries was, on average, more than four times their annual export earnings, and 120 per cent of GNP. Behind these figures is a deep human dimension that cannot be ignored. HIPCs are among the poorest countries on earth. Of the 600 million people in HIPC countries, more than one half live in absolute poverty, defined as living on less than one dollar per day (Chandrasekhar, 2000).

The launching of the Uruguay Round of trade negotiations in the mid-1980s and its culmination in the establishment of the WTO in 1995 resulted in opening up of domestic markets for trade by member nations. It has also led to an increased emphasis on international trade in the national economic policy of member nations.

The 1990s witnessed a boom in world trade, with an average annual increase of 6.3 per cent in the volume of global merchandise trade (1990–99) – outpacing global GDP growth by an average 4.2 per cent per year over the same period. Developing countries as a whole improved their penetration of world markets by increasing their share of global exports by 7 per cent, to about 25 per cent of world non-energy

merchandise trade. But, the export share of the 49 least developed countries (the majority of which fall under HIPCs) shrank from 3 per cent in the 1950s to around 0.5 per cent in the early 1980s, and has hovered around this very low rate over the last two decades (UNCTAD, 2001).

The low level of trade integration of LDCs can be attributed to several factors. Apart from the high level of trade protection on agricultural products and labour-intensive manufactures, which together account for about 70 per cent of LDC exports, and some behind-the-border trade barriers, such as lack of social and economic infrastructure, the chronic and increasing levels of debt experienced by developing countries have also been identified as one of the major factors for LDCs marginalised status in the global trading landscape.

'Trade as an engine of growth' can work well when foreign exchange earned through exports is reinvested to build up domestic export capabilities. But high indebtedness results in an outflow of foreign exchange in terms of debt servicing. In other words, high levels of external debt have a negative impact on the ability of indebted countries to take advantage of the trading system. A significant reduction of the debt burden, by way of debt relief or cancellation, would free resources they need to increase public investment in export-capacity improvements and loosen the foreign exchange constraints that limit their options for implementing a well-sequenced trade policy at the service of national development goals.

The expansion of trade also depends on a reliable, adequate and efficient source of financing, both long term (for investment in tradeable goods and services) and short term (financial instruments that allow 'real' transactions to be protected from instability in asset prices and for trade-financing). An efficient domestic banking system plays a key role in providing financing, as well as financial services related to trade.

The establishment of the Working Group on Trade, Debt and Finance (WGTDF), pursuant to paragraph 36 of the Doha Ministerial Declaration, offers an opportunity to reform international economic policies on the basis of an integrated developmental approach to trade, debt and finance. Such a reform needs to be directed towards the goal that multilateral trade rules and financial and debt policies work together as a whole to support the equitable and sustainable development needs of developing countries.

The *demandeurs* for examining this relationship were developing countries seeking ways to reduce their public debt burden in the context of the multilateral trading system. However, many developed countries consider that the exercise is of little or no use due to the limitations of the trading system in addressing international debt and finance problems.

Given this background, Section 2 of this paper explains the linkages between trade and debt and trade and finance. Section 3 outlines Working Group mandate and its work programme. Section 4 focuses on the current state of play and analyses Members'

submissions. Section 5 describes the progress made in the Working Group so far. Finally, Section 6 ends with conclusions and policy recommendations.

2 The Linkages

Trade and Debt

External debt is a major issue confronting developing countries and emerging market economies and it has an impact on their capacity to reap the benefits of their participation in the multilateral trading system. This was recognised by G8 leaders in 2002, as well as by the Bretton Woods Institutions and the WTO, when emphasising the complementarity of initiatives to reduce indebtedness and to improve market access for poor countries.

From an analytical perspective, the link between trade and debt appears less straightforward than that between trade and finance, or at least less direct. Debt is only one of several instruments of external financing, along with foreign direct investment and portfolio equity investment. It is important that borrowed funds should be used for productive investment that generates a return – and economic growth – that is sufficient to cover debt repayment. Even where that is that case, however, a number of factors may still constrain countries' ability to repay their debt or to attract foreign capital for development. Some of these factors are examined below:

- Overseas market access restrictions can impede the ability of indebted countries to earn the foreign exchange they need to service their external debt, and to avoid resorting to further unsustainable borrowing.
- At the world level, estimates of the gains from further liberalisation of merchandise trade range from US$250–550 billion, roughly one-third of which would accrue to developing countries. This is well in excess of the annual aid and debt relief flow.
- Liberalising trade restrictions can have a positive impact on external debt and debt servicing, as it tends to boost domestic growth, productivity and growth. It has been found that the level of openness to trade had positive effects on the debt structure of countries by attracting foreign direct investment (a cheaper source of foreign capital than debt) and hence foreign exchange reserves.
- High levels of external indebtedness reduce the capacity of developing countries to take full advantage of improved export market access opportunities because of insufficient new investment in productive capacity in their economies, particularly in their export sectors. The fact of being labelled as 'indebted' deters new investors, while debt service obligations absorb available capital and foreign exchange to pay for imports.

Some of these concerns are supported by empirical evidence found in the literature. A

recent paper by Pattillo, Poirson and Ricci (2002) tries to answer to the question of why large levels of accumulated debt lead to lower growth and under what conditions this occurs. They test the 'debt overhang' theory, which shows that if there is some likelihood, in the future, that debt will be larger than the country's ability to repay, expected debt-service costs will discourage further domestic and foreign investment and thus harm growth. Potential investors will fear that the more a country produces, the more it will be 'taxed' by creditors to service the external debt, and thus they will be less willing to incur costs today for the sake of increased output in the future.

Trade and Finance

As already mentioned, the expansion of trade depends on a reliable, adequate and efficient source of financing, both long term and short term. An efficient domestic banking system also plays a key role in providing financing, as well financial services related to trade.

The importance of a well-functioning international financial system has always been a matter of priority for international trade and the multilateral trading system. It figured in the drafting of the GATT, where attention was paid to ensuring complementarity between the multilateral trade rules and the financial policy disciplines of the IMF. It received attention in various GATT bodies, particularly in the late 1970s and early 1980s, by the (then) Contracting Parties, and it was elaborated upon in several areas of the Uruguay Round negotiations.

The result is that provisions that might be deemed relevant to the relationship between trade and finance can be found in many WTO Agreements and related ministerial declarations and decisions.

An important issue in this respect is balancing the advantages that can accrue from liberalising trade in financial services with the need to ensure that liberalisation is properly timed, sequenced and prudentially managed so that it does not become a source of financial instability in its own right. Most developing countries remain heavily dependent on foreign sources of finance. Private capital flows became a far more important source of foreign finance for developing countries in the 1990s than official capital flows, and foreign direct investment (FDI) and portfolio investment (bond and equity financing) became more important relative to bank lending, particularly in the emerging market economies.

The expansion of trade also depends on an appropriate mix of domestic macroeconomic management and foreign financing to prevent balance-of-payments disequilibria from spilling over into pressure on governments to apply restrictive trade or exchange policies. Adequate foreign financing for this purpose needs to be available from private capital markets and/or from international financial institutions such as the IMF, and in normal circumstances this is the case. However, large, frequent or unpredictable changes in foreign capital inflows and outflows that are not justified by

underlying macroeconomic fundamentals can place pressure on the balance of payments, undercut sound domestic monetary and fiscal policies, and result in wide fluctuations in exchange rate policies. In such circumstances a government may search for stop-gap solutions to its balance-of-payments problem, and turn to quantitative trade or exchange controls to restrict foreign exchange inflows and outflows. To the extent that the burden of adjustment to volatile inflows and outflows of foreign capital is placed entirely on a country's current account for a sustained period of time, domestic aggregate demand and trade will be affected.

Therefore, two issues of particular concern have been the need for exchange rate stability to provide a predictable price mechanism for conducting international transactions, price-based trade policies and trade negotiations, and the need to ensure that the rules-based trading system is not frustrated by the undisciplined use of multiple exchange rate arrangements or exchange restrictions.

3 Working Group Mandate

In the preamble of the Doha Declaration, trade ministers recognised that the 'challenges Members face in a rapidly changing international environment cannot be addressed through measures taken in the trade field alone', and decided to 'continue work with the Bretton Woods institutions for greater coherence in global economic policy-making'. The Declaration introduces a binding mandate for Members to examine the relationship between trade, debt and finance in the WTO. To this end, ministers established a Working Group on Trade, Debt and Finance, open to all Members, to operate within the permanent structure of the WTO.

The agenda of the WGTDF consists of three core issues: the relationship between trade and finance; the relationship between trade and debt; and greater policy coherence between relevant institutions. At its meeting on 11–12 July, the Working Group adopted its Work Programme for 2002 contained in WT/WGTDF/W/1/Rev.1 (see Box1), and agreed that it would focus on the issue of 'the relationship between trade and finance' at its July meeting, 'the relationship between trade and debt' at its September meeting and 'towards greater coherence' at its December meeting. While Members have tabled few proposals, institutions such as the IMF, the World Bank, UNCTAD, the OECD, regional development banks and UN regional economic commissions have made many presentations to the working group.

4 The Current State of Play

As the *demandeurs* for the WTO involvement on debt and finance issues, several developing countries and groups have made submission before the WGTDF. Notable ones are African Group, the Economic Commission for Latin America and the Caribbean (ECLAC), the United Nations Economic Commission for Africa (UNECA),

Box 1. Working Group on Trade, Debt and Finance

Draft Work Programme 2002

Revision 1

I. The Relationship Between Trade and Finance

- Financial Architecture and Trade
- Trade Policy and Financial Stability
- Any Relevant WTO Provisions
- Other Topics Raised by Members

II. The Relationship Between Trade and Debt

- External Debt and Trade
- Trade-Related Issues and Alleviation of the External Indebtedness of Developing and Least-Developed Countries
- Any Relevant WTO Provisions
- Other Topics Raised by Members

III. Towards Greater Coherence

- Assessment of Work in Progress
- Orientation of Future Work

Cuba, Indonesia and Argentina. The European Commission and major intergovernmental organisations such as OECD, UNCTAD, the World Bank, IMF and ADB have also contributed towards the discussion in the WGTDF through their detailed submissions. These international intergovernmental organisations have been granted observer status in the WGTDF.

Analysis of Developing Countries' Submissions

The African Group made one of the most useful submissions to the WGTDF (WT/WGTDF/W/16). Because of their high external indebtedness this issue is far more important to African countries than to any other country or region of the world.

The group in its submission argues that the poor trade performance of African countries can be directly linked to their unsustainable debt levels, as reduced export earnings from declining commodity prices hamper their ability to meet debt-servicing obligations. Conversely, ballooning debt service payments are a drain on the

exchequer, which would have otherwise provided resources for enhancing trade capacity. The working group could, therefore, engage the Bretton Woods institutions with the aim of re-invigorating the debt reduction agenda by identifying the shortcomings of the previous initiatives. UNCTAD's contribution to this policy dialogue will be highly desirable.

The work envisaged for this working group, in essence, requires greater co-operation with the Bretton Woods institutions so as to contribute to achieving greater coherence in global economic policy-making in line with Article III.5 of the Marrakesh Agreement establishing the WTO. Further, Part IV of GATT 1994 on Trade and Development provides an explicit mandate for the WTO's role on development matters under the rubric of global economic governance.

The marginalisation of Africa in the multilateral trading system and in international capital markets is not an irreversible phenomenon. African governments have embarked on economic reform programmes at national and regional levels, whose overriding goals are poverty eradication through, *inter alia*, integration into the global economy on equitable terms. Such efforts require the complementary support of the international community. In this regard, the working group, as an appropriate forum for linking multilateral trade policy with other economic policy measures, can make a positive contribution to the crafting of development strategies.

The African Group submission made some specific recommendations to the fifth ministerial conference (see box 2). This includes a review of existing WTO Agreements with a view to addressing financial instability and external indebtedness, ways and means of diversifying African countries' exports and monitoring of the implementation of the 'Monterrey Consensus'. Here, particular mention has been made of UNCTAD communication (WT/WGTDF/W/5), which contends that the external account imbalances of African countries stem from debt and debt servicing payments and not trade deficits.

The United Nations Economic Commission for Africa (UNECA) has made its submission on a request by the Chairman of the WGTDF (WT/WGTDF/W/11). The UNECA in its submission highlighted how the economic and social impact of the debt service burdens on the economies of developing countries raises serious economic, social and even moral issues. In the African context, with most countries heavily dependent on exports of commodities for financing government expenditure, mounting external debts and debt servicing have siphoned off a significant proportion of export earnings, with critical adverse implications for poverty reduction and social programmes.

The paper emphasises that trade liberalisation on its own without a grasp of the underlying forces is likely to severely constrain the scope of trade leading to structural change in developing and African countries. This requires adopting an integrated approach encompassing the following aspects:

Box 2. African Group Recommendations to the Fifth Ministerial Conference

- Review of existing relevant WTO Agreements with a view to addressing financial instability and external indebtedness. Such a review should be oriented towards identifying the causes of the external account imbalances consistently experienced by African countries;
- Ways and means of contributing to the diversification efforts of African countries away from commodity dependence to value-added exports. The design and actualisation of an international commodity policy, in co-operation with other relevant organisations such as the Common Fund for Commodities, is a crucial element of the expected outcome of the work of this Working Group;
- The WGTDF could also serve as the WTO body tasked with the monitoring of the implementation of the outcome of the UN Conference on Financing for Development. The direct relationship between trade performance and financing requirements for addressing supply-side constraints provides the rationale for this undertaking;
- Exchange of experience among Members on the impact of capital account liberalisation on exchange rates and hence competitiveness. The IMF, Regional development banks and UNCTAD should be invited to contribute to this debate.

- *Market Access:* A broad-based approach to market access needs to be worked out encompassing not only removal of all barriers to trade in developed countries but also positive support to developing countries such as exemptions/food security guarantees and supply-increasing capacities;
- *Terms of Trade:* The falling terms of trade have deprived developing countries of capacities for restructuring their domestic economies. Hence, protection through tariffs is required to enable developing countries to develop their infant industries and then enter the global market. Accordingly, trade and industrial policies are directly linked. Under trade liberalisation all this has been brushed aside and it is essential that WTO post-Doha thinking should reassess these issues. This is especially important in the case of indebted African nations;
- *Trade Liberalisation and De-industrialisation of African Economies:* Only a few African countries have benefited from trade policy reforms , while others have seen de-industrialisation of their economies as local companies have had to compete with foreign forms for domestic markets. The most vivid example of this has been in the textile and clothing industry where second-hand clothing and cheap textiles imported from abroad have wiped out local industries. It is important, therefore, that the international community takes cognisance of the negative aspects of global-

isation and liberalisation on the economies of developing countries;

- ***Trade Policy, and the Fallacy of Composition and Debt:*** It is important to recognise that many African countries are given the same advice – to increase the exports of their commodities. This carries the risk of increasing supplies and depressing prices, with adverse implications for export income and hence capacity to contribute to debt reduction;

- ***The Link Between International Financial Instability and Trade:*** Financial policies should ensure that incapacity to repay debts and the 'debt burden', and the movement of speculative capital arising from financial liberalisation, do not work against trade policies. There is need to co-ordinate the role of trade institutions, such as the WTO supported by UNCTAD, and the Bretton Woods institutions in tackling financial concerns and the interrelationship between trade, finance and debt.

The discussions above have highlighted a number of important issues which will need to be addressed in the WTO Working Group on Trade, Debt and Finance if these discussions are to result in concrete proposals for effectively dealing with the interface between 'trade, debt and finance'. Based on the above points, the UNECA outlined a scope for a durable solution to the debt problem in the framework of the WTO Agreements (see Box 3).

The Executive Secretary of the UNECLAC, Jose Antonio Ocampo made a presentation before the Working Group on 'Mechanisms to Deal with Debt Overhang' (WT/WGTDF/W/10). He concluded by highlighting five issues for consideration by Members in the context of the Working Group:

(i) increased market access was crucial for countries affected by debt overhang;

(ii) flexibility in the use of balance-of-payments restrictions should be allowed for highly indebted countries;

(iii) there was a clear link between trade and financing during debt crisis, which should involve co-operation between the WTO and International Financial Institutions in terms of greater availability of trade financing and compensatory financing;

(iv) while special and differential treatment in favour of highly indebted developing countries was not justified in the light of distortions this might create against developing countries not affected by debt, the question arose as to whether there would be scope, within the WTO framework, for mechanisms that would limit the use of contingency measures by third countries against the exports of countries experiencing debt overhangs;

(v) indebted countries should be allowed to use capital account restrictions.

Box 3. UNECA's Proposal on the Debt Problem in the WTO Framework

- Need to take a holistic approach which encompasses trade policy issues (such as market access, declining commodity prices, supply constraints of developing countries and imbalances in the multilateral trading system), on one hand, with issues of 'development finance' (such as ODA, debt relief, and FDI), on the other;
- Current debt rescheduling and re-negotiation arrangements leave much to be desired and provide creditors with greater leverage than debtors. Accordingly, there is need to look for alternative arrangements which will ensure 'neutrality' in the institutions adjudicating on such disputes.
- Trade policies in both developing and developed countries impinge significantly on the capacity of developing countries to mobilise development finance. Accordingly, resolving the issues of the interface between 'trade and debt' on one hand and 'trade, debt and finance' on the other will require ingenious thinking by all those involved.
- Enhancing the relationship of the GATT/WTO with the relevant international organisations and taking account of the importance of an improved trading environment providing, *inter alia*, for the ability of indebted countries to meet their financial obligations.
- Strengthening the inter-relationship between trade policies and other economic policies affecting growth and development, and to contribute towards continuing, effective and determined efforts to improve the functioning of the international monetary system and the flow of financial and real investment resources to developing countries.
- Provisions in the WTO Agreements, which could be examined to determine whether they provide scope for dealing with the interrelationship between 'trade and debt'. These include the GATS Annex On 'Financial Services' which could be examined further in the context of the debt/finance interface; GATT 1994 Article XVIII: B on Balance of Payments Provisions which acknowledges balance of payments difficulties for developing countries that could arise as a result of instability of their terms of trade; and the Agreement on Agriculture, in which a link is made between falling commodity prices and 'unsustainable debt stocks'.

Cuba in its submission listed several issues, which it is essential to consider in the 2003 agenda of the WGTDF. It endorsed some of the recommendations made earlier in UNECA's submission, such as adopting a comprehensive approach that embraces trade-policy issues, on the one hand, and development finance issues, on the other, addressing the problems of commodity trade and supporting efforts to diversify developing countries' exports. Some of the key recommendations made by Cuba are as follows:

- The work programme should address the linkages between trade, external debt and finance from a global and multidimensional perspective, focusing on systemic problems;
- The imbalances caused by the multilateral trading system's promotion of all-out trade liberalisation need to be identified, since they are resulting in the de-industrialisation of domestic economies;
- The WGTDF should consider measures that ensure the gradualness, coherence and correct sequencing of the liberalisation process, to enable less developed countries to integrate into the world economy on a sustained basis;
- Trade policies need to be accompanied and reinforced by a broad reform agenda covering regulatory issues, institutional dispute-settlement mechanisms, sound macroeconomic management and greater labour-market flexibility;
- The WGTDF's agenda should include activities to identify technical assistance modalities, together with capacity-building to create the infrastructure and technical capabilities needed to exploit the opportunities provided by trade liberalisation, and to attract export-oriented productive investment;
- As long as less-developed countries continue to face major access barriers to rich country markets, the working group should focus on consolidating the principle of Special and Differential Treatment, and on strengthening and broadening its modes of application;
- The WGTDF should evaluate the underlying coherence of policies emanating from the co-operation agreements between the WTO and the Bretton Woods institutions. It should not only monitor their mutual coherence, but also ensure they are compatible with development of the poorest trading partners;
- The WGTDF could act as a mechanism for monitoring compliance with international commitments on development financing, particularly those arising from the Monterrey Summit;
- The WGTDF should continue to scrutinise WTO Agreements and provisions wherever links can be established between trade, debt and finance issues. It should propose specific additions or corrections and evaluate how best to link the corresponding WTO rules and the policies promoted by IMF and the World Bank, seeking to reform these institutions internally.

The most recent submission (WT/WGTDF/W/20) on trade, debt and finance has been made by Argentina on 28 March 2003. Its submission is mainly focused on market access issue for poor countries. It has been pointed out that the multilateral trading

system currently lacks an appropriate mechanism for expanding market access for the highly indebted developing and least-developed countries. The WGTDF could, therefore, make a significant contribution towards solving these problems by conducting a more thorough analysis of the means or instruments that the multilateral trading system would require to enable the highly indebted developing countries to increase their exports in proportion to their level of indebtedness.

In short, Argentina considers that the examination of how the multilateral trading system could contribute to a lasting solution to the problem of the high level of external indebtedness of the developing and least-developed countries constitutes a key element of the mandate provided by the Ministers in Doha. Accordingly, Argentina proposes that the working group recommend to the fifth ministerial conference possible actions and measures relating to market access that could be adopted in the framework of the WTO in order to enable the highly indebted developing and least-developed countries to overcome this critical situation.

Analysis of Developed Countries' Submissions

Among the developed countries, the European Commission's submission (WT/WGTDF/W/8) is most comprehensive. The EC sees this process initially as one of information exchange and improving understanding of the problems and opportunities. This pertains to the underlying mechanisms and issues relevant to possible recommendations on the contribution of the multilateral trading system to tackling external indebtedness, and to the coherence of trade and financial policies.

The EC feels that issues related to trade, debt and finance cover several policy areas and fall under the mandate of different institutions. The process of information exchange and examination of the issues should therefore invite contributions from the relevant international organisations, such as the World Bank, IMF, UNCTAD and the regional development banks.

An important part of the work of the working group will be to look at ways to strengthen the coherence of policies of the different organisations, whose mandate relates to the trade-debt-finance nexus. In this context, the EC wishes to recall that in the Uruguay Round Declaration on the 'Contribution of the WTO to Achieving Greater Coherence in Global Economic Policymaking', ministers recognised that coherence between the structural, macroeconomic, trade, financial and development aspects of economic policy-making increases the effectiveness of these policies.

One important means to improve coherence will be to ensure better synergy between different policy areas through transparency and strengthened co-operation between relevant organisations. This, however, must not blur the distinct responsibilities of these organisations, each of which must continue to act within its own mandate and competence. In this context, the EC considers that the process of examining the interrelations and of considering possible recommendations for actions for the

Box 4. Issues for Consideration by the Working Group: An EC View

The EC wishes to underline a few issues that it considers of particular relevance for the work of the Working Group.

- **Trade liberalisation and indebtedness:** Trade liberalisation tends to decrease indebtedness by encouraging growth. However, because tariff cuts can cause a decline in fiscal revenue, attention should be given to possible complementary measures such as identifying alternative sources of fiscal revenue. Building administrative capacity is, of course, a highly relevant issue in this context. The working group could usefully address this issue and request relevant organisations (in particular, the IMF, but also WCO for customs simplification measures) to provide advice on reform measures, their sequencing and application.
- **Integrating trade in economic reform:** The working group could consider, together with relevant organisations such as the IMF, the World Bank and UNCTAD, as well as bilateral development partners, how best to integrate trade into economic reform programmes and ensure WTO conformity for sustainable reform. The Integrated Framework for Trade-related Technical Assistance to the Least Developed Countries is a useful example of a mechanism that integrates trade in the domestic economic and development policies.
- **Addressing supply-side constraints:** Many developing countries lack sufficient infrastructure and capacity to make use of the opportunities offered by trade liberalisation or to be able to attract productive and export-oriented investment. Measures to address supply-side constraints should therefore form part of economic reform programmes. The working group could usefully consider supply-side capacity-building in relation to economic reform programmes, and relevant organisations, such as UNCTAD and the World Bank, could be invited to present their activities in these areas.
- **Investment and indebtedness:** Foreign Direct Investment is an increasingly important source of foreign capital inflows for many developing countries. However, heavily indebted developing countries frequently suffer from economic instability and uncertainty, which makes it more difficult for these countries to attract foreign investment. The Working Group could, in co-ordination with the Working Group on Trade and investment, look at factors that help to attract FDI and consider recommendations that will support increased FDI flows to highly indebted developing countries.

WTO could possibly bring to light the need for complementary actions and measures that fall outside the mandate and competence of the WTO.

The WGTDF should also build on progress made in other fora, such as the Monterrey International Conference on Financing for Development. The EC

welcomes the consensus reached at the Monterrey conference in favour of increasing the coherence and consistency of the international monetary, financial, and trading systems in support of development. In particular, the EC agrees on the need to improve the relationship between the UN and the WTO on development issues, and to strengthen their capacity to provide technical assistance to all countries in need of such assistance, with a view to increasing the global economic system's support for development.

The OECD's submission (WT/WGTDF/W/20) focuses on the role of trade policy in responding to financial crisis. First, it is critically important to resist protectionist pressures and to keep markets open, and for these efforts to be backed by a continued flow of trade finance; second, it is necessary to encourage regulatory reform and liberalisation of financial services; and third, it is necessary that sound trade policy be accompanied, and bolstered, by a broad reform agenda.

5 Discussions in the Working Group

The Working Group has held four meetings: on 15 April (Wt/WGTDF/M/1); 11–12 July (WT/WGTDF/M/2); 30 September (WT/WGTDF/M/3); and 17 December 2002 (WT/WGTDF/M/4) under the Chairmanship of Ambassador Hernando José Gómez of Colombia.

The Relationship between Trade and Finance

At the group's first meeting, in April, a representative of the IMF presented an overview of the IMF's work on the reform of the financial architecture. He noted that the major building blocks of its work encompassed transparency and accountability, the strengthening of financial systems, strengthened external vulnerability analysis, and standards and codes.

The chairman noted the IMF's view that participation in its financial sector assessment programme, together with the design and implementation of prudential standards, could help WTO Members assess their readiness to benefit from opening their financial services sectors. The standards initiative, pursued by the IMF and the World Bank, focused on the development of internationally-agreed standards and codes to promote strong institutional underpinnings for a stable international financial system. The IMF had also stated that the adoption of standards and codes of good practice contributed to the effective functioning of markets and created an enabling environment conducive to investment and trade. Furthermore, Members had suggested that the working group should examine a number of issues: exchange rates and their effect on competitiveness; how the present financial architecture responded to the financial needs of developing countries; and how trade-financing facilities could be strengthened and made more secure.

At the second meeting, in July, representatives of UNCTAD, the Asian Development Bank and the OECD made presentations based on their written submissions. In the ensuing discussion, a variety of issues was raised, *inter alia* exchange rate volatility and trade, the role of trade and trade liberalisation in periods of financial crisis, the sequencing of trade and financial policy reform, difficulties in securing trade-financing, fiscal reform and tariff liberalisation, and the use of trade restrictions for balance-of-payments purposes.

In summing up the discussions on the relationship between trade and finance on his own responsibility, the Chairman drew attention to the following themes:

- The value of the WTO system in providing stability and economic security in periods of financial crisis;
- The value of keeping markets open worldwide in periods of financial crisis, so as to ensure that crisis-hit economies are able to continue to count on exports for foreign exchange earnings and a source of income growth;
- The role of trade liberalisation in resource allocation and the resilience of economies to external shocks;
- The relationship between the exercise being carried out by the IMF and World Bank to strengthen financial systems and the negotiations being carried out by the WTO on financial services;
- Based on experience gained in Asia, the need to improve the stability and security of sources of trade-financing, especially to help deal with periods of financial crisis.

The Relationship Between Trade and Debt

At the third meeting, in September, presentations were made by representatives of the United Nations Economic Commission for Latin America and the Caribbean, the United Nations Economic Commission for Africa and the World Bank on the basis of their written submissions. In the ensuing discussion, a variety of issues was raised, *inter alia* the importance of export market access for indebted developing countries, problems linked to deterioration in the terms of trade, and the importance of alternative sources of foreign finance for developing countries (such as FDI).

In summing up the discussions on the relationship between trade and debt on his own responsibility, the Chairman drew attention to the following themes:

- Overseas market-access restrictions impeded the ability of indebted countries to earn the foreign exchange that they need to service their external debt and avoid resort to further unsustainable borrowing. Relevant studies suggested that the gains that could be derived from eliminating barriers on these countries' exports far out-

weighed the annual flows they received of ODA and debt relief – flows that the UN Conference on Financing for Development in Monterrey had pledged to increase;

- A global, non-discriminatory reduction of trade barriers in the context of the current WTO negotiations, especially in areas where distortions affect developing countries' exports, could make a significant contribution to a durable solution to the problem of external indebtedness of developing and least developed countries;
- At the same time, indebted countries could improve the debt-servicing capacity of their economies by properly liberalising their own trade regimes. This could help boost their domestic growth, productivity and exports. Careful consideration needed to be given to the timing and sequencing of trade reform in this context, as well as to the cost of adjustment involved in such liberalisation and the assistance needed to meet these costs;
- Trade policy reform in indebted countries needed to be supported by pro-growth policies that would involve, *inter alia*, raising domestic private savings and encouraging foreign direct investment;
- Further examination of the issue of the deterioration of the terms of trade was needed, as it affected the capacity of countries, despite notable domestic reforms underway, to service their debt and move away from commodity exports.

Also at this meeting, the group discussed a written submission from the European Community (WT/WGTDF/W/8), containing a number of ideas on the process of the working group, proposals on how to move to a more substantive phase of its work, and suggestions of concrete areas for improved Coherence between the WTO and other international fora.

Towards Greater Coherence

The WGTDF held its fourth meeting on 17 December 2002. The group focused its discussion on Item III of the group's 2002 Working Programme, 'Towards Greater Coherence', thereby continuing its educational process along the lines begun at previous meetings on the relationship between trade and finance, and trade and debt.

The Secretariat introduced its Note 'Towards Greater Coherence' (WT/WGTDF/W/17), which addressed the two sub-items of Item III of the 2002 Work Programme, namely the assessment of work in progress in the area of coherence, and orientations for future work. Section II of the Note described the Marrakesh Coherence Mandate and regular activities that were being undertaken under this mandate. It highlighted the fact that under Article III.5 of the WTO Agreement, achieving greater coherence in global policy-making through co-operation with the IMF and the World Bank was one of the five core functions of the WTO.

The Chairman then summarised the themes and potential areas of interest that had been raised by Members during the course of the discussion on this agenda item, and noted that Members had focused on:

- The effects of financial and exchange rate instability on trade, drawing on lessons to be learned from the financial crises experienced by emerging economies in the 1990s;
- The examination and possible establishment of mechanisms and facilities to keep trade finance alive in periods of financial instability;
- The need for better integrating the work of international organisations in the areas of capacity-building and trade infrastructure;
- The issues of the liberalisation of financial services, on the one hand, and the efforts underway in the international financial architecture, on the other, which had been raised several times, as well as the links between WTO and other institutions on long-term, cross-border investments, and capital account liberalisation. Although these two topics were being debated in other fora, they nevertheless had been part of the discussion of the Working Group on Trade, Debt and Finance, which encompassed systemic issues of this kind.

6 Conclusions and Policy Recommendations

After analysing various submissions on trade, debt and finance, it is clear that this issue covers a vast area. It has also been realised that neither trade nor trade measures alone can solve a country's debt problems, but some felt that trade needed nonetheless to be seen as part of the solution. However, the problem of indebtedness in the developing and least developed countries significantly impairs their capacity to share in the benefits of the multilateral trading system. The capacity of a country to service its external debt clearly depends on its trade balance.

The above analysis makes clear that the chronic and increasing levels of debt experienced by developing countries are perpetuated and exacerbated by structural imbalances of the trading system which include:

- A deterioration in the terms of trade;
- Lack of capacity and enabling conditions to diversify and upgrade exports;
- Serious trade distortions caused by developed countries' policies;
- The stagnation of export markets.

All these combined together make it difficult for a country to honour its external debt commitments, causing financial instability and monetary disruptions which, in their turn, have a negative impact on growth and economic development.

Therefore, finding a durable solution to the problem external indebtedness being faced by developing countries, as expressed in the mandate of the Working Group on Trade, Debt and Finance requires an integrated approach that should address the following issues:

- The need to significantly improve the price stability of commodities of export interest to developing countries as the correlation between primary commodity dependence and debt is shown by the fact that 85 per cent of LDCs dependent on non-oil primary commodities have an unsustainable external debt.
- The need to create an enabling environment for developing countries to diversify and upgrade their export productive capacity. In order to achieve this, the WGTDF should devise ways to resolve adverse terms of trade problems arising from the way in which industrial countries market access commitments and trade practices hinder the ability of developing countries to upgrade and diversify their economies into skill and technology-intensive and higher value-added production.
- The multilateral trading system currently lacks an appropriate mechanism for expanding market access for highly-indebted developing and least developed countries. The working group should make a significant contribution towards solving these problems by conducting a more thorough analysis of the means or instruments that the multilateral trading system would require to enable the highly-indebted developing countries to increase their exports in proportion to their level of indebtedness.
- Consider the possible establishment of a debt relief mechanism through which debt reduction initiatives can help developing countries strengthen supply-side capacity for export upgrading and diversification and open more options for trade policy design. Such debt relief or cancellation should not be at the expense of official development assistance or already committed debt relief such as the HIPC initiative of the World Bank.

On the issue of trade and finance, from the various submissions, both from members and observers, such the IMF and World Bank, it has been realised that for most developing countries, the present international trade and finance systems do not provide sufficient long-term financial resources to enable them to achieve rapid and sustained economic growth through expansion of trade. Full implementation of commitments by most developing countries undertaken during the Uruguay Round, together with continued restrictions in market access in some major industrial countries, are generating payments imbalances that cannot be financed on a sustained and reliable basis by private international capital flows.

Moreover, despite sustained international pressure, official financial flows

continue to decline. The outcome of the Monterrey Financing for Development conference highlights this inconsistency; the additional pledges made in the context of this conference fall far short of the amounts needed to close the resource gap which, according to estimates made by the Zedillo Panel, as well as the World Bank, would require a doubling of official aid flows. In the absence of an increase in flows on this scale, many developing countries may have not only to curtail development plans but also to restrict their participation in the international trading system.

Given the decline in official development assistance, the provision of long-term financing for developing countries has been left to private capital flows. In direct contrast to those arrangements originally thought to be necessary to support the international trading system, current arrangements favour private capital flows over official flows, exchange rate flexibility over stability, austerity over expansion, adjustment over financing and the interests of creditors over debtors. They have moved international trade towards a single-tier system of rights and obligations in which developing countries have generally the same level of obligations as the developed countries.

Given this situation, it is much more important to find a durable solution to the deteriorating developmental finance, international financial instability and increasing exchange rate fluctuations that have adversely impacted on the ability of developing countries to reap the benefits of the multilateral trading system. Global financial stability is an indispensable element for the increased employment and outputs that would characterise a successful trading system. The recent and repeated financial crises in developing countries and the increased financial burden on developing countries resulting from the Uruguay Round commitments calls into question the effectiveness of current global arrangements to achieve global financial stability and provide developing countries with access to trade-financing capital. Therefore, the WGTDF should:

- Redesign the architecture of the international financial system with the basic objective of easing the integration of developing countries into the international trading system.

- Be entrusted with the task of monitoring of the implementation of the 'Monterrey Consensus'. The direct relationship between trade performance and financing requirements for addressing supply-side constraints provides the rationale for this undertaking.

- Strengthen the inter-relationship between trade policies and other economic policies affecting growth and development, and to contribute towards continuing, effective and determined efforts to improve the functioning of the international monetary system and the flow of financial and real investment resources to developing countries.

- Propose a redefinition of several provisions of the GATT 1994 and GATS. The

balance-of-payments provisions of the GATT provide an alternative mechanism for the reduction in imports through temporary suspension of commitments. However, recourse is only made to these provisions infrequently because they were not designed to deal with problems endemic in the current international system and because of the difficulties in the procedures involved. This should lead to greater flexibility for developing countries facing balance of payments problems.

- Address the need to rethink the role of the IMF, especially with respect to Article XV:2 of GATT 1994 and Article XII:5(e) of GATS, in judging the adequacy of country reserves and other prerequisites that countries need to fulfil in order to implement current and capital account controls. As long as industrial countries that have conflicting trade interests with the country seeking to implement the restrictions continue to play a decisive role in the governance of the IMF, critical questions of conflict of interest will remain. Until those questions have been addressed, the IMF's judgement on such matters should be given only non-binding and recommendatory, rather than mandatory and conclusive, weight.

- Adequately address the systemic problems associated with insufficient development finance or secular declines in commodity prices and the export earnings of developing countries. While Article XVIII:A allows measures to promote 'a particular industry with a view to raising the general standard of living of its people', it is not clear how far this article can be applied more generally to a country that seeks to reduce its dependence on primary export earnings by promoting structural change, upgrading and diversification, processes which typically involve more than one sector or industry.

- Recommend, in line with the mandate of the UN Financing for Development Conference, the creation of a mechanism for ensuring the co-ordination of macroeconomic and exchange rate policies among currency reserve countries. This mechanism should take into account the impact of dramatic exchange rate fluctuations and misalignments on the trade performance and debt-service obligations of developing country economies.

- Call for the creation of a regular and predictable mechanism to ensure that developing countries can opt out of their trade obligations to the extent required to compensate for the impact of the exchange rate misalignments of their economies.

- Propose reforms for development aid policies and practices regarding the appropriateness of the institutional vehicles used to provide it and the conditions attached to it.

In the eyes of the world, the Cancun Trade Ministerial Meeting will act as a litmus test of the major industrial countries' commitment to inclusive globalisation, to meeting the Millennium Development Goals (MDGs) and to a stable and peaceful world. Increased trade opportunities provide the best means of placing poor countries on a higher trajectory of growth and poverty reduction. The current system does not work for many developing countries and imposes burdens on the consumers of the developed world.

The launching of the Doha Round gave a boost to the multilateral trading system. The lessons from Seattle and the unifying perspective that emerged after 9/11 led to the recognition of the need for a new approach. It is now important that Cancun delivers on the promises built into the Doha Development Agenda. Key areas where decisions at Cancun are seen as essential are: agriculture, TRIPS/health, non-agricultural market access, special and differential treatment/implementation issues, review of the dispute settlement understanding; and the Singapore issues. It will not be possible to transform the lives of the poor and attain the Millennium Development Goals without delivery on the Doha Development Agenda.

This publication is a compilation of papers on the key issues for the Cancun Trade Ministerial meeting to be held in September 2003. It is intended primarily to assist policy-makers in Commonwealth developing countries, particularly small states and LDCs, in preparing their negotiating position for Cancun.

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