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# Challenges Facing the WTO Hong Kong Ministerial Conference

*The continuing deep divisions between developed and developing countries have given rise to concerns that the Sixth WTO Ministerial Conference to be held on 13-18 December in Hong Kong will – like its predecessor, the Fifth Ministerial in Cancún – end in failure. The contributions to this Forum explore the key negotiating issues.*

Kym Anderson and Will Martin\*

## Greater Market Access in Agriculture is the Key to Doha Success

Since agricultural policies are so politically sensitive, there are always self-interested groups suggesting they be sidelined in trade negotiations – as indeed has occurred in numerous sub-global preferential trading agreements, and in the GATT prior to the Uruguay Round. Today the groups with that inclination include not just farmers in highly protecting rich countries and food-importing developing countries but also those food exporters receiving preferential access to those markets. The latter groups include holders of tariff rate quotas, members of regional trading agreements, and parties to non-reciprocal preference agreements including all least-developed and ACP countries.

However, sidelining agriculture in the Doha round would do a major disservice to many of the world's poorest people, namely those in farm households in developing countries who receive little or no government assistance. New empirical research suggests almost two-thirds of the economic gains that would come from dismantling all merchandise trade barriers and farm subsidies globally would come from agriculture. This is so for the world as a whole, and also for developing countries as a group.

Developing countries are therefore right to focus on agriculture in the negotiations. To date that focus has been almost exclusively on developed country

policies. That is understandable, given that many in developing countries feel they did not get a good deal out of the Uruguay Round and so are determined to get significantly more commitments under Doha from developed countries before they contemplate opening their own markets further. However, our modeling suggests that over half the gains to developing countries from global agricultural reforms would come from liberalization by developing countries themselves (Table 1). The reason is twofold: because agricultural tariffs are even higher in developing than developed countries (18 compared with 16 percent on average), and because a large minority of developing country trade is now with other developing countries.

Within agriculture, developing countries – including the G-20 – are emphasizing especially the need for cuts to agricultural subsidies. This is partly because they do not want to lower their own food import restrictions (as well as because it may adversely affect their international terms of trade). However, our modeling results again suggest this may be detrimental economically: they indicate that 93 percent of the welfare gains from removing distortions to agricultural incentives globally would come from reducing import tariffs. That is, only 2 percent is due to export subsidies and 5 percent to domestic support measures (Table 2). Certainly it is very important to discipline those domestic subsidies and phase out export subsidies, so as to prevent re-instrumentation of assistance from tariffs to domestic subsidies and to bring agriculture into line with non-farm trade in terms of not using export subsidies. But to ignore market access in the Doha round would be to forego most of the potential gains from goods trade reform.

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**Table 1**  
**Effects on Developing Country Economic Welfare**  
**of Full Trade Liberalization for Different Groups of**  
**Countries and Products, 2015**

(in %)

Percentage due to:	From full liberalization of:			
	Agriculture and food	Textiles and clothing	Other manufactures	All goods
Developed country <sup>1</sup> policies	30	17	3	50
Developing countries <sup>1</sup> policies	33	10	7	50
All countries' policies	63	27	10	100

<sup>1</sup> Developed countries include Europe's transition economies that joined the EU in April 2004. The "developing countries" definition used here is that adopted by the WTO and so includes East Asia's four newly industrialized tiger economies.

Source: K. Anderson, W. Martin: Agricultural Trade Reform and the Doha Development Agenda, in: The World Economy, Vol. 28, No. 9, September 2005, pp.1301-27, Table 4.

#### Analysis of Available Options

The current Doha round has the advantage over the Uruguay Round of beginning from the framework of rules and disciplines agreed in that previous Round's Agricultural Round. In particular, it has the three clearly identified "pillars" of market access, export subsidies, and domestic support on which to focus. True, it took more than three years to agree on a framework for the current negotiations, reached on at the end of July 2004, but now that July Framework Agreement is likely to guide the negotiations for some time. It therefore provides a strong basis for undertaking *ex ante* analysis of various options potentially available to WTO members during the Doha negotiations.

In turning to what might be achievable under a Doha partial reform package, the devil is going to be in the details. For example, commitments on domestic support for farmers are so much higher than actual support levels at present that the 20 percent cut in the total bound AMS promised in the July Framework Agreement as an early installment will require no actual support reductions for any WTO member. Indeed a cut as huge as 75 percent for those with most domestic support is needed to get some action, and even then it would only require cuts in 2001 levels of domestic support for four WTO actors: the US (by 28 percent), the EU (by 18 percent), Norway (by 16 percent) and Australia by 10 percent – and the EU and Australia have already introduced reforms of that order since 2001, so may need to do no further cutting under even that formula.

Large cuts in bound rates are needed also to erase binding overhang in agricultural tariffs. Table 3 shows there is substantial binding overhang in agricultural

**Table 2**  
**Distribution of Global Welfare Impacts of Fully Re-**  
**moving Agricultural Tariffs and Subsidies, 2001**

(in %)

Agricultural liberalization component:	Beneficiary region:		
	High-income <sup>1</sup> countries	Developing countries	World
Import market access	66	27	93
Export subsidies	5	-3	2
Domestic support	4	1	5
All measures	75	25	100

<sup>1</sup> High-income countries include the newly industrialized East Asian customs territories of Hong Kong, Korea, Singapore and Taiwan as well as Europe's transition economies that joined the EU in May 2004.

Source: K. Anderson, W. Martin: Agricultural Trade Reform and the Doha Development Agenda, in: The World Economy, Vol. 28, No. 9, September 2005, pp.1301-27, Table 5.

tariffs: the average bound rate in developed countries is almost twice as high as the average applied rate, and in developing countries the ratio is even greater. Thus large reductions in bound rates are needed before it is possible to bring about *any* improvements in market access. To bring the global average actual agricultural tariff down by one-third, bound rates would have to be reduced for developed countries by at least 45 percent, and up to 75 percent for the highest tariffs, under a tiered formula.

Even large cuts in bound tariffs do little if "Sensitive Products" are allowed, except if a cap applies. If members succumb to the political temptation to put limits on tariff cuts for the most sensitive farm products, much of the prospective gain from Doha could evaporate. Even if only 2 percent of HS6 agricultural tariff lines in developed countries are classified as sensitive (and 4 percent in developing countries, to incorporate also their "Special Products" demand), and are thereby subject to just a 15 percent tariff cut (as a substitute for the TRQ expansion mentioned in the Framework Agreement), the welfare gains from global agricultural reform would shrink by three-quarters. However, if at the same time any product with a bound tariff in excess of 200 percent had to reduce it to that cap rate, the welfare gain would shrink by "only" one-third.

Given the high binding overhang of developing countries, even with their high tariffs – and even if tiered formulae are used to cut highest bindings most – relatively few of them would have to cut their actual tariffs and subsidies at all. That is even truer if "Special Products" are subjected to smaller cuts. Politically this makes it easier for developing and least developed countries to offer big cuts on bound rates.

Expanding non-agricultural market access would add substantially to the gains from agricultural reform. Adding a 50 percent cut to non-agricultural tariffs by

**Table 3**  
**Agricultural Weighted Average Import Tariffs, by**  
**Region, 2001**

(percent, *ad valorem* equivalent, weights based on imports)

	Bound tariff	Applied tariff <sup>1</sup>
Developed countries <sup>2</sup>	27	14
Developing countries	48	21
of which: LDCs	78	13
World	37	17

<sup>1</sup> Includes preferences and in-quota TRQ rates where relevant, as well as the *ad valorem* equivalent of specific tariffs.

<sup>2</sup> Developed countries include Europe's transition economies that joined the EU in April 2004. The "developing countries" definition used here is that adopted by the WTO and so includes East Asia's four newly industrialized tiger economies.

Source: K. Anderson, W. Martin: Agricultural Trade Reform and the Doha Development Agenda, in: *The World Economy*, Vol. 28, No. 9, September 2005, pp.1301-27, Table 2.

developed countries (and 33 percent by developing countries and zero by LDCs) to the tiered formula cut to agricultural tariffs would double the gain from Doha for developing countries. That would bring the global gain to \$96 billion from Doha merchandise liberalization, which is a sizable one-third of the potential welfare gain from full liberalization of \$287 billion. Adding services reform would of course boost that welfare gain even more.

Most of the DC gains from that comprehensive Doha scenario go to numerous large developing countries, notably Brazil, Argentina and Other Latin America plus India, Thailand and South Africa plus others in southern Africa. The rest of Sub-Saharan Africa gains when non-agricultural market access is expanded, and developing countries participate as full partners in the negotiations. An important part of this result is increases in market access – on a non-discriminatory basis – by other developing countries.

True, some least developed countries in Sub-Saharan Africa and elsewhere appear to be slight losers in our Doha simulations when developed countries cut their tariffs and those LDCs choose not to reform at all themselves. That results from their terms of trade deteriorating either because of tariff preference erosion on their exports or because they are net food importers and so would face higher prices for their imports of temperate foods.<sup>1</sup> Our simulations overstate the benefits of tariff preferences for LDCs, however, since they ignore the trade-dampening effect of complex rules of origin and the grabbing of much of the rents by

<sup>1</sup> See K. Anderson, K. W. Martin, and D. van der Mensbrughe: Would Multilateral Trade Reform Benefit Sub-Saharan Africa?, Policy Research Working Paper 3616, World Bank, Washington DC, July 2005. (Forthcoming in: *Journal of African Economies*, Vol. 15, 2006.)

developed-country importers. But even if they were to be losers after correcting for those realities, it remains true that preference-receiving countries could always be compensated for preference erosion via increased aid at relatively very small cost to current preference providers – and in the process other developing countries currently hurt by LDC preferences would enjoy greater access to the markets of reforming developed countries.

### Implications for the Doha Round

Several clear implications for the Doha round follow from this analysis:

- First, *in addition to outlawing agricultural export subsidies, domestic support bindings must be cut very substantially to reduce binding overhang*. In so doing, the highest-subsidizing countries, namely the EU and US, need to reduce their support, not just for the sake of their own economies but also to encourage developing countries to reciprocate by opening their markets as a quid pro quo. An initial installment of a 20 percent cut is nothing more than a start towards getting rid of that overhang.
- Second, *even more importantly, agricultural tariff bindings must be cut hugely so that some genuine market opening can occur*. Getting rid of the tariff binding overhang that resulted from the "dirty tariffification" of the Uruguay Round should be the first priority, but more than that is needed if market access is to expand. Exempting even just a few Sensitive and Special Products is undesirable as it would reduce hugely the gains from reform and would tend to divert resources into, instead of away from, enterprises in which countries have their least comparative advantage. If it turns out to be politically impossible not to designate some Sensitive and Special Products, it would be crucial to impose a cap such that any product with a bound tariff in excess of, say, 100 percent had to reduce it to that cap rate.
- Third, *expanding non-agricultural market access at the same time as reforming agriculture is essential*. A balanced exchange of concession is impossible without adding other sectors. With other merchandise included, the trade expansion would be four times greater for both rich and poor countries – and poverty in low-income countries would be reduced considerably more.
- And fourth, *South-South "concessions" also are needed, especially for developing countries, which means reconsidering the opportunity for developing countries to liberalize less*. Since developing countries are trading so much more with each other now, they are the major beneficiaries of reforms within

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their own regions. Upper middle-income countries might consider giving least developed countries duty-free access to their markets (mirroring the recent initiatives of developed countries), but better than such discriminatory action would be MFN tariff reductions by them. Even least developed countries should consider reducing their tariff binding overhang at least, since doing that in the context of Doha gives them more scope to demand “concessions” (or compensation for preference erosion or other contributors to terms of trade deterioration) from richer countries – and yet would not require them to cut their own *applied* tariffs very much.

#### Conclusion

The good news is that there is a great deal to be gained from liberalizing merchandise – and especially agricultural – trade under Doha, with a disproportionately high share of that potential gain available for developing countries (relative to their share of the global economy). To realize that potential gain, it is in agriculture that by far the greatest reform is required. However, the political sensitivity of farm support programs, coupled with the complexities of the measures introduced in the Uruguay Round Agreement on Agriculture and of the modalities set out in the Doha

Framework Agreement of July 2004, ensure the devil will be in the details of the final Doha agreement. To realize more of their potential gains from trade, developing and least developed countries would need to fully participate in trade (and complementary domestic) reforms, and to invest more in trade facilitation. High-income countries could encourage them to do so by being willing to open up their own markets more to developing country exports, and by providing more targeted aid. To that end, a new proposal has been put forward to reward developing country commitments to greater trade reform with an expansion of trade-facilitating aid, to be provided by a major expansion of the current Integrated Framework which is operated by a consortium of international agencies for least developed countries.<sup>2</sup> This may well provide an attractive path for developing countries seeking to trade their way out of poverty, not least because it would help offset the tendency for an expanded aid flow to cause a real exchange rate appreciation. As well, it is potentially a far more efficient way for developed countries to assist people in low-income countries than the current systems of tariff preferences.

<sup>2</sup> See B. Hoekman, S. Prowse: Development and the WTO: Beyond Business as Usual, in: *Bridges*, Year 9, No. 2-3, February-March 2005.

Roy Santana\*

## Challenges to the NAMA Negotiations: Finding New Solutions to Old Problems

Paragraph 16 of the Doha Ministerial Declaration (DMD) mandates that negotiations on market access for non-agricultural products (NAMA) “shall aim, by modalities to be agreed, to reduce or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing countries.”

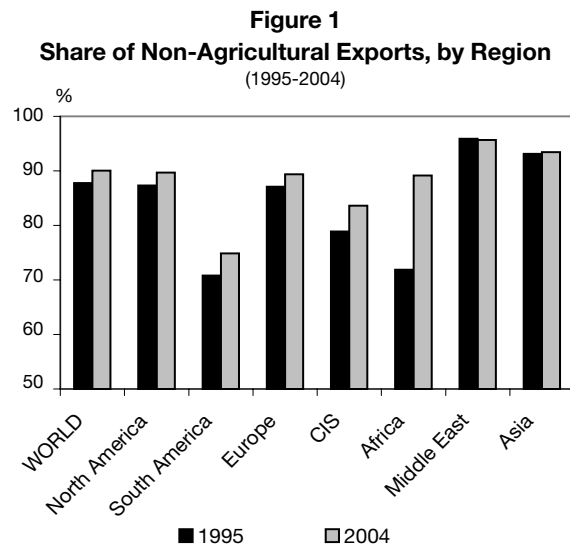
It should firstly be noted that non-agricultural products are defined, by way of exclusion, as those not covered by Annex 1 of the Agreement on Agriculture. The products in this residual category account for more than 90% of world merchandise exports and

comprise the main type of exports for all regions (see Figure 1).

Secondly, what is being negotiated are the so-called “bound tariffs”. Contracting parties were expected under GATT Article II to negotiate the binding of their tariffs, with a view to achieving a progressive liberalisation over successive rounds of negotiations. A binding or bound tariff is a legal commitment not to raise the most-favoured nation (MFN) applied rate of a tariff line above the level specified in the Member’s schedule of concessions.<sup>1</sup> Whether or not the cuts to the bound rates should lead to cuts in the applied rates is subject to one of the most intense debates in the NAMA negotiations.

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<sup>1</sup> The difference between the applied and the (higher) bound level is often referred to as “binding overhang” or “water”. The water is a feature in many developing countries and in some of the smaller developed Members.



Source: Own calculation based on WTO Secretariat data.

Thirdly, the Doha mandate calls for an agreement on “modalities” which is in essence a document defining the rules for preparing the new schedules of concessions, including new bindings and cuts on bound tariffs. Once the new schedules are prepared, revised and annexed to a Protocol, it would be these – rather than the modalities – that would constitute the legal source for Members’ obligations.

As to the negotiations, Members recognised after two years of intensive discussions and the failed Cancun Ministerial that an intermediate step was required to capture the progress made so far in the negotiations. It is for this reason that a “Framework” on NAMA was agreed upon as Annex B to the Decision adopted by the General Council on 1 August 2004.<sup>2</sup> This document contains the initial elements for work on modalities and has served as the basis for discussions in this area. Although reaching an agreement on “full modalities” was the purported goal for the Hong Kong Ministerial, Members recently decided to “recalibrate” these expectations. It remains to be seen what this means in practical terms.

A considerable amount of technical work has taken place on the different aspects of these negotiations. Without underestimating the importance of closely related issues such as non-reciprocal preferences, sectoral negotiations and non-tariff barriers, this paper will focus on three of the core issues on the agenda. Namely: the treatment of unbound tariffs, the tariff cutting formula and the flexibilities for developing countries.

It should be noted from the outset that most of the NAMA challenges arise from the significant divergences in the scope and level of existing commitments by WTO Members. The importance of bearing this diver-

sity in mind while examining the different issues cannot be overemphasised.<sup>3</sup>

#### **New Bindings: How Many and at What Level?**

Increasing the number of bindings was one of the traditional topics in GATT negotiations and it was also one of the main outcomes of the Uruguay Round (UR) in the goods area. Not only were all the tariffs for agricultural products bound,<sup>4</sup> but there was also a significant increase in the binding coverage of non-agricultural products.<sup>5</sup> A Secretariat assessment of the UR results for a sample of 21 developing countries concluded that their average binding coverage increased from 21% to 73%, covering 61% of their imports.<sup>6</sup> It was also estimated that developed countries increased their bindings from 78% to 99%, covering 99% of their imports. All the Members which have acceded to the WTO since 1995 have done so with near full binding coverage.

These numbers could lead to the impression that there is little to be done in this area. The Member-specific details, however, reveal a different story. Table 1 shows that 103 Members have more than 95% of their non-agricultural tariff lines bound, while 29 Members have less than 35%, including 13 which have less than 5%. In addition, there is still a large amount of imports taking place in products falling under unbound lines in both developed and developing countries. For example, 13.8% of Japan’s 2001 imports and almost 38.8% of India’s 2001 imports took place against tariff lines with no binding. Although it had been argued by some that the binding coverage reflected the Member’s level of development, others rebutted this assumption by noting that 9 least-developed countries (LDCs) have full bindings while other relatively advanced economies have only a handful of tariff lines bound.

Several developed and developing countries with full binding coverage have been keen proponents of achieving 100% binding for all Members in this Round. They consider this to be an issue of equity, as they would like their exports to enjoy the same degree of certainty that they currently provide to other Members’ exports. However, other developing countries consider that unbound tariffs are part of their vital policy space.

Probably the most difficult question with respect to unbound tariffs has been at what level the new bind-

<sup>2</sup> The “July Package” is contained in WT/L/579.

<sup>3</sup> Table 2 below provides a glimpse of the extent of the divergences in this area.

<sup>4</sup> Except for a few products under Annex 5 of the AoA.

<sup>5</sup> During the UR they were referred to as “industrial” or “other” products.

<sup>6</sup> GATT Secretariat: The Results of the Uruguay Round of Multilateral Trade Negotiations – Market Access for Goods and Services: Overview of the Results, Geneva 1994, p. 26.

**Table 1**  
**Current Binding Coverage of Non-Agricultural Products**

Binding coverage (%)	Number of Members	LDCs
100%	74 <sup>a</sup>	9
95 < 100%	29	4
35 < 95%	16	2
5 < 35%	16	8
< 5%	13	9
Total	148	32

<sup>a</sup> EC-25 members counted individually.

Source: Own calculation based on TN/MA/S/4/Rev.1 and WTO International Trade Statistics (2005).

ings should be set. The crux of this issue is whether unbound tariff lines should be (1) marked-up, then reduced through the formula and bound or, (2) simply bound at a certain level without any cut. Although the two approaches could lead to identical final bound rates, proponents of the second approach considered a simple binding to be more in line with the idea of bindings being a concession. However the proponents of mark-ups have noted that the Framework calls for no *a priori* exclusions from the formula which should be applied on a line-by-line basis. Proposals on unbound tariffs revolved around setting a target average for new bindings (e.g. to bind at an average of 25% with higher rates compensating the lower ones), or linking the new binding to the applied level of each tariff line to set the base rates on which the formula would be applied. This remains an unresolved issue.

Discussions have also explored possible methodologies for determining the “base rates” in the mark-up approach.<sup>7</sup> One of the first ideas in this respect was to double the level of the MFN applied rates.<sup>8</sup> Several delegations supported this approach as they considered that the applied level reflects the sensitivity attached by the Member to those products. However, Malaysia and others opposed this as many of their unbound lines are at low or even duty free applied levels. They criticised the approach for penalising those with liberal policies and questioned the fairness of ending up with new bindings that would be set at levels below those of others which have full bindings but at high levels. Members have been sympathetic to these arguments and have explored ways to distinguish the treatment of unbound items with low and high applied rates.

Two “non-linear” mark-up approaches have been discussed. Canada and others proposed adding X

<sup>7</sup> A base rate is the level from which cuts are made. Paragraph 5 of the Framework specifies that the base rate for bound tariffs will be the “bound rates after full implementation of current concessions”, but leaves open the question for the unbound.

<sup>8</sup> See TN/MA/W/35/Rev.1. When the MFN applied rate is less than 2.5%, the base rate would be 5%.

percentage points (e.g. 5 points) to the applied rate, in which case the low rates would increase proportionally much more than the higher rates.<sup>9</sup> An applied rate of 1% would have a base rate of 6% (a 500% mark-up), while an applied rate of 40% would become 45% (a 12.5% mark-up). Similarly, Mexico proposed a so-called “rational approach” which would in essence assign a high mark-up to the low rates (e.g. an applied rate of 0% would have a base rate of 15%), while the higher rates would receive a lower mark-up (e.g. a rate of 40% could become 46%) depending on two parameters to be negotiated.<sup>10</sup> This last proposal was of concern to some for its mathematical complexity but showed that Members were engaged in looking for solutions. India and others maintain that all unbound items, including the ones with high applied rates, are sensitive and need to be treated accordingly. Pakistan proposed using the Canadian approach with a mark-up of 30 percentage points as a possible middle ground.<sup>11</sup> The European Communities (EC) recently proposed a mark-up of 10 percentage points.<sup>12</sup> It remains to be seen whether this is the way forward in this area.

#### Setting the Appropriate Level of Ambition with a Formula

All Members agreed in the Framework to use a line-by-line tariff cutting formula. This decision is important in itself because a formula is better positioned to provide transparency, efficiency and predictability in the results of the negotiations. Several Members considered it would be too difficult to engage in “request/offer” negotiations among 148 Members, as had been done in earlier Rounds (see Table 3). Non-linear formulae are best suited for eliminating tariff peaks, high tariffs, and tariff escalation,<sup>13</sup> since they have the mathematical property of cutting the higher rates more than the lower ones. The “Swiss” formula is one such non-linear formula and has been the basis for the proposals in this area.<sup>14</sup>

<sup>9</sup> TN/MA/W/51.

<sup>10</sup> TN/MA/W/13/Add.1.

<sup>11</sup> TN/MA/W/60.

<sup>12</sup> The EC proposal was made public on 28 October 2005, but has not circulated formally.

<sup>13</sup> International organizations often define “national peaks” as 3 times the national average and “international peaks” as those rates above 15%. There is, however, no agreed WTO definition of what constitutes a peak or a high tariff.

<sup>14</sup> The Swiss formula was used during the Tokyo Round and is often described as:  $t_j = A \times t_0/A + t_0$  where “ $t_0$ ” is the initial rate in *ad valorem* terms (i.e. base rate), “A” is a negotiated coefficient and “ $t_1$ ” is the new rate in *ad valorem* terms. A Swiss formula with a coefficient of 20 would result in no duty rate above 20%. Developed countries applied coefficients of 14 and 16 for some products during the Tokyo Round. See TN/MA/S/13.

**Table 2**  
**WTO Commitments on Non-Agricultural Products**  
**Trade and Tariff Profiles of Selected Members**

Member	Total Merchandise Trade (2004)		Current WTO Commitments on Non-Agr. Products				2001 Applied Duties on Non-Agr. Products		
	Exports US\$ billion	Imports US\$ billion	Binding coverage (%)	Average of final bound tariffs	Max. <i>ad valorem</i> bound	2001 share of imports in unbound tariff lines (%)	Average in bound tariff lines	Average in unbound tariff lines	Max. <i>ad valorem</i> applied
1	2	3	4	5	6	7	8	9	10
Developed Countries									
Australia	86.4	109.4	96.5	11.0	55	0.1	4.5	7.1	25
EC-25 <sup>1</sup>	1,203.8	1,280.6	100.0	3.9	26	-	4.3	-	26
Japan	565.8	454.5	99.5	2.3	30	13.8	2.7	7.0	33.8
Norway	81.8	48.1	100.0	3.1	14	-	2.1	-	17.7
USA	818.8	1,525.5	100.0	3.2	48	4.7	3.9	0.3	48
Developing Countries									
Brazil	96.5	65.9	100.0	30.8	35	-	15.0	-	35
China	593.3	561.2	100.0	9.1	50	-	9.5	-	50
Costa Rica	6.3	8.3	100.0	42.9	100	-	4.6	-	48
India	75.6	97.3	69.8	34.3	150	38.8	28.7	34.4	55
Indonesia	72.3	54.9	96.1	35.6	150	5.9	6.6	10.6	170
Hong Kong <sup>2</sup>	265.5	272.9	37.5	0.0	0	43.1	0.0	0.0	0
Jamaica	1.4	3.8	100.0	42.5	100	-	5.9	-	40
Kenya	2.7	4.6	1.6	54.8	100	n.a.	10.2	16.7	45
Kyrgyz Rep. <sup>3</sup>	0.7	0.9	99.9	6.7	20	n.a.	4.6	9.4	15
Malaysia	126.5	105.3	81.2	14.6	40	9.5	8.6	5.8	300
Mauritius	2.0	2.8	5.3	19.5	122	92.6	9.2	19.5	80
Mexico	189.1	206.4	100.0	34.9	50	0.0	17.1	-	35
South Africa	46.0	57.1	96.0	15.8	60	n.a.	5.2	8.2	43
LDCs									
Bangladesh	8.2	12.0	3.0	35.7	100	n.a.	12.9	22.0	37.5
Cambodia	2.8	3.2	100.0	17.7	43	-	15.9	-	120
Rwanda	0.1	0.3	100.0	91.8	100	-	8.8	-	70
Tanzania	1.3	2.5	0.1	120.0	120	100.0	11.7	12.9	25

<sup>1</sup> Trade data refers to extra-EU trade. <sup>2</sup> Includes re-exports. <sup>3</sup> Economy in transition.

Note: The average of applied duties for bound lines in 2001 is sometimes higher than the average of final bound rates due to the implementation period. For example, China's commitments in some lines are to be fully implemented only in January 2010.

Source: Based on World Trade Report (2005), International Trade Statistics (2005) and WTO documents TN/MA/S/4/Rev.1 and TN/MA/S/14.

Proposals based on non-linear formulae were submitted in 2005 by (1) Argentina, Brazil, India (ABI);<sup>15</sup> (2) Chile, Colombia, Mexico and Uruguay;<sup>16</sup> (3) Norway;<sup>17</sup> (4) some Caribbean countries;<sup>18</sup> (5) Pakistan<sup>19</sup> and (6) the United States.<sup>20</sup> There was also a recent proposal from the EC on NAMA as part of the package they foresee for Hong Kong.<sup>21</sup> Although the details of these proposals differ, in particular with regards to the linkage with the flexibilities, they could be broadly categorised as follows:

1. A Swiss formula with one negotiated coefficient for all Members, with flexibilities for developing coun-

tries given outside of the formula. The EC has recently proposed a coefficient of 10 that would apply to developed countries and "advanced developing countries". Several developing countries consider this approach to be inconsistent with the mandate, because it would fail to respect non-reciprocity for developing countries in reduction commitments (see below).

2. A Swiss formula with more than one negotiated coefficient (e.g. one for developed countries and a higher one for developing countries). For example, Pakistan proposed a coefficient of 6 for developed countries and 30 for developing countries, which are close to their respective overall bound tariff averages. This dual coefficient approach seems to enjoy support from different sides, but there are wide gaps as to which two coefficients should be adopted. Proponents claim that this approach is superior as it would lead to both (1) harmonisation within the Member's schedule and (2) across different Members' schedules. It is, however, opposed by others who consider

<sup>15</sup> TN/MA/W/54.

<sup>16</sup> TN/MA/W/50/Add.1.

<sup>17</sup> TN/MA/W/7/Add.1.

<sup>18</sup> JOB(05)/150.

<sup>19</sup> TN/MA/W/60.

<sup>20</sup> JOB(05)/36.

<sup>21</sup> See footnote 12.



**Table 3**  
**Modalities for Tariff Reduction Used in Previous**  
**Rounds of Multilateral Negotiations**

Round	Developed countries	Developing countries
GATT – Dillon R. (1947-1961)	Request / Offer <sup>1</sup>	Request / Offer
Kennedy R. (1964-1967)	Linear cut formula (50% cut), but less than formula cuts were allowed for some products	Request / Offer
Tokyo R. (1973-1979)	“Swiss formula” w/ coefficient of 14 and 16 for some products	Request / Offer
Uruguay R. (1986-1994)	Targeted simple average reduction (33.3% AVG) plus some sectoral reductions (zero for zero and harmonization)	Request / Offer + new bindings

<sup>1</sup> In 1953 France proposed reducing duties by 30% to avoid extensive negotiations between participating countries. See GATT Doc. L/103, BISD 02S.

Source: WTO document TN/MA/S/13.

that there is no mandate for harmonising tariffs across the Members’ schedules and that they should not end up conceding higher average cuts than developed countries ever conceded in previous rounds.<sup>22</sup> Developed countries have responded that those cuts were real and not simply paper cuts.

3. Swiss-type formulae which rely on the tariff average ( $T_a$ ) of each Member to differentiate the coefficients. Under this approach (which is similar to the “Girard” formula discussed during the first part of the negotiations) each Member would be assigned a different coefficient depending on its current concessions. In the case of the ABI formula, a negotiated “B” coefficient would be added to set the overall level of ambition.<sup>23</sup> Assuming that  $B=1$ , the ABI formula would result in a Swiss formula with a coefficient of approximately 2.3 for Japan, 3.9 for the EC, 14.6 for Malaysia, and 34.3 for India. The proponents consider these results would be equitable as the average cuts would be similar for all. In this example, all Members would make an average cut of approximately 50%.<sup>24</sup> However, developed countries oppose this proposal because it would reward those that have done less in the past and would not deliver real market access. Malaysia and others also have concerns as they consider that their coefficient would be too low compared to that of other developing countries. In addition, they believe that the  $T_a$  is not a good development indicator.

It is interesting to note that the three approaches described above are all variations of the Swiss formula, with the differences arising from the number of coefficients and their level, rather than the functional

<sup>22</sup> Developed countries cut on average 33.3% during the Tokyo Round and approximately 40% in trade weighted terms during the Uruguay Round.

form itself. Members have argued extensively over which formula would best deliver on the mandate. Others have even explicitly indicated that they do not foresee any cuts in their applied rates.

Brazil, Argentina and others also note that the tariff cuts should be commensurate with those being negotiated in the market access pillar of agriculture which they fear would be lower. Others have responded that agriculture is negotiating two more pillars than NAMA (i.e. domestic support and export subsidies) and is therefore not comparable. The issue of equity is often mentioned in this context but, again, there seems to be no common understanding on what would be an equitable outcome.

#### **Treatment of Developing Countries: Finding the Right Level of Flexibility**

Paragraph 16 of the DMD states that the NAMA negotiations shall take fully into account the special needs and interests of developing and LDC participants, including through less than full reciprocity in reduction commitments (LFR), in accordance with the relevant provisions of Article XXVIII *bis* of GATT 1994. This provision notes, on the one hand, that negotiations should be carried out on a “reciprocal and mutually advantageous” basis, but notes on the other hand that negotiations shall be conducted on a basis that affords adequate opportunity to take into account the needs of developing countries for a more flexible use of tariff protection. The Enabling Clause<sup>25</sup> provides, in addition, that developed countries do not expect reciprocity in tariff negotiations from developing countries. In this light, LFR would appear to mean that developing countries would have to contribute “less” than developed countries.

It is worth noting that some developing countries consider LFR and special and differential treatment (S&D) to be two distinct concepts, meaning that both should be taken into account separately in the modalities. However, the developed countries consider that LFR is simply one expression of S&D and using a double coefficient in a Swiss formula, for example, would automatically take care of both elements. Probably because of this difference in views the word “flexibilities” is often used as an umbrella to cover both concepts.

Notwithstanding this discussion, there are two key questions with respect to LFR: (1) How should it be

<sup>23</sup> The ABI formula is  $t_i = B \times T_a \times t_0/B \times T_a + t_0$  which is essentially a modified version of the Swiss formula where  $A = B \times T_a$

<sup>24</sup> The reduction in the Swiss formula is 50% when the  $T_0=A$ , because  $t_i = t_0 \times t_0/t_0 + t_0 = t_0^2/2t_0 = t_0/2$ . The average cut could be higher depending on the dispersion of the rates.

<sup>25</sup> Differential and more favourable treatment reciprocity and fuller participation of developing countries, Decision of 28 November 1979 (GATT doc. L/4903).

measured and (2) How much “less” should developing countries do. On the first question, India and Brazil have argued that LFR means they should have lower average percentage cuts than developed countries in the formula. However, developed countries believe that LFR could alternatively be measured by the end result or by the cuts in the applied rates. Since developing countries would have higher tariffs than developed countries at the end of the day, they would be doing less. Such a result could be achieved even by applying a simple Swiss formula with a single coefficient for all Members. They also argue that reciprocity should be measured at the end of the negotiations, taking into account all the components of the modalities, including sectoral negotiations and the overall flexibilities for developing countries. Some developing countries argue that there should be LFR in each and every component of the modalities and, most importantly, in the formula. The measurement of “reciprocity” is a rather old and unresolved issue and the chances are slim that it will be solved in this Round.<sup>26</sup>

On the second question, some consider that Members should avoid granting too much flexibility to developing countries. It is argued that developing countries have substantial interest in improving their access opportunities into other developing country markets. They point out that (1) “South-South” trade constitutes 40% of their current exports (see Figure 2), (2) intra-developing country trade is growing at a much faster rate than “North-South” trade, and (3) almost 70% of import duties levied on products from developing countries are paid to other developing countries.<sup>27</sup> However, Brazil and others consider this to be a distraction from the main goal of reducing high tariffs, peaks and escalation in developed countries. They note that there are better ways to improve South-South trade outside of the WTO, such as FTAs and the recently resumed GSTP negotiations.<sup>28</sup> However, other developing countries such as Singapore and Costa Rica have noted that the mandate emphasises improvement of market access conditions on products of “export interest to developing countries”, and that they are interested in diversifying their export markets.

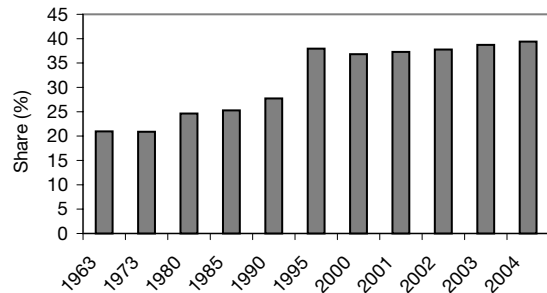
There appears to be, in addition, a profound divergence of views as to the role that flexibilities in paragraph 8 of the Framework will play *vis-à-vis* the formula cuts and the new bindings. This paragraph

<sup>26</sup> See A. Hoda: Tariff Negotiations and Renegotiations under the GATT and the WTO: Procedures and Practice, WTO, 2001, p. 52-56.

<sup>27</sup> See T. Hertel, W. Martin: Liberalizing Agriculture and Manufactures in a Millennium Round: Implications for Developing Countries, in: The World Economy, Volume 23, No. 4, 2000, p. 464.

<sup>28</sup> The Global System of Trade Preferences (GSTP) was an arrangement negotiated among developing countries, initially in the 1980s. Forty-one countries ratified the 1989 agreement.

**Figure 2**  
**Developing Countries,**  
**Share of Exports to Other Developing Countries**  
(Selected years)



Note: Based on WTO and GATT Secretariat data. The country definition differs slightly between some of the years.

would allow developing countries to choose one of the following options: (a) applying less than formula cuts of up to [10] percent of the tariff lines; or (b) keeping tariff lines unbound or not applying formula cuts for up to [5] percent of tariff lines. The numbers in brackets are still under negotiation and both options would be conditioned on not exceeding a certain level of imports. Some developed countries believe that developing countries should benefit either from a higher coefficient in the formula or from the flexibilities of paragraph 8, but not from both. They also recall that the numbers have not been agreed. However, several developing countries consider that they should benefit from both because they are stand-alone provisions in the Framework. These countries also consider the indicative numbers as a floor.<sup>29</sup> Paragraph 8 is of concern to others who fear that it would allow for peaks to continue even after the formula cuts and could potentially swipe the benefits of the NAMA negotiations for niche exporters, and they would like to have more transparency in this respect.

Finally, on the issue of new bindings, it should be noted that special provisions were included in paragraph 6 of the NAMA framework which would allow 12 developing countries that have less than 35% binding coverage countries to be exempted from the formula. In exchange they would be expected to bind all their non-agricultural tariffs at the average level of developing country bindings.<sup>30</sup> Similarly, under paragraph 9 of the framework, the 32 LDCs which are WTO Members would be exempted from the formula and only be expected to “substantially increase” their binding coverage. There are also ongoing discussions as to whether special treatment should be granted to the so-called

<sup>29</sup> See TN/MA/W/65.

<sup>30</sup> Preliminary calculations suggest that this average is approximately 27.5%.

<sup>31</sup> See TN/MA/W/66 and TN/MA/W/56/Rev.1 respectively.

“small economies” and the “small low-income economies in transition”.<sup>31</sup> This notion is challenged by others, particularly Latin American countries, who oppose creating new categories of developing countries.

#### Final Remarks

An agreement on full modalities for NAMA must provide for, *inter alia*, a common understanding on the treatment of unbound tariff lines, the formula, the number of coefficients and their level, as well as the

flexibilities for developing countries. Attaining this will not be an easy task, even if Members reach an agreement in the negotiations on agriculture. Notwithstanding appearances, the main obstacles in this area are not mathematical or statistical, but rather are grounded in negotiating tactics and profound differences of view in many of the issues. It is for this reason that a NAMA solution will probably only be found in the overall trade-offs of the Doha Development Agenda.

Lelio Iapadre\*

## The Bicycle on the Acclivity: WTO Negotiations and the International Integration of Services Markets

International market integration in the services sector is still relatively low, despite the widespread awareness of its beneficial role for economic development. This is partly the natural consequence of the intangibility of services, which often requires that they are consumed in the same place and time as they are produced, and partly the result of protectionist policies.

Services can be delivered internationally through four different channels, or “modes of supply”, in the language of the World Trade Organisation (WTO):<sup>1</sup>

- 1) *cross-border supply*, when the producer sells the service to a customer in another country, as in international transportation or in services delivered through telematic means. Cross-border sales are estimated to account for 35% of world international transactions in the services sector;
- 2) *consumption abroad*, when the consumer travels in order to purchase the service in the country where it is produced, as in international tourism. Consumption abroad is estimated to be in the range of 10 to 15% of world trade in services;
- 3) *commercial presence*, when the service is sold by the affiliate of a foreign firm, which normally has been established in the purchasing country through foreign direct investment (FDI). This is the most important mode of supply, accounting for 50% of the total;
- 4) *presence of natural persons*, when the provider travels in order to sell the service to a customer in another country, as in some personal and business services. Mode 4 is estimated at only 1 to 2% of

world trade in services, but its political importance is much higher, given the comparative advantages of developing countries and the restrictions they face in developed markets.

The share of services in international transactions is still low, as compared to their economic importance. Trade in commercial services, approximately corresponding to modes of supply 1 and 2, was only 19% of world trade in goods and services in 2004,<sup>2</sup> after fluctuating around a stationary trend in the previous decade. The share of services in the sales of foreign affiliates of multinational corporations (mode 3) is probably even lower than in trade.<sup>3</sup> On the other hand, the weight of services in gross domestic product (GDP) has been gradually growing, and reached 52% in developing countries and 72% in developed countries in 2001.<sup>4</sup> Even after discounting the serious problems that limit the availability and the reliability of statistics on services, it is clear that this sector is less open to international competition than the rest of the economy. The fact that most services are not easily traded across the border can partly explain this gap, at least for mode 1, but restrictive policies hindering international trade and investment in services are also very important, although difficult to measure.

However, this situation is changing. Strong technical and economic forces drive a process of gradual

<sup>1</sup> WTO: International Trade Statistics 2005, Geneva 2005, p. 8.

<sup>2</sup> WTO, op. cit., Table 1.

<sup>3</sup> This can be indirectly inferred from the fact that the ratio of foreign affiliates' sales to exports is lower in services than in manufactures in most countries for which data is available (UNCTAD: World Investment Report 2004, Geneva 2004, p. 320).

<sup>4</sup> UNCTAD: Handbook of Statistics 2003, Geneva 2003, p. 355.

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deepening of international integration in the services sector. Progress in electronic technologies is raising the degree of cross-border tradability of many services, such as education, health care and financial services. The very distinction between goods and services becomes more blurred in the context of e-commerce, with some services being incorporated into tangible reproducible goods. Although creating problems in the implementation of existing international agreements, this phenomenon is also contributing to making services more tradable.

An important integrating role is played by the growing international fragmentation of production processes, which is changing the geography of the world economy. The smooth functioning of global production networks, involving large multinational corporations, as well as an increasing number of small and medium-sized enterprises, requires intense cross-border flows of intermediate goods and services. Changes in labour markets, associated with diverging demographic trends between developing and developed countries, are fostering an increase in the international mobility of service providers.

Progress in the production of statistical information on the services sector is also developing,<sup>5</sup> and some signs of increasing international integration appear in the available data. For example, the share of services in the world stock of inward FDI has been estimated at 60% in 2003, as compared to 49% in 1990.<sup>6</sup>

The policy landscape is changing as well. An increasing number of developing and developed countries are adopting liberalisation policies, which usually imply opening domestic markets to international competition, in recognition of the crucial role played by services for consumers' welfare, as well as for the efficiency of production processes and the competitiveness of domestic enterprises. Preferential integration agreements, which are burgeoning in every region, extend their coverage to the services sector, aiming at removing market access barriers among member countries, although the implementation of the agreements often lags behind their formal conclusion. A new round of multilateral trade negotiations in the services sector is also a crucial element of the Doha Development Agenda at the WTO.

#### WTO Negotiations on Trade in Services

The starting point of the process of multilateral market integration in the services sector was the Uruguay Round of trade negotiations, which led to

the conclusion of the General Agreement on Trade in Services (GATS), in force since 1995. The GATS is widely considered to be an important framework agreement, setting valuable general principles and guidelines for future work, but with a limited immediate impact on the actual degree of trade liberalisation. An influential paper by B. Hoekman<sup>7</sup> used frequency ratios of specific market access and national treatment commitments undertaken under the GATS, in order to estimate the corresponding tariff equivalents by country and sector. A simple computation of their weighted average, with weights based on the value of output,<sup>8</sup> leads to an estimate of a tariff equivalent of 35% for developed countries and 58% for developing countries. In another paper B. Hoekman and A. Mattoo showed that the number of sectors where no restriction on market access and national treatment was maintained was only 25% in developed countries and 10% in developing countries.<sup>9</sup>

However, these figures overestimate the degree of protection, because they ignore the fact that actual policies are usually less restrictive than what is bound in GATS commitments. Borrowing a phrase which is often used to describe the difference between bound and applied tariffs, we could say that there is "water in the commitments". Governments tend to consider the gap between committed and applied measures as a cautionary "policy space", to be used if they need to re-introduce trade restrictions in case of unexpected shocks. The degree of restrictiveness of applied trade policies in the services sector can be assessed by comparing actual trade flows with their potential level, estimated through a gravity model. Using this approach, S.-C. Park obtained tariff equivalents that are considerably lower and less differentiated than those based on GATS commitments.<sup>10</sup> Their average level, computed with the same weights used for Hoekman's estimates, is 26% for developed countries and 27% for developing countries.

There is clearly much room for improving the situation, both by locking in applied policies into binding commitments and by further reducing the restrictiveness of applied policies. A new round of multilateral

<sup>7</sup> B. Hoekman: Assessing the General Agreement on Trade in Services, in: W. Martin, L. A. Winters (eds.): *The Uruguay Round and the Developing Countries*, Cambridge 1996, Cambridge University Press, pp. 88-124.

<sup>8</sup> Data on the value of output by country and sector has been drawn from the GTAP database.

<sup>9</sup> B. Hoekman, A. Mattoo: *Services, Economic Development and the Next Round of Negotiations on Services*, in: *Journal of International Development*, Vol. 12, 1999, pp. 283-296.

<sup>10</sup> S.-C. Park: *Measuring Tariff Equivalents in Cross-Border Trade in Services*, KIEP Working Paper 02-15, Korea Institute for International Economic Policy, Seoul 2002.

<sup>5</sup> E. Giovannini, W. Cave: *The Statistical Measurement of Services: Recent Achievements and Remaining Challenges*, OECD Statistics Working Paper, STD/DOC(2005)2, Paris, 3 August 2005.

<sup>6</sup> UNCTAD: *World Investment Report 2005*, Geneva 2005, p. 260.

negotiations on services was already envisaged in the GATS *built-in agenda*, and started in January 2000, proceeding very slowly in the following months. It was subsequently merged into the much more ambitious Doha Development Agenda, agreed in November 2001. After the failure of the Cancún Ministerial Conference in 2003, the July 2004 Package confirmed the Doha negotiating mandate and tried to give new impetus to the process.

Negotiations on services are based on bilateral requests and offers of specific commitments, allowing any country to choose what sectors and modes of supply to open to foreign competition. Since the first round of offers was believed to be very poor, the need for revised and more substantial offers was recognised in the July package. However, the results have not followed yet. As of 13 October 2005, 54 WTO members had not even presented their initial offers,<sup>11</sup> and only 28 revised offers had been tabled, counting the European Union (EU) as one.<sup>12</sup> Although the sector coverage of the offers is wide, their content is generally considered still inadequate, and the revised offers do not improve this situation significantly.<sup>13</sup> Offers tend to concentrate on mode 3, whereby countries seek to attract FDI, but are still weak on mode 1 and particularly on mode 4. In addition, very limited progress has been reached in the negotiations on horizontal issues, involving all sectors and modes of supply, and in the so-called GATS rules, such as the discipline on domestic regulations, the emergency safeguard mechanism, subsidies and government procurement.

The widespread awareness of the limitations of the request-offer approach has prompted some countries to explore the feasibility of alternative negotiating modalities. In particular, a group of members, including the EU, Japan and other Asian countries, has advocated the adoption of quantitative and qualitative benchmarks, to be used in order to agree on a minimum level of multilateral liberalisation of trade in services. Furthermore, they have proposed supplementing the bilateral request-offer mechanism with a plurilateral approach, meaning that groups of interested members could negotiate deeper specific commitments in particular sectors, to be applied on a most-favoured nation basis, leaving the door open to the participation of other members.

<sup>11</sup> The 33 Least Developed Countries (LDCs) that are members of the WTO are not expected to present offers.

<sup>12</sup> WTO: Special Session of the Council for Trade in Services, Report by the Chairman to the Trade Negotiations Committee, TN/S/22, Geneva, 13 October 2005.

<sup>13</sup> R. Adlung: *Turning Hills into Mountains? Current Commitments under the GATS and Prospects for Change*, Staff Working Paper ERSD-2005-01, World Trade Organization, March 2005.

These proposals have met strong opposition from most developing countries. If benchmarks were defined uniformly, the adjustment burden would be disproportionately high for developing countries, given their very limited initial degree of trade liberalisation, in contradiction with the principle of special and differential treatment. Even some developed countries, including the United States, have criticised the insistence on quantitative benchmarks, in the fear that it could jeopardise the formation of consensus.

It is clearly a matter of negotiating tactics. Members such as the EU and Japan, that are expected to offer more substantial liberalisation in the agricultural sector, in order to create the conditions for a successful conclusion of the round, are trying to increase the price of their concessions and widen the scope of the negotiating game, which now appears almost exclusively dominated by agriculture. By the same token, developing countries resist, in order to extract the maximum gains from their recently developed coordination capacity. The current situation appears deadlocked, and the final outcome is difficult to predict, depending on the double-edged interaction between governments and interest groups at the domestic and international levels.

#### The Reasons for the Deadlock

According to the logic of "reciprocal mercantilism" that drives trade negotiations, governments do not see external liberalisation as a structural reform in the interest of their own country, as it should be, but only as a "concession" to be traded against equivalent market opening measures from their partners. Most developing countries do not appear ready to offer significant liberalisation commitments in services, not only because they are still waiting for significant changes in the positions of developed countries on agriculture, but also because they envisage few beneficial trade-offs among different services sub-sectors, in which they feel that they do not enjoy significant comparative advantages. Furthermore, they often lack the sophisticated technical skills required to carry out successful international negotiations on trade in services.

On the other hand, developed countries are also finding it increasingly difficult to open their domestic markets to foreign competition. Protection demand is on the rise, propelled by fears of job losses due to international outsourcing of services, which compound with the widespread political aversion towards inflows of service providers from developing countries.<sup>14</sup> The problem is particularly evident in the EU, where the allegedly strong policy stance in favour of external trade liberalisation is at odds with the serious obstacles encountered in completing the single market for services, as shown by the harsh reactions against the

recent Commission's proposed directive on services.<sup>15</sup> Notwithstanding the large benefits that open services markets could generate for the European economy,<sup>16</sup> it has been argued that the EU is far from being a free trade area in services, given the persistent differences in national regulations among member states.<sup>17</sup>

Social organisations are not helping unlock the WTO round. As the Hong Kong Ministerial Conference approaches, the large and diversified movement opposing globalisation is intensifying its efforts to derail the negotiations. Even interest groups that are normally expected to favour trade liberalisation are not playing their role. In particular, the incentives for export-oriented producers to lobby for the removal of trade restrictions could be weaker than in the past. WTO negotiations are very slow and are perceived as less relevant, as the pace of technical progress accelerates, changing market conditions, and national policies become more open, going well beyond GATS commitments (often in the context of preferential trade agreements). It has also been argued that, in some cases, large multinationals that have entered a new market in the context of a privatisation process could be interested in hindering its external liberalisation, in order to reap the monopoly rents from protection.<sup>18</sup>

The prospects for a successful conclusion of negotiations are however less bleak than the above picture suggests. As already mentioned, important technological and economic forces are driving towards a more intense international integration in the services sector, eroding the demand for protection and the feasibility of traditional restrictive policies.<sup>19</sup> The widespread

awareness of the fundamental role played by services as production inputs in all sectors of the economy reinforces, from the importers' side, the lobbying pressure of services exporters. It has been argued that this pressure is asymmetric: it seems to vanish during the ordinary course of negotiations, given the costs of lobbying, but it can become very strong at the crucial junctures of the round.<sup>20</sup>

In addition, it should be remembered that the GATS is a very flexible agreement, allowing WTO members to set the pace of their liberalisation process according to their perceived needs. This flexibility, which has often been blamed as the main reason of the unsatisfactory liberalisation results achieved so far, is at the same time an important factor facilitating consensus building. An increasing group of developing countries, that have revealed comparative advantages in some services sectors and modes of supply, is taking an active role in the negotiations. India is the prominent example, being part of the recently formed "core group" of WTO members trying to favour an agreement on services.<sup>21</sup>

#### Conditions for a Successful Outcome

What shape should the negotiation outcome take to be defined as a success? The minimum requirement would be to substantially reduce the gap between applied policies and GATS specific commitments. As already mentioned, the actual degree of trade liberalisation in the services sector is higher than that implied by GATS commitments, because national policies have become more open, independently of the WTO process. This however does not mean that a multilateral binding of applied policies would be easy and/or irrelevant. On the one hand, it will reduce the "policy space" of national authorities. On the other hand, it will help overcome domestic interest groups asking for protection and it will increase the degree of stability of the regulatory framework.

A more ambitious scenario would require that developed countries offer serious commitments on modes 1 and 4, in exchange for a further opening of developing countries on mode 3, especially for infrastructural services such as energy, finance, telecommunications and transport, the liberalisation of which is essential to foster economic growth.<sup>22</sup>

Are these prospects plausible? The main conditioning factors are well known and lie outside the services table. A balanced agreement on agriculture still ap-

<sup>14</sup> Developed countries tend to link commitments on modes 3 and 4, opening market access to temporary inflows of service providers connected to the commercial presence of multinational corporations, which are clearly of limited interest to developing countries (P. Sauvé: Towards Development-Friendly Services Negotiations, paper prepared for the High-Level Meeting on WTO Key Doha Round Issues, Asian Development Bank, Osaka, 3-5 August 2005).

<sup>15</sup> Forum "Liberalising Services Trade in the EU", in: INTERECONOMICS, Vol. 40, No. 3, May/June 2005, pp. 120-39.

<sup>16</sup> P. Guerrieri, B. Maggi, V. Meliciani, P. C. Padoan: Technology Diffusion, Services, and Endogenous Growth in Europe – Is the Lisbon Strategy still alive?, Bruges European Economic Research Papers, No. 2, College of Europe, May 2005.

<sup>17</sup> R. Langhammer: The EU Offer of Service Trade Liberalization in the Doha Round: Evidence of a Not-Yet-Perfect Customs Union, in: Journal of Common Market Studies, Vol. 43, No. 2, 2005, pp. 311-25.

<sup>18</sup> P. Sauvé, A. Subramanian: Dark Clouds over Geneva? The Troubled Prospects of the Multilateral Trading System, in: R. B. Porter, P. Sauvé, A. Subramanian, A. Beviglia Zampetti (eds.): Efficiency, Equity, and Legitimacy – The Multilateral Trading System at the Millennium, Center for Business and Government, Harvard University, Washington 2001, Brookings Institution Press, pp. 16-33.

<sup>19</sup> B. M. Hoekman, P. A. Messerlin: Liberalizing Trade in Services: Reciprocal Negotiations and Regulatory Reform, in: P. Sauvé, R. M. Stern (eds.): GATS 2000: New Directions in Services Trade Liberalization, Center for Business and Government, Harvard University, Washington 2000, Brookings Institution Press, pp. 487-508.

<sup>20</sup> P. Messerlin: Success Requires a 'Grand Vision', in: Finance & Development, March 2005, pp. 24-5.

<sup>21</sup> EU Offer of Deeper Farm Tariff Cuts Fails to Restart Talks, in: Bridges – Weekly Trade News Digest, International Centre for Trade and Sustainable Development, Vol. 9, No. 37, 2 November 2005, pp. 1-3.

<sup>22</sup> P. Sauvé, op. cit.

appears as the most important key to successfully concluding the negotiation agenda, although other issues are also very controversial. Externally to the WTO, the general climate of international political relations is of fundamental importance, as shown by the success of the Doha Ministerial Conference in November 2001, but the ordinary interplay between domestic interest groups, national governments and international coalitions remains essential.

The dynamics of trade negotiations is often described as the behaviour of a bicycle, which must be continuously pushed forward, in order not to slip back into protectionism.<sup>23</sup> Some theoretical models show that the bicycle can be self-propelling, in the sense that successful trade agreements tend to create conditions favourable to further liberalisation, by reducing the bargaining power of import-competing interest groups and the incentives for governments to defeat the agreements.<sup>24</sup>

The previous analysis suggests that the virtuous circle of self-propelling trade liberalisation can be put into motion, at least in the services negotiations, where traditional protection tools are lagging behind technological progress and changes in market structures. However, it will not be an easy process. There are also internal and external forces pushing in the opposite direction.

First of all, it must be remembered that, given the limited cross-border tradability of services, the long-standing upward trend of their economic weight in terms of value added and employment – other things being equal – would translate into a fall of the average degree of international openness of the world economy, prompting a further strengthening of the demand for protection.<sup>25</sup> This composition effect has so far been more than offset by stronger integration factors, but its presence further underlines the importance of the current round of WTO negotiations.

However, since the failure of the Seattle Ministerial Conference in 1999, it has become clear that the WTO is prone to the risk of becoming a victim of its own success.<sup>26</sup> Consensus building has become more difficult with the continuous increase in the number of

member countries. Moreover WTO members, including developing countries, are now much more active than in the past in pursuing their own targets, since the agenda of trade negotiations has been gradually extending from border barriers to politically sensitive domestic regulations. The principle of the “single undertaking”, asking members to reach an agreement on all the negotiation tables, tends to further increase the rigidity of their positions.

At a deeper level, related to the interplay between different interest groups, the difficulties of negotiations are increased by the tighter interdependence of national economic systems. Even if the progress of international economic integration might reduce the weight of vested interest groups, as implied by the self-propelled bicycle model, it is also evident that the risk of a protectionist backlash is always present, as is shown by the recent reactions to the competitive success of China and other emerging countries.<sup>27</sup> On the other hand, as mentioned before, the counterbalancing action of interest groups favouring trade liberalisation could have been weakened by diminishing incentives. When alternative negotiation tables exist, such as bilateral and regional integration initiatives, not only does the pressure of groups interested in trade liberalisation decrease, but trade negotiators tend to adopt more aggressive stances at the multilateral table.<sup>28</sup>

This is not to say that the WTO system will inevitably face a protectionist backlash. On the contrary, as was also mentioned before, many forces still sustain the process of international economic integration. Even if they were weaker than protectionist interest groups, this would not be enough to mechanically draw negative conclusions on the prospects of the current round. The value of free trade is nowadays strongly rooted in dominant cultural orientations, although the public opinion increasingly cares about its possible social and environmental implications. The outcome of trade negotiations is not so much the exclusive result of interest group interactions, but rather depends on the battle of ideas, as well as on the ability of governments to define and accomplish a common vision of the general interest of the international community.

The WTO bicycle is still available, but the climb is hard. Good riders are urgently needed.

<sup>23</sup> J. Bhagwati: *Protectionism*, Cambridge, USA, 1988, MIT Press.

<sup>24</sup> R. W. Staiger: *International Rules and Institutions for Trade Policy*, in: G. Grossman, K. Rogoff (eds.): *Handbook of International Economics*, Vol. III, Amsterdam 1995, Elsevier, pp. 1497-1551.

<sup>25</sup> J. Stiglitz: *Addressing Developing Country Priorities and Needs in the Millennium Round*, in R. B. Porter, P. Sauvé (eds.): *Seattle, the WTO, and the Future of the Multilateral Trading System*, Cambridge, Massachusetts 2000, Harvard University, John F. Kennedy School of Government, The Centre for Business and Government, pp. 31-60.

<sup>26</sup> J. J. Schott, J. Watal: *Decision-making in the WTO*, in: J. J. Schott (ed.): *The WTO after Seattle*, Institute for International Economics, Washington 2000, pp. 283-92.

<sup>27</sup> A. W. Deardorff: *Market Access for Developing Countries*, in: R. B. Porter, P. Sauvé, A. Subramanian, A. Beviglia Zampetti (eds.), op. cit., pp. 159-73; A. Sapir: *Who's Afraid of Globalization? Domestic Adjustment in Europe and America*, in: R. B. Porter, P. Sauvé, A. Subramanian, A. Beviglia Zampetti (eds.), op. cit., pp. 179-204.

<sup>28</sup> J. S. Odell: *Negotiating the World Economy*, Ithaca 2000, Cornell University Press.

Sheila Page\*

## Special and Differential Treatment in the Doha Round

Special and Differential Treatment (SDT) has served three purposes in the WTO in the past:

- to give developing countries better market access
- to offer them less restrictive rules
- to use the trading system to transfer money to them.

The third was unintentional, and is highly distorting.

The first is of declining use, and the second has limited relevance to the current generation of developing countries. And the first and third cause damage to other developing countries which they are no longer willing to accept. Therefore it is now necessary to find a new mechanism.<sup>1</sup>

### History of SDT in the WTO

From the beginning, the reasons for SDT have derived from a range of positions, depending on differing, and changing, views of the needs of developing countries and of the requirements of the international system. Any "special" treatment can only be defined relative to what is "normal", so SDT must depend on what rules are generally accepted. The increase in the coverage and the legal enforceability of trade rules has meant that what needs to be defined as "special" has changed. What will help development depends on explicit or implicit assumptions about what "development" is and about whether and how policy and trade can influence this. It is also influenced by perceptions about the current characteristics of "developing countries", so of how they need to change to be come "developed". In the 1940s and 1950s, development was regarded as virtually synonymous with industrialisation. In the 1960s, weakness and dependency were stressed. In the 1970s and 1980s weak institutions and economic vulnerability were seen as most important. In recent years, the focus has been on poverty. Now, there is the beginning of a return to emphasising capacity to produce and to trade.

The system that evolved tried to meet two criteria. SDT was to be consistent with the "rule-based" system, offering fair access and certain trading conditions for all, to provide the conditions for efficient, non-distorted growth. But within this, SDT was intended to let the GATT, later WTO, help development, and certainly to avoid damaging it, through offering more

favourable than normal conditions for developing countries. In that it was offered, it was always a top-down approach. An alternative approach might have been to strengthen developing countries within the international system, and thus allow them to negotiate what *they* considered favourable conditions. The growing influence of developing countries in the WTO has meant a *de facto* shift to this second approach, but there remains a serious conflict even among those who are broadly in favour of "special" treatment for developing countries between those who want this to be designed to do what developing countries want and those who want it to do what they consider to be "good for them". As with all negotiations, the outcomes were often compromises that could be justified on more than one criterion.

We can identify five types of argument for SDT, but in fact well over 50% of the value of preferences and probably of SDT in total comes from a sixth. The first is that development requires different policies from growth, and the second is a variant of this, that adjustment to new trade rules requires different policies because developing countries have further to go: these can justify both a need for more favourable trading conditions, such as preferences, and more policy independence. The third is retaliation: given the special treatment allowed to developed countries, such as the special provisions for agriculture or textiles and clothing, developing countries have the right to equal amounts of deviation from WTO rules (whether they actually benefit economically from this or not). The fourth argues that some countries require different types of policy: small countries or islands or whatever the speaker's particular interest is. This is in some ways the most difficult to deal with as it suggests that universal rules are not achievable and the WTO has avoided conceding this. The fifth, the one which has emerged recently, is that some developing countries need non-trade gains in trade negotiations, because they have little to gain from trade. Both the WTO system, of trade-offs, and the rhetoric, of a development round, require that all countries should have a gain.

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<sup>1</sup> See Peter Klein, Sheila Page: Special and Differential Treatment of Developing Countries in the World Trade Organization, Global Development Studies No. 2, 2005, for a fuller discussion of the history and possible reform of SDT.



The one which has been most popular, however, has been that trade can and should be used as aid, providing what are in economic terms rents: developed countries paying above market prices for a fixed quantity of an import from developing countries, not to use that product as an engine of development (as manufactured exports were in the more traditional, first argument, preferences), but to transfer income to traditional suppliers. This contorted phrasing mainly means sugar, but the exemption of some countries from the Multi-Fibre Arrangement (MFA) controls and provisions on bananas and fish have had a similar effect.

### **Why SDT Is a Major Issue in the Current Negotiations**

Preferences do give countries an advantage, so preserving them is a significant trading interest for some countries. For those with high concentrations of exports in heavily protected commodities, the gains from preferences are very large. The role of concentration means that it is mainly small countries who gain. The highest barriers, and therefore the highest gains from preferences, are in sugar, bananas, and clothing, so the gainers have included a number of small LDCs: Malawi (which could lose more than 10 per cent of its exports if preferences ended), Mauritania, Cambodia, Maldives, Haiti, Cape Verde, Sao Tome, Tanzania, and the Comoros, but also some non-LDCs, principally among the small islands: Mauritius and the Caribbean. Only one large country is affected: Bangladesh whose massive response to the special concessions for Least Developed Countries (LDCs) exporting clothing during the period of the MFA now makes it vulnerable to the end of the Arrangement.

There is less evidence that policy flexibility has major benefits, but a very strong desire to keep it. For many countries just starting development, it seems important to keep the option of using interventions that other countries used, even if they are not currently using them and even if they do not currently have the resources to use them.

And finally, developing countries are no longer passive, so what they think matters. First the big countries, especially Brazil and India, were active: this dates from the 1970s.<sup>2</sup> The G20 is a new name, but not a new force. What is new is that the small and poor countries, which had previously been inactive because they depended on preferences, not on GATT rules, have become active, because they now under-

stand the potential risks of preference erosion and of new rules.

The evidence that SDT is an issue should not, however, obscure the fact that the largest benefits, to the largest numbers of poor people in developing countries, will be from liberalisation, of agriculture, non-agricultural goods, and services. This must be the major part of any "development agenda" or Hong Kong Development Package. But to secure this, it is necessary to have at least the consent, if not the enthusiasm, of those developing countries which may lose from liberalisation.

Most of the largest countries (because they are large) do not have preferences, and do face barriers: India and China, for example, were specifically targeted as exclusions in the EU's 2005 GSP reforms.<sup>3</sup> India, Brazil and South Africa are the leaders of the G20 and are pressing for more liberalisation by developed countries.

The policy flexibility agenda has gained importance because there is increasing pressure to expand the areas regulated in the WTO. This includes not just the introduction of new areas, like trade facilitation, but deepening integration in existing areas, like services and rules. As countries become more integrated into the system, there are clear benefits to predictable international regimes, but new rules are costly and may not be the priority for the poorest or smallest developing countries. Exemption from new rules and/or compensation for the costs of compliance have emerged as major issues, in the specifically SDT negotiations and in trade facilitation.

How to resolve the conflicts of interest, between preference receivers and the rest, and the conflicts of approach, of regulation and policy freedom? A possible answer is: by a combination of new principles and new money.

### **New Principles**

*An inclusive organisation must build in flexibility.* When it was founded, GATT was what today would be called a group of like-minded countries, major traders accepting a particular system of international economic relations. This meant that the members could assume agreement on a common approach to most rules. As it has expanded, it has acquired *de facto* a different aspect, of being the organisation that regulates most international trade. This has given countries which might not be "like minded" an incentive to join to avoid the costs of exclusion from both trade and rule-making. At the same time, the existing members have started to want universality of mem-

<sup>2</sup> The history of developing country participation in GATT negotiations is summarised in Sheila Page: *Developing Countries: Victims or Participants*, ODI 2003.

<sup>3</sup> European Commission, GSP regulation, 2005, and press release.

bership in order to ensure that the benefits of certainty and predictability apply to all trade by its members. If WTO members want this, then both the possibility that some countries are permanently “different” and the certainty that some will not share the same approach to all rules imply that the WTO must either limit its rules to those which can benefit and be accepted by all members or allow permanent derogations for countries with different economies or different approaches to economic policy.

*SDT must be consistent with countries’ own assessments of their interests.* SDT must now aim to give developing countries what they want, not what benevolent donors, or even researchers, think that they should want: the growing interest and activity by developing countries in the WTO must be rewarded by taking their views seriously.

Preferences are no longer an acceptable long-term policy. As well as the inevitability of erosion, there is the problem that the more effective they are, the more damaging they are to other developing countries. Most of the gains from preferences come from trade diversion, from other developing countries, not from trade creation, replacing developed country producers. But ending them will have a cost because they remain valuable to those who receive them.

#### Trade Solutions

Some argue that the solution lies in new preferences and new forms of trade assistance. Are there solutions within trade, as the Doha mandate and current negotiating framework suggest?<sup>4</sup> Suggesting that countries find gains in other trade does not work for some countries on any calculations of the net effect of changes in trade goods.<sup>5</sup> Some countries will have a measurable negative outcome from any significant liberalisation of trade because their losses from preference erosion will be greater than their gains from other parts of the agreements. The more special access has been offered to groups like the LDCs, for example Everything But Arms (EBA) from the EU, or to the African countries, who benefit from the Africa Growth and Opportunity Act (AGOA) of the USA, the more difficult it is to find gains for them from WTO liberalisation.

Preferences for services are a theoretical possibility. These would be more likely to be trade creating, especially if in forms such as Mode 4, temporary movement

of persons, which are currently very restricted. Many countries have not opened a wide range of services to imports, and seem unlikely to do so on a general basis because they fear competition from the big countries, like China and India, so preferences for others would not be quickly eroded by MFN liberalisation. There is no equivalent of “tariffs”, so markets are only open or closed, with no intermediate level. Therefore, if preferences are offered to one group of countries, whether all developing countries or only the LDCs, this will “create” new trade. It is unlikely to displace countries that are already exporting. There are high estimates of potential gains from complete freeing of movement of people. Such gains would certainly reduce the number of countries facing loss, but would require a willingness to open to foreign labour that has not yet been seen in developed countries (and a major transformation in some developing countries to a migrant economy).

Taking advantage of existing preferences is limited by rules of origin, so liberalising these could be useful, and the contrast between the successful development of African exports of clothing to the USA under AGOA and their limited success to the EU under Lomé and Cotonou agreements, shows that rules can make a difference, but obviously this would only help processed goods. Two of the three most affected goods are sugar and tobacco.

#### New Money

The type of country at risk suggests that trade may not be the logical answer. Many LDCs are landlocked and/or distant from markets, with poor trading infrastructure. They are precisely the countries where the supply constraints on using preferences may be most serious. The obvious answer, to an economist, is money, and this is now finally being more broadly recognised. Transferring resources to a country through distorting trade is not the most efficient way of transferring resources, just as trade protection is not the best way to help the poor at the national level.

The 2005 slogan has thus become Aid for Trade, replacing the old slogan of “trade not aid”. Proposals have emerged from research,<sup>6</sup> taken up by the UNDP,<sup>7</sup> from a commission chaired by Ernesto Zedillo,<sup>8</sup> from a consultation process among delegations to the WTO,

<sup>4</sup> WTO: Ministerial Declaration, 2001, WT/MIN(01)/DEC/1; WTO: Doha World Programme, General Council Decision of 31 July 2004, WT/GC/W/535.

<sup>5</sup> The first calculations showing this were by the IMF: Financing of Losses from Preference Erosion, Note on issues raised by Developing Countries in the Doha Round, 2003, WT/TF/COH/14; these were extended in Katerina Alexandraki, Hans Peter Lankes: Estimating the Impact of Preference Erosion on Middle-Income Countries, IMF Working Paper, 2004.

<sup>6</sup> Sheila Page: A Preference Erosion Compensation Fund, ODI 2005.

<sup>7</sup> The 2005 Human Development Report, p. 147, suggested: “Establish in 2006 a trade adjustment compensation fund providing \$500 million a year for the next decade to compensate countries for preference erosion.”

<sup>8</sup> Committee for the project Development and the Global Trade Architecture, chaired by Ernesto Zedillo: Strengthening the Global Trade Architecture for Economic Development: An Agenda for Action, September 2005, www.ycsg.yale.edu.

although these were not accepted when published with the more hesitant proposals by the World Bank and IMF in the Autumn 2005 meetings,<sup>9</sup> from statements by the Director General of the WTO,<sup>10</sup> and in the EU WTO position paper of 28 October.<sup>11</sup> These discussions led in November 2005 to a WTO-secretariat-driven process to add a reference to Aid for Trade to the negotiating mandate.

The broader proposals look at increasing significantly the share of aid going to help countries develop the supply needed to trade: infrastructure, institutions, investment in productive sectors, i.e. a full replacement of what preferences were intended to do. A more narrow approach focuses on resolving the conflict in the WTO: offering those countries which will lose preferences if there is general liberalisation at least as much as they will lose. Both are needed, but the second is more urgent.

Compensating those who lose preferences through a fund, rather than other trade concessions would be a major new initiative for the WTO. The reason for suggesting it is that the other proposals for dealing with the problem of preference erosion are more unsatisfactory and more difficult.

- There is no realistic way of using trade.
- Ignoring the problem has not made it disappear: this was the Uruguay Round solution, partly because it was only taken seriously towards the end of the Round, and partly because even when some did recognise it, the African countries and LDCs affected were not participating actively in the Round; they did not themselves recognise the problem; and there was no negotiating pressure to deal with it.
- Asking other agencies to deal with the problem did not work when attempted on an informal basis for the problems of food importers (Net Food Import-

<sup>9</sup> World Bank, IMF: Doha Development Agenda and Aid for Trade, 25 September 2005.

<sup>10</sup> "I hope that by Hong Kong we can reach consensus on a decision to enhance our common existing mechanism for trade related technical assistance for least developed countries, the 'Integrated Framework'. Looking to the conclusion of the Round, I believe we should arrive at a more ambitious package of commitments for technical and financial assistance by the end of 2006." (Speech by Pascal Lamy, Director General of the WTO, to the Development Committee, Geneva, 5 October 2005.)

<sup>11</sup> "Commitment by all members to address the issue of preference erosion ... through a combination of trade-related and supply-side related responses in Hong Kong, so as to provide the countries concerned with at least the outlines of a substantial package of measures to be finalised in the remainder of the DDA and that will be part of the end-result of the Round.

"Agreement by developed Members on an aid-for-trade package in Hong Kong. .... This package would be based at a minimum on improving the Integrated Framework ... to be in place no later than 1 January 2007, together with commitments from donor Members to increase their trade related aid." (EU position paper submitted to WTO 28 October 2005.)

ing Developing Countries, NFIDC) in the Uruguay Round, and has not worked for preference erosion, because these agencies have their own priorities.

For one new issue in the WTO, a route seems to have been found, by directly linking the proposed "binding" of any new agreements on trade facilitation to technical assistance. This is not directly applicable for preference erosion because the countries suffering preference erosion have no control over either the tariff cuts or the response of other countries to them, so there is no similar sanction available. But the funding of this and any compensation for terms of trade losses on food could be treated with preference erosion, as all are "third party" costs of a WTO settlement: costs incurred so other countries can benefit from the Round.

Whatever the mechanism is, in or outside the WTO, a formal assurance would need to be built into WTO negotiations, "bound" as enforceably as the tariff changes that would give rise to the preference erosion, because experience of previous good intentions, such as the NFIDC, means that countries could not rely on unenforceable indications of good will. The most obvious way to set up a fund for designated purposes would be required contributions from all developed countries (some developing might contribute, but in a development round, the major responsibility should fall on the developed), but the fund could be a "virtual" fund, with commitments and disbursement monitored, not administered, by the WTO. How the contributions were determined could have various criteria (share of trade, income, "guilt" in preferences ...) If developed countries preferred to make voluntary contributions, to avoid the inference that they were being compelled to do so because of past "errors" in preferences, this would be feasible, provided the commitments were legally irrevocable. Funding should not reduce other aid flows, and would need to be paid as grants, not loans.

Estimates by the IMF and others suggest the sums required even for a significant Doha settlement would be of the order of \$500 million a year. A weaker settlement would produce smaller losses. Direct EU support for sugar exporters affected by EU reforms, which has already been agreed, further reduces the required new resources.

SDT has evolved from giving access to providing benefits for the poorest countries. Now it must find a way to take account of the bargaining power of developing countries, both those who gain from preferences and those who do not, and it must meet the needs of those who cannot benefit directly from trade liberalisation.

Simon J. Evenett\*

## Some Tough Love on “Aid for Trade”

Recently the staffs of the World Bank and the International Monetary Fund wrote the following in a memorandum to their respective Development Committees:

“But while there are real gains for developing countries from active participation in the Doha Round, gains will not necessarily be automatic, and some countries may experience transitional adjustment costs. Increased international assistance will be required to help countries overcome supply-side constraints in order to take advantage of new trade opportunities from the Doha Round, or to address transitional adjustment costs from liberalization. This “aid for trade” is an essential element of a successful, pro-development Doha package.”<sup>1</sup>

In this short essay I examine several of the claims made in this quotation, including the rationales advanced for aid for trade (AFT). I also ask what this statement implies about our understanding of the effects of trade liberalisation over time and about the appropriate role of international organisations, such as the World Trade Organization (WTO).

Before examining in detail the rationales for AFT a number of contextual observations are in order. The first is that the factors identified in the above quotation – namely, adjustment and integration – are not new, even if proposals for AFT are. Why, then, have proposals for AFT only been advanced recently? A combination of the following factors may go a long way to answering this question: the adoption by WTO members at the Doha Ministerial meeting of the so-called development mandate (which, for the first time, elevated the performance of developing countries to be an important objective of a multilateral trade round); the expansion of preference regimes in the mid-to-late 1990s and the belief that any across-the-board tariff cuts negotiated in the Doha round could substantially reduce the value of the preferential market access to industrialised country markets enjoyed by some developing countries; and the widespread perception

encouraged by some non-governmental organisations and found in certain World Bank reports that many developing countries did not benefit from the Uruguay Round of multilateral trade negotiations and, on this view, the causes were circumstances external to, or imposed on, these developing countries. Taken together these factors imply that some developing countries – as many as 100 according to some trade experts in Geneva – see themselves as victims of the last trade round and likely losers from this round.<sup>2</sup> This, it is said, they find galling especially in a round which is supposed to be devoted to taking their interests seriously. Proposals for AFT, then, can be seen as one way to persuade these developing countries that the further liberalisation of the multilateral trade system is in their interests as well.

### Assessing the Rationales for AFT

The advocates of AFT have identified at least five possible uses to which additional support for developing countries could be put. These quite disparate uses are:

- to cover, in whole or in part, the likely adjustment costs and losses that result from so-called preference erosion<sup>3</sup>
- to cover, in whole or in part, the likely adjustment costs and losses felt by net food importing countries should certain agricultural trade reforms be implemented<sup>4</sup>
- to cover, in whole or in part, adverse macroeconomic adjustments in developing countries that may be triggered by multilateral trade reforms, including the loss of tariff revenues and the costs of inter-sectoral labour reallocation<sup>5</sup>

<sup>1</sup> «Doha Development Agenda And Aid For Trade», A submission by the staffs of the World Bank and the International Monetary Fund to the 25 September 2005 meeting of the Joint Ministerial Committee of the Board of Governors of the Bank and the Fund On the Transfer of Real Resources to Developing Countries (the “Development Committee.”), Document number DC2005-0016, 12 September 2005, p. 7.

<sup>2</sup> It should be remembered that not every developing country stands to benefit from agricultural trade liberalisation, which has been the focus of most of the trade negotiations in 2005. Indeed, from time to time the African, Caribbean and Pacific (ACP) group of nations signals to other WTO members that the successful conclusion of negotiations on agricultural trade matters, should that ever come to pass, in no way implies that these countries’ negotiating objectives have been met.

<sup>3</sup> Susan Prowse: “Aid for Trade” Increasing Support for Trade Adjustment and Integration – A Proposal, Department for International Development, United Kingdom, June 2005.

<sup>4</sup> Ibid.

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- to finance, in whole or in part, the trade-related supply side and administrative investments that developing countries “must” make so as to benefit from the opportunities created by multilateral trade reforms or, more generally, by integrating further into the world trading system<sup>6</sup>
- to finance, in whole or in part, some of the new resource-intensive commitments that developing countries may take on as part of the Doha round.<sup>7</sup>

Proponents of AFT go on to note that, should the Doha round be concluded with a high degree of ambition then this would generate (in absolute terms, if not necessarily as a percentage of national incomes) substantial benefits for industrialised countries. It is argued that a small fraction of those gains should be put aside to fund AFT projects in eligible developing countries. Prowse<sup>8</sup> and others suggest that the Integrated Framework programme could be expanded in scale to administer the AFT funds, but do not rule out other organisational modalities.

An exclusive focus on aggregate welfare effects of the successful conclusion of the Doha multilateral trade negotiations is misplaced, advocates of AFT contend. The distribution of those gains across countries is an important determinant of the political viability of multilateral trade liberalisation. The existence of preference erosion, potential losses to net food importers, and the possible difficulties in replacing some tariff revenues with other sources of governmental income in countries without well developed taxation systems, implies that one cannot dismiss *a priori* concerns that some of the elements of national welfare could be detrimentally affected by the conclusion of the Doha round on ambitious terms. Having said this, proponents of AFT are quick to note that although some of the elements of national welfare may be adversely affected, if only temporarily, by the conclusion of the Doha round, it is the effect of the round on a nation’s overall level of welfare that should influence the eligibility of a nation for AFT.

Although it is never stated this way, one way to think about the role of AFT is that it is to ensure that any Doha round package results in pareto improvements for each developing country. Here, AFT can be seen as effectively as a series of transfers that compensate (where appropriate) and facilitate adjustments in developing countries so that they do not lose from the conclusion of the Doha round. Seen in this way pro-

<sup>5</sup> Ibid.

<sup>6</sup> Ibid.

<sup>7</sup> «Doha Development Agenda And Aid For Trade», op. cit., and “An approach to development-related issues in Trade Facilitation. Ideas developed by Switzerland, Switzerland 2005.”

<sup>8</sup> Susan Prowse, op. cit.

posals for AFT may be well received by those economists (myself included) who are unwilling to see the interests of one group of nations (or interests within those nations) sacrificed to attain the greater good (however defined). Of course, ensuring that no nation is made worse off by the conclusion of the Doha round is not the same as arguing that each country should share in the gains created by the Doha round. The latter – perfectly legitimate – normative objective would require a different set of transfers to developing countries and I note that proponents of AFT have not made their case in these terms either.

Having stated by support for one form of AFT let me express some doubts about a number of the arguments used to advance these proposals. I make no apologies for relating these arguments to our understanding of resource allocation in economies open to trade because, from time to time, in discussions on AFT I wonder if those linkages are as extensive as they could be.

My first comment on the arguments for AFT is that it is important to distinguish between the erosion of rents and the costs of adjusting from one situation (equilibrium outcome) to another. I start by noting that, as an ethical matter, I suspect that many are far less willing to support compensation for rent loss than for adjustment costs, even though compensating the former may be necessary in some instances to assure the political viability of any trade accord.

However, my main concern here is that our understanding of the adjustment processes that developing countries go through during and after multilateral trade liberalisation is a lot less well advanced than the comparisons of the beginning or end points of rest, or equilibria. Is it any exaggeration to say that the number of studies reporting comparative statics estimates of the gains from multilateral trade liberalisation exceed the number of careful studies of trade-related adjustment processes in developing countries by a ratio of ten to one? Moreover, when adjustment costs are discussed by trade economists they tend to be reported (often dismissed) as small and therefore (so the argument goes) easy to accommodate with complementary national measures, such as job retraining.<sup>9</sup> These claims, resting as they do on a limited body of evidence, are hard to square with developing country concerns about the magnitude of adjustment triggered by trade reforms. Rather than downplaying the latter, researchers might ask if they have missed something about the adjustment process.

In this respect, the adjustments often triggered (or the changes often recommended) relate to policy and

<sup>9</sup> I note that proponents of AFT appear to have kept an open mind about the magnitude of adjustment costs.

institutional changes and not just to markets, which most economists tend to feel more comfortable analysing. For example, replacing tariff revenues with income from broad-based labour or value-added taxes may be an essential part of the adjustment process for some developing countries in an ambitious Doha round outcome. Are trade economists absolutely confident about the magnitude of the transition costs associated with what is essentially a public finance question? Similar questions could be posed about the labour market adjustment processes in developing countries. Here a little more humility may be in order.

Another logical possibility that tends to get overlooked is one that arises when preference erosion undermines the commercial viability of an entire sector in a developing country. Some poorer countries forcefully assert that, even with ambitious cost reduction programmes on the part of their producers, substantial preference erosion will result in the collapse of a major industry. Many models that are used to estimate the costs of preference erosion assume that the minimum marginal cost of production of the good in the preference-receiving country is very low, or even zero, and so do not generate complete industry collapse when preferences are eroded by substantial cuts in most-favoured nation (MFN) tariff rates in industrialised countries. Arguably, we need to know more about the likelihood of such collapse and about how developing countries have adjusted in the past to the elimination of industries that employ a substantial proportion of the national labour forces. How long did adjustment take before unemployment returned to its pre-collapse levels? What were the effects on wages and employment? What steps can be taken to reduce the transition costs of inter-sectoral reallocation of resources? What is needed here is more facts and more analysis of those facts, and less resort to first principles to dismiss the adjustment-related concerns. In sum, I suspect that our ability to cost and implement AFT will require a much deeper understanding of the adjustment processes that developing country workers, consumers, firms and governments go through as result of multilateral trade liberalisation.

My second set of comments relates to an implicit assumption made in proposals for AFT; namely, that developing countries under-invest in the administrative, infrastructure, and other reforms that influence the extent to which they benefit from the opportunities created by trade reform and by open markets more generally. In my view it is appropriate to ask why such under-investment occurs, as the diagnosis may reveal something about the optimal cure. Perhaps the best attempt to address this matter can be found in a

document by the staffs of the World Bank and the IMF where it was argued:

“There may be too little trade reform not only because the benefits of unilateral trade liberalization may be poorly understood by the general public, but also in part because MFN (non-discriminatory) trade reform has some of the characteristics of a global public good and is not adequately internalized in country processes. Trade policy reforms (such as lowering of tariffs) and investments in trade machinery (such as customs reform and ports) can have significant externalities. All countries benefit from one country’s trade reforms and trade-related investments, and benefits are increased when undertaken by a number of countries concurrently. However, the full benefits of reform are not captured by the country itself, leading potentially to “under-investment” in reform.”<sup>10</sup>

What should one make of this argument?<sup>11</sup> First, it seems to suggest that a difference exists between national and global returns/benefits at the margin. If the costs of investments in reform are borne entirely by a nation, then under-investment will result. Some reforms that are optimal from the perspective of world welfare will not be undertaken by the nation in question. If indeed this is the argument then the proper policy response is to offer a subsidy to the decision-maker equal to the difference between the national and global marginal benefits at the optimal level of investment – and not to offer a lump sum transfer, which one could conceive the current AFT proposals calling for. Having said that, one could conceive of a broader AFT programme having a subsidy-based component (to tackle under-investment) and, where appropriate, a transfer-based component (to compensate outright “losers” from multilateral trade reforms). The underlying point, however, is that AFT programmes need to be structured to remedy the sub-optimal decision-making in each area where policymaking and private sector decision-making critically impinge upon developing country export performance.

My second concern with this “internalisation” argument is that it is far too broad to be a convincing defense of AFT for developing countries. The argument, after all, does not discriminate between countries on the basis of their level of development. And it certainly does not show that under-investment is a more serious problem for developing countries than for other countries. Also, it is unclear that full internalisation occurs in industrialised economies, in which case shouldn’t we be subsidising investments in these economies too (especially since developing country

<sup>10</sup> «Doha Development Agenda And Aid For Trade», op. cit., p. 9.

<sup>11</sup> Readers should note that space considerations only allow me to make a limited number of comments about this argument.

exporters will benefit from some of these trade-related investments)? I suspect that the implicit assumptions being made are that industrialised countries are rich enough to take care of themselves or that the development mandate for this round calls only for a focus on developing countries in this regard. (I am not arguing that either of these assumptions is appropriate in this context.) Either way, it would be better to spell out any implicit assumptions in making the case for AFT, or to reformulate the argument so that it specifically relates to the circumstances of developing countries.

My third concern about this argument is that it may be misleading to think about the rationale for under-investment in a given activity or reform as essentially independent of the levels of investment in other areas that affect the ability of developing country firms to take advantage of the opportunities created by multilateral trade liberalisation. Here, so-called O-ring reasoning may be more appropriate, where sub-optimal outcomes in any one component of a nation's trade-related capacity reduces the returns to investing in other components. One could, for example, envisage that the returns expected from investing in a new port are reduced by the existence of a corrupt and inefficient customs service. This way of thinking about the problem suggests that the goal of AFT is to break a self-enforcing cycle of under-investment in supply side-related capabilities that has persisted over time. In a nutshell, the AFT programme that one might design if the internationalisation argument is employed may well differ markedly from a programme based on O-ring reasoning.

Proposals for AFT also bring to the fore a question that has not been resolved ever since WTO members adopted the development mandate at the Doha Ministerial meeting. That question is: given the pre-existing mandates of the WTO in what ways, if at all, does the adoption of the development mandate alter how the performance of the multilateral trading system is evaluated? One of the factors motivating AFT is the perception that developing countries need assistance to capitalise on the opportunities created by trade reforms. If AFT is adopted does that mean that the WTO in general, or the Doha round in particular, will be judged in terms of its impact on developing country exports – rather than on the opportunities created by negotiating lower trade barriers or by the implementation and compliance with new multilateral commitments? If so, where does this argument stop? There are plenty of ways of expanding the exports of developing countries that violate the non-discrimination principle (unilateral preference schemes are one example that comes to mind). Are we to start trading off departures from non-discrimination for increases in the exports of a subset of the WTO membership?

Or, given the development mandate, is the correct way to judge the Doha round in terms of the export growth it generates for developing countries recognising that the round seeks to reduce the degree of discrimination in the world trading system? If this is the correct formulation (and arguably there are more compelling objectives than export growth), then one might be able to assess the extent to which AFT contributes to the overall success of the Doha round. Some notes of caution, however, are merited. Export growth is affected by many factors, only some of which are under the control of the government. Is there a risk that lousy export growth after the Doha round could be misattributed to poor implementation of AFT, possibly also tarnishing the reputation of the WTO? Moreover, is there a risk that some developing countries will perceive that the implementation of AFT implies that the multilateral trading system is taking responsibility for their economies' export growth, so absolving national policymakers of any responsibility in this regard? In short, the metrics for evaluation, expectations, and responsibilities associated with the parties to AFT programmes would have to be clearly spelled out to avoid a number of pitfalls.

A focus on promoting developing countries' abilities to capitalise on the opportunities created by multilateral trade liberalisation often appears to be silent on distributional issues, which would have implications for the likely design of a successful AFT programme. If the promotion of each developing country's exports is the objective, then surely the credibility of an AFT scheme will depend on assurances about the level and allocation of funds committed to AFT, assurances which I doubt donors and the multilateral development banks will be willing to give. This in turn raises the fear that discrimination against developing country exports could be replaced by discrimination in the allocation of funds for AFT. This is the minefield in which AFT proponents must tread if distributional equity concerns are to be addressed comprehensively.

#### Concluding Remarks

In this paper I have summarised and assessed selected aspects of recent proposals for Aid For Trade. In my view, when properly reformulated, these proposals could play a very important part in persuading many developing countries that they have a stake in the further liberalisation of the multilateral trading system and, therefore, that they should not block the eventual conclusion of the Doha round. I have also identified a number of weaknesses in the rationale for Aid for Trade and in the underlying factual base; deficiencies that can be readily rectified through further data collection and analysis.

Georg Koopmann\*

## The (Almost) Lost Agenda: Rules and Institutions

In the Doha Round, the main focus of the multilateral negotiations is on market access or “negative regulation” in the three areas of agriculture, manufacturing industry and services, and thus on the World Trade Organisation’s core role of opening trade. The rejection of the “Singapore issues” (competition, foreign direct investment, transparency in government procurement and trade facilitation) by the developing countries at the failed WTO conference in Cancún in September 2003, and the removal of these themes (with the exception of trade facilitation) from the multilateral agenda in the “July 2004 Package”, which brought the Doha Round back on track, were a clear vote against any further extension of “positive regulation” in the WTO. Positive regulation of international trade, loosely speaking, is about telling governments what to do in domestic policy areas which affect cross-border transactions; it therefore potentially has a strong bearing on sensitive issues related to national sovereignty.

Market access policy must nevertheless be complemented by market *regulation* policy which essentially involves the formulation of binding multilateral rules and the imposition of discipline on national policies that directly or indirectly relate to trade. Rules and discipline matter both as principles guiding the liberalisation negotiations, and in their own right as constituent elements of the WTO. Relevant guidelines in this context include the promotion of transparency and predictability in trade policy, for instance by replacing specific duties with *ad valorem* tariffs, or by WTO members binding their tariff lines to a greater extent. At the same time, an important constituent of the trading order is the availability of escape clauses or “safety valves” that make trade liberalisation politically acceptable.

A third pillar of the multilateral trading system, besides liberalisation and rule-making, concerns the institutional underpinning of the WTO’s workings. Salient features are the arrangements for dispute settlement and trade policy reviews among member countries, as well as the rules and procedures for decision-making in the organisation. Reform is needed in these areas, as major imbalances have built up over time. This is also true for the institutional relationship between non-discriminatory multilateral trade agree-

ments in the WTO and preferential trade agreements on a regional and bilateral basis.

A number of these non-market-access issues are part of the Doha Round’s work programme, as laid down in the Doha Ministerial Declaration of 14 November 2001. More specifically, this holds for escape clauses concerning “contingent protection” (paragraph 28 of the Doha Declaration), regional trade agreements (para. 29) and dispute settlement (para. 30). In all these cases, the Doha Declaration calls for the clarification and improvement of existing rules, procedures and disciplines.

### Contingent Protection

Contingent protection typically comprises safeguard measures against quickly increasing “fair” imports, as well as devices against supposed “unfair” trade such as anti-dumping measures and measures against subsidies granted in foreign countries. Of these instruments, particularly the unfair-trade remedies are up for revision in the Doha Round. However, the wording of paragraph 28 of the Doha Declaration is rather ambiguous, as negotiations should aim, on the one hand, at “clarifying and improving disciplines” for anti-dumping policies, while on the other hand “preserving the basic concepts, principles and effectiveness” of existing anti-dumping provisions. In other words, as Finger and Zlate put it, the paragraph states that some WTO member countries want to change things – improve disciplines – while other members want to keep things the same, i.e. preserve the effectiveness of the instruments.<sup>1</sup> The same applies to the subsidisation policies and countervailing duties to which the granting of subsidies may give rise.

Even though the total number of both new anti-dumping investigations and new final anti-dumping measures has been declining recently, anti-dumping policy is still very much alive. This can be witnessed by the European Union’s current move to impose punitive tariffs on imports of shoes from China, the world’s largest exporter of footwear.<sup>2</sup> Over time, anti-dumping has become the instrument of choice to protect domestic firms against foreign competition, whereas ordinary safeguard measures, which are sanctioned

<sup>1</sup> J. Michael Finger, Andrei Zlate: Antidumping. Prospects for Discipline from the Doha Negotiations, in: The Journal of World Investment & Trade, Vol. 6, No. 4, 2005, p. 531.

<sup>2</sup> Cf. “EU to Set Tariffs on Shoe Exports from China”, in: Financial Times 4.11.2005.

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by the WTO as well, have lost their former importance. Safeguard actions were also unable to restore this role even after voluntary export restraints – a popular substitute for safeguards during the 1970s and 1980s – were banned in the early nineties as a result of the safeguards reform agreed in the Uruguay Round. This is true despite temporary surges in safeguard measures, such as in the wake of the steel tariffs imposed by the United States in March 2002 and the elimination of textile quotas under the multilateral Agreement on Textiles and Clothing, which expired on 1 January 2005.<sup>3</sup>

In political economic terms, the spread of anti-dumping actions can easily be explained. Anti-dumping is a politically convenient alternative to the common safeguard option in that it pits “free traders” against “fair traders”. Moreover, as opposed to the basically non-selective safeguard clause, anti-dumping policy can be targeted against individual countries, industries and competitors. The proof of injury for domestic firms that may suffer from rising imports is also less demanding in anti-dumping than in safeguard cases as a prerequisite for taking protective action.

#### Emergence of “New Users” of Anti-dumping

To a considerable extent, the dynamics of anti-dumping actions is an expression of the vastly broadened country base involved in the initiation of investigations and application of final measures. Until a decade ago, anti-dumping policy was an almost exclusive affair of a handful of developed countries, which reflects the *à la carte* approach prevailing under the former General Agreement on Tariffs and Trade. Under this approach, only a small (and varying) number of the old GATT’s contracting parties, typically developed countries, subscribed to the various codes of conduct in trade policy agreed in the Tokyo Round (1973-1979), one of which concerned anti-dumping policy. In the Uruguay Round, with the adoption of the “single undertaking” approach, a shift in direction took place. Accordingly, since the inception of the WTO in 1995, all its members are, in principle, bound by all agreements reached under its aegis, including the agreement on anti-dumping measures.<sup>4</sup>

This has led to the introduction of anti-dumping legislation in most WTO member countries and greatly

contributed to the emergence of “new users” of the anti-dumping instrument, mainly developing countries, in particular the more advanced members of this country group. In fact, the new users have chosen to undertake anti-dumping actions very intensively. Per dollar of imports they have filed anti-dumping cases up to 15-20 times more frequently than the traditional users such as the USA and the EU.<sup>5</sup> Most recent evidence, compiled by the WTO Secretariat, shows that South Africa, with 17 initiations of new anti-dumping investigations, ranked first during the period January-June 2005, followed by the European Union (15), India (13) and China (11). In terms of new final anti-dumping measures, the United States reported the largest number (13) for the first half of 2005, with China (10 measures) and India (7 measures) in second and third place respectively.<sup>6</sup>

Concerning a possible reform of anti-dumping rules, the most radical (and from a welfare-economic viewpoint “first best”) solution would be the withdrawal without substitution of this trade policy instrument and related legislation. However, from a political economic perspective, such an option would not be feasible. The very fact that the anti-dumping weapon is used more frequently, by more countries and against more products than ever in its history, makes the prospect for its elimination very unlikely. For the same reason, the substitution of anti-dumping policy with competition policy, nationally or internationally, also seems to be unrealistic. Extending the reach of national competition policy beyond a country’s territory, based on the effects principle, is highly controversial as is the establishment of binding competition rules, or even a competition authority, at the multilateral level. The removal of trade and competition, one of the four Singapore issues, from the Doha Round agenda is a clear indication in this respect. Politically, it would also be difficult to replace anti-dumping statutes with a renewed or extended safeguards clause. This option would acknowledge the protectionist rationale underlying anti-dumping policies, but it would ignore the fact that politicians have a preference for variety among protective instruments, preventing their renunciation of anti-dumping.

If anti-dumping must be accepted as a fact of life in trade policy, existing legal provisions could nevertheless be modified to bring anti-dumping policy closer to competition policy, of which it might effectively represent the international arm or counterpart. In particular, a corresponding reform would mean that all economic

<sup>3</sup> During the period 1 January 1995 to 30 June 2005, a total of 139 safeguard investigations were initiated under the WTO safeguards clause, and a total of 68 safeguard measures were imposed. This compares with 2743 anti-dumping initiations and 1729 anti-dumping measures, and with 176 countervailing duty initiations and 108 countervailing duty measures notified during the same period. For further details, cf. WTO News Items, 16 November 2005.

<sup>4</sup> The same is true for the other agreements concerning contingent protection, i.e. the agreements on safeguards and on subsidies and countervailing measures.

<sup>5</sup> Cf. Thomas J. Prusa: Anti-dumping: A Growing Problem in International Trade, in: *The World Economy*, Vol. 28, No. 5, 2005, p. 684.

<sup>6</sup> For further details, cf. WTO Press Release, Press/418, 24 October 2005.

interest groups involved (producer industries, user industries, consumers etc.) would be considered evenly in anti-dumping proceedings, and thus economy-wide aspects would prevail in the evaluation. However, present submissions in the Doha Round rules negotiations, concerning the “public interest” in anti-dumping cases, largely fail to meet this criterion. A more moderate reform proposal would retain two features of existing WTO anti-dumping rules (the right to impose discriminatory duties on dumped imports and the right to apply a relatively permissive injury standard) while changing a third feature (the lack of compensation provisions) by introducing the right to demand compensation for, or employ retaliation against, the imposition of anti-dumping measures. The underlying assumption is that this might remove, or reduce, the incentive to misuse anti-dumping policies for protectionist purposes.<sup>7</sup>

With regard to subsidies granted in WTO member governments and retaliation against those practices by fellow governments in affected member countries, the regime established in the Uruguay Round under the agreement on subsidies and countervailing measures seems likely to be further weakened rather than bolstered in the Doha Round.<sup>8</sup> The proposals put on the table to date appear overwhelmingly weighted toward loosening direct discipline on subsidies and/or making it harder to apply the countervailing duty remedy, which is itself a key method of discipline regarding subsidies. This is particularly true for proposals from developing countries, which almost exclusively aim to loosen regulations to which most of them subscribed for the first time in 1994. Irrespective of severe resource or budget constraints, developing countries therefore insist on a wide freedom to subsidise domestic industries. This is also a focal point of the broader debate on special and differential treatment for these countries and their products.

#### **Proliferation of Preferential Trade Agreements**

Similar to contingent protection, a comprehensive reform of multilateral rules, discipline and procedures is also unlikely to come about in the field of regional and bilateral trade agreements. At present, around 170 preferential trade agreements (PTAs) of this kind between WTO member countries are in force and registered with the WTO. More than three-fourths of these agreements were concluded after the WTO was founded in 1995. A large – and quickly growing – number of further PTAs have been agreed upon (but

not yet ratified and notified to the WTO), are currently under negotiation, or have been proposed. This rush into separate deals which defy the WTO’s core principle of non-discrimination threatens to undermine the multilateral trading system and to create an institutional imbalance between multilateral and sub-multilateral bodies of rules and regulations.

Most of the PTAs that are in operation have serious shortcomings. In actual fact, PTAs have done little to open markets and create trade, all the more so since sensitive product groups are frequently carved out of liberalisation schemes. They also hinder trade by creating complex regulations, bureaucracy and costs. A case in point is the set of restrictive, overlapping rules of origin, which among others may gravely impair the functioning of international supply chains. In consequence, should the multilateral trading system disintegrate into regional and bilateral agreements, much of the potential gain from the global production system would be lost.

High-quality, WTO-plus PTAs with strong elements of non-discriminatory deep integration in areas like competition policy, technical standardisation or services (de)regulation are the exception rather than the rule. PTAs typically fall short of existing WTO provisions related to customs unions and free-trade zones in the goods sector, and economic integration agreements in services. This particularly applies to the requirements stipulated in Article XXIV GATT and Article V of the General Agreement on Trade in Services (GATS) concerning the depth, coverage and speed of trade liberalisation among the partner countries. The preferences exchanged between these countries must be 100 per cent, cover “substantially all” the internal trade, and have a definite timeframe for implementation. In fact, hardly any PTA examined under the former GATT and the WTO has been found to meet these (and other) criteria to the full extent.

Given the circumstances, a major challenge for the multilateral trading system is to ensure better compliance of regional and bilateral trade agreements with the corresponding multilateral rules and thus render regionalism and bilateralism economically advantageous. A possible way of achieving this could be to define more precisely relevant terms like “substantially all the trade”, “substantial sectoral coverage”, “reasonable length of time”, “other (as opposed to tariffs) restrictive regulations of commerce” etc. This could help to tighten existing rules and close loopholes. In the same vein, transparency could be enhanced through improved notification and ex-post surveillance of PTAs. One innovation, currently on a voluntary and experimental basis, is the reporting by the WTO Secretariat on PTAs following notification. This prac-

<sup>7</sup> Cf. Robert W. Staiger: Some Remarks on Reforming WTO AD/CVD Rules, in: *The World Economy*, Vol. 28, No. 5, 2005, p. 739 ff.

<sup>8</sup> Cf. John R. Magnus: World Trade Organization Subsidy Discipline: Is This the “Retrenchment Round”? in: *Journal of World Trade*, Vol. 38, No. 6, 2004, p. 985 ff.

tice could evolve into a regular trade policy review mechanism for members of preferential trade areas, along the line of the established trade policy reviews for individual countries.

However, WTO member countries have a distinct preference for ambiguity, which is also evident from a number of proposals submitted in this area in the Doha Round negotiating group on rules. They also shy away from a strengthening of rules if compliance can be compelled in the way of dispute settlement. Moreover, in view of the fact that virtually all WTO member countries are now involved in at least one preferential trade agreement and often in a number of PTAs at the same time, there is little political interest or incentive to impede one another's deal. This lessens the prospect for a critical review of PTA terms to take place and for consensus on their conformity to be found.<sup>9</sup>

The ideal way to contain the proliferation of PTAs would be to speed up multilateral liberalisation and thus undermine the effectiveness of regional and bilateral arrangements by cutting the preference margins. By contrast, should the market-access agenda fail, this would inevitably lead to even more preferential agreements. The post-Cancún scramble for bilateral and regional trade deals clearly suggests a negative correlation between multilateral and regional/bilateral trade negotiations.

#### Dispute Settlement

Finally, in the area of dispute settlement, which is one of the key functions of the WTO and widely re-

<sup>9</sup> Cf. Consultative Board: *The Future of the WTO. Addressing Institutional Challenges in the New Millennium*, Geneva 2004, p. 22.

garded as its "crown jewel" or "core linchpin",<sup>10</sup> the multilateral negotiations did not yield the "early harvest" as envisaged in the Doha Ministerial Declaration. Paragraph 31 calls on the negotiators "to agree on improvements and clarifications (of dispute settlement) not later than May 2003". In July 2003, the timeframe was extended by one year, to May 2004. After missing this deadline as well, the negotiating mandate for dispute settlement was renewed in the July 2004 package without setting a new target date.

Over and above the specific issues addressed in the numerous proposals submitted during the Special Negotiating Session of the WTO's Dispute Settlement Body, which concern individual provisions of the multilateral Dispute Settlement Understanding, there is a more fundamental concern that an unsustainable imbalance between political and judicial decision-making might arise in the WTO.<sup>11</sup> Moreover, as already noted in the context of regional and bilateral trade agreements, there is a possible trade-off between the strengthening of multilateral rules, on the one hand, and of institutions to secure compliance with these rules on the other. The current multilateral negotiations will hardly offer any solutions to these problems. However, they could be part of a post-Doha agenda.

<sup>10</sup> Cf. Raj Bhalra: *The Myth About Stare Decisis and International Trade Law*, in: *American University International Law Review*, Vol. 14, 1999, p. 845 ff.

<sup>11</sup> Cf. Thomas A. Zimmermann: *WTO Dispute Settlement at Ten: Evolution, Experiences, and Evaluation*, in: *Außenwirtschaft*, Vol. 60, No. 1, 2005, p. 52.

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## The Challenges of Trade Facilitation

**N**egotiations in the area of trade facilitation got under way relatively late: the decision to launch them was only taken in July 2004, at a time when other Doha Round topics had already some negotiating past behind them. Yet, since the adoption of the "July 2004 package" and consistently throughout the year 2005, discussions in the Negotiating Group on Trade Facilitation have been proceeding really well. By the end of the summer the Negotiating Group had received some 60 negotiating proposals, sponsored by more than

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100 Members and covering the main elements of substantial commitments in the area of trade facilitation.

It is noteworthy that the negotiating initiative was largely shared among developed and developing countries and that even least-developed countries teamed up with developed ones to present proposals. All proposals benefited from a series of constructive rounds of comments and clarifications, so that the Negotiating Group has already a good sense of the possible format of measures to be included in the agreement. At a time when other Doha Round topics went through highly critical stages, trade facilitation debates enjoyed Members' unabated eagerness to

pull their weight : most WTO Members recognise that they have a stake in the outcome and seem ready to work towards success.

For trade facilitation believers this was an unsurprising success for a well deserving topic. OECD analysis of the potential worldwide income gains from trade facilitation estimates that a modest reduction in trade transaction costs by a mere 1% of the value of world trade would generate benefits of US \$43.26 billion, 65% of which would accrue to developing countries. However, if only OECD countries undertook trade facilitation the benefits would not exceed US \$14 billion and the resulting trade diversion would cause a 3% income drop in developing countries. Moreover, past experience with trade facilitation reforms shows that even the most costly trade facilitation measures bring cost savings elsewhere and generate additional government revenue by increased efficiency in revenue collection and improved customs effectiveness. From a development point of view trade facilitation was indeed a fair topic to include in the negotiating agenda.

Does this mean that trade facilitation negotiations only risk stumbling on external factors, such as agriculture or NAMA? Some observers believe that discussions have acquired enough dynamics on their own to “survive” even if other parts of the Doha agenda stall. In fact the real challenge, despite the dynamics, is issues of architecture that Members have felt reluctant to engage earnestly in up to now: going beyond the question of *what type* of commitments should be included in the agreement, the issue is *how* to put in place and implement those commitments. Although the generally constructive mood has discouraged the expression of conflict on these topics until recently, increasing signs of impatience now come out in the Negotiating Group. The clearest expression of this impatience focused on the question whether issues of technical assistance and capacity building should be resolved before defining the measures that should be part of the agreement or whether they can only be determined once those measures have taken clear shape.

The experience of developing countries which have undertaken trade facilitation reforms in the recent past shows that the design of trade facilitation reforms must be tailored closely to reflect particular circumstances and needs, so as to ensure ownership and sustainability. At the same time, a holistic approach to customs and border procedures reform can yield more sustainable results than can a piecemeal approach. Narrow-focus reforms cannot necessarily be sustainable outside a more comprehensive modernisation programme aiming to enhance the capacity of the administration to cope with the change.

An overview of the proposals already put on the negotiating table shows that the agreement will involve a number of – sometimes complex – regulatory issues and that the supporting mechanisms can be resource intensive. OECD research on the costs of introducing and implementing trade facilitation measures clearly indicates that the introduction and efficient implementation of some trade facilitation measures will require other measures to be up and running. But it also shows that, as a result of improved revenue collection and of staff and time savings, many measures generate additional resources which can partly be devoted to further promoting trade facilitation. There are clear links between measures, which may not realize their full potential if implemented in isolation or without due regard to the appropriate sequencing of measures. This means that, although there is still room for flexibility in the way trade facilitation is put in place, an “à la carte” approach could be a sure recipe for failure.

OECD work on the costs of trade facilitation also confirms the generally shared view that different countries – even at an equivalent level of development – face different situations and need sufficient policy space to reflect their specific capacities, limitations or needs in the area of trade facilitation. It has shown that implementation capacities are not only a matter of the country’s overall economic situation, but also reflect various other factors, the most important of which seem to be its geographical situation and trade patterns (proximity and accessibility of major trading markets, composition of imports and exports) and the priority accorded to customs modernisation and trade facilitation in the context of the country’s political process. Among developing countries some least developed countries seem to have already achieved more progress towards trade facilitation than some more advanced developing countries.

Accordingly, a future trade facilitation agreement should not aim at excluding some countries indefinitely from the system and its anticipated payoffs but rather at incorporating them gradually into a common system of rights and obligations, in a way that reflects their specific capacities, limitations or needs in given areas covered by the agreement. These provisions should be based on simple and transparent criteria that would reflect in an objective manner the very different institutional capacities of different members, their ability to participate in international trade, their income levels, or the ability of their economies to adjust to fuller rights and obligations

They need to go along with a more clearly articulated relationship between the extent of commitments, the lengths of transitional periods for assuming commitments, and the provision of technical assistance to help meet those commitments. Consideration could

be given to providing stronger guarantees for technical assistance and more specific work programmes in return for clear commitments of implementation on the part of recipient countries. Measures that genuinely require more difficult or more costly transitions for developing countries should be recognised in terms of longer periods, more flexible rules and specific offers of technical assistance. In this regard, a number of WTO Members have stressed the need for a co-ordination mechanism that would ensure coherence between identified needs and capacity building and complementarity among donor support.

Some upfront costs will need to be underwritten by the donor community. Capacity building in this area should be considered as responding to the same rationale developed during the Uruguay Round, i.e. assisting WTO Members to integrate into the system by facilitating adjustment. However, the question is to identify possible approaches for doing this in a way that would reflect more closely individual needs and capacities without compromising the effectiveness and consistency of the future agreement.

At the same time, the issue of "prerequisites", in particular with respect to infrastructure needs, risk inflating the negotiating agenda to a point where no common ground could be found. Although donor institutions estimate that available technical assistance funds are largely sufficient to meet the capacity building needs directly linked to the negotiations, this should be distinguished from major development aid commitments, e.g. for the development of ports, roads or telecommunication networks. While the former is directly linked to possible WTO commitments in the area of trade facilitation, the latter raises much broader questions pertaining to the aid-for-trade debate. Care would be needed to avoid unrealistic expectations about the allocation of aid for developing countries in support of their engagement in the trade facilitation negotiations.

Elements of response are already contained in Annex D of the "July Package". In particular, Annex D specifies that "... the extent and the timing of entering into commitments shall be related to the implementation capacities of developing and least-developed Members." It further states that "... technical assistance and support for capacity building is vital for developing and least-developed countries ... to fully participate in and benefit from the negotiations ... [and to] implement the commitments resulting from the negotiations ..." But alongside the responses the text generates further questions.

Should the above provisions be read to mean that a clear assessment of Members' implementation capacities has to precede any specific formulation of com-

mitments under a trade facilitation agreement? That, having concluded such an agreement, WTO Members are not bound to implement – and are not subject to dispute settlement proceedings for – trade facilitation commitments for which they lack the necessary capacity? That the implementation of trade facilitation commitments is subject to the provision of technical assistance and support for capacity building?

None of these questions can be clearly answered at this point and work to clarify them will be at the heart of the Negotiating Group's efforts after Hong Kong. However, each of the questions raises a number of challenges. If the agreement can only be shaped on the basis of available capacities, should all WTO Members have the necessary capacity before a given commitment is implemented, with the risk of indefinitely postponing the implementation of the agreement? Or could the agreement envisage various levels of implementing ambitions and how should such levels be defined? If some countries put in place more sophisticated commitments than others, how can a variable-geometry agreement avoid marginalising smaller and poorer countries?

On a more practical level, how can it be judged whether a Member has the capacity to implement a given commitment and whose responsibility it is to make such an assessment? In the absence of transparent and measurable criteria any assessment might transform the agreement into a discretionary wish list. If commitments do not match the capacities, how should it be assessed whether technical assistance offered by the donor community is appropriate and sufficient to close capacity gaps? Some WTO Members have called for a mechanism to coordinate the work of various international agencies and donors providing technical assistance and review the effectiveness of technical assistance in "support[ing] the implementation of the results of the negotiations". But such a mechanism will have to come to terms with the need for technical assistance to remain demand driven. Finally, what if, despite the provision of technical assistance, implementation capacity continues to be lacking?

The provisions of Annex D in the "July Package" have offered negotiations on trade facilitation an innovative yet challenging framework that could deeply affect WTO perceptions of the concepts of technical assistance, capacity building and special and differential treatment for developing and least-developed countries. For the outcome of these negotiations to be successful they will have to refine and clarify that framework. The real stumbling blocks – and at the same time the extraordinary success potential of the future agreement – lies therein.