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## The challenge of reforming the WTO dispute settlement understanding

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## The WTO after Cancún

*The collapse of the Fifth Ministerial in Cancún on September 14 sent shock waves around the world, with some observers predicting the demise of the WTO and the fragmentation of the multilateral system of trade policy into regional and bilateral agreements. The contributions to this Forum examine a number of relevant issues and discuss the prospects for future trade negotiations.*

Bernard Hoekman and Marcelo Olarreaga\*

### Economic Development and the WTO: Back to Basics?

During September 10-14, 2003, WTO members met in Cancún for a mid-term review of the Doha Round of trade negotiations, launched in November 2001. Trade ministers entered the 5th WTO Ministerial divided on agricultural and non-agricultural negotiating modalities, on whether to launch negotiations on the so-called Singapore issues (competition, investment, transparency in government procurement, trade facilitation) and their possible scope, and on the approach to take towards strengthening existing WTO provisions on special and differential treatment for developing countries. In the event, Ministers failed to agree on how to move forward on this complex agenda.

The question confronting the international community is whether Cancún represents a crisis that will derail multilateral cooperation on trade for some time to come, or whether it represents an opportunity to focus more narrowly on a negotiating set that is both economically meaningful and politically feasible to pursue.

#### Developing Countries and Cancún

In post-Cancún commentary, much has been made of the role that developing countries played. Clearly their active engagement in the negotiations was noteworthy. Developing countries came prepared to push for specific negotiating modalities and targets, and formed coalitions to do so. Thus, Brazil, China, India and South Africa formed part of a group of over 20 countries that negotiated as a bloc on agriculture.

Despite active efforts to split the group, the coalition remained together. West African countries – Benin, Burkina Faso, Chad and Niger – formed a coalition around a proposal to abolish export and other trade-distorting subsidies granted to cotton producers by other countries, and to seek compensation for their cotton farmers while subsidies were phased out. On the Singapore issues, three groups of developing countries came to Cancún with a clear position: the ACP, the LDCs and the African Union (AU). All three groups had agreed at Ministerial level before Cancún that they were not supportive of launching negotiations on these topics.

While progress was reportedly being made on the key issue of agriculture, on the final day of the Ministerial, the meeting failed because of the Singapore issues. Although the EU reportedly indicated a willingness to remove competition and investment from the table, others, such as Korea and Japan, indicated that they could not agree to removing any of the four issues, while the ACP/AU group reiterated that they opposed negotiations on all four issues. Given the divergent positions, the Chair of the conference decided there was no possibility of consensus and adjourned the meeting.

From an economic development perspective, there is a high opportunity cost associated with the failure to agree to negotiating modalities for agriculture and non-agricultural market access. Agricultural protection, tariff peaks, tariff escalation, and closed services markets in high-income countries all discriminate against poor countries. High trade barriers in develop-

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ing countries further reduce trade opportunities for South-South trade and impose costs on domestic consumers. Eliminating these trade distortions could help raise millions of people out of extreme poverty. A good Doha Round outcome would be an important instrument to help attain the Millennium Development Goal of halving income poverty by 2015. As research suggests that there are still great gains to be had from further liberalization of trade in goods and services, and that the gains from multilateral rules on Singapore issues are unlikely to be very large,<sup>1</sup> from an economic (and development) point of view a good case can be made that Cancún represents an opportunity to go back to basics—to focus on the market access agenda. If this can be achieved in the coming months, Cancún could turn out to be less of a disaster than many now make it out to be.

### Moving Forward

A key challenge confronting WTO members is to rapidly resuscitate the talks. This will require leadership, both by the EU and US. As, if not more, important is constructive engagement and leadership by middle-income developing countries in particular.

One lesson we draw from Cancún (and the discussions pre-Cancún) is that seeking to expand the negotiating set by adding “behind the border” issues such as investment and competition policies to link to agriculture is counterproductive. This linkage strategy proved highly divisive, with poor countries in particular concerned that multilateral rules might not be in their interest, would do little to promote progress on key market access issues and could give rise to major implementation burdens.<sup>2</sup> The presence of the Singapore issues allowed the intransigent to block progress on subjects on which they had major political problems.

Arguably Cancún identified the way forward – starting with an acceptance by the demanders to remove investment, competition and procurement from the table. This would allow members to focus on what research suggests matters most for development – removing trade-distorting policies that hurt the poor

disproportionately. The fact that the EU was willing to take competition and investment off the WTO table, and that the US is not a strong demandeur in these areas, suggests that this should be feasible.

A traditional market access agenda that focuses on border barriers is not only likely to bring large gains for both developed and developing countries, but such a negotiating agenda is likely to involve less difficult and costly decisions. In contrast to regulatory issues or demands for the stronger enforcement of rights to intangible assets (intellectual property, geographical indicators) that may entail a zero-sum bargain, the market access agenda involves trading of “bads”. An implication is that there is a greater likelihood that all gain at the end of the day.<sup>3</sup>

There is huge scope to trade “concessions” on tariffs – both applied rates and tariff binding. The same is true for access to service markets.<sup>4</sup> Services were given little attention in Cancún, as there was no need for Ministerial decisions on the subject. Concessions in agriculture should probably focus more on the market access side of the negotiations. Domestic support in the OECD involves huge income transfers from OECD tax payers to OECD farmers, but their impact on (developing country) agriculture exporters is smaller than the impact of tariff barriers in both developed and developing countries.<sup>5</sup>

In addition to focusing centrally on market access, the negotiating agenda should also include four basic principles that in our view would support development. First, it should aim at increasing the transparency of trade policy. For example, a simple proposition to move in this direction would be the replacement of specific duties by ad valorem tariffs. OECD countries are frequent users of specific or compound tariffs that are less transparent in terms of protective effects – and often involve very high ad valorem equivalents – and impose a heavier burden on exporters from developing countries because they tend to produce lower quality (cheaper) products.<sup>6</sup> A ban on specific tariffs would therefore be a desirable outcome. The same

<sup>1</sup> An exception is trade facilitation, but the Cancún Ministerial draft declaration was very vague about what was being put on the table in this area. Although important income gains can be achieved by the elimination of redundant red tape, for example, much of the agenda here is domestic.

<sup>2</sup> In turn driven in part by the lessons learned in the Uruguay Round: that not participating can lead to being confronted with a set of rules that give rise to transfers to high-income countries (TRIPs) or to substantial implementation costs that divert resources away from priority areas.

<sup>3</sup> Michael J. Finger: *The Doha Agenda and Development: A View from the Uruguay Round*, Asian Development Bank 2002.

<sup>4</sup> Aaditya Mattoo: *Liberalizing Trade in Services*, World Bank 2003, mimeo ([www.worldbank.org/trade](http://www.worldbank.org/trade)).

<sup>5</sup> B. Hoekman, F. Ng, M. Olarreaga: *Reducing Agricultural Tariffs versus Domestic Support: What's More Important for Developing Countries?*, 2003, mimeo.

<sup>6</sup> “Dirty” tariffication is likely to occur as part of any shift to the sole use of ad valorem tariffs, but this is likely to be a low price to pay for a ban on the use of specific tariffs.

is true of “other” duties and taxes on imports, which are frequently used in developing countries. Indeed, some developing countries have replaced high tariffs by “other” duties and taxes, in the process reversing liberalization, maintaining high barriers to trade and introducing non-transparency into the trade regime. A ban on the use of additional “other” duties and taxes would also help increase transparency.

A second principle is to promote greater predictability of trade policy. This can be achieved by reducing uncertainty regarding the conditions of market access – e.g. through stronger rules for the use of contingent protection, in particular antidumping – and through moving towards greater uniformity in the structure of protection. Agreement by OECD and middle-income countries not to use anti-dumping duties against developing countries is one option to consider.<sup>7</sup> Predictability would also be increased by eliminating tariff peaks. Sometimes a simple average tariff of 20 percent at the six digit level of the Harmonized System (HS) hides a 100 percent tariff line and nine 0 percent tariff lines at the eight digit level of the HS for very similar types of products. A simple rule that would move in this direction would be not to allow any WTO member to impose tariffs at the tariff line level that are larger than 3 times its average tariff. Predictability would also be enhanced through full binding by all WTO members of their tariff lines. For example, of the 41 African WTO members, only 9 have bound all their manufacturing tariff lines. Fifteen have bound less than 10 percent of their tariffs. Even if bindings remain above currently applied tariffs, this would nonetheless be valuable.

A third principle involves reciprocity. Developing countries need to make “concessions” to OECD countries and other trading partners to induce them to take on the domestic interests that benefit from trade protection. Developing countries’ main bargaining chips are further reforms of their own trade policies for goods and services. This is of course the central element of the market access negotiation. In the past, the concept of special and differential treatment (SDT) for developing countries implied that these countries could undertake fewer commitments. However, the case for exempting developing countries from liberalization is weak – own trade protection also hurts poor people in poor countries. But low-income countries with weak institutional capacity may not be able to implement, or may not benefit from implementing, resource-in-

tensive WTO agreements. The experience with the Uruguay Round, as well as more recent discussion before and at Cancún, suggests that greater differentiation between countries is needed in determining the reach of SDT.<sup>8</sup> Deciding on a new framework for SDT in the WTO could do much to move the market access agenda forward, and could also facilitate movement on new “behind the border” regulatory policies where members may agree cooperation is beneficial, such as trade facilitation.

Finally, it is important that end points or targets be established. The focus in Cancún was on negotiating modalities – how to cut tariffs, agricultural support, etc. Agreement on explicit focal points or targets would do much to ensure that the outcome of the talks will be beneficial to developing countries. Thus, while a non-linear type of formula approach to trade liberalization commitments can greatly reduce the average level and the dispersion of tariff rates, it needs to be complemented by agreement on an end point or ultimate objective. Given that the average OECD rates for manufactures are already low, a possible focal point here would be the complete elimination of tariffs by these countries by 2015 – the target date for the achievement of the Millennium Development Goals. Similarly, a target should be set for the maximum level of protection in developing countries – say no more than 10 percent by 2015.

### Conclusion

An effective WTO is critical for developing countries – the alternatives, bilateral and regional agreements, will give rise to trade diversion and discrimination, and most likely exclude sectors such as agriculture and policies such as antidumping. Developing countries have a strong incentive to put together an agenda that offers potential benefits to OECD countries as well as themselves. The Singapore issues are arguably not necessary to move forward on the market access agenda. There is huge scope to trade “concessions” on tariffs – both applied rates and tariff binding. The same is true for access to service markets. A re-focused effort centered on market access, complemented by an emphasis on transparency, predictability and reciprocity, could help realize the development promise of the Doha round.

<sup>7</sup> The first best solution of a ban on antidumping by all WTO members is unlikely to be feasible.

<sup>8</sup> B. Hoekman, C. Michalopoulos, L. Alan Winters: More Favorable and Differential Treatment of Developing Countries: Towards a New Approach in the WTO, World Bank Policy Research Paper 3107, 2003.

Jens van Scherpenberg\*

## Whither Euro-American Leadership in the WTO?

Global trade liberalisation, as negotiated within the multilateral trade regime of the GATT, has been one of the paramount drivers of globalisation in the last decades. In particular, the two most recent – and most comprehensive – rounds, the Tokyo Round of the 1970s and the Uruguay Round of 1986-1994, succeeded in promoting the global exchange of goods, services and capital. Two factors may have been instrumental in achieving those results through multilateral trade negotiations:

- The consensus principle of decision making within the GATT and its successor organisation, the WTO. Unanimity in finalising a package deal has been the appropriate decision-making mechanism for a process that can best be described as an exchange where mutual asking and bidding for concession offers is matched to maximise turnover. In economic terms, the result might be described as the common optimum of participants' preferences. Of course, to succeed, this process requires a common understanding that trade does indeed have positive welfare effects for every party.
- The United States and, increasingly from the 1960s onwards, the European Union clearly had a leading role in this process. Since their respective markets could absorb the greatest volume of imports they were the dominant negotiating powers. Japan, the third big player in international trade, took a long time to come to grips with the view that imports, too, can be a source of wealth for its own economy. Therefore, despite its economic potential, its role in international trade negotiations has been that of an outsider.

The Doha Round has been designated a “development round” in order to give globalisation some institutional underpinning by focusing on those countries whose economies hitherto had been profiting only in a rather unbalanced way – if at all – from the growing interdependence of markets. The *leitmotif* of the round has been twofold: (1) opening up further the markets of industrialised countries for developing country

exports, not least for agricultural products; (2) fostering the regulatory framework for efficient markets in developing countries by including a number of new issues such as foreign direct investment (FDI), competition policy, public procurement and trade facilitation into negotiations – essentially creating new incentives for “good governance”.

As the WTO Cancún Ministerial broke off on September 15, 2003 the failure to reach any substantial results has been interpreted as indicating a breakdown of the two basic supporting elements of the multilateral trade regime. The first, consensus-building, with a membership of 148 countries, is seen by some major players as impossible to sustain without a more structured aggregation of interests in preparing negotiations. The second, the leading Euro-American role in the WTO, has been said to have taken a possibly fatal blow at the hands of the new Group of 21 led by Brazil, India and China.

To both interpretations I would like to object, with a special focus on the latter.

### Eroding Multilateral Trade Consensus?

The issue of the WTO decision-making process being in a crisis became the subject of an intense and widespread academic and political debate soon after the spectacular failure of the WTO ministerial meeting in Seattle in December 1999. The more moderate recommendations brought forward then<sup>1</sup> are still valid. They include a formal establishment of the hitherto informal “Green Room” group of those major trading countries that have the greatest stake in the liberalisation process. All of the developing country members considered for membership in a formal “Green Room” grouping are, indeed, members of the Group of 21 that emerged as a major player in Cancún. But as we have seen in Cancún with the prominent role played by four West African cotton-growing countries, newly emerg-

<sup>1</sup> See especially Jeffrey J. Schott, Jahashree Watal: Decision-Making in the WTO, Policy Brief 00-2, Institute for International Economics, Washington DC, March 2000. More radical proposals envisage a switch in WTO decision making – in particular for dispute settlement, the “hard core” of the WTO regime – to a principle of weighted voting, that reflects a country's trading volume, among other economic factors. See for instance Thomas Cottier, Satoko Takenoshita: The Balance of Power in WTO Decision-Making: Towards Weighted Voting in Legislative Response, in: *Aussenwirtschaft*, Vol. 59, No. 2, 2003, pp. 171-214.

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ing or shifting interests may also require leeway for bottom-up aggregation of negotiating positions.

The debate on reforming the WTO negotiating and decision-making process, however, risks becoming moot. Any such reform discussion is based on the common understanding that trade liberalisation is wealth-creating for all participants, both for the country making market opening concessions and for the one that receives such concessions. In this regard, it is the erosion since the Doha Ministerial of American support for the WTO as an international organisation and for the multilateral trade regime as such that may matter most to the WTO's future after Cancún.

Irritation with the WTO has been a constant feature of the US domestic policy process since the conclusion of the Uruguay Round in 1994, nurtured by each ruling of the WTO dispute settlement body that found the US in violation of WTO law. This is reflected in the failure of President Clinton to have the US Congress renew the Administration's fast track authority for trade negotiations that expired in 1994. Thus, President George W. Bush's positive attitude towards trade liberalisation and the WTO process and his nominating Robert Zoellick, an experienced and highly able international negotiator, to the post of United States Trade Representative (USTR), certainly were seen as a positive sign of renewed US commitment to the multilateral trade order. Zoellick's strong showing in the difficult weeks between the terror attacks of September 11, 2001, and the Doha Ministerial in November 2001, as well as his concessions, e.g. on anti-dumping, during the Doha meeting itself underpinned this perception.

However, the Administration's turning away from multilateralism in its foreign policy approach in the wake of September 11 was reflected in its trade policy as well. This became apparent when Zoellick and other members of the Administration tried to build support in the Congress for Bush's "Trade Promotion Authority" (TPA) – his version of fast track renewal. TPA was essentially promoted as a precondition for negotiating bilateral free trade agreements (FTAs).<sup>2</sup>

The Administration rallied further domestic support for TPA by imposing protective tariffs against an alleged "import surge" of steel (based on the "safeguard clause" of Article XIX of the GATT) in March 2002 and by adopting legislation consolidating and expanding farm subsidies (the "Farm Security and Rural Invest-

ment Act of 2002", signed on May 13, 2002). However, major trade disputes with other WTO members, notably with the EU, in which the US was defeated in the dispute settlement process, increased domestic resentment against the WTO. This was particularly true in light of the conflict on tax subsidies to US exporters through the Foreign Sales Corporation (FSC) mechanism, which was later replaced by the Extraterritorial Income (ETI) scheme. Members of Congress felt that the ruling of the WTO dispute settlement body (DSB) infringed upon their own sovereign power of taxation.

Therefore, anti-WTO statements are playing an increasing role in the upcoming US election campaign. As almost all Democratic presidential candidates pronounce themselves more or less openly against the WTO, the Administration will be less than willing after the Cancún failure to come out in favour of WTO negotiations prior to the election in November 2004. The ongoing loss of well-paid jobs in the manufacturing sector, which makes the current slight economic recovery a jobless one so far, is seen as a result of "unfair" competition from other countries, notably from China (and, indeed, from Mexico, whose competition is attributable, however, not to the WTO, but to NAFTA). The current Administration's constituency in Southern and Mid-Western agricultural states that have a vested interest in continuing subsidies for cotton, wheat, corn and soy beans adds to a potential bipartisan coalition against major WTO concessions.

#### **An "Ambitious Agenda" Leading Nowhere**

A year ago, there seemed to be less reason for scepticism. After Congress had ratified TPA and the President had signed it into law on August 6, 2002, Zoellick supplemented those two protectionist measures with a radical free trade agenda. He brought forward two very ambitious proposals for multilateral trade negotiations – so ambitious, indeed, that they could hardly be taken seriously in the midst of an ongoing trade round. First, he proposed to eliminate all export subsidies on agricultural products within 5 years, limit production subsidies to 5% of production value and slash all agricultural tariffs worldwide to a maximum of 15%. Then, in November 2002, he tabled an initiative for a tariff-free world, abolishing all tariffs on industrial and consumer goods by 2015.

In their multilateral aspirations, Zoellick's proposals certainly topped those of his European counterpart Pascal Lamy who had initiated in 2000 his own ambitious "everything-but-arms" initiative to grant free market access to 48 least-developed countries for all of their products (but arms). Lamy's initiative came

<sup>2</sup> See Zoellick's exemplary op-ed "Falling Behind on Free Trade", in: *The New York Times*, April 14, 2002, Section 4, Page 13, in which he stated that "worldwide, there are 150 regional free-trade and customs agreements; the United States is a party to only three," asking the Senate for "trade legislation that could help remedy this imbalance".

into force in March 2001 even though it was slightly watered down to an “everything but arms, sugar, bananas and rice” initiative, since for those latter products a transition period up to 2009 was implemented. The EU initiative followed the traditional EU method of granting unilateral market opening concessions to those poorer countries whose competition did not hurt European producers too much. The US proposals, however, asked other countries for substantial – and even comparably larger – concessions of their own in exchange for US trade liberalisation and subsidy cuts. Therefore they were perceived as biased against developing countries and thus not well suited for serious negotiation, especially since most developing countries believed that this time *they* should primarily be on the receiving end of trade concessions.

It is hard to say whether those two USTR initiatives were meant to be serious or whether – to take literally the wording of the USTR press release for the “Tariff-free World” proposal – they were to be merely “*demonstrating* continued U.S. leadership in the Doha Development Agenda”<sup>3</sup> (emphasis added, JvS).

#### Challenging Trade Policy Power Parity

US-EU partnership in keeping the multilateral trade regime moving was based on both powers’ view that trade liberalisation, including market opening concessions of their own, was in their vital interest. Each arrived to this conclusion from a different point of departure: the US from its own post-Second World War position of strength, the EU from its self-perceived role of a rising and dynamic trading power that was keen to catch up in trade expansion while leveraging its own import capacity for global economic influence. For both, the Uruguay Round may have been the one

point where their paths finally crossed. The Marrakesh Treaty of 1994 that gave birth to the WTO may be seen as the ultimate institutional structure of a US-European balance of power in trade policy. Similar perhaps to the US-Soviet nuclear balance of power in the 1970s, both were bound to some extent by a contractual framework to refrain from unilateral acts while third countries were able to take advantage of their mutual competitive balance.

Similar, however, to the greater balance of power, the United States has never fully accepted a situation that left it bound by rules which it could not set – and change – itself by will. This has been especially true for the Bush administration. The Administration’s post-Cancún attitude, as expressed by Robert Zoellick,<sup>4</sup> mirrors to some extent its foreign policy approach: either you follow our ambitious agenda or you are against us. The turn towards regionalism – and this should be considered a euphemism for bilateralism – actually may turn out to be a course towards unilateralism. Bilateral free trade agreements provide the maximum leverage with the minimum cost to the country that predominates in such an agreement.

The European Union on the other hand, having followed a regionalist course of its own for many years, has refrained from concluding any new FTAs in recent years. In addition, the EU has shown more flexibility in core contentious issues of the WTO negotiations, such as agricultural subsidies, than anticipated by most countries. Clearly, for the EU, more is at stake regarding the future of the World Trade Regime than there seems to be for the US.

But given the eroding consensus for the multilateral trade system in the US, it is hard to envisage how joint US-European leadership in trade policy can resume after Cancún.

<sup>3</sup> U.S. Proposes Tariff-Free World. WTO Proposal Would Eliminate Tariffs on Industrial and Consumer Goods by 2015, Office of the United States Trade Representative, November 26, 2002; <http://www.ustr.gov/releases/2002/11/02-112.htm>.

<sup>4</sup> Robert B. Zoellick: America will not wait for the won’t-do countries, in: Financial Times, 22.9.2003, p. 15.

Georg Koopmann\*

## Growing Regionalism - A Major Challenge to the Multilateral Trading System

It is not uncommon for multilateral trade negotiations, such as in the Doha Round, to be preceded and paralleled by liberalisation initiatives and rule-making activities at lower levels, be it unilaterally, bilaterally,

plurilaterally or in a regional context. Such moves have also been portrayed as a better/faster way to abolish barriers to international trade and investment, labour movements and knowledge flows, and to create reli-

able and enforceable rules governing these transactions and related interventions by governments. The “domino theory” of regional trade agreements, for instance, predicts a multiplier effect, triggered by single incidents of regionalism, such as the completion of the Single Market in Europe in 1992 or the Mexican proposal for a free trade agreement with the United States, and driven by political forces and economic interests seeking participation in existing regional clubs, that would knock down bilateral import barriers like a row of dominoes and thus steadily amplify the space of liberalisation. Ultimately, it is claimed, the process could even lead to universal free trade. Following this line of reasoning, one might be tempted to interpret the collapse of the recent “mid-term” conference of the Doha Round in Cancún as a victory won by a superior regional model of organising international economic relations over a multilateral scheme that has outlived its usefulness and become more and more unwieldy.

However, regionalism is certainly neither responsible nor to blame for what has happened in Cancún. Even so, regionalism may in a significant way affect the incentives of major players in the international arena to take the multilateral route. Conversely, the failure of multilateralism, as well as its success, will hardly leave the path of regionalism unchanged. Contrary to the domino theory, which implicitly regards regionalism and multilateralism as processes that are largely independent of each other (“strangers”), the two phenomena in fact appear to be interdependent to a considerable degree. The question then is whether they are “friends” or “foes” or, put differently, whether regionalism is a “building block” or a “stumbling block” on the road to multilateralism.

In the early 1980s, the ill-fated GATT Ministerial Conference in Geneva (held in November 1982), where the European Community refused to go ahead with a new multilateral round to reduce trade barriers (which did not start until four years later in Punta del Este/Uruguay), provided the rationale for a fundamental change of course in US trade policy from a clear priority for multilateral trade negotiations to a multi-track trade strategy containing multilateral as well as bilateral and unilateral elements. Seventeen years later, the “Battle of Seattle”, which caused a postponement for two years of the “Millennium Round” mainly pushed by the Europeans at the time (which finally, in November 2001, became the Doha Round), gave additional

momentum to the proliferation of regional and bilateral trade agreements already in force or under way. Lastly, after the breakdown in Cancún, Robert Zoellick, the United States Trade Representative, told delegates from other WTO member states that, “We’re going to move elsewhere” and “We will move towards free trade with can-do countries”, thus warning that the USA might now even more vigorously press ahead with preferential trading agreements (PTAs) of all sorts. In a similar vein, Pascal Lamy, the European Commission’s trade commissioner, indicated the European Union could possibly rethink its multilateral trade obligation and change its current trade policy stance, adopted in 1999, not to open new preferential trade talks but attach priority to the multilateral route. However, according to Franz Fischler, the agricultural commissioner, the pursuit of bilateral or regional free trade “could (for the EU) never be an alternative to the WTO or the multilateral process”.

During the negotiations in Cancún, the United States also brought its African Growth and Opportunity Act, a PTA-like initiative, into play, offering African trading partners extra preferential market access for textiles and clothing, in order to fend off their demands for the elimination of US (and some other countries’) cotton subsidies, which highly distort international trade and work to the particular disadvantage of various West African countries. US negotiators likewise tried to split up the newly formed group of 22 developing countries, which more generally called for reductions in industrial-country agricultural subsidies, going well beyond those offered in a joint EU-US proposal, by telling its members that they were jeopardising their chances of doing bilateral deals with the United States. Brazil, which is a leading member of the new coalition, immediately announced its own intention of intensifying bilateral trade links, preferably with other developing countries in different parts of the world, after the talks in Cancún had fallen apart.

In actual fact, a virtual explosion of membership in preferential trading agreements has taken place in recent years. Of the about 265 PTAs that were notified until May 2003 to the WTO, and previously to the GATT, its predecessor, nearly 185 are still in force. About two-thirds of these agreements have been concluded since 1995, when the WTO was founded. With the sole exception of Mongolia, all WTO members are now either a party to at least one existing PTA or are engaged in negotiations on future preferential agreements. The percentage of world trade accounted for by PTAs is therefore expected to grow from slightly

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under 45 per cent currently to approximately 55 per cent by 2005.

Many of the new PTAs are no longer regional trade agreements in a strict sense but extend beyond regional borders into the global economy.<sup>1</sup> This is a novel phenomenon, since two-way or reciprocal preferential trade liberalisation (as distinct from the unilateral granting of trade preferences) was hitherto largely restricted to fairly well-defined geographical areas within Europe, the Americas, Asia-Pacific and Africa. Latterly, however, the major trading powers, and likewise a number of smaller countries among themselves, have become engaged in various cross-regional PTAs, witness the EU's agreement with Mexico of July 2000 and most recently (August 2003) those of the USA with Singapore and of Singapore with Chile. Altogether, one-third of the PTAs currently under negotiation are among trading partners that belong to different world regions.

Closely related to this trend is the growing share of PTAs between developed and developing countries (North-South agreements), following the precedent established by Mexico's inclusion into NAFTA, the North American Free Trade Agreement with the United States and Canada. A completely new category of cross-regional PTAs arising in this context is those PTAs in which each party is a distinct PTA itself. Currently, there are no agreements of this kind in force, but several are under negotiation, most notably one between the European Union and the South American Common Market (Mercosur). As the United States concurrently aims to create a Free Trade Area of the Americas, which would include Mercosur, too, competition is also building up between two trading powers which both wish to integrate a third regional grouping into their own cross-regional trade agreements.

Indeed, with the number of PTAs escalating, a growing number of countries simultaneously participate in a growing number of agreements and thus enter into multiple partnerships. Hence individual PTAs increasingly overlap one another. The overlapping aspect of PTAs has certainly changed from being an occasional phenomenon to being the rule rather than the exception. At the same time, the pattern of agreements resulting from this development is no longer dominated by the "hub-and-spokes" model, where

PTAs exist between each spoke and the hub, the centre country, and none between the individual spokes, but more resembles a "spaghetti bowl" as the spokes increasingly have agreed PTAs among themselves. A major implication of this is the coexistence of a growing number of different trading regimes in individual countries, with widely diverging provisions concerning depth of integration, preference margins, coverage of sensitive products, phase-out periods, methods of conferring origin etc. This inevitably makes trading more complicated, increases transaction costs and may even deter traders from actually using the preferences granted.

The predominant mode of forming new PTAs is to build free trade areas (FTAs) where the individual partner countries, other than in a customs union, retain their own tariff structures and thus autonomy in external trade policy. Third countries might therefore try to play individual FTA members off against one another, e.g. by choosing the most liberal point of entry for their merchandise to be sold anywhere in the FTA. In order to prevent ensuing "trade deflections" and "transshipments", border controls are typically maintained in FTAs to determine the origin of goods circulating internally. This frequently gives rise to a high incidence of trading costs within FTAs mainly caused by complicated regulations together with opaque customs procedures and related activities of vested protectionist interests. These problems tend to be compounded with the emergence and proliferation of overlapping PTAs as noted above. The whole phenomenon of overlapping PTAs is in fact closely associated with the formation of free trade areas, as customs unions by definition cannot overlap one another. However, they can – and do – form FTAs with non-member countries. From a politico-economic viewpoint, FTAs are also seen as less conducive to further trade liberalisation than customs unions. The reason given is that, insofar as protection is "exported" from one FTA member to another via restrictive rules of origin, for instance, the economic weight of producers who have a vested interest in opposing moves towards an open multilateral system grows.

A common characteristic of the free trade areas and customs unions forming under the "new regionalism" is the growing share of "deep integration". Members of these "new age" PTAs do not confine themselves to reducing or eliminating trade barriers, but also harmonise, adjust or mutually recognise other economic policies (e.g. in the fields of government procurement, competition, capital mobility and investment, technical, social and environmental standards, services or in-

<sup>1</sup> It is therefore more appropriate to speak of *preferential* rather than *regional* trading agreements. The term PTA is also preferable to the phrase *free trade agreement*, which is frequently used to characterise exclusive trade liberalisation between a limited number of countries. Such wording may cause confusion as the freeing of trade among members often entails a sizeable measure of discrimination against third parties.

lectual property) and provide cooperation/technical assistance to economically weaker partner countries. This frequently happens notwithstanding the fact that "shallow integration" remains incomplete (with sensitive sectors like agriculture and financial services, for instance, often excluded from internal liberalisation) and trade policy proper diverges between member countries. In many respects, PTAs therefore appear to go beyond existing WTO agreements, either by containing more ambitious provisions or by covering areas not regulated by the WTO at all. In others, however, they stay behind existing multilateral rules.

The implications for multilateralism of these widening discrepancies between rules laid down in PTAs and those contained (or not) in WTO agreements are hard to ascertain. Increasing deep integration via PTAs may entail an additional discriminatory impact on third countries and insert further layers of complexity into the trading system as the approaches adopted vary between individual PTAs. Governments consequently have to manage different provisions within the same policy areas, which carries the risk of mutual inconsistency and may hamper trade. Moreover, the advantages of deeper integration tend to be distributed asymmetrically among PTA partners, especially within North-South agreements where the bigger gains seem to accrue to "northern" countries. By the back door, PTAs may also introduce non-trade issues such as labour standards into the international trading system. Furthermore, there are cases of direct conflict between WTO and PTA rules. For instance, some PTAs provide extra opportunities to use safeguard measures, with disciplines less stringent than those applying in the WTO. However, PTAs may also complement, rather than substitute, WTO agreements (e.g. in the area of trade-related technical cooperation), they may permit gains from integration in the WTO and they may generate considerable positive externalities where non-member countries effectively participate in the benefits of deeper integration among PTA members. Examples include more effective policies against anti-competitive business practices, the elimination of trade-distorting internal taxes and the consolidation of trade reforms in developing countries through PTAs. This may promote imports from all countries and thus mitigate the problem of trade diversion.

Sound empirical evidence on trade creation (where high-cost production in one member country is shut down as lower-cost competing goods from another member country displace it) and trade diversion (i.e. a member country replacing imports from a low-cost source in the rest of the world with imports from a

higher-cost member) caused by recent PTAs is scarce. Simple indicators, such as intra-regional/intra-PTA trade shares and measures of relative trade intensity among member countries, seem to suggest that both effects might on the whole turn out to be rather modest. PTAs, and in particular multiple memberships in such agreements, are nonetheless giving rise to a patchwork of "positive discrimination" (through favouring some trading partners over others) in international trade that may highly distort competition. It bears resemblance to the chaos that was created in the 1930s through widespread "negative discrimination" (i.e. protecting domestic producers against foreign ones).

Especially smaller and less developed countries, for lack of bargaining power, are seen to lose out in a shift towards bilateral trade deals. At the same time, as the prevalence of overlapping PTAs mounts, the range of possibilities for the play of special interest groups seeking to prevent any erosion of the agreed preferences widens and opposition to further trade liberalisation at the multilateral level may therefore be expected to grow. Positive shocks caused by big singular events of regionalism like the creation – and enlargement – of the European Economic Community, which propelled the United States to initiate successive GATT negotiations under the Dillon, Kennedy and Tokyo Rounds in the 1960s and 1970s, are unlikely to occur again. The simple reason is that multilateral liberalisation has substantially progressed in the past decades, thereby narrowing the margin of possible discrimination through preferential liberalisation. Concerning present and future PTAs, it is more probable that these agreements, in a rather silent/creeping manner, may interfere with the functioning of a multilateral trading system built upon the pillars of non-discrimination and reciprocity, by offering routes to opportunistic behaviour that may impair the efficiency of multilateral bargaining.

The multilateral trading system itself has proved to be largely ineffective in dealing with regionalism. It allows for the formation of customs unions (CUs) and free trade areas (FTAs), which by their very nature discriminate against non-participating WTO member countries, if certain conditions are fulfilled: the preferences exchanged between CU/FTA members must be 100 per cent, they must cover substantially all the internal trade, not raise protection against third countries and have a definite timetable for implementation. However, GATT Article XXIV, where this is laid down for the goods sector,<sup>2</sup> was controversial at its inception and has recently met with renewed controversy as PTA

notifications have mushroomed. Since there has never been consensus on how to interpret the constraints noted above, hardly any PTA has been successfully challenged under the GATT or in the WTO while more than 125 agreements are currently under examination by the responsible WTO Committee on Regional Trade Agreements. In consequence, what in the early GATT years was a rare deviation from multilateral rules, is now widespread practice and has become the most frequently used exemption from most-favoured-nation treatment and thus non-discrimination in the multilateral trading system.

All this suggests a strong need to revisit the relevant multilateral rules. In Doha, WTO member countries agreed to launch "negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements".<sup>3</sup> To date, discussions of the issue in the Doha Round have largely concentrated on notification

<sup>2</sup> A similar provision, with slight modifications, applies to the services sector (Article V GATS).

<sup>3</sup> Cf. Paragraph 29 of the Doha Ministerial Declaration.

aspects of PTAs, i.e. what has to be notified when and to be considered where in the WTO. A more challenging theme would be to define precisely the requirement for PTAs to liberalise "substantially all the trade" between member countries (in the case of goods) or ensure "substantial sectoral coverage" (in the case of services).<sup>4</sup> However, the scrutiny of PTAs should not be confined to the pre-operation stage, i.e. before they enter into force. Even more important appears to be multilateral surveillance of their conduct and impact "after the fact". This could become an important exercise in transparency, covering also the intricate issues associated with deeper integration among PTA members, and work in a similar way to the Trade Policy Review Mechanism, already established in the WTO system, under which trade and trade-related policies of *individual* WTO member countries are examined.

<sup>4</sup> The underlying presumption is that economic distortions caused by PTAs may be lower when free trade covers all sectors within preferential areas. At the same time, of course, fully-fledged internal liberalisation could further harden political resistance (by pressure groups) against the erosion of the preferences through multilateral liberalisation.

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## The Challenge of Reforming the WTO Dispute Settlement Understanding

The May 2003 deadline for the completion of the negotiations on improvements and clarifications of the Dispute Settlement Understanding (DSU) under the Doha Mandate has not been met. However, Members agreed in July 2003 to extend the deadline for the review until the end of May 2004. This article briefly summarises the past six years of negotiations on the DSU review, the most contentious issues and the systemic difficulties of the negotiations. We conclude with prospects for the forthcoming negotiations until 2004.

### The DSU: Rules for Settling Disputes in the WTO

The DSU contains the rules for settling disputes between WTO Members that arise under the agreements covered. In short, it provides for a procedure that

starts with mandatory consultations as a negotiatory element. If the parties cannot agree to a settlement during these consultations within a certain period, the complainant may request a panel to review the matter. Panels engage in fact-finding and apply the relevant WTO provisions. Their findings and recommendations are published in a report, which either or both of the parties may appeal. The Appellate Body is then to review the issues of law and legal interpretations in the panel report. It can uphold, modify or reverse the panel's findings. Subsequently, the reports are adopted in a quasi-automatic adoption procedure by the Dispute Settlement Body (DSB) where all WTO Members are represented by a delegate. "Quasi-automatic" adoption means that the reports are adopted unless the parties decide by consensus (i.e. including the party that has prevailed) not to adopt the report. If it has been found that a trade measure is in violation of WTO law, the defendant must bring this measure into compliance with the covered agreements within a reasonable period of time, normally not exceeding 15

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months. If the defendant refuses to comply, the complainant may ask the defendant to enter into negotiations on compensation, or it may seek authorisation from the DSB to suspend concessions or other obligations vis-à-vis the defendant in an amount equivalent to the injury suffered. If the adequacy of implementation is disputed, the implementation measures are subject to further review under the DSU. Retaliation, if authorised, normally takes the form of punitive tariffs on a defined volume of the complainant's imports from the defendant.

The DSU has often been praised as the "crown jewel" of the Uruguay Round Agreements. Key innovations with regard to dispute settlement under the GATT are strict time-frames and the lifting of the former consensus requirement which allowed a defendant to block the adoption of an adverse ruling. Since the DSU entered into force on 1 January 1995, its provisions have been applied to the settlement of some 300 disputes on a wide range of topics.

#### **DSU Review: Fruitless Efforts Since 1998**

Originally, a 1994 Ministerial Decision had called upon Members to complete a full review of the DSU by 1 January 1999, and to take a decision whether to continue, modify, or terminate the DSU at the Seattle Ministerial Conference. Despite intense discussions and an extension of the deadline until July 1999, no result was achieved. After the failure of the Seattle Ministerial in December 1999, the DSU review fell into an inconclusive limbo. Efforts to further the review during 2000 and 2001 remained unsuccessful. It was only at the Doha Ministerial Conference in November 2001 that a mandate for further negotiations on improvements and clarifications of the DSU was included in the Ministerial Declaration. Between spring 2002 and May 2003, 42 specific proposals were submitted by members, covering virtually all provisions of the DSU. The "Chairman's text" of 28 May 2003, named after the Chairman of the negotiations Péter Balás, incorporates many of these proposals and was meant to serve as a basis for agreement.<sup>1</sup> However, portions of the text are still bracketed (which indicates disagreement between the parties) and, more important, many of the more controversial proposals have been left out. Although the text was not accepted by the negotiators, it is worth looking at in some detail.

#### **Searching for Compromise: The Balás Text**

The Balás text contains a procedure to overcome the "sequencing issue" which arose over ambiguities (or even contradictions, as some may argue) in Art.

21.5/22 DSU. It surfaced during the *EC - Bananas* case, where the WTO-consistency of the EU implementation measures was disputed. The key question is whether a "compliance panel" must first review the implementation measures undertaken by a defendant before a complainant may seek authorisation to retaliate on grounds of the defendant's alleged non-compliance. Whereas the US initially opposed any idea of sequencing and favoured immediate retaliation, the EU and many other Members argued in favour of the completion of such a compliance panel procedure as a prerequisite to seeking an authorisation to retaliate. Over time, however, this debate lost its acrimony: after the US had been defeated in the *US - Foreign Sales Corporations (FSC)* case, it found itself unable to implement the rulings in a timely and WTO-consistent manner. It subsequently agreed with the EU on sequencing for that particular case. This practice, which was also applied in other disputes, would now have been introduced into the DSU.

The Balás text would also have brought noteworthy modifications at the appellate stage, introducing an interim review, and a remand procedure. In this procedure, an issue may be remanded to the original panel in case the Appellate Body is not able to fully address an issue due to a lack of factual information in the panel report. Remand panel reports could be appealed as well. The compromise text would have introduced numerous amendments in other areas, including, *inter alia*, housekeeping proposals, enhanced third party rights, enhanced compensation, strengthened notification requirements for bilateral solutions, and special and differential treatment of developing countries.

#### **Contentious Issues**

The controversial issues that have not been integrated into the text include, for instance, several elements of a proposal by the United States and Chile on "improving flexibility and member control in WTO dispute settlement". Obviously motivated by a series of defeats in trade remedy cases and a surge of criticism of WTO dispute settlement from US Congress, it would have allowed the deletion of findings in panel or Appellate Body reports by mutual agreement of the parties. Furthermore, it would have provided for the partial adoption of panel and Appellate Body reports, and it called for "some form of additional guidance to WTO adjudicative bodies". A majority of small and medium-sized trading nations refuses any increase of political control, as this would automatically benefit the more powerful Members.

<sup>1</sup> Document TN/DS/9, available at the WTO website.

Another proposal that was not taken into account is the EU call for a permanent panel body. Whereas panelists are usually government officials or other trade specialists who are appointed ad hoc and discharge their tasks as panelists on a part-time basis and in addition to their ordinary duties, the EU wants to establish a roster of 15 to 24 full-time panelists. The EU hopes that this would lead to a professionalisation of the panel process and help overcome problems with the selection of panelists, as parties find it increasingly difficult to agree on the composition of panels. Opponents of the proposal argue that members of a permanent panel body could be more "ideological" and might engage in lawmaking. They therefore feel more comfortable with the current system as it draws heavily on government officials who are familiar with the constraints faced by governments. The EU equally failed in introducing a prohibition on "carousel" retaliation. Carousel retaliation consists of periodic modifications of the list of products that are subject to the suspension of concessions if a respondent fails to comply with an adverse ruling. The US signed such provisions into law in 2000 as the EU did not comply with the adverse WTO rulings in the Hormones and Bananas cases. Although the provisions have never been applied, the EC continues to oppose them as it already did in the DSU review during 1999.

The US, in turn, failed to have its proposals on increased transparency considered. The US wants to make submissions of parties to panels and the Appellate Body public, and it wants to allow public observance of panel and Appellate Body meetings. Particularly developing countries oppose such increased transparency, as they fear "trials by media" and undue public pressure. Insisting on the intergovernmental nature of the WTO, they also resist efforts by the US and the EC to formalise the acceptance of *amicus curiae* or "friend of the court" briefs. *Amicus* briefs are unsolicited reports which a private person or entity submits to the adjudicative bodies in order to assist (and to influence) the Court in its decision-making. The issue had surfaced for the first time in 1998 when the Appellate Body decided in *US – Shrimp/Turtle* that the panel had the authority to accept unsolicited *amicus curiae* briefs. That right was subsequently expanded in further disputes, causing outrage among many developing country Members.

Developing countries, in turn, did not manage to introduce collective retaliation into the draft. It was meant to address the problems caused by the lack of retaliatory power of many small developing economies, such as those experienced by Ecuador in the *EC Intereconomics*, September/October 2003

– *Bananas* case. With collective retaliation, all WTO Members would be authorised (or even obliged under the idea of collective responsibility) to suspend concessions vis-à-vis a non-complying Member.

#### **Diverging Views on the Fundamental Orientation of the DSU**

There are at least three major reasons why it has been so difficult to agree on a compromise text. The first one is disagreement on specific issues as outlined above, combined with a lack of political will to settle for a compromise. The second one is a more fundamental disagreement which blocks successful negotiations: the dispute settlement system has gradually moved, over the past few decades, from barely codified practices relying heavily on diplomatic negotiations to an increasingly codified litigation mechanism with strong emphasis on the rule of law. Currently, however, there seems to be no consensus on whether that trend towards judicialisation should continue. Some proposals would contribute directly or indirectly to a strengthening of the rule of law, such as a professional permanent panel body, increased notification requirements for mutually agreed solutions, improved enforcement or strengthened third party rights. Other submissions, however, such as the US proposal on flexibility and increased Member control, aim at reversing this trend and seek to strengthen the political element of dispute settlement. While one might expect at first that this is largely an issue that divides larger and smaller nations, things are not as simple as that: many developing countries equally argue for strengthening the negotiating mechanisms, as they are disappointed with the final outcome of litigation. The Ecuadorian experience in the *Bananas* case has shown that retaliation as the last resort is ineffective for small developing countries. Not only do they lack retaliatory power because of insufficient market size, but they would also mainly harm their own development prospects by shutting out imports from industrial nations. Moreover, litigation is expensive. Finally, overall political considerations (such as GSP preferences, official development assistance and many others) may prevent developing countries from engaging in litigation with developed countries.

#### **Systemic Difficulties in Reforming the DSU**

Thirdly, there are also systemic reasons for the low success of the DSU review: the dispute settlement mechanism has a "constitutional" character, as it contains the basic rules for the settlement of any dispute that may arise under any of the covered WTO Agreements. Factually, it also has a crucial function in interpreting the provisions. Not surprisingly, the decision

to approve amendments to the DSU shall be made by consensus, as Art. X.8 WTO Agreement provides. As Rawls taught us, constitutional rules should always be agreed by actors in the "original position" and behind a "veil of ignorance" in order to prevent self-serving choices. In the reality of trade policy, however, such a veil of ignorance does not exist, as Members, after nearly 300 disputes, know fairly well their own and the other parties' vulnerabilities. The "context" in which the DSU review takes place thus creates difficulties on three levels in particular.

- Firstly, the review is conducted in the light of the substance of the disputes that are brought to the WTO on a continuing basis, and in particular of the politically more controversial ones. It is in these disputes or in their respective context where all the crucial issues in the debate have arisen (sequencing and collective retaliation in *Bananas*, carousel in *Hormones*, and *amicus curiae* in *Shrimp/Turtle*) and where country positions have been shaped. In addition, country positions are not only influenced by past experience but also by expectations with regard to looming disputes. For instance, the EC will have been aware during the entire review exercise of a potential challenge to its GMO regime. Indeed, a panel has now been established.
- A second element of this context consists of specific procedural disagreements which, at the same time, are the subject both of on-going disputes and of negotiations on the DSU. For instance, the EC tried to settle the sequencing dispute by making it the subject of specific complaints in *US – Certain EC products* and *US – Section 301*. Similarly, a consultation request in *US – Section 306* on carousel retaliation is still pending. Each time such a dispute is under consideration and the outcome is unclear, no party has an interest in prejudicing its position through a prior agreement on the issue during DSU review negotiations.
- Finally, the third layer of this context consists of on-going negotiations on material WTO law. The extent to which new disciplines such as the Singapore issues (e.g. investment, competition) could be subject to dispute settlement rules has a direct impact on Members' approach to the DSU. This logic also holds for the re-negotiation of existing agreements. For instance, there is a clear link between the current Doha Round negotiations on WTO Rules (such as anti-dumping and countervailing measures) and the on-going US debate on the "standards of review" applied by the adjudicative bodies. It will clearly be more difficult for the US to agree on new rules on

trade remedies in a setting where the adjudicative bodies act independently than if they operate under close control of Members.

Add to these considerations a dynamic aspect: this entire context is not static, but it evolves with each new (or merely expected) development that threatens to modify positions taken on the DSU review, thereby making negotiations even more difficult.

#### **What Can We Expect from Negotiations Until the New May 2004 Deadline?**

The foregoing analysis may help us to evaluate the context under which the review will take place during the following months as the new May 2004 deadline comes closer.

As far as potential outcomes are concerned, fundamental changes to the system must not be expected. Each of the more far-reaching proposals with implications on the fundamental orientation of the DSU (rule versus power-orientation) will not be acceptable to a substantial number of Members. Therefore, a package of mainly technical modifications seems to be feasible at best. Such a package, however, may not enjoy sufficient support from the large players (notably the EC and the US) as it will do little to satisfy their ambitions and improve their situation.

Although the EC and the US are not the only participants in the negotiations, much will depend on the evolution in (and between) Brussels and Washington. Figures available today suggest that the US will continue to be in a defensive position, because (as of 22 July 2003) it was the complainant in only 10 active cases, as opposed to 21 active cases where it was the defendant. Of the latter, all but two concern trade remedies.<sup>2</sup> More adverse rulings will therefore likely spur the criticism of Congress and prevent US negotiators from consenting to any package that would not increase political control. Interests could change, however, if the US prevailed in the new transatlantic trade dispute on Genetically Modified Organisms (GMOs). Rulings in the GMO case could finally set the stage for a comprehensive settlement of all outstanding transatlantic trade disputes within a package. So far, the EU has consistently refused any package deal, probably because not all issues were on the table. If accounts could finally be settled, pressure from DSU negotiations could be lifted and a mini-package might become feasible. However, settling the many cases involving the US would not only have to involve the

<sup>2</sup> USTR: Snapshot of WTO Cases Involving the United States, updated 22 July 2003; <http://www.ustr.gov/enforcement/snapshot.pdf>.

EC but many other important WTO Members such as Japan, China, India or Brazil.

As this is a tremendous task, it is unlikely that the new May 2004 deadline for the DSU negotiations will be met – particularly now that the failure of the Cancún Ministerial has caused a severe setback to the Doha Round negotiations in general.

A lack of progress on the DSU review does not, however, need to impair the functioning of the DSU. First of all, negotiators have missed several deadlines so far, and the DSU is still functioning relatively well. Secondly, provisional solutions have been found for most practical problems in DSU practice: For instance, countries make bilateral agreements on sequencing that bridge the gaps of Articles 21.5/22. With regard to the *amicus* issue, the Appellate Body has developed its own methodology which grants a lot of discretion. It is using this discretion wisely, displaying a general openness towards accepting *amicus* briefs while at the same time not giving them decisive weight in its decisions, at least not explicitly. And as some observers privately argue, the increasing judicial restraint which the Appellate Body exercises in trade remedy cases helps to appease growing US concerns with

regard to an alleged anti-US bias of the system. These are just three examples which show that the system has displayed enough flexibility to deal with new issues as they arise.

Whereas the timely completion of the DSU review is therefore less urgent, the improvement of the *political* decision-making mechanism will be crucial. Adjudicative bodies are currently forced to issue rulings even on provisions that have been left deliberately vague as negotiators were unable to agree on clear treaty text. Interpreting these vague provisions in a legal adjudication procedure inevitably creates political tensions. These, however, are difficult to correct as the political decision-making mechanism in the WTO is very weak. This imbalance between the inefficient political decision-making mechanism and the efficient adjudication mechanism causes problems for the long-term sustainability of the WTO. Whereas the US proposal seeks to remedy the imbalance by introducing more political elements into the dispute settlement procedure, legal scholars strongly advocate an improvement of political decision-making. Changing the traditionally consensus-based decision-making in the WTO, however, is yet a much more formidable task than the relatively limited DSU review.

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## How Relevant is the Failure of Cancún for World Agriculture?

The Cancún Conference ended without the desired outcome. The WTO member countries were unable to agree on the main elements of policy changes and their phasing in. However, surprisingly, the failure of the meeting was not due to dissonance over agricultural trade issues, but over the main Singapore issues (trade and investment, trade and competition policy, transparency in government procurement, trade facilitation). WTO members had not yet agreed on new rules for agricultural trade, but a consensus seemed possible. The extent to which progress on agriculture had been made remained partly hidden because the Ministerial Conference was terminated before a final negotiation round on agriculture could take place. The

reactions to the failure are mixed and range from disappointment to cautious optimism.

Of course, the assessment depends very much on the reference system. If one expected the meeting to result in an agreement far beyond what has been achieved so far, disappointment is indeed a justified reaction. However, if one compares the results with the situation in agricultural trade policy about 10 years ago, the present state of agricultural trade negotiations deserves to be viewed with cautious optimism. The latter point of view does not neglect the manifold dangers that still might compromise a successful outcome of the Doha Round (presidential elections in the USA, increased regionalism, etc.) There is still a long way to go before an agreement might finally be reached. However, considering the Ministerial Conference as a barometer for the willingness of individual parties to give and take in the process of the negotia-

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**Table 1**  
**EU Share in World Exports for Selected**  
**Agricultural Products**  
 (in %)

	1990/1992	1995/1997	1999/2001
Wheat and wheat flour	19.1	12.7	12.3
Sugar	16.8	13.9	14.3
Butter	22.4	15.5	13.0
Cheese	19.7	17.2	13.1
Poultry meat	16.0	13.9	12.4
Beef and veal	19.2	9.1	2.6

Source: FAO Trade Statistics, <http://apps.fao.org>.

tions lends support to a more optimistic judgement, at least as far as agriculture is concerned.

### **Why is Agricultural Trade So High on the International Agenda?**

Economists are convinced that the liberalisation of trade and also of agricultural trade will under most conditions improve the well-being of the population. This conclusion also holds for unilateral liberalisation. Hence, individual countries would be better off if they were to open their borders. Strangely enough, world agricultural trade is in disarray. Most countries intervene in agricultural markets, and thus distort trade in agricultural products. Far from being prepared to open up their borders unilaterally, countries follow a give-and-take strategy. They are only willing to reduce domestic protection if other countries do the same. Of course, multilateral liberalisation tends to generate higher welfare effects than unilateral liberalisation, but welfare generation does not seem to be the main concern of policy-makers. Why is it so difficult to remove the distortions in world agricultural trade?

Agricultural trade was not on the international trade policy agenda up to the Uruguay Round. Up to that point national agricultural policies were focused on solving domestic problems without taking international repercussions into account. Budgetary effects were the main driving force behind changes in domestic agricultural policies. The welfare effects of policy changes never received much attention as these effects were not visible (and apart from the profession of economists there was hardly any pressure group to demand the corresponding changes). Hence, the agricultural policy in most countries was just a reflection of the situation on the domestic political market, which is determined by the influence of interest groups and the willingness of policy-makers to respond to them.

Much has changed since 1986 when the Uruguay Round was initiated and focused on agricultural trade. However, the significant changes in agricultural

policies worldwide are not due to the outcome of the final agreement in 1995 but have also been affected by changes in national policies in the forefront of the agreement. E.g., there was hardly any policy-maker (or economist) who had expected in 1990 that the Council of Agricultural Ministers of the EU would agree on a 30 per cent reduction in intervention prices for grain in 1992. This decision was only possible in the context of the then ongoing GATT negotiations.

The environment for agricultural trade has continued to change significantly since 1995, the signing of the GATT/WTO agreement. Agricultural policies have become significantly constrained by international trade rules and less by budgetary pressure. The changes in the Common Agricultural Policy (CAP) over the last decade support this view. Budgetary costs have gone up by more than 40 per cent from 1990 to 2002. Obviously, the budget was not the main constraint in policy reforms. The last Uruguay Round has been initiating a significant change in the choice and implementation of policy instruments; market price support has declined, and direct payments have increased. The result is less distortion in consumption, production and trade. The EU's share in world trade has significantly declined over the past years (see Table 1), followed by reduced export subsidies. Moreover, the EU has acknowledged the interest of developing countries in world agricultural trade by signing an agreement which allows the 49 least developed countries free imports of agricultural products to the EU markets.

No doubt, these are positive developments. On the other hand, the Uruguay Round has left some important issues unresolved, in particular in the area of market access and the structure of domestic support. Actually, the Uruguay Round had ended with a commitment to open a new trade round around the turn of the century. The agenda for the negotiations was set at the Doha Meeting in Qatar. The name of the agenda "Doha Development Agenda" indicates that the focus of the Round was to be on development. As agriculture is highly related to economic progress in developing countries, agricultural trade was perceived as a key issue in the negotiations.

The failure of the Cancún meeting lowers expectations of an agreement. Nevertheless, this Round will positively affect world trade, even if no agreement is met. This cautious optimism is founded on recent policy changes in some countries, such as the EU, by the increased concern for developing countries' interests, and by the concern with non-economic matters. The changes on the international political market are partly in favour, partly against, further liberalisation.



The changes in the market for protectionism push more in the former direction. The new constellation of negotiating power in the WTO (as evidenced by the formation of the G20+, and the African initiative on cotton subsidies) might endanger further success, in particular if the established players in the international trade negotiations fail to adjust to these shifts. Furthermore, in the USA, the presidential elections might put agriculture trade liberalisation very low on the agenda for the coming months.

### Recent Policy Changes in the EU

Most important for the world trading system in many agricultural products is the CAP. It was to liberalise the CAP significantly in June 2003. The decision was made in expectation of the need to change the policy as a consequence of the Doha Round. The most important forthcoming policy changes include a significant reduction in farm gate milk prices (by about 25 per cent), and a significant decoupling of direct payments. These changes are part of the present legislation and will not be altered even if the Doha Round were to end without an agreement. Moreover, the EU has submitted a proposal to the WTO which implies further liberalisation steps. Agriculture Commissioner Fischler stated in the meeting, "Whatever happens to the Doha Development Agenda, one thing I can promise: for us, there is no way back. Europe will continue the path of agriculture reform we have embarked upon. We will continue to change our farm policy to make it more competitive, trade-friendly and more in tune with the interests of poor countries, European farmers and citizens".

This statement gives reason to hope for less disarray in world agricultural trade. Indeed, it seems fairly likely that this round will end with an accord in some of the main agricultural issues. The EU and the USA tried to provide an impetus to the Cancún meeting by means of a joint proposal. While this type of settlement of the main differences had proved to be sufficient for the breakthrough in the last round (Blair House Agreement), it did not lead to an agreement at Cancún. Both the EU and the USA have positively reacted to the final proposal submitted by the Mexican host, although the developing countries, as well as the "friends of multifunctionality", were not agreeable. This reflects a shift in the balance of negotiation power. Although formally the WTO decides by unanimity, thus giving all members equal nominal decision-making power, the previous experience with agriculture was different, as shown by the Blair House Agreement. If the "elephants" (EU and USA) are able to adapt to the new circumstances, this will not necessarily endanger the

accomplishment of a final agreement. In that case, one can nevertheless expect that a final agreement will most likely not lead to less trade liberalisation than a Cancún accord on the lines of the last draft proposal on agriculture had achieved.

The Doha Ministerial Declaration called for "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". The last draft proposal at Cancún addressed the following issues: domestic support, market access, export competition, and exemptions for least developed countries. It will be investigated in the following first, whether the proposal in these fields would have contributed to a reduction of the "distortions in world agricultural markets", and second, whether a modification of the proposal along the lines of opponents would lead to huge amounts of world welfare foregone.

### Domestic Support

The industrialised countries, in particular the EU and the USA (in the area of cotton), were reluctant to accept the demand by developing countries to *decouple domestic support* completely and to *lower it significantly*. The EU seems to have problems with this demand as domestic support has increased in recent years in order to compensate for reduced price support. However, the EU is willing to accept a reduction in domestic support as expressed in the June 2003 decisions of the Council. More important, the Commission had proposed the decoupling of the whole amount of direct payments in January 2003, but the Council had decided to allow some linkage to production or use of factors. This concession was given to avoid a failure of the reform. Nevertheless, taking into account the last proposal of the Commission and the positive view of some member countries it is not unlikely that the EU might be willing to accommodate the demand of the trading partners, with significant effects on the world trading system. Take the case of the EU grain sector. Currently, wheat production might be profitable on EU locations with low quality soil because the payments are linked to the use of land. If the payment were totally decoupled the regional production pattern and the intensity of production would change. Less wheat would be produced and land use would shift towards low intensity livestock production. Hence, the pattern of agricultural production would change significantly and would be more in line with comparative advantage.

It is questionable whether industrialised countries, in particular the EU, are prepared to limit direct payments to no more than 5 per cent of the value of production in a short period of time as demanded by developing countries. It should be acknowledged that these payments have been introduced over the last decade in order to compensate for the huge reduction in price support. If the direct payments are decoupled and degressive over time the production effect is likely to be small, and occasionally even negative. If e.g. inefficient grain farmers have to leave the sector due to reduced payments, more efficient farmers may take over the land and use it more efficiently. Hence, developing countries would be well advised to push more strongly for decoupling than for the reduction of direct payments in the area of domestic support. It is fairly likely that an agreement could be found along this line. This would become even more likely if the USA<sup>1</sup> showed more flexibility on the Cotton initiative, which has received a lot of attention from the public. With this initiative, four West African countries call "for phasing out support for cotton production with a view to its total elimination", thus leading to "substantial and accelerated reductions in each of the boxes of support for cotton production". The last draft proposal largely neglected this initiative by calling for an integrated approach to the cotton sector. Some flexibility on the part of the USA (and, to a lesser extent, of China and the EU) might pave the way for an agreement that came close to reaching the proclaimed goals of the Doha Development Agenda.

#### Market Access

The main elements of market access are:

- the average rate of tariffs
- the existence of tariff peaks
- tariff escalation
- the existence of import quotas.

The final document in Cancun asked for significant changes in all four aspects. It can be assumed that a forthcoming agreement will be along the same lines.

The final proposal would not have healed the main problems of the Uruguay agreement. The main problems were, first, significant water in the bound rates (actual tariff rates to secure actual domestic market prices were much higher than needed to support prevailing domestic market prices): "In the United States it is estimated that the current tariff imposed on imports of raw sugar needs to be cut by more than 38 per cent

before trade into this market is likely to become profitable. In Japan, the cut to the existing bound tariff on raw sugar would need to be greater than 68 per cent before additional trade became profitable" and in the EU the figure would be 24 per cent.<sup>2</sup> The final proposal did take care of tariff peaks, but also included a yet unspecified cut in the average tariff rate. However, the average rate does not mean much if there is significant water in the tariffs.

Second, tariff rates across products vary significantly (the most highly protected market in the EU is the sugar market), and there is significant tariff escalation, i.e. the tariff rate for processed products is higher than for the equivalent raw products. Hence, it is misleading to base any judgement on the average rate only. Tariff escalation implies a trade bias against developing countries. The magnitude of tariff escalation is quite substantial for some products. The EU has a bound tariff rate of zero for oilseeds but 13 per cent for vegetable oils, 30 per cent for live animals but 43 per cent for prepared meat, and 14 per cent for raw tobacco but 38 per cent for tobacco products. The evidence for the USA is similar. Tariff escalation allows a high effective protection for the processing industry in developed countries, but impedes industrialisation in developing countries. It is understandable that the developing countries pushed for wiping out tariff escalation. The last WTO draft proposal had foreseen cutting the tariff rates of processed products progressively when the tariff is higher than the tariff rate of the product in its primary form. Moreover, it was proposed cutting above-average tariff rates by a higher percentage. If these elements had been part of a new agreement, world trade in agricultural products would have received a stimulus, in particular exports from developing countries.

#### Export Competition

The final proposal foresaw abolishing export subsidies for a yet unspecified number of products completely and reducing them for the remaining products with a view to phasing them out. As the products were not grouped there was ample margin for negotiations. The EU as the by far largest user of export subsidies made clear that it expected to be pushed in this direction.

The abolishment of export subsidies would certainly increase transparency in international trade and would make discretionary bureaucratic decisions less powerful. However, it is not certain that a world with only

<sup>1</sup> In 1999, the USA spent US \$ 2.3 billion on red box, i.e. trade-distorting, support to its cotton sector.

<sup>2</sup> ABARE, <http://www.abare.gov.au/research/tradereform/tradereform.htm>

protection for importables and no protection for exportables would be better off. World trade is distorted by both measures. If a country is not allowed to use export subsidies but only tariffs as border measures, then the domestic production pattern will exhibit a "home market bias".

Anyway, the EU seems prepared to accept further constraints on using export subsidies and has already taken actions in this direction. The implementation of the last CAP reform will reduce the amount of export subsidies.

### Conclusion

The Cancùn meeting was supposed to set the modalities for the Doha Round. This was an ambitious undertaking, which the negotiations failed to achieve. However, this so-called failure does not come entirely as a surprise. The ongoing trade round has a focus on developing countries. The number of these countries has increased significantly over time. One hundred member countries of the 146 WTO members have claimed to be developing countries. Moreover, these countries are much better organised than in past trade

rounds. Hence, the conflict between industrialised and developing countries was much more visible in this round. Developing countries had high demands for dismantling the protectionism of agriculture in industrialised countries. No wonder, that industrialised countries were not yet prepared to move as much as requested. However, some of these countries, in particular the EU, have undertaken domestic policy reforms in line with the expected outcome of the Doha Round. These countries have recognised that their agricultural policies have to be changed and they have shown their willingness to policy reform, albeit not to such a degree as requested by developing countries. This change in attitude can be considered a success. Of course, this is an ongoing process. Significant steps towards liberalising agricultural trade had been made with the Uruguay Round and in preparation of the Doha Round. This process is partly an expression of the changes in the attitudes of policy-makers and the public in industrialised countries. This engine will continue to work. It is most likely that in spite of the so-called "failure" of the Cancùn Ministerial Conference the WTO negotiations will induce a significant step forward in agricultural trade liberalisation.

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Stephen Woolcock\*

## The Singapore Issues in Cancùn: A Failed Negotiation Ploy or a Litmus Test for Global Governance?

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The "Singapore issues" in the debate on the agenda of the Doha Development Agenda of the World Trade Organisation are investment, competition, transparency in government procurement and trade facilitation. More accurately the issue is what role the WTO should play in each of these policy areas. A number of developed countries, above all the European Union, have argued that these issues should be on the WTO agenda. Developing countries have been either reticent or downright opposed to including these issues. They are referred to as the Singapore issues because it was at the WTO Ministerial Meeting in Singapore in 1996 that agreement was reached to study the issues in WTO. After five years of discussions there was still no consensus on the inclusion of these issues when the Doha Development Agenda (DDA) was launched in November 2001. The decision on whether to include

the issues in the DDA was postponed until the Cancùn WTO Ministerial in September 2003. It was also agreed that a decision on "the modalities" of negotiations on these issues would be taken by an "explicit consensus". This meant that any of the 144 WTO members could veto their inclusion. Whilst the WTO normally takes decisions by consensus, this is normally taken to be the case when no WTO member explicitly opposes a decision.

It was ostensibly differences over the inclusion of the Singapore issues in the DDA that resulted in the collapse of the WTO Ministerial meeting in Cancùn. As negotiations moved into their final stage on Sunday, September 7, three crucial issues needed to be resolved if the "round" was to progress and have a chance of meeting the scheduled completion date of January 2005. These three issues were: agriculture (e.g. the scale of reductions in domestic support, export subsidies and tariffs), market access for goods

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(e.g. tariffs) and whether the four Singapore issues should be included. These three topics were discussed in the so-called "green room" process of the WTO, where a group of leading countries representing all the key interests meet to thrash out agreements. In these discussions the Singapore issues were placed first on the agenda. In the face of opposition to inclusion of the issues the EU negotiators dropped their insistence that all four issues should be treated together. In other words, the European Commission agreed to drop or de-link investment and competition, in the hope that agreement could be reached on the less controversial issues of transparency in government procurement and trade facilitation. But Japan and South Korea, who had long supported the EU position, were not prepared to make the same concession and the developing country members present vetoed any inclusion of the Singapore Issues. The tough posture adopted by the developing countries came as a bit of a surprise to the EU, but followed the bolstering of developing country positions by the successful creation of the Group of 20 plus, a coalition of developing countries at the Cancún Ministerial. Faced with this deadlock the Mexican chairman brought the negotiations to a close before the final negotiations on agriculture and market access had even started.

What was the cause of this failure? Was it a failed negotiating tactic on the part of the EU? It has been argued that the EU sought to add the Singapore issues to the DDA in order to slow progress and thus delay the day when further reforms of the Common Agricultural Policy would be required. It could also be argued that the EU's tactics were poor and that it should have de-linked the issues sooner. On the other hand it may be argued that in rejecting the EU's compromise proposal the developing countries showed a lack of sophistication and flexibility. Should these countries not have made concessions on the Singapore issues in order to get more of what they wanted on agriculture and market access for goods? After all many developing countries were seeking reductions in the agricultural support programmes of the EU and US, which may not now happen. Or was the failure due to the inherent difficulties negotiating on complex issues with 144 parties when decision-making is by consensus?

Aside from the problems of tactics and process, there are also inherent tensions concerning the scope of the WTO that may have made the collapse on talks inevitable. These tensions have been present in the trading system since the 1960s, but have become more acute since the end of the Uruguay Round (1986-94). These tensions concern whether the WTO should address new potential barriers to market

access, even if this means intruding further into national policy autonomy. Or should the WTO remain essentially a trade organisation that leaves scope for national policy options? The lines of confrontation on the scope of the WTO agenda are by no means purely North-South, with the North more ready to see the addition of new issues and the South opposing new rules. There are, for example, powerful interests in the North, in the shape of a range of non-governmental organisations, which see an increase in scope of WTO rules as an unacceptable extension of globalisation. Such tensions have been present in every discussion of the Singapore issues between the 1996 WTO Ministerial and the 2003 Cancún Ministerial. Tactical errors or difficulties in the negotiating process may have determined the nature and timing of the collapse of talks, but disagreements over the role of the WTO in regulating international markets in these areas were arguably the main cause.

### **The Thin End of the Wedge?**

Does the inclusion of the Singapore issues<sup>1</sup> on the DDA represent a modest step towards global governance or the thin end of the wedge for continued domination of the WTO by "Northern business interests"? Are the Singapore issues a major threat to the policy autonomy of developing countries? Will they cost a great deal to implement? The following discussion of the issues will show that the substantive commitments involved in all the Singapore issues are modest. They would not sweep away national policy autonomy or "policy space" for developing countries. Whilst there would be modest gains for international business, thanks to more transparent and predictable conditions for trade and investment, consumers in all countries including developing countries would also gain. In the area of competition, there would also be the prospect of gaining more effective control over international restrictive business practices. Preparatory work in the WTO had made all parties aware of the potential costs of compliance. As a result the focus of the debate has been on how to promote wider implementation of good regulatory practices, rather than imposing a "one size fits all" approach. Developing countries can, however, be forgiven for arguing that they have heard all this before and that previous experience suggests that once an issue is on the GATT/WTO agenda there is pressure for them to accept more binding obligations.

<sup>1</sup> For a recent discussion of the four Singapore issues see The Federal Trust: Expanding World Trade Rules? Should there be rules on competition, investment, trade facilitation and government procurement?, 2003; [www.fedtrust.com](http://www.fedtrust.com).

### Investment

At the end of the Uruguay Round in 1994 it was assumed by leading policy-makers that "investment (could) provide the next great boost to the world economy following the powerful impulse given by the removal of trade barriers during the Uruguay Round".<sup>2</sup> The United States had pressed for stronger rules on investment since the early 1980s. Whilst progress was made in the OECD, there was less success in the GATT, where opposition from developing countries resulted in only modest results in the shape of bans on six main performance requirements on foreign direct investment. The US had more success in NAFTA where it had extended the CUSFTA provisions to establish high standards of investment protection including "regulatory taking" provisions when regulation denies investors the expected benefits. Other NAFTA provisions banned a range of performance requirements, established a top-down, negative list approach to liberalisation of investment, and set up investor-state dispute settlement.<sup>3</sup>

When it came to the post Uruguay Round debate the US interests favoured plurilateral negotiations on investment within the framework of the OECD in order to extend the high standards achieved in NAFTA to more countries. The EU on the other hand favoured multilateral negotiations in the WTO, arguing that most barriers to investment were in developing countries and that the developing country negotiators would not simply sign up to a multilateral investment agreement negotiated in the OECD. A two-track approach was therefore adopted. Negotiations on the Multilateral Investment Agreement (MAI) began in the OECD in May 1995 and investment was proposed as an agenda item for the WTO. Given the opposition to investment in the WTO, the WTO forum was always likely to produce an agreement of "lower standards".<sup>4</sup> Nevertheless, a Working Group on Trade and Investment was established in the WTO.

In 1997 the MAI negotiations stalled and finally collapsed in 1998, with a coalition of non-governmental organisations, including development and environment NGOs and trade unions, claiming victory. The US government therefore saw little point in pressing the issue at the WTO Ministerial in Seattle in November 1999, since WTO rules would always be second best to what the US had achieved in NAFTA and could demand in bilateral investment agreements (BITs). The

<sup>2</sup> See Sir Leon Brittan: "Smoothing the Path for Investment Worldwide", speech in Washington, January 1995.

<sup>3</sup> See Stephen Woolcock: Investment in the World Trade Organisation, in: Klaus Deutsch (ed.): The European Union in the Millenium Round, Cambridge University Press, 2001.

EU, however, continued to argue for general principles on investment to be included in the WTO as part of its comprehensive package for the WTO. In this effort the EU was joined by Japan and South Korea, which supported a joint paper with the EU on the issue in the run up to Seattle.

At the Doha Ministerial of the WTO the EU, with some lukewarm support from the US again tried to get investment on the agenda along with competition, government procurement and trade facilitation. It was clear that if investment provisions were to be included they would have to take account of developing country interests. This was reflected in the Doha declaration on the topic:

"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. Due regard should be paid to other relevant WTO provisions. Account should be taken, as appropriate, of existing bilateral and regional arrangements on investment."<sup>5</sup>

The wording of the Doha text clearly limits the scope of WTO coverage of investment. For example, reference to the right to regulate in the public interest clearly indicates that provisions on "regulatory takings" similar to those in NAFTA, would not be on the agenda. The reference to commitments commensurate with the needs of developing countries clearly points to a "GATS type" positive listing of coverage, rather than the more far-reaching negative listing. It was also very clear from the discussions within the Working Party on Investment, that there would be no scope for investor-state dispute settlement. In short, at issue was not a MAI-type agreement but something much more limited.

### Competition

Like investment, competition is not a new issue in GATT/WTO. Indeed, the International Trade Organisation (ITO) negotiated in Havana in 1948, included provisions on restrictive business practices. At that

<sup>4</sup> Due to opposition from India and Brazil the investment provisions in the Uruguay Round were modest and took the form of Trade Related Investment Measures or TRIMs. Investment was, however, included in the GATS agreement.

<sup>5</sup> Doha Ministerial Declaration, World Trade Organisation, WT/MIN(01)/DEC/1.

time memories of the damaging effects of international cartels during the 1930s was still fresh. Following the failure of the ITO, competition did not figure in the GATT, in part because most governments were keen to promote concentration of national champions in order to enhance competitiveness. With the growth of global production there has been an increased debate on the need for international agreements on competition. Globalisation means that markets are global but competition authorities are still largely limited by national (or regional in the case of the EU) jurisdictions.

As with the coverage of investment in the TRIMs and GATS agreements, elements of competition policy have also found their way into existing WTO rules. In particular the 1997 sector agreements on basic telecommunications and financial services under the GATS contain important elements of competition. There have also been significant developments at the regional and bilateral levels. The EU represents by far the most developed form of regional competition regime. This was built on the view that European-wide competition rules were needed if private restraints on trade were not to replace public restraints on trade with the creation of the common/single market. The EU's promotion of competition policy within the WTO clearly represents an attempt to apply this logic to global markets. Other regional agreements include putative competition regimes, such as COMESA and Caricom, which are modelled on the EU approach but at a very early stage of development. The EU and the US have concluded bilateral agreements on competition/anti-trust, both with each other and with third countries. Competition rules have also been developed within the OECD. The UNCTAD Set of Mutually Agreed Equitable Principles and Rules for Control of Restrictive Business Practices (The Set) also represents an ongoing effort to promote coherent competition policies in developing countries.<sup>6</sup> Somewhat analogous to the case of investment, the US has favoured bilateral cooperation in the field of competition policy, with the US Department of Justice arguing that multilateral agreements would be so general as to not offer much value and that bilateral cooperation can effectively address any major anti-trust issues.

As with investment, early grand ideas, such as proposals for a global competition authority, have not survived the dialogue within the WTO's Working Group on Trade and Competition Policy (WGTC) established in Singapore in 1996. Indeed, discussion within this group made considerable progress towards a far greater understanding of the issues involved in establishing international cooperation in competition policy and the proponents of competition within the

WTO (i.e. the EU) have trimmed their ambitions. The work of the WGTC focused on what core principles should be included in any agreement, how to deal with so-called hard-core cartels, "modalities for cooperation" (between national competition authorities) and "support for the progressive reinforcement of competition institutions in developing countries." These central issues were also reflected in the text of the Doha declaration that covered competition.<sup>7</sup>

Although the likely provisions in any WTO agreement are modest they would still require resources from developing countries. Governments in developing countries might argue that establishing national competition authorities and policies is low on their list of priorities. Having said this, there is a growing number of developing countries that have recently introduced competition policies.

In terms of core principles the debate in the WTO has focused on standard WTO types of principles such as transparency and non-discrimination. Transparency provisions on competition involve national governments publishing national laws on competition (*de jure* transparency). Although this would clearly involve some costs, many WTO members that currently have competition laws already provide such information. There are also a number of inventories of competition law and procedures already in existence. Transparency with regard to how competition laws are implemented (*de facto* transparency), such as the decisions of competition authorities and/or courts of law, is much more resource-intensive. Although decisions implementing rules set precedents and therefore form an integral part of national competition laws, their inclusion would mean significant compliance costs. Even if the number of cases in developing countries would not be very large, the consensus in the WGTC was that transparency provisions would have to be limited to *de jure* rules.

The same distinction applies to the core principle of non-discrimination. If applied *de jure*, meaning that national competition legislation and implementing provisions could not discriminate between the country of origin of a company, the compliance costs are not great. There would, however, be limitations on the policy choices since national legislation would not be able to grant any preference for national companies. The real issue in terms of non-discrimination, however, arises in the application of competition rules (*de facto*

<sup>6</sup> See Experience gained so far on international cooperation on competition policies issues and the mechanisms used, Report for the UNCTAD Secretariat, UNCTAD TD/B/COM.2/CLP/21/Rev1 12.

<sup>7</sup> See for example WTO Report of the Working Group on the Interaction Between Trade and Competition Policy to the General Council, WT/WGTC/6 2002.

non-discrimination). For example, WTO provisions requiring non-discrimination in the application of competition law would mean there would have to be some way of showing that decisions of national competition authorities did not favour national producers. As most competition cases are unique, an effective regime to ensure compliance with *de facto* non-discrimination would require extensive and costly procedural safeguards. This would increase the cost of compliance and as a result was more or less discounted in the discussions in the WPTCP.

One area where the WPTCP brought forward proposals for concrete commitments was that of hard-core cartels. International cartels exist. A large number of international cartels have come to light as a result of work by established national competition authorities,<sup>8</sup> and others are probably still to come to light. Nor are they due to a coincidental convergence of interest on the part of the producers organised over business breakfasts (*Fruehstueckskartelle*), but are intentional and professionally run. Cost estimates of such restrictive business practices are not without their difficulties. The OECD work suggests that the median mark-up in terms of prices is about 10%, with mark-ups ranging from 5% to 65%. The costs may also fall disproportionately on developing countries, with one estimate showing that between 6 and 7% of all developing country imports could be affected by international cartels, with price mark-ups in a range between a few per cent and 50%.<sup>9</sup>

If developing countries have an interest in controlling such restrictive business practices they also have an interest in gaining access to information from the competition authorities of the OECD countries. The developing countries with competition regimes therefore favour provisions on cooperation. But should there be WTO provisions requiring cooperation?

Another issue in competition has been how to deal with countries at different levels of development. Here the WGTCP made significant progress towards identifying the process by which developing countries that wish to introduce competition policies could be supported in this exercise. The idea of a "one size fits all" approach to competition was never on the agenda. Indeed, the approach emerging from the discussions in the WGTCP was not very different from that pursued by the UNCTAD "Set" for the past twenty years.

#### Transparency in Government Procurement

Unlike investment and competition, the GATT 1947 had a specific exclusion for government procurement

<sup>8</sup> See OECD: Draft Report on the nature and impact of hard-core cartels and the sanctions under national competition laws, Paper for the Global Competition Forum, 2001 CCNM/GF/COMP(2001)3, October 2, 2001.

from GATT disciplines. This was partially corrected in the Tokyo Round of the GATT when a number of, but not all, OECD countries signed a plurilateral agreement. The Uruguay Round efforts to get all WTO members to sign up to the strengthened agreement negotiated essentially between the United States and the EU failed. So the 1994 Government Procurement Agreement (GPA) remained a plurilateral or qualified MFN agreement, despite the general requirement for all WTO members to sign a single undertaking.

As with other Singapore issues, procurement has figured in many of the recent regional trade agreements, especially those involving one of the main signatories to the 1994 GPA, i.e. the US and the EU. As a result the number of signatories to the GPA seems likely to grow steadily.

Government purchasing is an important part of all economies, reaching 10% of GDP in the developed economies and possibly more in some developing economies. Although it is seen as an important instrument of national policy, lack of transparency and competition in the award of contracts can result in inefficient allocation of resources. Transparency measures therefore help to reduce corruption and improve efficiency.

"Liberalisation" of government procurement is not as clear-cut as a tariff reduction or even the inclusion of a service activity in the GATS schedules. Although some countries retain *de jure* discrimination in favour of national suppliers, such as a specified price preference for national suppliers, government procurement markets generally remain closed for a range of much less obvious reasons. Thus while the 1994 GPA requires *de jure* non-discrimination it also includes elaborate measures to ensure that contracts are notified, processed and awarded in a transparent fashion designed to enable foreign competitors to bid. These procedures include provisions for both domestic reviews of contract award decisions by independent authorities and the ability of foreign suppliers to challenge the award of a contract they believe has been awarded unfairly. The 1994 GPA is also based on reciprocity in the sense that signatories have sought to ensure that commitments made will result in reciprocal opening of national government procurement markets.

The WTO Working Group on Transparency in Government Procurement (WGTGP) soon identified reluctance on the part of many WTO members to make commitments on non-discrimination and on enhanced

<sup>9</sup> M. Levenstein: Private cartels and their effects on developing countries, Background Report for the World Development Report 2001.

market access. The Doha declaration made clear that discussions on government procurement in the run-up to Cancún would be limited to transparency. There would be no commitment to non-discrimination or market opening. In other words WTO members would still be able to favour local suppliers. They would just have to be transparent about it. This compromise resulted in a rather unique position of trying to negotiate transparency provisions in the absence of any market opening obligations, and led to much confusion during the discussions between 2001 and Cancún.

A number of issues caused difficulties. First of all there was the question of the scope of any possible agreement on transparency in government procurement. Should such an agreement cover only central government, or should state/provincial and local government (which accounts for nearly 60% of government purchasing) also be included? Then there was the question of whether goods and services should be included. The proponents of a WTO agreement (i.e. the EU, the US and other countries) argued that transparency should apply to all purchasing since its aim was to promote best practice and thus the most economic use of public funds. Developing countries led by India and Brazil argued that only purchasing of goods by central government should be covered. Developing countries also argued that thresholds should be set fairly high so that many contracts would fall outside the scope of the agreement and thus reduce the costs of compliance.

Another issue that created tensions was whether all WTO members should be obliged to provide review procedures under national law for aggrieved parties that believe a contract award procedure has not been transparent. The proponents of WTO rules on transparency in government procurement argued that there should be such review procedures, because only such provisions could ensure that the required national procedures were respected. Some leading developing countries argued that review provisions constituted a form of compliance mechanism, which in turn implied that the provisions on transparency would be used to open up markets. As the agreement at Doha had made clear that the negotiations were not about market opening, these developing countries argued there was no need for review provisions.

Another important difference of view in the WGTGP was over the application of WTO dispute settlement provisions. The proponents of WTO rules on transparency argued that all WTO rules should be subject to the common WTO dispute settlement provisions. These proponents also felt that it would set a bad precedent to exclude some parts of the WTO system

from dispute settlement. It could also be argued that without the provision for ultimate recourse to dispute settlement, WTO members could simply ignore the rules. As with the issue of review provisions, some leading developing countries argued that dispute settlement was not needed because the negotiations were not about trade/market access.

### **Trade Facilitation**

Trade facilitation can be broadly defined as any measure that helps speed up the passage of goods through ports. As customs duties and other barriers to trade have come down, the relative importance of delays and other costs associated with customs clearance has increased. In some cases such costs may be more important for exporters than tariff barriers. Hence the interest in trade facilitation as tariffs are reduced.

Unlike investment, competition and transparency in government procurement, no special working group was established for trade facilitation. Work on this topic has been done in the WTO Committee on Trade in Goods (CTG). Broadly speaking the aim of the proponents, which are again predominantly the developed countries, has been to develop a framework of WTO commitments to simplify and harmonise trade procedures. They claim that there are excessive documentation requirements, a general lack of automation, a lack of transparency and thus predictability in customs clearing procedures, and a lack of audit-based controls and risk assessment techniques. The aim of the latter two methods is to reduce the need to stop and check every consignment without undermining the ability of authorities to regulate and collect customs duties.

In pursuit of these goals it has been suggested that what is needed is (i) the harmonisation and simplification of trade and transport documents and data, drawing on international standards, and relying on commercial information; (ii) the progressive introduction of modern customs techniques designed to strengthen compliance and control while speeding release of legitimate goods; (iii) progressive automation and electronic data interchange (EDI) at the level of customs and other agencies to replace paper procedures for export and import; (iv) development of measures to facilitate convergence of official controls on border crossing goods; (v) capacity building to strengthen human and physical infrastructure and improve import/export management; (vi) consideration of scope for provision to ensure smooth conduct of banking and payment transactions. Although trade facilitation sounds fairly arcane and innocuous the im-



plementation of these sorts of measures would entail considerable costs for many WTO members.

Rather than develop new agreements the work in the CTG focused on how existing GATT provisions might be improved to promote these aims. The main GATT articles identified were Art V (freedom of transit), Art VIII (on fees and formalities) and Art X (publication and administration of trade regulations). As with the other Singapore issues therefore, the work on trade facilitation represents building on existing GATT measures, as well as the work of the World Customs Organisation and other bodies that are doing relevant work in the field. It does not represent a new issue, although efforts to promote best practice in trade procedures could well mean new commitments for WTO members.

Opposition to work on trade facilitation has been muted, in part because of the highly technical nature of the issue. Developing countries are however concerned about the potential costs of complying with any new obligations. Developing country governments are also concerned that new measures should not make it any harder for them to collect customs revenue, which for some developing countries can constitute a major share of tax revenue.

### Conclusions

This brief discussion of the Singapore issues shows that they are not "new issues". In each case there is an existing patchwork of rules in multilateral, plurilateral and regional/bilateral agreements. The existing WTO rules also touch upon all the issues. What is at issue therefore is not whether these topics should be covered by international rules, but whether there should be a general framework agreement for each within the WTO.

Second, the form in which each of the issues has emerged from the working groups set up in Singapore is such that they are not likely to impose significant obligations on developing country members of the WTO, at least in the short to medium term. The resource implications of implementing provisions in these issues will also be limited although not insignificant. The work carried out in the WTO as well as in UNCTAD, the OECD and elsewhere over the past seven years, has led to a clearer understanding of the issues involved for developing economies. This has been the case for investment and competition especially, which have been the two most controversial issues, and has led to both an awareness of the need for more technical assistance for developing countries and flexibility in the proposed rules. The proposals on investment, competition and government procurement all appear mod-

est. Indeed, one has to ask whether WTO rules based on the rules envisaged would have much impact. The issues are somewhat less clear with trade facilitation, as work in the CTG is less advanced.

A third conclusion would be that despite this greater flexibility on the part of the proponents of the Singapore issues many developing countries have remained very suspicious of efforts to negotiate on these issues in the DDA. There remains a fear that even modest provisions represent the thin end of the wedge that would lead to more intrusive, costly and inappropriate rules at a later stage. Such suspicion is not unjustified given the experience of developing countries in previous negotiations. On the other hand it should not be forgotten that there were potential benefits for developing countries in the introduction of multilateral disciplines. In the case of competition, developing countries could benefit from more effective controls of hard-core cartels, which may be having a disproportionately detrimental impact on developing economies. Consumers and taxpayers in developing countries also stand to benefit from improved regulatory practices and thus reduced corruption, which the Singapore issues promise to help bring about.

Another fairly safe conclusion is that the Singapore issues will not go away if the EU drops its insistence that they be included. The absence of an agreed multilateral framework for rules in the WTO will mean that plurilateral, regional or bilateral measures will continue to fill the vacuum. While the developing countries can, under WTO rules, block the adoption of plurilateral agreements within the WTO, they may not find it in their interests to frustrate efforts by countries wishing to conclude such agreements. Developing countries will also find it harder to resist pressure to conclude regional or bilateral agreements including the Singapore issues. The current generation of regional/bilateral agreements being negotiated by the US and EU all include these issues.

Finally, WTO Ministerial negotiations have stalled or failed in previous rounds, such as in Montreal in November 1988 and Brussels in 1990 in the Uruguay Round. What is different about Cancún is the higher public profile of the WTO today. Past experience suggests that the failure in Cancún may not be fatal for the DDA round, even if it is likely to put it (well?) behind schedule. But a perception that multilateralism is not working could well lead to a redoubling of regional and bilateral negotiations, as indeed already seems to be the policy the US is pursuing. In such bilateral negotiations developing countries will be in a weaker position than in the WTO.

Welf Werner\*

## Financial Services: Broad Support for a Difficult Task

Financial services were included in the Doha negotiations as part of the effort to expand the coverage of the General Agreement on Trade in Services (GATS). This agreement first appeared on the agenda of the World Trade Organization (WTO), then still the GATT, during the Uruguay round (1986-1994). When it came into force on January 1, 1995, financial services were not covered because of controversies over the strength of liberalization commitments. As a consequence, negotiations on this specific service sector had to be carried on after the official completion of the Uruguay round. They led to the stand-alone Financial Services Agreement in December 1997, which will be in force until a new agreement has been reached. As part of the so-called built-in agenda of the Uruguay round, services talks were resumed in 2000 – almost two years before the Fourth WTO Ministerial Conference in Doha, Qatar provided the mandate for negotiations on a broad range of subjects.

Because of the collapse of the Fifth Ministerial in Cancún on September 14, the outlook on improving the 1997 agreement in the near future is bleak. This situation is particularly disturbing because the goals of expanding the coverage of the GATS and of improving the 1997 Financial Services Agreement were not controversial in the Doha negotiations. Although the US initiative to include services in the Uruguay round met with skepticism from the European Union and outright rejection by a number of developing countries in the early days of the round, by the end, services had developed into one of its least controversial topics. The conclusion of the GATS in 1994 was supported not only by mature industrial economies in the OECD but also by emerging-market economies and developing countries. The positive attitude towards the GATS carried over into the Doha negotiations. With the exception of voices raised in the anti-globalization movement in western industrial countries, which have concentrated on certain segments of the service sector like public services, the goal to expand the coverage of the GATS found broad support.

### Sensitive Issues

The fact that service talks did not divide WTO members along regional or developmental lines does

not mean that they did not present great challenges. Among the twelve service sectors covered by the GATS, talks on financial services led negotiators into especially difficult territory. Negotiations on this topic inevitably concern two sensitive issues of sovereign economic policy: prudential regulation and capital account convertibility. Prudential regulation comes into play simply because most barriers to trade and investment in the financial service sector are embodied in these rules. Examples of prudential limitations on market access are restrictions on foreign equity ownership, the number of foreign service providers, the type of legal entity required (for example branches or subsidiaries) and the scope of operations. The sensitivity of these regulations is due to the fact that their main function is to guarantee the safety and soundness of local financial markets and that the opening up of these markets can under certain circumstances compromise this goal. A developing country, for example, that wishes to bring in more foreign competition in order to strengthen market efficiency must take into consideration that such policies might also undermine the strength of local service providers.

Capital account convertibility, which refers to the freedom with which capital flows of varying maturities are allowed to move across borders, is affected by negotiations on financial services liberalization because opening up the capital account is a prerequisite for opening up financial markets in many instances. The dividing line between liberalization measures which affect capital account policy and those which do not lies between the two major methods of providing financial services internationally: cross-border supply, which is comparable to traditional international trade flows, and commercial presence, which involves foreign direct investment. Commercial presence is not problematic, because it involves capital flows of a long-term nature, which are granted nowadays by practically all countries. However, certain forms of cross-border business present countries with special challenges because they involve short-term capital flows. Examples of such cross-border business are certain forms of commercial bank lending, short-term debt and equity, and bonds. Opening up the capital account to the capital flows of such cross-border business can lead to massive inflow or outflow of foreign capital, thus putting pressure on interest and exchange rates and seriously

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impairing a country's ability to pursue macroeconomic stabilization policy.

The importance of decisions on capital account liberalization is exemplified by the fact that, with few exceptions, industrialized countries kept their capital accounts closed for more than three decades after World War II and only reluctantly opened them after the Bretton Woods system of fixed exchange rates broke down in the early 1970s. Developing countries and emerging-market economies have not yet followed suit. Even though quite a few of these countries have started to allow short-term capital to move freely, the majority of these countries still have strict limitations. The timing and the extent of scaling-back these limitations depends, among other factors, on the progress made with modernization of the domestic financial service sector and the establishment of macroeconomic stability. Opening up the capital account too early not only curtails the scope of macroeconomic policy management for these countries but also makes them more prone to international financial crises.

#### **Sovereignty over National Regulation**

The rules of the GATS that deal with the sensitive issues of capital account convertibility and prudential regulation were already developed during the Uruguay round. Prudential regulation falls under the provisions regarding Domestic Regulation (Article VI, GATS). The main emphasis of these provisions is on guaranteeing signatories freedom with respect to the means and goals of their regulatory policies. This goes back to a demand by developing countries, that made sovereignty over regulatory policies a prerequisite for their participation in the GATS negotiations right at the beginning of the Uruguay round. With respect to financial services, sovereignty over national regulation is emphatically ensured in sector-specific provisions of the Annex on Financial Services in its so-called prudential carve-out.

Granting WTO members the greatest possible freedom to pursue their national economic policy goals also governed discussions regarding capital account convertibility. Relevant provisions are Art. XI, XII and XVI GATS as well as the prudential carve-out. These provisions make clear that capital account policy is only influenced by the negotiations if countries make liberalization commitments which require unrestricted short-term capital flows. Obligations to grant capital account convertibility are limited in this case to those capital transactions necessary for the commitments made – not for any others. If a country decides not to make any such liberalization commitments, capital account policies remain untouched. Moreover, once commitments are made, they can be suspended for

two reasons: to deal with balance of payments difficulties (Article XII) and to ensure the integrity and stability of the financial service sector (prudential carve-out).

#### **Going Beyond the Status Quo**

The great freedom that negotiation parties enjoy under the GATS becomes even more obvious if one of the basic principles of the framework agreement is considered: all WTO members decide freely with respect to all service sectors whether or not to participate in negotiations and if so, what liberalization commitments to offer. A country is already a member of the GATS and profits from liberalization commitments of all other signatories if it makes a single commitment, for example if it grants foreign reinsurance companies the right to offer local insurance companies their services via cross-border business. This remarkable situation is exemplified by the Financial Services Agreement of 1997. Although the financial service sector made the most commitments of any service sector, many countries had made extremely limited offers regarding this sector and quite a few, especially small developing countries, had not made any offers at all. Of 132 countries which were members of the WTO in 1997 (counting the EU as one), 104 participated actively in the financial services negotiations.

The fact that liberalization commitments in financial services are very heterogeneous also of course shows something else: that the great freedom granted by the GATS made it difficult for negotiators to accomplish its main goal, namely to achieve an opening of markets that goes beyond the status quo. On the other hand, the active participation of the financial services sector in the GATS negotiations leaves no doubt that WTO members did not only see the sector-specific problems of financial service liberalization but also recognized the potential gains. A broad consensus exists nowadays that the opening of financial markets helps to channel foreign capital into domestic investment and to distribute it efficiently among competing industries. Both the inflow of foreign capital and its efficient distribution are seen as being an important prerequisite for growth and economic development, not only in the mature economies in the OECD, but even more so in emerging-market economies and developing countries. Participation of foreign service providers in local financial markets helps these countries to strengthen the efficiency of these markets, stimulate innovation, and provide consumers with a broad range of services at lower cost. There are some additional advantages for these countries if foreign firms participate in their home markets through a commercial presence rather than via trade business, among them the long-term inflow of capital, the transfer of know-how and the abili-

ty to monitor and regulate business activities of foreign firms closely through domestic laws and institutions.

A positive influence on financial services negotiations also comes from the fact that the majority of emerging-market economies and developing countries do not have to be convinced of the potential gains from opening up their financial markets, but have already taken steps on their own to pursue such policies through unilateral measures. While in the 1970s import substitution policies governed not only the goods markets of most of these countries but also their service and financial service industries, the times are long gone when leaving the development process in these industries to an omnipresent government or a small group of local capital owners was seen as the best solution. At the beginning of the 21st century, most developing countries and emerging-market economies see the participation of foreign firms in domestic markets as a way to eliminate crony capitalism, which to the present day causes great difficulties where it still exists, for example in Japan. The developing countries' move to a free market orientation was described at the end of the 1980s by John Williamson in his famous work on what he then called the Washington Consensus. The change in attitudes is also reflected in the policy recommendations of the UNCTAD, which has long abandoned its focus on protecting financial service industries from foreign competition.

At the same time, the opening of financial markets requires caution and by no means has the blind opposition to financial market liberalization traded places with blind endorsement of such policies. International financial crises like the Asian crisis of 1997-98 have led to a broad discussion on sequencing, that is, when and how to open financial markets to foreign competition. One of the central insights of this discussion is that the modernization of local financial service industries should come before – not after – capital account liberalization. For negotiations in the WTO this means concentrating on improving market access to branches and subsidiaries and being cautious with the liberalization of cross-border business that requires opening up the capital account on the short end.

Although developing countries and emerging-market economies had the most to gain from the financial services talks in the WTO, mature industrial economies in the OECD also could have benefitted greatly. The active role that some large financial firms from these countries play in international markets such as the international exchange markets has led to the remarkable misconception that globalization has taken possession of each and every segment of financial

markets. Indeed there are quite a few such markets which lag far behind the international integration of goods markets. The great majority of private households in these countries has not had any contact with foreign financial firms in their home country. The same is true for the majority of small business owners and for the *Mittelstand*. Among the financial service industries with little or no foreign presence is the insurance industry. Even in the most mature industrialized economies, domestic insurance companies have market shares close to 100% in their home markets.

Interestingly, the segments of the financial service sector which are protected from foreign competition are by no means the ones which are especially difficult to liberalize. The insurance industry is neither known for its active role in sending hot money around the globe nor for seriously undermining the safety and soundness of financial services markets. In the banking sector, market access restrictions are more widespread with respect to commercial presence than they are with respect to large sum trade business, although relaxing restrictions on the former presents governments with fewer problems with respect to prudential regulation and macroeconomic policy management. These few examples may be sufficient to show that financial services negotiations in the WTO by no means only dealt with the sector-specific challenges described above, but also with a problem common to all trade talks, namely protectionism. While financial service sector liberalization does have far-reaching consequences, publicly expressed concerns about them are in many cases nothing but a cover for protectionist interests.

### Future Challenges

On what areas should negotiations focus if they were to be resumed in the future? The tasks are defined by the limited results of the Financial Services Agreement of 1997. But drawing a picture of the strengths and weaknesses of this agreement is not as easy as could be expected, considering that it covers only one of many service industries and that opening up the service sector is only one of many topics with which the WTO deals. The GATS offers unlimited possibilities to make commitments on the many aspects of international trade and investment in the service sector. Negotiations on financial services cover not only the banking and security industries, but also the insurance sector. As already indicated, methods of providing services internationally that are covered by the agreement include not only trade business but also commercial presence, which is absent from other WTO agreements. In addition, the GATS addresses

two more “modes” of supply – consumption abroad and presence of natural persons.

The broad coverage of the Financial Services Agreement appears most clearly in the countries’ schedules of commitments, which are part of the agreement. The Uruguay round negotiations produced thousands of pages of commitments from the 104 countries that actively participated. Each of these countries had the opportunity to make commitments in hundreds of fields of the schedules, which result from combinations of the four modes of supply with the numerous commercial transactions offered by the financial service sector. If a country decides in favor of a commitment it can grant either limited or unlimited market access. In the former case, specifications can run to several pages due to the complexity of the underlying prudential regulations.

Despite the limited transparency of the schedules of commitments, weak points of the 1997 agreement can be summarized as follows:

- The agreement focuses strongly on commercial presence. This is appropriate insofar as the balance of advantages and disadvantages of opening up financial markets is particularly positive for this mode of supply, especially for developing countries and emerging-market economies. What makes this result less satisfactory is the fact that not only developing countries and emerging-market economies but also the more mature economies in the OECD concentrated on commercial presence. Because these countries had already opened their capital accounts, they should have approached commitments for trade business much more aggressively. Negotiations at the WTO offered them the opportunity to secure the immense improvements that have been made in the last two decades with respect to large sum trade business, and which have so far been confined to unilateral measures.
- The fact that liberalization commitments concentrate on commercial presence does not mean that they are satisfactory. Controversies over the strength of commitments already erupted during the Uruguay round. While the US postponed signing the Financial Services Agreement several times because it regarded commitments as unsatisfactory, other WTO members, including the EU, would have signed it without the progress that was made in the last years of negotiations. Studies of the results of the 1997 agreement show that regardless of the US efforts to improve commitments over their 1994 level, the majority of these commitments do not even reach the status quo. The studies confirm American concerns that emerging-market economies in Asia and Latin

America showed the greatest resistance to securing multilaterally what had already been granted unilaterally.<sup>1</sup> This result is regrettable because there are no reasons not to secure improvements that have already been granted on a unilateral basis. Moreover, in the many cases in which negotiations do not extend to sensitive policy issues with respect to macroeconomic policy management and safety and soundness of the financial service sector, negotiations should have gone further. Commercial presence in the banking industry and almost all international activities of the insurance industry are cases in point.

The continuation of the Doha negotiations would have offered the opportunity to bring the Financial Services Agreement to life by improving the liberalization commitments. WTO members had already started to put forward negotiating requests and offers. Of course, there would have also been other challenges, the most important of which stem from the competing goals of opening up financial services markets on the one hand and prudential regulation and capital account policies on the other. In the 1997 agreement, negotiators refrained from drafting rules with respect to these two policy issues, except for granting signatories freedom to pursue national policy goals. Historical experience from the latter half of the 20th century suggests that it would have been difficult to make progress on the basis of such an agreement in the long run. It is little-known that the first initiatives to approach financial market liberalization on a multilateral basis were already developed under the auspices of the OEEC in the 1950s, and that these initiatives did not gain momentum because of their limitations with respect to these two policy issues. Better known is the positive experience of the EU with its Single Market Program and the fact that the decisive elements of this program with respect to financial services are new and effective concepts for capital account liberalization and prudential regulation.<sup>2</sup>

The poor record of multilateral initiatives for financial services with the same limitations as the WTO’s should not prevent us from trying again. History does not always repeat itself, especially if circumstances change. At the beginning of the 21st century, opening up the financial services sector has become a much more significant factor in development and growth than ever before. More importantly: most governments also see it that way.

<sup>1</sup> For a closer look at the results of these studies, see Welf Werner: *Das WTO-Finanzdienstleistungsabkommen*, München 1999, Oldenbourg.

<sup>2</sup> For a detailed account of these historical experiences, see Welf Werner: *Handelspolitik für globale Finanzmärkte. Die Initiativen von OECD, EU und WTO* (forthcoming).