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The Role of Industrial Policy in Attaining the Development Objectives of the Doha Round

Introduction

The previous chapters described the assistance provided to delegations for participation in the negotiations for liberalisation of trade in agriculture products, commodity issues, non-agricultural (industrial) products and trade in services. When the negotiations reached an advanced stage some of the members of the Group requested the Adviser to provide them with an assessment of the benefits that would accrue to their trade as a result of the liberalisation measures taken in the Round. They also wanted advice on steps that may have to be taken to ensure the attainment of the development objectives of the Doha Round. In pursuance of this request, the Adviser prepared a paper that examined the extent to which the Doha Round could be called a 'development round' (Rege 2007). The paper provided a useful basis for discussions and exchange of views on the strategy that would have to be adopted in the remaining part of the negotiations for achieving the development objectives. At the request of some delegations, the Commonwealth Secretariat circulated it at a meeting it had arranged for senior trade officials from selected countries of the Group of 90 (G90) developing nations to review progress in the Round. This Chapter provides an overview of the issues discussed in the paper.

Macroeconomic Studies

How far are the liberalisation measures taken in the Round likely to contribute to the economic development of developing countries?

The World Bank, international trade organisations and economic research institutions differ in their assessments of the benefits to the trade and income of developing countries from the liberalisation measures taken in the Round. Macroeconomic studies published by the World Bank prior to the launching of the negotiations overemphasised the benefits of liberalisation by making unrealistic assumptions about the extent to which trade would be liberalised. For instance, one of the macroeconomic studies that was widely publicised before the 2003 Cancun Ministerial meeting

estimated overall gains in world income of US$832 billion if trade was liberalised further, with the share for developing countries expected to be around US$530 billion. However, the projected gains were based on 'total liberalisation' of trade through elimination of all tariffs and all barriers to trade – an unrealistic proposition that no one expected to happen.

Since then the Bank has been significantly scaling down its projections of gains, relating them to the extent to which participating countries were willing to liberalise as reflected from time to time in the ongoing negotiations. Its projections going into the December 2006 Hong Kong Ministerial meeting, based on the likely scenario of liberalisation as reflected in the July package, showed a fall in total welfare gains to US$96 billion and in those of developing countries to US$16 billion. The Bank subsequently scaled its projections to take into account the possibility that sensitive and special products would be excluded from the formula cuts; as a result total welfare gains dropped to US$38.4 billion and those of developing countries to a mere US$6.7 billion. These findings coincided with other studies undertaken by economic research organisations. For instance, Carnegie Endowment for International Peace (CEIP) estimated total welfare gains of between US$38 and US$43 billion and that of developing countries between US$7 and US$21 billion. However, these projections do not include gains from service liberalisation – in projections that do, it is estimated that in a scenario resulting in 50 per cent reductions in service trade barriers, the additional gains for developing countries would not exceed US$6.9 billion.

This implies that despite all the political promotion of the Doha Round as a 'development round' by the international financial and trade institutions and by economists supporting the Washington consensus, the additional gains that would accrue to developing countries would not exceed even half of one per cent of their GDP. Moreover, hidden behind these extremely modest benefits are the 'adjustment costs' their economies would have to bear in implementing the liberalisation programmes and the financial resource constraints they would face as a result of a reduction in customs revenue collection (Wise and Gallagher 2006).

Relative share of manufacturing and agriculture in the welfare gains

Both the World Bank and CEIP studies project that the major gains for developing countries would come from liberalisation of trade not in agriculture, but in manufacturing. Even though some developing countries would gain from liberalisation in the agricultural sector – particularly large-scale producers of agricultural crops like Argentina, Brazil and some other countries in Latin America, and South Africa – overall gains from liberalisation of trade in this sector may be marginal or even negative. Both the studies recognise that some products may be excluded from tariff reduction by developing countries on the grounds that the existing level of protection is necessary for maintenance of 'food and livelihood security and rural development'

(special products) and by the developed and developing countries on environmental and other grounds (sensitive products). But the two studies take dramatically different positions on the effect of such withdrawals.

The authors of the Bank study hold that the negative overall gains in their estimates are primarily due to the exemption of special and sensitive products, so virtually all gains would be lost even if a relatively small number of products were excluded from tariff cuts. Taking an opposite view, the authors of the Carnegie study argue that since most of the developing countries have a sizeable population of small-scale farmers growing basic staples for self-consumption and for sale in home markets, liberalisation in their case cannot bring efficiency gains. In fact, liberalisation may swamp those producers with flood of imports, particularly of food and other agricultural crops that are subsidised in developed countries. Developing countries were therefore fully warranted in maintaining protection by designating a certain percentage of tariff lines as special products by excluding them from tariff cuts. Moreover, it should be left to the country concerned to determine the percentage of tariff lines that can be excluded. However, they viewed the situation of developed countries quite differently – in their case the reductions in the level of subsidies and in tariffs on an MFN basis could lead to increased productivity. There was, therefore, no justification for these countries to exclude the so-called sensitive products from tariff reductions (Anderson and Martin 2006; Polaski 2006).

Distribution of benefits among countries

As regards distribution of benefits among countries in both agriculture and manufacturing, the main beneficiaries among developing countries are likely to be those countries at a higher stage of development. Least-developed and other countries at the lower stage of development, particularly those of East and Sub–Saharan Africa and Asia are likely to emerge from the negotiations with extremely modest gains, if not as net losers, in both sectors.

The CEIP study suggests three reasons for this situation:

- First, in the manufacturing sector, the supply constraints may put serious limitations on the ability of these countries to take advantage of the new opportunities created by the liberalisation measures taken by other countries.
- Second, in certain products, where preferential access provides meaningful advantage to exporters from these countries in exporting to the preference-granting countries, reductions in MFN duties may lead to the loss of preferential advantage as a result of reductions in preferential margins.
- Third, since agricultural production is undertaken on a small scale and at subsistence level there are very few possibilities of these countries becoming significant exporters of agricultural products.

The study therefore emphasises the need for taking special measures in the negotiations to assist these countries in dealing with the negative effects on their trade, and providing increased technical assistance to them for taking advantage of the liberalisation measures that would be taken in the round. Such assistance to these countries would serve to:

- Meet the challenge posed to export trade as a result of the erosion of preferential margins;
- Overcome supply constraints faced by industrial and agricultural producers in marketing their products in other countries; and,
- Meet adjustment costs of liberalisation measures they may have to take.

Past Experiences of Liberalisation Confirm the Findings

How far would it be desirable for countries participating in the negotiations to rely on the forecasts in these macroeconomic studies in determining the policy approach they could adopt?

The general view is that it is necessary to treat the forecasts with great caution and scepticism. The results of the studies depend greatly on the assumptions made. These assumptions must therefore be carefully weighed before assessing how far the results would be relevant, taking into account countries economic and trade situation. Moreover, even though it is now common practice, particularly for international financial institutions, to publish such studies periodically to highlight the importance of following open and liberal trade policies, there has been so far no systematic evaluation of how far their estimates of welfare gains have been realised.

Despite this note for caution these projections need serious consideration, for two reasons. First, projections in other macroeconomic studies confirm the estimates in the World Bank and CEIP studies that a number of countries, particularly those that are poor or least developed, would benefit only marginally, if at all, even though their total estimates of welfare gains and how these would be shared between industrial and agricultural sectors are different. Second, and perhaps more importantly, the experience of a number of countries in Africa and Latin America that had undertaken liberalisation measures during the last two decades or so under structural adjustment programmes supported by the World Bank and IMF shows that liberalisation can lead to de-industrialisation and increased unemployment, unless it is gradual and properly tailored to the needs of the country. The analysis that follows sets out the findings of the empirical studies on the past experience of developing countries in following open and liberal trade policies.

Contrasting Experiences: Imposed and Voluntary Liberalisation Measures

It is often not widely known that so far the major steps towards liberalisation of trade have been taken by developing countries outside of trade negotiations held under the legal framework of GATT. As indicated above this has occurred through structural adjustment programmes supported by the World Bank and the IMF or on a voluntary basis by governments as part of their policies for promoting economic development. The experiences from the two approaches have been quite different.

Disappointing experience under structural adjustment programmes

A number of countries, particularly those of Africa and Latin America, were required to liberalise their trade and internal polices under these programmes in order to obtain the foreign exchange resources needed to cover balance of payments deficits. The approach was based on the Washington consensus', which is supported by neo-liberal economists and international financial institutions, and calls on developing countries to adopt the following three-pronged approach:

- Liberalise trade by reducing tariffs and removing quantitative restrictions;
- Reduce governmental intervention through privatisation of state enterprises; and
- Deregulation of economic activities.

Prior to having these policies imposed on them many of the countries had been following import substitution policies and were trying to develop domestic production by providing protection from foreign competition. Now they were required to liberalise by reducing tariffs and removing quantitative restrictions in both in the industrial and agricultural sectors. The tariffs were to be reduced by high percentages, so that the economy could have what UNCTAD has called the 'big bang' effect.

These liberalisation polices were further complemented by policies for deregulation. For instance, a number of countries in Africa were required to abolish institutions like marketing boards, which played a useful role in ensuring that farmers got reasonable prices for the agricultural commodities they produced for exports. It is no doubt true that many of these boards were used by governments to get additional revenue, which sometimes resulted in taxation of farmers, and that many of the boards were also extremely corrupt. However, the desirable course would have been to reform the boards; abolishing them meant farmers lost the protection of assured prices for their produce, and the assistance they received for maintenance and improvement of the quality of their products was discontinued.

In the industrial sector, the liberalisation measures did not improve the competitive strength of industries, resulting instead in what economists call 'de-industrialisation'.

The term is used to describe a situation in which existing industries are compelled to reduce or shut down production and no new investment for the development of new industries is taking place. The reasons for this situation were twofold.

First, the governments could not protect domestic industries from the increases in dumped or low priced imports, as most of them had not yet been able to establish effective mechanisms to investigate petitions for the application of anti-dumping or countervailing duties or other trade measures such as safeguard actions. The international financial institutions insisted that if such measures were to be applied, they must be applied according to GATT rules and provisions, but did not assist in establishing the necessary institutional framework for the application of such measures on the grounds that their national bureaucracies often did not have the expertise to apply the complex rules. The countries concerned could have provided increased protection for temporary periods by increasing tariffs, as most of the rates were not bound. They were, however, prevented from doing so because of their commitments assumed under the structural adjustment programmes not to increase tariff rates.

Second, the neo-liberal policies to which the international financial institutions were committed required governments to refrain from adopting policies for assisting affected industries to improve their competitive position by giving them subsidies or loans for technological upgrades.

The experience of countries in Latin America and Africa that had taken trade liberalisation measures under structural adjustment programmes since the early 1980s shows that more than half of these poor and low-income countries faced de-industrialisation. These reforms failed to encourage private investment in the manufacturing sector resulting in increased unemployment, particularly in the rural areas.

Positive Asia experience

Developing countries that adopted liberalisation measures on a voluntary and autonomous basis as a part of national policy for promoting economic development, fared better than those described above. These countries, which were mostly located in Asia, started resorting to liberalisation only after they had developed a certain minimum level of physical and financial infrastructure. Further liberalisation measures were taken on a selective basis to expose those industries that had been provided protection under the import substitution polices to foreign competition.

Some analysts and the international financial institutions initially argued that the phenomenal success of the four countries known as 'Asian Tigers' in developing exports of manufactured products, was largely due to the liberal and open trade policies they had followed right from the beginning. This was however far from the case. Two of the four, South Korea and Taiwan, had been following highly protectionist policies before they started liberalising gradually on a selective basis. The remaining two, Singapore and Hong Kong, had low levels of protection. However, these are small

city-states with different development needs due to the absence of agriculture and an almost entire dependence on foreign trade in the absence of a significant domestic market (Lall 2005; Chang 2005).

Apart from initially maintaining a high level of protection and adopting a gradual and selective approach in liberalising, both South Korea and Taiwan had adopted complementary industrial policies. The industries to be liberalised were carefully chosen on the basis of expert reports and in consultation with the business community. They also offered a variety of incentives to promote exports, such as export credits and exemption of export profits from income tax. 'Local content requirements' obliged foreign multinationals to produce in the country some portion of manufacturing inputs. Export performance requirements obliged industrial units to export a certain portion of production or face penalties. The two countries screened foreign investment and directed it to industries targeted for development.

In the last decade a number of other countries in Asia, notably China, India and Malaysia, have pursued similar liberalisation policies. Trade liberalisation was undertaken on a selective basis and was properly sequenced. Further support came from complementary measures introduced under industrial policy. The nations that pursued these policies experienced per capita growth rates of 5 per cent a year between 1980 and 2000.

Industrial Policy as a Complement to Liberalisation Policies

What is industrial policy?

The contrasting experiences of countries of liberalisation measures taken on an across-the-board basis and those taken on a selective basis goes to show that liberalisation policies can succeed only if such measures are taken on a selective basis after the industry has reached a certain degree of maturity to meet import competition, and are properly sequenced. It also brings out that for such policies to succeed they must be complemented by incentives and other appropriate measures by adopting appropriate industrial policies. Economists, however, take widely differing views on the need and desirability of developing countries adopting industrial policy, particularly if it involves selective interventions by governments in the economy.

Most of the economic literature on the subject recognises the importance of governments intervening through 'functional polices' for improvements in physical infrastructure, human capital and functioning of capital markets. There appears to be general support for 'selective' government intervention in cases where there is 'information failure' arising from the lack of information about opportunities to make productive investment, or 'co-ordination failure' where profitable investment is not likely to be forthcoming unless upstream and downstream industries are developed simultaneously.

Opinions vary widely, however, on the form such selective intervention should take and whether it would be in the interests of developing countries to make such interventions. Neo-classical liberal economists think the case for increasing protection through trade measures in order to promote development of infant industries, is weak. Governments generally lack the information needed for identifying industries with potential for exports and would not be able to compete in international markets after the protection is withdrawn. The danger is that the decision to give protection through trade measures on the basis of the 'infant industry' argument could lead to misallocations of resources. The second best alternative is to use 'subsidies', where the level of protection granted is measurable and transparent. It is also possible to keep the granting of a subsidy under review and to modify or withdraw it when such assistance is considered to be unnecessary. In the case of protection granted through trade measures, it is generally difficult to reduce the level of protection or to withdraw it because the protected industries develop a strong vested interest in its continuation.

While recognising that there could be an argument for selective intervention in the case of market failure, some analysts caution against developing countries adopting industrial policies that provide for selective interventions, on political economy grounds. These analysts argue that the implementation of selective interventions requires detailed information about the nature and location of the market failure as well as the organisational skills required for selecting industries for continued or higher level of protection or for administration of subsidy programmes. Such skills are often in short supply in developing countries. Moreover, they say, such policies are open to political capture, corruption and rent seeking, therefore for most developing countries policies 'that are rule based' and provide little or no discretionary authority to the bureaucrats are preferable to those that give them authority to intervene in the market.

While sharing some of these concerns, other analysts argue that the governments can be helped to improve their capacities to intervene efficiently. They point out that developing countries would not be able to achieve development that is equitable and results in poverty alleviation simply by being required to liberalise and integrated in the WTO system. Dani Rodrik, for instance, describes the view that the developing countries lack expertise to adopt appropriate industrial policies, as superficial and in need of more analysis. Liberalisation has become a substitute for a development strategy, despite its 'shaky empirical ground' and its serious distortion of policy-makers' priorities, and this has to change (Rodrik 2001).

An increasing number of economists now hold the view that the liberalisation programmes adopted by countries under the World Bank/IMF structural adjustment programmes failed to achieve the desired results. This failure was not only because liberalisation was rigidly applied on an across-the-board basis without assessing whether the industries involved could withstand foreign competition but also because of the failure of the reform programmes to support the liberalisation measures by the adoption of appropriate industrial policy. Ho Joon Chang (2005) and Sanjay Lall (2005)

point out that developed countries had, in the past, encouraged industrial development by providing protection through tariffs on a selective basis. In recent years they have been relying on selective interventions by granting subsidies since they can no longer provide additional protection through tariffs because of the bindings given in tariffs negotiations and other GATT rules (Chang 2005; Lall 2005; Stiglitz 2003).

For example, under its industrial policy the EU grants subsidies for the development of the aerospace industry, and it has adopted programmes for improving industrial skills (in engineering, textiles and leather), managing structural changes (in textiles, leather, furniture, footwear, ship building, steel and certain food industries), and for research and innovation (WTO 2007). The USA also has policies for assisting and promoting certain industries; it heavily subsidises its aircraft industry and also has a programme for assisting other industries and for the development of small-scale enterprises.

These analysts hold that it is both short-sighted and unfair to advise developing countries not to adopt industrial policies and to require them to reduce tariffs and to remove barriers to trade on an across-the-board basis by adopting a tariff-cutting formula. It is short-sighted because experience has shown that liberalisation, if it is to lead to economic growth, must be made on a selective basis so as to expose only those industries that are ready to meet foreign competition. Across-the-board liberalisation, instead of promoting economic growth, can lead to de-industrialisation by causing the closure of industries that are not able to withstand competition. Such liberalisation programmes are unfair because they do not allow developing countries to provide the protection needed for the development of their industries while the developed countries are able to nurture and support the development of their industries through subsidies. The budgetary constraints that developing countries face place serious limitations on the extent to which they could use subsidies for the development of industries.

An Approach For Future Discussions

Modalities for negotiations

Based on the macroeconomics studies and the past experiences of the liberalisation measures taken by developing countries referred to earlier, the ongoing round of negotiations will likely make only a modest contribution to promoting development in the agricultural sector. The major beneficiaries among developing countries are going to be large-scale producers like Argentina and Brazil, while for a large number of countries, where production is undertaken on small scale and at subsistence level, liberalisation in itself is not expected to lead to improvements in productivity and efficiency. On the contrary, reductions in the protection levels will likely result in increased imports leading to displacement of local production and loss of income

and livelihood to poor farmers. Already, even at existing levels of protection, there is growing evidence of heavily subsidised dairy and poultry products from developed countries displacing local production in some of the African, Latin American and Caribbean countries.

In the industrial sector, the major beneficiaries are likely to be countries like China and India, which are already major exporters of manufactured products and have potential for development of trade in such products. For many of the countries, particularly those that are least developed, liberalisation of trade may result in de-industrialisation and increased unemployment, unless they are permitted to liberalise on a selective basis, and exclude sectors of production that are not as yet ready to meet open foreign competition.

In the situation the extent to which the results of the negotiations would contribute to increased trade of developing countries would depend on three factors. First, the willingness of the developed countries to make substantial reductions in the trade-distorting subsidies they grant to agricultural products, and deeper cuts in tariffs applicable in both the agricultural and industrial sectors. Second, whether the negotiations on modalities for reductions in tariffs adhere to the principle that in the round developing countries should not be required to make reductions in tariffs, on the basis of 'less than full reciprocity'. Third, the willingness of developed countries to concede to the following demands made by a large number of developing countries:

- In the agricultural sector they should be permitted to exclude from tariff reductions at least 20 per cent of tariff lines where the existing levels of protection are considered necessary for ensuring food security and for promoting rural development, and allowed to use 'special safeguards measures' to restrict imports, in cases of sudden surges; and
- In the industrial sector they should be permitted to exclude tariff lines (say 10%) covering industries that are not as yet ready to meet foreign competition.

In the area of services, for a large number of developing countries (barring those that have now become important exporters of back-office services) the benefits from liberalisation would accrue from the supply of services through the mode of movement of natural persons. (None of the developed countries has so far made offers for significant improvements in the existing access for supply of such services through movement of skilled or unskilled workers.)

Modifications in the rules of GATT

It would be further necessary to secure clarifications in some of the rules of the GATT to enable developing countries to derive maximum benefits from the liberalisation measures taken in the post-Doha Round period. These would include rules relating to:

- Application of trade remedy measures by developing countries; and
- Granting of temporary protection by developing countries, for the development of new industries.

Trade remedy measures

It would be necessary for all developing countries to ensure that they have in place a viable and effective mechanism to provide protection to their agricultural producers and industries by imposing trade remedy measures such as anti-dumping or countervailing duties, where dumped or subsidised imports are causing them injury. It would also be necessary to provide temporary protection in the form of safeguard measures to any industry that is being hurt by increased imports, even when such imports are not dumped or subsidised. The aim of providing temporary protection in such cases should be to enable the domestic industry to take appropriate steps to improve its ability to meet the competition posed by foreign suppliers.

The GATT rules require that trade remedy measures can be taken only after it is established, on the basis of investigations undertaken by an independent investigating authority, that increased imports are causing injury to the domestic industry. A number of developing countries have not yet found it possible to establish the institutional framework required for such investigations. Moreover – barring a few developing countries at a higher stage of development like Argentina, Brazil, Chile, India and Pakistan, which have now become important users of trade remedy measures – many others that have established the legal framework needed for taking such measures lack the necessary expertise for initiating and conducting investigations on the basis of the detailed principles and rules laid down by the relevant GATT article.

Further difficulties arise from the requirement that applications for investigations must be made by the industry that is alleging injury, and from the breadth and complexity of information required in support of the submission – for example, detailed information on volume of imports and data on prices for goods in both the domestic market and the home markets of the exporters. The issue is that the affected industries in developing countries lack the expertise and resources required for the collection of such information, and this often prevents them from applying for investigations.

In order to overcome the difficulties industries encounter in applying for investigations, the rules of the Agreement on Anti-dumping and the Agreement on Subsidies and Countervailing Measures would have to be clarified to recognise that governments of developing countries may have to play a role in assisting the industries to collect the information they need to apply for investigations.

To ensure that the information required is readily available, the governments could establish a mechanism for putting under 'surveillance' products with rapidly rising import levels. For products put under surveillance customs could be requested to collect

information on the volume of imports and their prices on a transaction-by-transaction basis. Alternatively, the relevant products could be subjected to a system of licensing requiring importers to indicate in the application for licence the quantities they propose to import and the price. In cases where it is alleged that goods are being dumped, the importer may be requested to indicate in the application, the price at which the product is being sold in the domestic market of the exporting country by obtaining such information from the exporter. The licences should be issued automatically on receipt within a period of 10 days, as required by the Agreement on Import Licensing Procedures. The information obtained under the system would be collated and published in a way that ensures it is readily available to all interested parties from the business community. The establishment of such a mechanism for surveillance of imports would also help countries to make effective use of the 'special safeguard measures' that would be permitted for restricting imports of agricultural products in proposals that are under consideration in the Negotiating Group on Agriculture.

A proposal embodying the above ideas was initially tabled by Kenya in the Negotiating Group on Rules. It has since received support from countries belonging to the ACP and African groups and they have tabled it as a joint proposal.

It is important to note in this context that some of the developed countries are adopting the practice of putting products with rapidly rising import levels under surveillance. The EU's safeguard regulations authorise the Commission to put all such products under surveillance for two reasons. First, it enables the Commission to consider whether the imposition of safeguard actions to restrict imports is warranted. Second, it provides a warning to the exporters that if exports increase further safeguard action may be taken. There is also US legislation that authorises the US Administration to put under surveillance products with rising import levels in cases where the industry is alleging that imports are causing them injury.

Rules on temporary protection for development of new industries

One of the likely results of the Round would be that the flexibility available to developing and least-developed countries to provide increased protection for the development of 'new or infant or recently established industries by raising tariffs' would be greatly reduced.

In the Uruguay Round these countries bound all of their tariffs in the agricultural sector. They were, however, permitted to bind them at rates that were higher than their applied rates. Since the reductions would be made on the basis of a formula to be applied primarily to bound rates, their application would further lower the bound rates. The harmonisation factor in the formula would result in greater reductions being made in the rates where binding is given at higher level. This would greatly reduce the difference between the applied and bound rates (or the water between the two as it is sometimes called).

In the industrial sector the extent to which these countries have bound tariffs varies widely. However, it is expected that the modalities for negotiations in this area would provide that countries should bind all of their tariffs. Bindings could be given at levels that are higher than the applied bound rates, but the modalities being adopted aim at ensuring that the difference between the lower applied rate and the bound higher rate remains small.

The result, both in the agricultural and industrial sectors, would be that the flexibility available to these countries to increase tariffs in order to provide for higher level of protection would be greatly reduced. They would therefore have to invoke the GATT provisions that permit countries to provide increased protection for temporary periods for the development of new or recently established industries. These provisions are contained in sections A and C of Article XVIII. Both sections deal with situations where countries 'consider it desirable' to take trade protective measures in order to promote the 'establishment of a particular industry with a view to improving standards of living of its people'. Section A deals with situations where the tariff rate is bound and the country is planning on providing protection by increasing the bound tariff rate. Section C deals with situations where a country has decided to provide such protection by applying quantitative restrictions on imports or by applying any other measure that is not permissible under GATT rules. The provisions of the two sections were clarified by the decision, adopted in 1979, to broaden their application to include the 'development of new, or the modifications or extension of existing production structures'.

Procedures that must be followed before applying the measures

Section A requires that before applying the rate that is higher than the bound rate, the country concerned must enter into consultations with the exporting countries with a view to offering them compensation for any loss of trade they may suffer as a result of increased duties. Such negotiations must ordinarily be completed before the new rates are applied. If no satisfactory agreement is reached, it is open to the country concerned to bring the matter to WTO for examination and consultations. If it is then found that the country proposing to increase the bound rate has made every effort to reach an agreement on compensatory concessions, and that the concessions offered are adequate, the country concerned could proceed to make changes in the bound rate. In such a case, however, the countries that are adversely affected are entitled to take retaliatory action by modifying the bound rates on products of export interest to the country applying the increased tariff rate.

Section C provides that where a country has decided to grant additional protection for the development of an industry by applying quantitative restrictions, it should follow simultaneously a two-pronged approach. First, it must commence negotiations with countries that have an export interest in the product if the rate of tariff is bound

against further increases, in order to offer them compensatory concessions. The procedures prescribed are similar to those described above under Section A for negotiations with the exporting countries when the bound rate is to be increased. The negotiations on compensatory concessions are considered necessary in the application of quantitative restrictions because even though tariff rates may not be increased the restrictions reduce the value of concessions for the exporting countries. Second, the country concerned must notify the WTO of its intention to apply the quantitative restrictions to imports of a product or products for which it proposes to promote development of domestic industries, in order to obtain its approval. In granting such approval the WTO member countries are expected to examine whether the objective 'for which the measure is proposed to be applied' could be achieved by using measures that are consistent with GATT and the possible effect the imposition of the quantitative restrictions could have on the commercial and economic interests of other countries. Section C permits the notifying country to apply the measure if the WTO does not grant such approval within 90 days of its notification. However, in such an event, the exporting countries with an interest in the products that are subjected to quantitative restrictions are entitled to take retaliatory action by withdrawing tariff concessions on products, in which the country taking the measure has trade interest.

Section C's complex procedures for seeking approval and the rigour with which the member countries were examined in the first two or three cases brought to the GATT in the initial years, made the developing countries reluctant to invoke its provisions. GATT members assigned the responsibility of reviewing the proposed measures to small working groups. These groups went to the extreme of drafting alternative plans for industrial development, which in their view were more appropriate than the original proposals. These developments left countries reluctant to invoke the provisions of the Article. Instead they justified the quantitative restrictions they imposed in the context of restricting the outflow of foreign exchange resources because of the balance of payments difficulties.

The GATT rules permitting countries to impose quantitative restrictions, to protect their balance of payments situation, were adopted under IMF rules when it was obligatory for all countries to have fixed exchange rates (Section B, Article XVIII). With the discontinuance of the mandatory obligation to have fixed exchange rates, almost all countries, including developing and least-developed countries, are presently adopting systems that provide for either floating or variable exchange rates. These systems also provide an automatic mechanism for adjustments in the balance of payments. The developing countries would therefore find it difficult to justify the imposition of quantitative restrictions on balance-of-payments grounds; indeed, the number of countries that are applying restrictions on balance-of-payments grounds has already declined.

In the post-Doha Round period, therefore, if the developing countries consider it necessary to provide increased protection for the development of a new or existing

industry, they would have to invoke the provisions of Section A if they want to provide such protection through tariffs and the tariff rate to be applied exceeds the bound rate. Likewise, if protection were to be provided through the imposition of quantitative restrictions, countries would have to justify them under the provisions of Section C and apply them only after they have been able to secure approval from the WTO. As such it would be necessary to ensure that the procedures the two sections lay down, are in practice implemented and applied in such a way that the right to take trade policy measures for assisting development of new or existing industries, which Article XVIII provides to the governments of developing countries, is not unnecessarily restrained.

Simplifying the rules to conform with those on safeguard actions

Many of the elements in the procedures prescribed under sections A and C are based on the procedures for the application of safeguard measures, which were adopted in the early years of GATT under Article XIX. The drafters of these provisions appear to have considered that there was a marked degree of similarly between the way in which safeguard measures were permitted in emergency situations and the actions that the governments may wish to take to restrict imports for the development of new or existing industries. In the first case governments are permitted to restrict imports, either by raising tariffs or by imposing quantitative restrictions, as increased imports are causing material injury to the domestic industry. In the second case, governments are permitted to take such measures in order to ensure that imports do not prevent the establishment of a new industry or development of a recently established industry. This is one of the reasons why the provisions of sections A and C are often referred to as safeguard actions that are permitted for economic development purposes.

The basic rules of Article XIX were clarified and elaborated by the Agreement on Safeguards adopted during the Uruguay Round. This was due to the realisation that countries were not invoking the provisions of Article XIX and were circumventing its rules by adopting measures such as voluntary export restraints and orderly marketing arrangements. These measures were not consistent with the principle that safeguard actions should be taken only after it has been possible for a country to establish through investigations by an independent investigating authority, that increased imports are causing or threatening to cause injury to the domestic industries.

One of the reasons countries circumvented the rules of Article XIX was the requirement that the country applying the measure must make compensatory concessions to countries exporting the product and if no agreement was reached on such concessions, the exporting countries would have a right to take retaliatory action for withdrawal of concessions on products of export interest to the country taking the measures. The Agreement found a solution in providing that the right of exporting counties to take retaliatory action shall remain suspended during the first three years

of the application of the safeguard measures. In order to ensure that the rights of exporters are not unnecessarily compromised, it lays down precise rules governing the duration for which such measures can be applied and provides that restrictive measures should be progressively liberalised during the period of their application.

The rules require countries to notify the WTO about safeguard measures taken by them, but there is no requirement that the WTO Committee on Safeguards should approve all such measures.

To enable developing countries to make full and effective use of their rights under sections A and C to provide a higher level of temporary protection for the development of new or recently established industry, it would be necessary to review the procedures in Article XVIII for WTO notification and approval, to bring them in conformity with the applicable rules under the Agreement on Safeguards. The broad features of the rules that could be adopted in this area are as follows:

- Such measures could be applied in the first instance for a period of 10 years. The period could be extended by five years to enable new or recently established industries to prepare themselves for competition. However, the total period should not exceed 15 years. (It should be noted that the total period for which safeguard measures could be applied is 10 years.)
- The measures taken should be digressive and, where possible, progressively liberalised.
- Countries proposing to take measures should enter into consultations with exporting countries immediately after notification to WTO with a view to offering compensatory concessions. These consultations would be based on the principle that the country taking the measure shall not be required to make concessions that are inconsistent with its development, trade and financial needs in cases where the affected country is a developed country.
- The negotiations should be completed within a reasonable period of time. However, the right of countries to take retaliatory action if no agreement is reached on compensatory concessions shall remain suspended for the first six or eight years. (In the case of safeguard measures, the right of the exporting countries to take retaliatory measures remains suspended for the first three years.)
- The notifying country would be expected to take into account the comments and views expressed in the WTO discussions on the measures taken and to modify them where possible. As in the case of safeguard actions, there would be no requirement for formal approval of the measures by WTO.

Preventing Extension of WTO Law to New Areas

As emphasised earlier in this chapter, it is unrealistic to hold that liberalisation of trade by itself would lead to economic and social development. Experience has shown that liberalisation measures are more likely to succeed if governments adopt 'industrial policy' in co-operation with industry and business associations, and guide development in different sectors of the economy by providing incentives or imposing conditions, where necessary. However, it would not be possible for developing countries to use all of the policy measures used by some of them in the past (like export subsidies, import content and export performance requirements) as they are now prohibited under modifications to the WTO law made in the Uruguay Round.

The policy measures adopted by developing countries to promote development in the agricultural and industrial sectors are aimed at complementing the measures they have taken for deregulation and liberalisation of their internal economies and for the liberalisation of their external trade. In the agricultural sector the main measure is the provision of fertilisers, insecticides and other inputs either free of cost or at lower prices. In the industrial sector the aim is to promote export-oriented industries. The measures include:

- Industrial zones with subsidised rates for land, electricity and water.
- Tax holidays to industrial units established in such zones, including exemption from paying direct taxes like income tax for the first 10 years.
- Exemption from payment of customs duties and excise taxes on inputs used in the manufacture of products to be exported.
- Incentives in the form of government commitments to meet a percentage of the cost of infrastructure and machinery used in manufacturing products for exports.
- Incentives to foreign investors in the form of tax holidays or lower rates of taxes on profits to be remitted.
- Adoption of systems for regulation and direction of foreign investment to certain sectors of the economy or to certain regions in the country.

Most of these measures are considered to be permissible under the present WTO rules. However, developing countries must ensure that the flexibility on subsidies available to them under the Agreement on Agriculture is not reduced or eliminated in the negotiations that are underway in the agricultural sector. In the industrial sector the developing countries would need to carefully examine proposals that may be made to modify the rules of the Agreement on Subsidies and Countervailing Measures in terms of the implications for their trade and development.

After relying extensively on the use of subsidies for the development of high technology and other industries, the developed countries are now complaining that the subsidies granted are causing distortions and adverse effects in international trade. They are likely to press for development of disciplines on the use of subsidies in these and other sectors where, in their view, industries have been able to develop the strength to compete in the international markets by taking advantage of subsidies that have been granted. The proposal that has been floated for an international agreement to tighten the discipline on the use of subsidies in the aircraft sector is an example of this trend.

As the negotiations enter the final phase and discussions commence on how the work relating to 'unfinished business of the Doha Round' and 'future work programme of WTO' could be organised, there may be proposals for the development of agreements strengthening the disciplines on a sectoral basis, as imposed by multilateral agreements like the Agreement on Subsidies and Countervailing Measures, Technical Barriers to Trade. There would also be pressure to commence negotiations by an agreed future date, in the three subject areas excluded from the present round of negotiations – that is, trade and investment, trade and competition policy and government procurement. It is important to note that these subjects have been excluded from negotiations during the Doha Round only. Countries that secured the inclusion of these subjects in the Doha Round are likely to press for recommencement of study and analysis in these areas during the concluding phase of negotiations. It would be necessary to examine carefully the implications of accepting any new disciplines in these areas (particularly trade and investment) with respect to the policy space that developing countries have in regulating and directing foreign investment to priority sectors and in providing tax and other incentives to foreign investors. One of the aims of the developed countries in the adoption of an Agreement on Trade and Investment would be to prohibit such practices.

Lastly, it would appear from discussions in the United States Congress that the US might press for developing rules on trade aspects of labour standards. There would be particular demands for the WTO rules to recognise that countries could restrict or prohibit imports of products produced in countries where minimum standards regarding wages or working conditions in factories are not followed. In the past most of the developing countries had taken the stand that the International Labour Organisation (ILO) was the appropriate forum for dealing with such standards and they should not be brought for negotiations in WTO. It would be necessary to consider whether they would like to maintain the same position.

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