ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

STUDIES IN TRADE AND INVESTMENT 51

THE DOHA DEVELOPMENT AGENDA: PERSPECTIVES FROM THE ESCAP REGION

UNITED NATIONS

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Papers presented at the "High-level Regional Policy Dialogue on the WTO Negotiating Agenda in Preparation for Cancún" and the "Regional Seminar on Facilitating the Accession of ESCAP Members to WTO through Regional Cooperation"

Bangkok, 10-13 June 2003

UNITED NATIONS
New York, 2003

ESCAP WORKS TOWARDS REDUCING POVERTY
AND MANAGING GLOBALIZATION

ST/ESCAP/2278

UNITED NATIONS PUBLICATION

Sales No. E.03.II.F.61

ISBN: 92-1-120338-4 ISSN: 1020-3516

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I. CONCLUDING STATEMENT BY THE CHAIRPERSON

By Jose-Antonio Buencamino[*]

Introduction

We have now reached the closing session of the High-Level Regional Policy Dialogue in Preparation for Cancun. It is with some regret that I say this, because I believe that we have had open, frank, thought-provoking and very useful discussions. The discussions have brought to the fore some of the core issues that we, as Government officials, must confront and address in the remaining time before Cancun. Just as importantly, the discussions have also take into account the core interests of the business sector in the Asian and Pacific region; after all, it is commercial interest in growing, competing and succeeding that give impetus to multilateral trade negotiations. The meeting has also considered linkages between trade, the environment and human development. These concepts are relatively new and somewhat undeveloped from the point of view of negotiators and businesses, but they are concepts that future trade activities will need to take into account if the multilateral trading system (MTS) are to benefit society.

In a region as diverse as that covered by ESCAP, and given the very wide range of perspectives that have been presented at this meeting, it will not be possible for me to do full justice to the debate. The purpose of my closing statement is not to provide an exhaustive overview and I do this on my own responsibility. It is merely to highlight some of the pertinent issues that have been put forward, and on which I feel there could be some broad and common understanding.

I sensed some urgency among the participants. Trade negotiations are at a standstill in the World Trade Organization (WTO). Yet, Cancun is fast approaching and much work remains to be done if the deadline of 1 January 2005 for the Doha Development Agenda (DDA) is to be met. Working towards this deadline is important because the regional and global economies are inextricably linked and both remain sluggish. Concluding the Doha negotiations would boost confidence and growth. The distribution of benefits between the developed and developing countries is an issue of major concern, especially when one considers the less than equitable sharing of the benefits and costs of the Uruguay Round agreements. A number of estimates have been given at this meeting, and all have shown that, on balance, the developing countries could be major beneficiaries of a successful round.

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A. Agriculture

Agriculture lies at the heart of the negotiations. By World Bank estimates, by 2015 income gains for developing countries to the extent of US$ 400 billion could be achieved if the Doha mandate of removing distortions in agriculture is achieved. For the ESCAP region, given that 75 per cent of the region's poorest population lives in rural areas, progress in agriculture lies at the heart of giving the Doha negotiations a tangible development-related outcome. However, a range of views and differences in priorities has been expressed as to how such an outcome could be brought about.

Making special and differential treatment (S and D) more operational, precise and effective has been identified as an emerging fourth pillar of the negotiations in agriculture. Agriculture in developing countries is a vastly different sector from agriculture in developed countries. S and D treatment should safeguard the role of agriculture as a source of livelihood and survival for more than 75 per cent of the region's poorest. At the same time, competitive exporters in the region have stressed the need for a Doha-mandated reduction in commitments, including the elimination of trade distorting production subsidies and export subsidies together with flexibility by the European Union including reform of CAP, which were the key to keeping the WTO negotiations on agriculture on track. The least developed countries (LDCs) stressed, through Bangladesh, the current Chairman of the WTO Consultative Group on LDCs, that they should (a) continue to be exempted from reduction commitments in agriculture, taking into account the importance of food security, (b) be allowed full use of the special safeguard measures (SSGs), and referred to the need for compensatory mechanisms due to the gradual erosion of preferences that current negotiations would bring about.

B. Market access for non-agricultural products

Manufactures have become the most important traded merchandise in developing countries. Tariff protection through tariff peaks and escalation has been biased against those products with which developing countries have a comparative advantage, thus affecting diversification and value-added opportunities. At the same time, developing countries have maintained high tariffs on each other's products, thus constraining the potential for intra-ESCAP trade.

The modalities for tariff reduction, under consideration in the Negotiating Group on Non-Agricultural Market Access (NAMA), should be able to deal with these issues. This meeting took note of the tariff harmonizing effects of the Girard formula, while stressing that the impact of deep tariff cuts on revenue as well as the costs of adjustment to certain business subsectors should be taken into account. Therefore, the need for a modality that accords less than full reciprocity to developing countries as mandated in the Doha Declaration was underlined.

Increased market access through tariff cuts could be negated by increased use of non-tariff barriers. With regard to paragraph 16 of the Doha Declaration, which makes specific reference to the reduction of non-tariff measures on products of export

interest to developing countries, there should be a clear and practical outcome that went beyond best endeavour efforts.

Significant increases in manufactures trading, which one estimate puts as US$ 256 billion, could be achieved by implementing a range of trade facilitation measures. It was noted by the meeting that consumer concerns in developed countries were driving those countries to increasingly resort to the use of wide-ranging environmental and health standards and technical requirements. Rules of origin, particularly those arising out of a proliferation of Regional Trade Agreements (RTAs) were further impeding market access.

The region is economically dependent on, and a competitive exporter of, fish and fish products. The reduction of subsidies in this sector represents a win-win-win situation for trade, environment and human development. It is important to recognize the vulnerabilities of fisherfolk, and a distinction should be made between those subsidies that seek to promote greater human security and improved worker protection, and those that lead to excess capacity, overexploitation and depletion of stocks.

C. Accession issues

The meeting benefited from an interesting country-led discussion on the accession experiences of those LDCs and economies in transition that were seeking membership in WTO. All countries had had extensive, difficult and, in some cases, dramatic experiences. It was noted that there was a need to continue promoting, on a regional cooperative basis, the sharing of those experiences as well as views on how the accession process could be simplified and made more relevant to the development needs of those countries.

ESCAP, in collaboration with the United Nations Conference on Trade and Development (UNCTAD) and WTO, was requested to continue providing a venue for those countries to share their negotiating strategies and policy options. In future, an active dialogue with developed countries, particularly Geneva-based delegates, and the more advanced developing countries of the region would play an important role in facilitating this process among the poorest countries of the region.

D. Services

The meeting also held interesting discussions on the current state of play in the services negotiations. It was noted that in services a relatively constructive negotiating environment prevailed. Nevertheless, the pace of negotiations and outcome would become part of the overall negotiating dynamics and would be linked to progress, or a lack thereof, in other areas. It was noted that virtually no progress had been made in the rule-making area, particularly with regard to emergency safeguard measures (ESMs).

As far as liberalization was concerned, about 25 initial offers had been tabled. Many developing countries doubted there would be net gains from the negotiations, and appeared to demonstrate a defensive position. Nonetheless, the view was expressed

that, given the positive linkage between services liberalization and development as well as the increasing propensity for developing countries to become competitive exporters of services, more proactive liberalization strategies should be followed.

It was further noted that the offers by Canada, Japan and the United States of America provided little in the way of additional content with regard to existing obligations. The schedule of the offer by the European Union model on the movement of natural persons was an attempt at significant improvement, but needed to be evaluated further.

Of more concern was the risk that anti-terrorism related measures would diminish potential gains from liberalization in mode 4. It was also noted that skilled labour shortages were cyclical, and that developed countries would want to retain policy flexibility in their commitments on that issue.

Liberalization of the environmental services area was discussed as being another sector that could offer win-win-win opportunities for developing countries.

E. Singapore issues

With regard to the four Singapore issues, it was important for countries of the region to continue to monitor and assess the deliberations underway in the respective Working Groups and the Council for Trade in Goods. The mandates contained in the Doha Declaration were noted, as was the fact that decisions on the modalities of negotiations were to be taken by explicit consensus in Cancun.

The meeting also noted that foreign direct investment (FDI) had risen exponentially in developing countries, and that significant unilateral liberalization and generous fiscal incentives were in place in most developing countries. Investment protection and investment performance measures were seen as two key areas that had not been included as part of the seven issues under study in the Working Group. A range of views was expressed on whether or not there was a need to pursue a multilateral framework setting out some minimum common WTO disciplines on investments. The discussions also considered the issue of whether or not an increase in foreign direct investment could be guaranteed by a multilateral investment framework. The qualitative differences between bilateral investment treaties and a multilateral framework were also discussed.

In competition policy, the benefits of a strong and operational competition policy regime and law were acknowledged. It was noted, however, that a number of concerns persisted among the developing countries on negotiating competition rules in WTO. These concerns included: (a) the high cost of compliance; (b) the possible intrusive effect of non-discrimination on investment and industrial policy; (c) the non-binding character of cooperation and technical assistance; and (d) S and D as distinct from the issue of flexibility and progressiveness, which remained unclear. The point was stressed that developing countries should be allowed, on their own, to evolve competition policy and law, and develop proficiency through experience.

An interesting and useful discussion was also held on transparency in government procurement. There was recognition that transparency was a facilitator of trade, and that transparency in government procurement can benefit all, including developing countries. It was also observed that government procurement can serve to achieve secondary objectives, such as social development. The pros and cons of negotiating this issue in WTO were discussed, and it appeared that before a decision could be reached, a precise framework for definition, objectives and other concepts would need to be in place.

Convergence was apparent on the issue of trade facilitation, which, among the Singapore issues, appeared benign and could easily lend itself to rule-making. Priorities in terms of issues in respect of Articles V, VIII and X of the General Agreement on Tariffs and Trade (GATT) 1994 were identified, and the potential for facilitating business transactions through their correct implementation and elaboration was highlighted. The need for technical assistance and capacity-building was similarly raised.

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II. AN ANALYSIS OF THE PROPOSALS BY THE WORLD TRADE ORGANIZATION, THE UNITED STATES AND THE EUROPEAN UNION ON AGRICULTURAL REFORM

By David Vanzetti and Ralf Peters[*]

Introduction

Proposals for further reform in the current ongoing negotiations on agriculture appear to be diverging rather than converging. At least, the proposals of the two major protagonists, the United States and the European Union, appear to be headed in different directions. The United States, supported by the Cairns Group of agricultural exporters, is apparently pressing for substantial liberalization of agricultural trade. In contrast, the European Union, with support from Japan, Norway, the Republic of Korea and Switzerland, is taking a more conservative approach. Under the programme adopted by the Special Session of the WTO Committee on Agriculture, chairperson Harbinson is required to prepare a draft of modalities for further commitments.

Concerning the reduction in tariffs and export subsidies, the first draft of the proposal by the WTO chairman in February 2003 was a compromise between the European Union and the United States proposals. However, the WTO proposal emphasized and described the special needs of developing countries in more detail. At this stage (March 2003), these countries' proposals may be seen somewhat as ambit claims, with scope for convergence at a latter stage. Whether the proposals are good, bad or merely inelegant is, of course, a matter of perspective. Nonetheless, it is useful to analyse the potential impacts of the various proposals, particularly on third countries.

Of particularly interest is the impact of negotiated outcomes on developing countries. Development issues have become more important within WTO negotiations in recent years, following the absence of substantial benefits flowing to developing countries after the implementation of the Uruguay Round reforms. Indeed, developing country concerns may have contributed to the failure of the WTO Ministerial Meeting in Seattle in 1999. Recognition of their concerns was emphasised at the Doha Ministerial Meeting in November 2001, whereupon a work programme focusing on development issues was initiated. Much of the work programme involves technical cooperation, including assisting developing countries in formulating a negotiating position. This paper contributes to this objective by providing negotiators with a quantitative assessment of the potential impacts of the three proposals. The United Nations Conference on Trade and Development (UNCTAD) Agricultural Trade Policy Simulation Model (ATPSM), a deterministic, comparative static, partial equilibrium trade model is used

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to assess the potential impacts on developed, developing and least developed countries by the WTO, United States and European Union proposals, given that they are actually implemented as specified.

Section A of this paper describes the negotiating context and the key proposals. Various modelling issues and scenarios are discussed in Section B while Section C describes the results. The paper concludes with Section D on policy implications, limitations and conclusions.

A. State of play and the proposals for reform

The Uruguay Round Agreement on Agriculture led to the tariffication of many non-tariff barriers and agreed reductions of 36 per cent from bound tariff rates (with a minimum of 15 per cent on each tariff line), plus additional reduction commitments on domestic support (20 per cent) and export subsidies (21 per cent of export volumes and 36 per cent of expenditure) to be implemented over six years. Developing countries agreed to commitments at two thirds of these levels, to be implemented over 10 years. Part of the agreement included a built-in agenda for further negotiations.

The current WTO negotiations on agriculture focus on five key issues: market access; domestic support; export subsidy; special and differential treatment for developing countries; and non-trade concerns.

1. Market access

WTO members have bound themselves to maximum tariffs on nearly all agricultural products. The issue of market access is about reductions in tariffs and other matters concerning the improvement of access to foreign markets. Tariffs are still significant. The average negotiated, out-of-quota bound tariff rate on agricultural products globally is 51 per cent and the average applied rate is about 26 per cent.[1] Developing country-applied tariffs on agricultural products are sometimes as high as 100 per cent (for example, Kuwait, the Congo Democratic Republic and Gambia) or even 200 per cent (Lesotho).[2] Furthermore, a substantial gap between applied and bound tariffs in developing countries implies that negotiated reductions in bound tariffs will have little or no impact on trade flows in many instances. Finally, the higher tariffs tend to be at the higher stage of processing, limiting the scope for value added industries. Thus, there remains plenty about which to negotiate.

The Uruguay Round introduced several retrograde steps. The Agreement on Agriculture led to the establishment of a two-tier tariff system based on import quotas – the tariff rate quota system (TRQ) – for 1,370 tariff lines. Under this system, imports are taxed at the relatively low in-quota rate until the quota is filled, at which point the higher out-quota rate is applied. Two-tier tariffs tend to be used by developed

[1] These are simple averages of tariffs at the four digit level for commodities listed in table 1. Tariffs are averaged over 142 countries for which data are available.

[2] On average, developing and least developed countries have higher bound rates but smaller applied rates than developed countries.

countries with highly protected agriculture to shelter their sensitive products. Norway has 232 such TRQs, but the European Union (87), the United States (54) and Japan (20) are well represented.

The United States proposal for addressing market access issues is to reduce applied tariffs according to a harmonizing Swiss formula by which higher tariffs are reduced more than proportionately (United States Department of Agriculture, 2002). Under this formula, the maximum final tariff is proposed as 25 per cent. This implies, for example, that a tariff of 100 per cent would be reduced according to (100*25/ [100+25] =) 20 per cent while an initial tariff of 10 per cent would be reduced to 7 per cent. Other elements of the proposal include elimination of in-quota tariffs and a 20 per cent expansion in import quotas. This proposal has the merits of requiring substantial reform, the cutting of the most distortionary tariffs by the largest amounts and the elimination of the "water" in the tariff by focusing on applied rather than bound tariffs.

However, a uniform approach based on a single harmonizing formula has a significant drawback for developing countries, where agricultural tariffs are on average higher than in developed countries. Thus, developing countries would be making proportionally greater cuts. This is in contrast to the Uruguay Round where developing countries implemented lesser (two-thirds) reductions over a longer implementation period. The approach does not recognize special and differentiated treatment for developing countries as previously agreed in the Uruguay Round.

The European Union proposal for market access reform is a continuation of the Uruguay Round approach, a 36 per cent average cut in bound tariffs with a minimum 15 per cent cut in each tariff line. The major attraction and, conversely, the problem with this approach is the inherent flexibility. For example, a reduction in tariffs on a sensitive product from 100 per cent to 85 per cent could be offset by reducing a 10 per cent tariff to 4.3 per cent to give the required simple average cut of 36 per cent. The European Union has not suggested any increase in import quotas.

The Harbinson proposal also applies to bound tariff rates. Out-of-quota tariffs would be reduced by a simple average for all agriculture products subject to a minimum reduction per tariff line. The formula includes bands where, depending on the initial tariff, average and minimum reductions are different. Proposed reductions are higher for higher tariffs.

For developed countries the proposed reductions are:

$x > 90$	Average reduction = 60 per cent (minimum 45 per cent)
$15 < x \leq 90$	Average reduction = 50 per cent (minimum 35 per cent)
$x \leq 15$	Average reduction = 40 per cent (minimum 25 per cent)

where x is the initial bound tariff.

For developing countries the bands are:

$x > 120$	Average reduction = 60 per cent (minimum 30 per cent)
$20 < x \leq 120$	Average reduction = 50 per cent (minimum 23 per cent)
$x \leq 20$	Average reduction = 40 per cent (minimum 17 per cent)

Least developed countries would not be required to undertake any reduction commitments.[3]

A further issue concerning market access is the special agricultural safeguard. Safeguards are contingency restrictions on imports, taken temporarily to deal with special circumstances such as a sudden surge in imports. The United States proposes to eliminate the existing special agricultural safeguard whereas the European Commission proposes to extend special safeguard instruments to facilitate the implementation of further tariff reductions and meet the developing countries' concerns on sensitive agricultural crops ("food security box"). This shows that this issue can also be considered under special and differential treatment of developing countries.

2. Domestic support

Support levels are still significant despite declarations of intent. For example, in the Organization for Economic Cooperation and Development (OECD) countries, total farmgate agricultural production in 2000 was valued at US$ 632 billion, but to encourage this production, producers received support of US$ 323 billion, over US$ 300 per capita and nearly a US$ 1 billion a day (OECD, 2002). The major beneficiaries of this largesse are producers in the European Union (35 per cent of OECD receipts), the United States (27 per cent) and Japan. A third of every US dollar received by OECD producers is attributed to assistance. Consumers contribute about half the cost, taxpayers the remainder.

Most developing countries cannot afford substantial domestic support, while such measures in developed countries appear to increase global production, forcing down world prices. This benefits net food importers in developing countries at the expense of net exporters. Thus, developing countries are divided on this issue.

In WTO terminology, subsidies are classified by "boxes". In agriculture there is a green, amber and blue box. Green box support must not distort trade. The blue box contains subsidies that are tied to production limits. Amber box support, defined by the Aggregate Measurement of Support (AMS), are trade-distorting measures and subject to reduction commitments.

The United States' proposal for domestic support reductions is to reduce, over five years, the non-exempt support as (amber box) and production-limited (blue box) support to, at most, 5 per cent of the average value of agricultural production in the base period of 1996-1998. By some later date, all non-exempt domestic support

[3] The World Trade Organization has since revised the draft, with the inclusion of four categories for developing country tariff cuts. The resulting global welfare gains are virtually unchanged from the contents of the initial draft.

would be eliminated. Developing countries would have special conditions to enable them to provide additional support to facilitate development and food security.

The European Union proposal involves maintaining the amber, blue and green boxes essentially unchanged and reducing the (amber box) AMS by 55 per cent. This is substantially more than the 20 per cent in the Uruguay Round. However, the green box criteria would be expanded to encompass so-called non-trade concerns such as rural development, the environment and animal welfare. For example, payments to compensate for the additional cost of meeting higher animal welfare standards would be exempt from reduction commitments under the proposal. This is in contrast to the United States' proposal whereupon the green box criteria would not be expanded. At present, the European Union's AMS expenditure is not a binding constraint, but may become so. A flexible green box allows support to be switched from the non-exempt amber to the exempt green box by, for example, increasing direct income support. Finally, the European Union proposes eliminating the *de minimis* provision in developed countries. The European Union makes less use of this provision than the United States and has less to lose from relinquishing it.

The Harbinson proposal on domestic support is to maintain green box support measures unchanged. Blue box payments would be reduced by 50 per cent in developed countries and 33 per cent in developing countries. The amber box AMS would be reduced by 60 per cent in developed countries and 40 per cent in developing countries. The *de minimis* level of 5 per cent would be reduced to 2.5 per cent.

3. Export subsidies

The majority of agricultural export subsidies are provided by the European Union. It is perhaps not surprising than that the United States proposes to eliminate export subsidies over five years whereas the European Union suggests a modest reduction of an average 45 per cent in expenditure. As with tariff cuts, averaging provides flexibility by permitting large cuts in lightly traded or lightly protected products. At present, export subsidy expenditure in the European Union (US$ 5.6 billion) is comfortably inside the total bound limit of US$ 8.6 billion and could accommodate a reduction of 32 per cent in the total expenditure. However, several individual commodities are currently up against volume constraints, including bovine meat, poultry, pig meat, skimmed milk powder, wheat, coarse grains and rice. The European Union proposes a "substantial" but unspecified cut in export subsidy volumes. United States expenditure is around US$ 15 million, well within the limit.

The United States proposes, in addition to the elimination of export subsidies, that disciplines should be placed on officially supported export credits, food aid and other forms of export support without specifying quantitative limits. Most of the export credits are provided by the United States to that country's farmers. The European Union proposes that the trade-distorting elements of export credits for agricultural products be identified and subjected to strict disciplines.

The Harbinson proposal involves the reduction of budgetary outlays and quantities to zero in developed countries within six years. A much longer time period is proposed for developing countries. Export credits would be subject to disciplines.

4. Special and differential treatment

This issue is about a special and differential treatment of developing countries. In order to ensure that developing countries benefit from the expansion of world trade the proposals contain to a different extend more flexibility for developing countries.

The European Union proposal calls for developed countries to accept duty-free all imports from least developing countries and 50 per cent of imports from developing countries. The European Union itself already meets this criterion. Among the major importers, Japan would face the greatest difficulty in meeting this standard as only a quarter of its imports from developing countries are duty-free. Furthermore, the European Union proposal calls for developing countries to be permitted reduced commitments if this is necessary for them to meet food security and other multifunctional objectives.

A further element adding to the complexity is the existence of preferential trade arrangements. Many developing countries, particularly those that were former colonies of current European Union members, have preferential access to particular developed country markets. The superseded Lóme Convention between the European Union and the African-Carribbean-Pacific countries is one well-known example. A general reduction in tariffs erodes these preferences, and countries holding such preferences may not see it as being in their interests to press for further tariff reductions.

The United States proposal involves no concrete suggestions concerning special and differential treatment. The United States has is open to consideration of the desirability of modifying the agreed terms and conditions regarding exports from developing countries and providing exception provisions to meet emergency situations.

The Harbinson proposal involves special and differential treatment on all the above-mentioning issues. In addition, developed countries should provide duty- and quota-free access to their markets for all imports from least developed countries. Furthermore, the declaration of strategic products for which developing countries do not have to reduce tariffs is proposed.

5. Non-trade concerns

The agriculture negotiations provide scope for governments to pursue "non-trade" concerns such as the environment, rural development, labour standards and food security. However, not all countries are ready to negotiate these "non-trade" issues. The United States does not mention this issue at all and favours a narrow round excluding these issues.

The European Commission proposes that measures aimed at achieving certain societal goals such as the protection of the environment, traditional landscapes, rural

development and animal welfare should be accommodated in the agreement on agriculture. The Harbinson proposal acknowledges non-trade concerns such as structural adjustments and animal welfare. Payments should be time limited.

These issues cannot be modelled using with the partial equilibrium model that is employed in assessing the economic effects of the three proposals. Thus, this analysis focuses on tariffs, domestic support and export subsidies.

B. Modelling agricultural reform

The UNCTAD Agricultural Trade Policy Simulation Model[4] (ATPSM) is used to estimate the potential impacts of the European Union and United States proposals, assuming they were to be implemented as specified. ATPSM is able to estimate the economic effects of changes in within-quota, applied and out-quota tariffs, import quotas, export subsidies and domestic support on production, consumption, prices, trade flows, trade revenues, quota rents, producer and consumer surplus, and welfare.

The Uruguay Round reforms raised several modelling issues. Quotas on imports and exports generate quota rents amounting to an estimated US$ 10 billion as well as the need to assess the magnitude of the rents and their allocation.[5] It is assumed here that the rents generated by the European Union and United States sugar policies are initially allocated to producers in exporting countries according to the distribution of trade.[6] Rents on sugar are estimated to be worth an estimated US$ 790 million, of which US$ 658 million goes to developing and least developed countries. Foregone global rents equate with rents receivable. That is, it is assumed that none of the rents are dissipated through rent-seeking activities or inefficient means of quota administration. Rents are diminished as out-of-quota bound tariffs are reduced but producers are assumed to not respond to changes in rents.

A further simplifying assumption is that quotas are filled, either explicitly or through administrative constraints. This implies that in the model the applied tariff or out-of-quota tariffs, rather than the in-quota tariff, drive the domestic prices. This further implies that changes in in-quota tariffs do not have price and quantity effects, as these instruments are not binding. (They do, however, change the distribution of rents.)

A second difficult modelling issue concerns the decoupling of domestic support, that is, the effects on production by changes in support. This is a complex issue concerning the method of administration, perceptions of risk, the wealth effects of

[4] ATPSM is a static, partial equilibrium global agricultural trade model with two-way trade flows. An operational version of the model, associated database and documentation are available free of charge from the United Nations Conference of Trade and Development (http://192.168.202.134/tab).

[5] This estimate assumes import quotas are filled.

[6] In a previous application of the model, reported by Vanzetti and Sharma (2002), it was assumed that the rents from all products went to producers, although this assumption is difficult to justify. The allocation of rents affects the distribution of gains from liberalization. Here it is assumed that rents from products other than sugar are captured by importing countries.

direct payments and the likelihood of changes in government policies. In addition, there are potential problems of double counting in that if border support is removed, reducing domestic prices, there may be no role for domestic support. The approach taken here is to assume that most of the domestic support is decoupled or is conflated with border support.[7] Thus, the additional effects of removing domestic support are minimal in most cases. This assumption may bias downwards the benefits from liberalization.

A final observation relates to limitations in modelling preferential access. Data on bilateral tariffs are not included in the database, although data on bilateral trade flows are available. Thus, it is not possible to liberalize on a bilateral basis and directly capture the effects of preference erosion as MFN rates are brought down closer to preferential rates held by many developing and all least developed countries. However, much of the effect of diminishing preferences is captured by the depletion of quota rents allocated initially to exporters. The model structure does not allow for trade diversion from changes in rents; however, where the quotas are filled this effect will be minimal, at least for small changes in prices.

1. Country and commodity coverage

The present version of the model covers 160 individual countries plus one region, the European Union, which includes 15 countries (see annex). Those countries not covered are mostly small island economies. Countries designated here as "developed" are defined by the World Bank as high-income countries with a per capita gross national product (GNP) in excess of US$ 9,266 (World Bank, 2001). A third group comprises the 49 least developed countries.

There are 36 commodities in the ATPSM data set. This includes many tropical commodities of interest to developing countries, although many of those commodities attract relatively little trade by comparison with some of the temperate products. Included commodities are meat, dairy products, cereals, sugar, edible oils, vegetables, fruit, beverages, tobacco and cotton (see annex).

2. Data

Volume data are from 2000 and are compiled from Food and Agriculture Organization of the United Nations (FAO) supply utilization accounts.[8] The year 2000 represents the base year for the model. The price data are also from FAO. Parameters on elasticities and feedshares are from the FAO World Food Model; they are based on a trawling of the literature and are not econometrically estimated specifically for the model. Some of the elasticities were modified by the authors where necessary. In-quota tariffs, out-quota tariffs and global quotas, notified to WTO, are obtained from the AMAD database[9] where available and aggregated to the ATPSM commodity

[7] See de Gorter, 1999, for a discussion on the methodological issues involved in measuring domestic support.

[8] See FAOSTAT at <http://www.amad.org/>.

[9] The AMAD database is available at <http://www.amad.org>.

level. Export subsidy data are notified to WTO. Bilateral trade flow data relate to 1995 and are from the UNCTAD Comtrade database. These data are used to allocate global quotas to individual countries. The UNCTAD TRAINS[10] database is the source of information on applied tariffs.

An indicator of the degree of distortion is the revenue raised or government expenditure outlaid on each commodity. These are a combination of the rate of support plus annual flows and are shown in table 1. It is apparent that most of the global protection in agriculture is on temperate products, particularly beef, wheat, maize, dairy products, vegetables oils and oilseeds. According to the ATPSM database, tariff revenues and rents for the products in the model amount to around US$ 45 billion, with export subsidies and production-distorting domestic support accounting for an additional US$ 13 billion. Among the products that can be grown in tropical regions, tobacco, sugar and poultry attract substantial protection. These products can also be grown in temperate regions or are close substitutes. There is relatively little tariff revenue raised on tropical products such as beverages (except chocolate) and cotton. For the products listed in table 1, tariff revenues amount to 17 per cent of import costs.

Table 1. Initial global tariff revenue and rents by commodity

(Unit: US$)

Commodity	Tariff revenue	Export subsidy expenditure	Domestic support expenditure	Quota rent
Bovine meat	3 360	1 335	688	604
Sheep meat	241	10	24	589
Pig meat	615	284	68	66
Poultry	2 183	169	12	165
Milk, fresh	87	0	692	2
Milk, concentrated	1 093	504	1	419
Butter	534	413	0	169
Cheese	1 057	668	2	360
Wheat	1 882	2 242	234	2 315
Rice	705	138	912	955
Barley	439	0	226	583
Maize	2 652	96	326	2 120
Sorghum	74	0	10	17
Pulses	338	0	73	1
Tomatoes	184	0	73	35
Roots and tubers	103	0	77	0
Apples	1 119	0	18	15
Citrus fruit	537	0	265	15
Bananas	639	0	117	390
Other tropical fruit	251	0	0	0
Sugar	1 850	719	120	789

[10] The UNCTAD TRAINS database is available at <www.unctad.org/trains/index.htm>.

Table 1. *(continued)*

(Unit: US$)

Commodity	Tariff revenue	Export subsidy expenditure	Domestic support expenditure	Quota rent
Coffee, green	576	0	13	3
Coffee, roasted	20	0	0	0
Coffee, extracts	7	0	0	0
Cocoa beans	61	0	0	0
Cocoa powder	44	0	0	0
Cocoa butter	48	0	0	0
Chocolate	1 314	0	0	108
Tea	357	0	0	0
Tobacco leaf	2 173	0	1 698	20
Cigars	3 684	0	0	0
Cigarettes	27	0	0	0
Other manufactured tobacco	666	0	0	0
Oil seeds	2 634	34	234	188
Cotton linters	288	0	536	29
Vegetable oils	2 894	439	0	1
Total	**34 736**	**7 051**	**6 419**	**9 956**

Source: Derived from the Agricultural Trade Policy Simulation Model database.

The European Union and Japan raise the largest amounts of agricultural tariff revenue (over US$ 4 billion each) but Egypt, the Republic of Korea, Mexico, Turkey, the United Arab Emirates and the United States account for over US$ 1 billion annually. Indeed, 50 countries gather in excess of US$ 100 million annually in agricultural tariff revenues. This illustrates the scope for global reform rather than focusing only on the European Union, Japan and the United States. However, tariff revenue makes a significant contribution to government finances in some countries and this source would need to be replaced if revenues fall following liberalization.

The major commodities attracting export subsidies are wheat, beef, dairy products and sugar. Of the US$ 7 billion attributed to commodities in the database, US$ 5.4 billion is paid by the European Union, followed by the United States at US$ 600 million.

The European Union (US$ 2.3 billion) and Japan (US$ 1.9 billion) also provide most of the domestic support that is considered in the ATPSM database to be production distorting. Again, the United States accounts for most of the remainder. Tobacco leaf, cotton, fresh milk and beef account for the largest slices of domestic support.

Finally, over 70 per cent of the global quota rents of US$ 10 billion are generated within developed countries. Of the total rents, US$ 2.2 billion is assumed to find its way to developing country exporters. Quota rents on sugar are important in that the bulk of the rent accrues to developing countries. Fiji, India, Mauritius and Zimbabwe are the major beneficiaries. China is assumed to retain all the sugar quota rents

generated through its recent accession to WTO, as its import quota (1,945 kt) far exceeds its imports (647 kt).

In the absence of import quotas, tariff liberalization leads to significant transfers between taxpayers, consumers and producers largely within one country. Where quota rents are generated, liberalization may involve transfers between countries over and above the terms of trade effects.

Several modelling assumptions are important to note. First, ATPSM allows two-way trade. This requires an additional equation to specify either exports or imports. In this version of the model the change in exports is in proportion to the initial ratio of exports to production. If 50 per cent of production is exported in the initial database, then 50 per cent of any additional production will be exported. This implies the percentage change in exports equals the percentage change in production. Imports are determined so as to clear the market, that is, supply plus imports equals demand plus exports.

As noted above, where producers receive rents they do not respond by changing quantities produced. This implies, for example, that changes in in-quota tariffs change only quota rents, not quantities, prices or global welfare. The shifting of quota rents is a zero sum game.

The model does not have a specific time dimension. The general interpretation is that the economic effects are of a medium-term nature, with their impact taking three to five years to work through.

3. Scenarios

Three simulations are undertaken to illustrate the potential impacts of the United States, Harbinson and European Union proposals. The proposals comprise many elements, not all of which can be captured within ATPSM. For example, the European Union proposal comprises flexibility for tariff reductions so long as the average is 36 per cent. It is not possible to predict *a priori* which tariffs are reduced by less and which by more than 36 per cent. Another example is that the Harbinson proposal comprises strategic products to which a minimal cut applies. Therefore, the three simulations that capture important, but not all, elements of the three proposals are not exact simulations of the proposals.

The ambitious scenario is relatively straightforward. The United States proposal emphasises tariff cuts from applied rather than bound rates and with a Swiss formula coefficient of 25 per cent.

The conservative scenario is more problematic as the European Union proposal is less definitively specified. First, specified reductions in bound rates apply to all commodities. Countries are assumed not to have the flexibility to make lesser reductions in support of politically sensitive commodities, even though this is specified by the European Union proposal. In the conservative scenario, within-quota tariffs are only reduced if the out-quota or applied rate is cut to below the within-quota rate.

Table 2. Alternative liberalization scenarios

Number	Label	Description
1	**Ambitious**	A reduction in applied out-quota tariffs according to the formula t1 = (t0*25)/(t0 + 25), elimination of in-quota tariffs, a 20 per cent expansion of import quotas, and the elimination of domestic support and export subsidies in all countries and for all commodities.
2	**Conservative**	A reduction in bound out-quota tariffs of 36 per cent, a 55 per cent reduction in domestic support and a 45 per cent reduction of export subsidy equivalent in developed countries to two thirds of these cuts in developing countries. No reductions in least developed countries.
3	**Compromise**	A reduction in bound out-quota tariffs of 60 per cent where the initial tariff is higher than 90 per cent, 50 per cent (initial tariff between 15 and 90) and 40 per cent (initial tariff smaller than 15), an 80 per cent reduction of export subsidies and a 60 per cent reduction of domestic support in developed countries. In developing countries, a 40 per cent reduction where the initial tariff is higher than 120 per cent, 33 per cent (initial tariff between 20 and 120 per cent) and 27 per cent (initial tariff smaller than 20), a 70 per cent reduction of export subsidies and a 20 per cent reduction of domestic support. A 20 per cent expansion of import quotas in developed and developing countries. No changes in least developed countries.

Likewise, in modelling the conservative scenario on export subsidies, it is assumed that the rates are binding and that countries do not take advantage of flexibility to vary the reductions across different commodities. This assumption thus overstates the likely impacts from reform. However, the European Union has called for "substantial reductions" in export volumes, which may have a greater impact because many volume constraints are binding or close to it. Finally, while the European Union proposal does not specify the special and differentiated conditions that apply to developing countries, they are interpreted here as being similar to the Uruguay Round conditions.

The compromise scenario is even more problematic. In the Harbinson proposal, countries have the flexibility to reduce certain tariff lines by a minimum amount whenever the average equals the above stated reductions. Developing countries can declare some commodities as strategic products for which no reductions are required. The proposal includes the flexibility to reduce export subsidies in different steps. The proposed expansion of import quotas depends on current quotas and countries have some flexibility as an average expansion within certain limits is considered. Furthermore, a possibility of assuring preferential schemes as well as several other special and differential treatment issues is proposed. Since it is not possible to model all the elements of the Harbinson proposal, the compromise simulation is only similar to the proposal capturing important, but not all, aspects.

4. Results

The impacts of the compromising, ambitious and conservative proposals are assessed in terms of prices, government and export revenue effects, and national welfare (table 3). Commodity prices are examined first.

Table 3. Increases in world prices from alternative scenarios

(Unit: Percentage)

	Ambitious	Compromise	Conservative
Bovine meat	8	5	3
Sheep meat	11	6	4
Pig meat	5	3	2
Poultry	7	3	2
Milk, fresh	11	7	4
Milk, conc.	18	12	7
Butter	25	18	11
Cheese	16	12	7
Wheat	14	9	5
Rice	3	2	1
Barley	3	1	1
Maize	5	3	2
Sorghum	1	0	0
Pulses	5	0	0
Tomatoes	3	2	2
Roots and tubers	4	1	1
Apples	4	3	2
Citrus fruits	2	1	1
Bananas	2	1	1
Other tropical fruit	4	1	1
Sugar	10	5	3
Coffee, green	1	0	0
Coffee, roasted	0	0	0
Coffee, extracts	7	0	0
Cocoa beans	0	0	0
Cocoa powder	1	1	1
Cocoa butter	1	1	1
Chocolate	2	2	1
Tea	3	1	1
Tobacco leaf	4	2	2
Cigars	1	0	0
Cigarettes	0	0	0
Other manufactured tobacco	1	0	0
Oil seeds	2	1	1
Cotton linters	2	1	0
Vegetable oils	8	2	1

Source: Agricultural Trade Policy Simulation Model simulations.

(a) Prices

Comparing world prices across the commodities confirms that the more highly protected sectors (dairy products, sheep meat, sugar, beef and vegetable oils) are the most affected in all scenarios. Price changes are lower for tropical than for temperate products. A comparison across scenarios shows that increases in world prices for the

conservative simulation are about a third of the ambitious simulation, with a trade-weighted average of 2.2 per cent compared with 6 per cent. The trade-weighted average increase under the compromise proposal is 4 per cent. Under the conservative and compromise scenarios there are many markets in which there are no tariff cuts because of the divergence between applied and bound rates. For example, United States beef has an out-quota tariff of 11 per cent and an applied rate of 2.6. A 36 per cent or 60 per cent cut in the bound rate would not increase trade flows. Across all 4,263 markets with positive tariffs in the model, actual tariffs are reduced in 1,680 markets under the conservative scenario, and in all cases under the ambitious proposal.

(b) Government revenues

Many developing countries are concerned that trade liberalization will have a significant adverse impact on government revenues because tariff revenues make up a substantial contribution to public revenue.

Eliminating tariffs altogether implies tariff revenues would be reduced to zero. Many developing countries would have to raise taxes on income, profits, capital gains, property, labour, consumption or through non-tax revenues in order to compensate. Broad-based taxes have the advantage of being less distortionary but they are not as simple to collect as tariff revenues. It may be that in small countries where most goods are imported, imposing a sales or consumption tax, for example, would in fact operate essentially against imports. In such a case, the essential difference is that a domestic tax would not be subject to WTO negotiations, while revenues would be unchanged and come from the same source.

The simulation results indicate the ambitious scenario would result in an estimated 26 per cent decline in global revenues from agricultural trade (table 4). Included in government revenues is the reduction in expenditure resulting from the elimination of US$ 7 billion in export subsidy and a US$ 6 billion reduction in domestic support. The conservative scenario, which features moderate (36 per cent on bound rates) tariff cuts and smaller (45 per cent) export subsidy reductions, results in an increase in government revenues in developed countries and only a marginal impact on developing and least developed countries as a group. Among developed countries the major beneficiary is the European Union where net government revenues increase

Table 4. Changes in government revenues relative to base from alternative scenarios

Category	Ambitious		Compromise		Conservative	
	(US$ m)	(%)	(US$ m)	(%)	(US$ m)	(%)
Developed	1 237	12	7 636	74	7 530	73
Developing	-9 183	-45	55	0	-291	-1
Least Developed	-463	-30	-47	-3	-36	-2
World	-8 409	-26	7 644	24	7 203	22

Source: Agricultural Trade Policy Simulation Model simulations.

US$ 6.7 billion due to a US$ 3.5 billion increase in tariff revenue and a reduction of US$ 2.4 billion in export subsidy expenditure.

Tariff revenues rise because of the increase in trade flows. For example, tariff revenues on European Union beef imports rise from US$ 771 million in the base period to US$ 1,996 million even though the tariff has fallen from 138 per cent to 88 per cent. Imports increase from 407 kt to 1,138 kt. This is driven by a 3 per cent fall in production and a 7 per cent increase in consumption in response to an 18 per cent fall in domestic prices. Similar effects occur in other countries, depending on domestic price changes as well as supply and demand elasticities. The revenue effects are not evenly distributed. Of the 161 countries in the model, only 37 experience a gain in government revenues. The compromise simulation results in a global government revenue increase of 24 per cent. There is almost no change in developing and least developed countries and a relatively high increase in developed countries.

(c) Export revenues

The change in export revenues is perhaps the variable of most interest to negotiators. The estimated impacts of the two scenarios on export revenues are shown in table 5.

Table 5. Increase in export revenues relative to base from alternative scenarios

Category	Ambitious		Compromise		Conservative	
	(US$ m)	(%)	(US$ m)	(%)	(US$ m)	(%)
Developed	13 329	14	6 778	7	4 321	4
Developing	28 434	30	14 693	15	9 596	10
Least Developed	1 972	48	995	24	773	19
World	43 736	22	2 247	1	14 690	7

Source: Agricultural Trade Policy Simulation Model simulations.

It is not surprising that export revenues increase as the rise in imports following trade liberalization has to come from somewhere. The real interest is in the magnitude and distribution of the revenue gains. In interpreting these results, it should be remembered that an underlying assumption of the model is that the ratio of exports to production is maintained. This means that most of the increase in exports is likely to come from the largest producing countries. Whether this will bias the results in one way or the other is not clear. However, because of supply constraints, this assumption does not seem unreasonable.

Looking at table 5, the most obvious point for the country groups is that, as expected, trade effects are about three times higher under the ambitious scenario than under the conservative scenario. The export revenue increase under the compromise scenario lies between the other scenarios. Initial global export revenues in the database are US$ 197 billion. This figure increases by 7 per cent under the conservative scenario, 22 per cent under the ambitious scenario and 11 per cent with the compromise

scenario. For all individual countries and individual commodities, trade effects are positive and greater under the more ambitious proposals. Export revenue is estimated to increase even for the European Union (by 6 per cent under the ambitious scenario) where export subsidies are removed. However, export revenues in the European Union decline for several types of cereals, fruit and vegetables.

(d) Welfare

The static annual global welfare gains are estimated at around US$ 6 billion under the ambitious scenario, US$ 17 billion under the compromise scenario and US$ 12 billion under the conservative scenario. In all three cases, the bulk of the gains accrue to developed countries because the greater part of the protection is on temperate products in those countries. Developing countries as a group gain only marginally from modest liberalization and the 49 least developed countries lose as a group. However, both groups gain substantially more from the more ambitious liberalization under the ambitious scenario.

Developing countries share a greater proportion of the global welfare gains under the ambitious scenario because they are making more substantial cuts. In the compromise and the conservative scenarios developing countries make reductions to a lesser extent, and the cuts are from bound rather than applied rates. With a 24 per cent cut as in the conservative scenario, or an average reduction of 33 per cent as in the compromise scenario, in bound tariffs many applied tariffs are unchanged.

Under the conservative scenario, the gains to developing countries through improved market access and allocative efficiency effects are almost offset by the removal of export subsidies and world price raises. The least developed countries, which do not liberalize and have no efficiency gains, lose US$ 262 million.[11] With greater liberalization under the other scenarios, the benefits of domestic reform and improved market access begin to outweigh the negative effects of export subsidy removal.

A further contribution to losses in some developing countries is the fall in quota rents received on exports of sugar. According to the model database, quota rents on sugar imports amounting to US$ 505 million and US$ 212 million are generated by the European Union and the United States, respectively. All this is assumed to accrue to exporting country producers, US$ 640 million in developing countries and US$ 15 million in least developed countries.[12] The remainder finds its way to other developed countries such as Australia. Tariff reform lowers these rents. Quota rents received are reduced from US$ 717 million to US$ 473 million under the conservative

[11] To isolate the impact of export subsidies and domestic support alone, a separate simulation was undertaken in which export subsidies were reduced by 80 per cent and 70 per cent, and domestic support by 60 per cent and 20 per cent in developed and developing countries, respectively. In the simulation, developing and least developed countries lost US$ 1.2 billion and US$ 241 million respectively, while developed countries gained US$ 10.5 billion. The vast bulk of these gains, US$ 8.7 billion, accrued to the European Union.

[12] Except for China, as stated above.

Table 6. Changes in welfare relative to base from alternative scenarios

(Unit: US$ m)

Category	Ambitious (US$ m)	Compromise (US$ m)	Conservative (US$ m)
Developed	19 394	17 842	12 262
Developing	5 516	67	96
Least Developed	856	-415	-262
World	25 766	17 495	12 096

Source: Agricultural Trade Policy Simulation Model simulations.

scenario, US$ 312 million under the compromise scenario and US$ 183 million under the ambitious scenario. These reductions are effectively a transfer from foreign producers to European Union and United States consumers. The reduction in quota rents, essentially a transfer from governments to consumers, is higher under the ambitious scenario than under the conservative scenario.

Individual country winners and losers are shown in table 7. From medium liberalization (compromise scenario), at least using the standard welfare measures, the main winners in absolute terms are the European Union (US$ 10.5 billion), Japan (US$ 2.5 billion) and the United States (US$ 1 billion). Among the developing countries the greatest gains accrue to Romania (US$ 568 million), Argentina (US$ 365 million), Turkey (US$ 291 million) and Morocco (US$ 184 million). However, there are numerous losers among developing countries. In fact, 50 of the 161 countries in the model appear to gain from global liberalization under the compromise scenario. This is because many are disadvantaged by rising world prices and loss of quota rents. The most notable losers are the Russian Federation (US$ 295 million), Algeria (US$ 203 million) and the Islamic Republic of Iran (US$ 137 million). Among the least developed countries the major loser is Bangladesh (US$ 57 million). A total of US$ 2.7 billion would need to be put aside to compensate all the losing countries. Under the conservative scenario, compensation for the 106 (161 minus 55) losing countries needs to be around US$ 1.9 billion. Under the ambitious scenario, however, 74 countries are estimated to gain in terms of welfare, but for some individual countries the losses are greater. The cumulative losses amount to US$ 3 billion.

The source of gains in developed countries is mainly consumer surplus (table 8). Under the compromise and the conservative scenarios, consumers in developing and least developed countries are estimated to be worse off since those country groups liberalize only to a small extend but are hit by increasing commodity prices. Under the ambitious scenario all groups are estimated to gain.

Finally, on the subject of welfare, producers in developed countries lose from trade liberalization while those in developing countries gain around US$ 10 billion in the conservative and ambitious scenarios (table 9). Under the compromise scenario, developed country producers gain about US$ 18 billion. What requires an explanation is the loss to producers in least developing countries under the ambitious scenario,

Table 7. Changes in welfare relative to base for individual countries

(Unit: US$ m)

Country/area	Compromise	Conservative	Ambitious	Country/area	Compromise	Conservative	Ambitious
Afghanistan	-10	-7	-16	Gabon	-5	-3	-7
Albania	-12	-8	-21	Gambia	-5	-3	11
Algeria	-203	-80	-249	Georgia	-17	-11	-30
Angola	-22	-15	43	Ghana	-8	-4	-8
Argentina	365	214	780	Grenada	-1	-1	-2
Armenia	-15	-9	-25	Guatemala	3	3	28
Australia	792	478	1 307	Guinea	-13	-9	19
Azerbaijan	-16	-10	-24	Guinea Bissau	-1	-1	-1
Bahamas	-3	-1	-4	Guyana	-27	-18	-32
Bangladesh	-56	-37	-83	Haiti	-13	-8	-12
Barbados	-12	-8	-15	Honduras	-6	-3	-3
Belarus	-16	-9	-24	Hong Kong, China	-86	-58	-174
Belize	-12	-8	-13	Hungary	94	58	135
Benin	-5	-3	-5	Iceland	104	91	103
Bolivia	-10	-6	-6	India	9	5	1 411
Bosnia and Herzegovina	-20	-13	-33	Indonesia	-100	-57	62
Botswana	4	3	6	Islamic Republic of Iran	-137	-84	-219
Brazil	11	6	283	Iraq	-69	-42	-113
Brunei Darussalam	-2	-1	-4	Israel	533	392	553
Bulgaria	33	26	56	Ivory Coast	-11	-4	0
Burkina Faso	0	0	1	Jamaica	-42	-27	-51
Burundi	-1	-1	32	Japan	2 449	1 868	2 526
Cambodia	-9	-7	-19	Jordan	-27	-17	-49
Cameroon	-6	-3	-1	Kazakhstan	72	40	103
Canada	767	293	1 171	Kenya	-13	-9	15
Cape Verde	-2	-1	-3	Kuwait	74	52	54
Central African Republic	-2	-1	-1	Kyrgyzstan	3	3	11
Chad	1	0	5	Lao People's Democratic Republic	-1	-1	5
Chile	-23	-12	-33	Latvia	-5	-4	-8
China	74	154	84	Lebanon	-47	11	11
Colombia	-21	-26	72	Lesotho	-10	-7	58
Comoros	-1	0	-1	Liberia	-3	-2	-4
Costa Rica	9	8	26	Libya	-39	-7	-27
Croatia	-2	-1	-3	Lithuania	21	11	32
Cuba	-7	-6	14	Macao, China	-3	-2	-6
Cyprus	187	141	188	Macedonia	-11	0	-4
Czech Republic	62	36	86	Madagascar	-4	-3	-6
Democratic People's Republic of Korea	-18	-11	-29	Malawi	3	7	16
Democratic Republic of the Congo	-7	-4	-11	Malaysia	21	24	399
Dominica	0	0	-1	Maldives	-2	-1	-3
Dominican Republic	-2	1	-5	Mali	3	3	8
Ecuador	6	5	16	Malta	-6	-4	-10
Egypt	46	55	16	Mauritania	-7	-5	-13
El Salvador	-15	-10	-19	Mauritius	-77	-51	-95
Eritrea	-4	-3	-7	Mexico	-12	-286	1 295
Estonia	3	1	3	Moldova	3	1	5
Ethiopia	-18	-10	-23	Mongolia	-1	-1	-1
European Union	10 478	7 222	10 203	Morocco	184	126	328
Fiji	-55	-36	-67	Mozambique	-11	-6	1
French Polynesia	-4	-3	-7	Myanmar	-16	-12	345
				Namibia	8	5	14
				Nepal	-4	-3	-7

Table 7. *(continued)*

(Unit: US$ m)

Country/area	Compromise	Conservative	Ambitious	Country/area	Compromise	Conservative	Ambitious
Neth. Antilles	-4	-2	-6	Saint Vincent and the Grenadines	-1	0	-1
New Zealand	473	288	741	Sudan	-8	-5	-6
Nicaragua	4	2	11	Suriname	-2	-1	-3
Niger	-4	-3	-7	Swaziland	8	5	20
Nigeria	-83	-53	39	Switzerland	291	214	332
Norway	766	529	829	Syria	-8	-5	-12
Pakistan	-61	-50	61	Taiwan Province of China	-59	-39	-137
Panama	-5	-3	-5	Tajikistan	-9	-5	-14
Papua New Guinea	-2	-1	23	Tanzania	-9	-3	-2
Peru	-30	-16	-45	Thailand	156	107	245
Philippines	-60	-25	-35	Togo	-2	-1	-2
Poland	16	-41	176	Trinidad and Tobago	-10	-6	-11
Republic of Korea	-104	-76	226	Tunisia	-38	-24	-48
Russian Federation	-295	-183	-523	Turkey	291	180	400
Rwanda	0	0	-1	Turkmenistan	-5	-3	-5
Sao Tome	0	0	0	United Arab Emirates	53	50	17
Saudi Arabia	-119	-79	-230	Uganda	0	1	5
Senegal	-12	-7	-16	Ukraine	23	73	163
Seychelles	-1	0	-1	United States	1 032	748	1 713
Sierra Leone	-3	-2	1	Uruguay	52	32	87
Slovakia	4	3	0	Uzbekistan	-14	-6	-12
Slovenia	1	1	-9	Vanuatu	0	0	0
Solomon Islands	0	0	3	Venezuela	-64	-43	-91
Somalia	-1	0	-1	Viet Nam	-21	21	39
South Africa	-32	-21	23	Zambia	0	0	4
Sri Lanka	-33	-20	-28	Zimbabwe	-26	-15	0
Saint Lucia	-1	-1	-2	**World**	**17 495**	**12 096**	**25 766**

Table 8. Distributional effects: changes in consumer surplus

(Unit: US$ m)

Category	Ambitious	Compromise	Conservative
Developed	77 379	60 426	33 788
Developing	4 996	-17 645	-9 309
Least developed	3 879	-2 489	-1 793
World	86 254	40 292	22 686

Source: Agricultural Trade Policy Simulation Model simulations.

Table 9. Distributional effects: changes in producer surplus

(Unit: US$ m)

Category	Ambitious	Compromise	Conservative
Developed	-59 222	-50 220	-29 057
Developing	9 703	17 657	9 696
Least developed	-2 560	2 121	1 568
World	-52 078	-30 442	-17 793

Source: Agricultural Trade Policy Simulation Model simulations.

reversing the result for the conservative and the compromise scenarios. This loss can be attributed mainly to a fall in production in the roots and tubers sector in the Democratic Republic of the Congo, where an initial applied tariff of 100 per cent is reduced to 20 per cent under the Swiss formula. The consequent 38 per cent reduction in domestic prices leads to a fall in production of 11 per cent from 16 million mt and a decrease in producer surplus of US$ 1.9 billion. Neither under the conservative nor under the compromise scenario are applied tariffs changing in that country and producers gain slightly from the rise in world prices.

5. Limitations, implications and conclusions

There remains considerable uncertainty whether either the European Union or the United States proposals could be successfully negotiated and implemented; however, assuming that this occurs, should developing countries support the conservative European Union proposal for agricultural reform, the more ambitious United States proposal or the intermediate Harbinson proposal? The ambitious proposal generates more static gains, US$ 26 billion as opposed to US$ 12 billion or US$ 17 billion, but also more losses for the fewer countries that do lose. In addition to higher tariff cuts, the ambitious scenario has a greater emphasis on removing export subsidies than the conservative alternative. The bulk of the welfare gains from reforming export subsidies go to the European Union with some going to developing country exporters while importing countries are adversely affected by rising prices. Individual countries are affected in different ways, depending on the current trade flows and specific levels of protection, and need to make an individual assessment of the impacts of alternative scenarios.

The results imply that developing countries must undertake some liberalization themselves if they are to gain significant benefits. The advantages of improved market access in developed countries in the agriculture sector are relatively slight because much of the reform is in the dairy and livestock sector, in which developing countries tend not to have a comparative advantage. Two exceptions are sugar, where liberalization leads to the erosion of quota rents currently accruing to many developing countries, and tobacco, where tariffs may be seen in some countries as an instrument of social policy.

The ambitious scenario has the characteristics of using applied rates as a basis and of addressing tariff peaks. However, negotiations have historically been based on bound rates and it is difficult to see this changing. Tackling the high tariffs first makes economic sense from a global point of view; however, as it is developing countries that currently have the highest tariffs, this approach contradicts the need to provide developing countries with special and differentiated treatment. It can be argued that negotiations should be about bound rates in order to acknowledge unilateral reductions of applied tariff rates. This objection, however, can be easily met by reducing bound rates from an historical base, such as 1990, to give credit for more recent reductions.

Our conclusions are based on three scenarios that capture most, but not all, important elements of the United States, European Union and Harbinson proposals.

The Harbinson proposal, in particular, comprises many special and differential treatment elements that cannot, for technical reasons, be captured by ATPSM. Nonetheless, we believe the results provide a useful indicator as to the relative impacts of the alternative proposals.

Further limitations of the analysis should be noted. Apart from the usual limitations regarding data deficiencies, the key inadequacy is the lack of knowledge about the distribution of quota rents. It is assumed here that only sugar rents accrue to exporters. This assumption probably biases upwards the welfare gains from MFN liberalization to developing countries, as liberalization erodes quota rents. If, in fact, quota rents on bananas currently accrue to developing countries, these will be reduced following trade reforms.

A further assumption that overstates the benefits of liberalization, this time in favour of developed countries, is the view that the higher out-quota tariffs determine domestic prices, in spite of the number of observed unfilled import quotas.

Limitations applicable to all models of this nature should be observed. The estimated annual gains are static rather than dynamic, and there is no attempt to account for the one-off costs of moving labour and capital from declining to expanding sectors. Intersectoral and macroeconomic effects are not considered. Finally, data quality is an issue, especially when considering the results for a particular country or sector.

In spite of these limitations, the results provide an indication of the likely nature of the impacts of alternative liberalization scenarios on a country-by-country basis. This enables individual country negotiators to determine how their country may be affected by specific proposals. All of the proposals analysed here suggest that there are net gains and that every country can share in these if they are distributed appropriately. With so many individual countries adversely affected by rising prices, it would be difficult for WTO to reach a consensus on reform through agricultural negotiations alone. This points to the need to: (a) broaden the negotiations; (b) consider some form of compensation; and (c) ensure social safety nets are in place as far as possible.

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Annex

Annex table 1. Country coverage in the Agricultural Trade Policy Simulation Model

Developed	Developing		Least developed
Australia	Albania	Ivory Coast	Afghanistan
Brunei Darussalam	Algeria	Jamaica	Angola
Canada	Argentina	Jordan	Bangladesh
Cyprus	Bahamas	Kazakhstan	Burundi
European Union	Barbados	Kenya	Central African Republic
French Polynesia	Belarus	Kyrgyzstan	Cambodia
Hong Kong, China	Belize	Latvia	Cape Verde
Iceland	Bolivia	Lebanon	Comoros
Israel	Bosnia and Herzegovina	Libya	Congo
Japan	Botswana	Madagascar	Democratic Republic of the Congo
Kuwait	Brazil	Malawi	Djibouti
Macao, China	Bulgaria	Malaysia	Eritrea
Netherlands Antilles	Cameroon	Malta	Ethiopia
New Zealand	Chad	Mauritius	Gambia
Norway	Chile	Mexico	Guinea
Slovenia	China	Moldova	Guinea-Bissau
Switzerland	Colombia	Mongolia	Haiti
Taiwan Province of China	Costa Rica	Morocco	Lao People's Democratic Republic
United Arab Emirates	Croatia	Namibia	Lesotho
United States	Cuba	Nicaragua	Liberia
	Czech Republic	Nigeria	Maldives
	Democratic People's Republic of Korea	Pakistan	Mali
	Dominica	Panama	Mauritania
	Dominican Republic	Papua New Guinea	Mozambique
	Ecuador	Paraguay	Myanmar
	Egypt	Peru	Nepal
	El Salvador	Philippines	Niger
	Estonia	Poland	Rwanda
	Fiji	Republic of Korea	Sao Tome
	Gabon	Romania	Senegal
	Georgia	Russian Federation	Sierra Leone
	Ghana	Saudi Arabia	Solomon Islands
	Grenada	Seychelles	Somalia
	Guatemala	Slovakia	Tanzania
	Guyana	South Africa	Togo
	Honduras	Sri Lanka	Uganda
	Hungary	Saint Lucia	Vanuatu
	India	Saint Vincent and the Grenadines	Yemen
	Indonesia	Suriname	Zambia
	Islamic Republic of Iran	Swaziland	
	Iraq	Syria	
		Tajikistan	

Annex table 1. *(continued)*

Developed	Developing	Least developed
	Thailand	Ukraine
	Trinidad and Tobago	Uruguay
	Tunisia	Uzbekistan
	Turkey	Venezuela
	Turkmenistan	Viet Nam

Note: Althouogh among the 49 least developed countries, Bhutan, Chad, Equatorial Guinea, Kiribati, Madagascar, Malawi, Samoa, Somalia, the Sudan, Togo and Tuvalu are not included in the model.

Annex table 2. Commodities in the Agricultural Trade Policy Simulation Model

Meat
01100 Bovine meat
01210 Sheep meat
01220 Pig meat
01230 Poultry

Dairy products
02212 Milk, fresh
02222 Milk, conc.
02300 Butter
02400 Cheese

Cereals
04100 Wheat
04400 Maize
04530 Sorghum
04300 Barley
04200 Rice

Sugar
06100 Sugar

Oils
22100 Oil seeds
42000 Vegetable oils

Vegetables
05420 Pulses
05480 Roots, tubers
05440 Tomatoes

Fruit
05700 Apples and pears
05710 Citrus fruit
05730 Bananas
05790 Other tropical fruit

Beverages
07110 Coffee, green bags
07120 Coffee, roasted
07131 Coffee, extracts
07210 Cocoa beans
07240 Cocoa butter
07220 Cocoa powder
07300 Chocolate
07410 Tea

Tobacco and cotton
12100 Tobacco leaf
12210 Cigars
12220 Cigarettes
12230 Other tobacco – manufactured
26300 Cotton linters

III. MARKET ACCESS ISSUES IN INDUSTRIAL PRODUCTS

By Peter Gallagher [*]

Introduction

The purpose of this paper is to help evaluate, from a national perspective, the options for reaching a decision at the Cancun Ministerial Meeting in September 2003 on ways to cut barriers to non-agricultural trade in goods. The paper summarizes the situation as of mid-2003 in the WTO negotiations on market access for goods other than agriculture as part of the Doha Development Agenda (DDA), with a focus on the interests of developing countries and, in particular, on the business implications of the current negotiations.

The paper is divided into three sections. Section A comprises a review of existing tariff levels and peaks, and their impact on developing country trade. Section B consists of a summary of proposals for cutting protection in accordance with the DDA objectives while section C reviews the issues that are already the subject of negotiation or under consideration in the DDA, and which would address some concerns regarding non-tariff barriers and resistance to trade in non-agricultural goods.

A. Tariff levels and peaks, and their impact on developing country trade

This section deals with the level of bound and applied tariffs in developed and developing countries, and it reviews some estimates of the impact of those barriers on developing country trade.

1. Manufactures: crucial in most developing country trade

Non-agricultural goods make up most of the merchandise exports of developing countries measured by value, and trends in the composition of developing country trade suggest that in future the proportion will be even greater than it is today.

In one of the most remarkable changes in the direction of manufactures trading in the second half of the twentieth century, the proportion of manufactures in exports by developing countries as a group had grown from about a 25 per cent of exports to more than 75 per cent by the late 1990s.

However, the developing country group is very diverse. The composition of the exports of many least developed countries is very different from that of other developing countries: for them, manufactures comprises a smaller proportion of exports. In sub-Saharan Africa, for example, manufactures comprised only about 5 per cent of

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exports in the mid-1960s; on average, such products still only account for less than a third of their exports. For those countries, agricultural and mineral exports remain much more important sources of foreign exchange.

2. Lower average rates on industrial products

If we consider trade in three broad groups of goods, that is, industrial goods, textiles and clothing and agricultural goods, it will be seen that the average tariff levels both in developed and developing countries have a similar structure. The highest average tariffs are on agricultural imports, while slightly lower rates apply to imports of textiles and clothing. The lowest average rates apply to imports of industrial goods.

In addition, bound tariff rate averages are slightly higher than the average applied tariff rates for all three categories of products, both in developed and developing countries. There are two common reasons for this difference:

- The legal bound rates in the WTO schedules may be the result of a negotiation. Because the bound rate represents the "upper boundary" under WTO rules for an economy's tariff, the applied tariff rate, if it is different, can only be lower than the bound rate;
- Many developing countries bound their tariff rates for the first time when they joined WTO in 1995. Some of these countries took a "safety-first" approach to the creation of their new legal tariff schedules and bound their tariffs at higher rates than they were applying in order to leave room for possible future policy changes.

Finally, developing countries as a group have higher average tariff rates than developed countries in each of these tariff categories, including the textiles and clothing category.

It should be noted that the averages in the tables, drawn from WTO data, are calculated by providing a "weight" to each tariff rate when the average across all tariffs in any product group is calculated. This weight reflects the value of imports under than tariff line in the country for which the calculation is being made: a bigger weight is attributed to tariffs lines where imports have a higher value. Tariffs with a higher weight have a greater influence on the final average level. This is standard procedure for calculating tariff averages. However, it tends to disguise the impact that high or prohibitive tariffs have on reducing import values in tariff lines to which they are applied. Simple (unweighted) average rates can be twice as high as import-weighted rates. It must be remembered that the median tariff rate is almost certainly higher for some countries than these broad averages imply.

3. Higher duties on imports from developing countries

The similarities in the structure of average tariffs also extend to the impact on imports from different country groups. Developed and developing countries alike impose higher duties, on average, on imports from developing countries. The average

high-income (OECD country) tariff on imports from developing countries is four times higher than tariffs on imports originating from other high-income countries, reflecting high tariffs on products such as textiles and clothing.

This is a key observation for developing countries considering the modalities of an agreement to improve market access for their exports. Although developed countries impose higher average duties on imports from developing countries than they do on imports from the world as a whole, other developing countries impose still higher duties. According to World Bank economists Hertel and Martin in 2000, estimates of the tariffs paid by developing country exporters of industrial goods suggested that more than 70 per cent of all the duties paid by those exporters were levied by the governments of other developing countries.

The impact of the protection imposed by developing countries on each other is shown by data on the direction of developing country trade. Because of their increasing importance in the world economy, due in part to higher rates of growth of population and income, developing countries now represent important markets for each other.

Almost 40 per cent of all developing country trade in non-agricultural products is with other developing countries. Developing countries therefore have a strong interest in a broad-based reduction in trade barriers that will bring about liberalization of markets, both in developed and developing countries.

4. Tariff averages hide significant "tariff peaks" and escalation

The lower average rates of duty on industrial products than on agricultural products may appear to indicate that there are fewer market access problems in industrial goods. However, the averages can be deceptive; in the lower industrial goods averages there are, in fact, many peak rates that have an adverse impact on developing country interests.

A "tariff peak" is any tariff that is higher than others in the same product category; in general, a peak is any rate that exceeds 15 per cent *ad valorem.* Using this definition, there are more than 1,000 peak tariffs in the schedules of the United States, the European Union, Japan and Canada. About twice as many peak rates occur in industrial product categories, with the United States and Canada accounting for most of the industrial peaks. The European Union and Japan tend to have many more peak rates on agricultural products than on industrial products.

The (unweighted) average over all these rates is 28 per cent or more than four times the (unweighted) average over the entire range of tariffs of those countries (6.2 per cent).

Many of the industrial tariff peaks occur in textiles, clothing, footwear and other manufactures of particular interest to developing country exporters. More than half of the imports into the Quad countries in 1999 under these tariff peak lines were from countries that received generalized system of preferences or other preferences. Of course, for some developing countries, tariff preferences in those markets alleviate

the impact of the tariff peaks, but the preferences have until recently been significantly less generous in these categories than elsewhere in the tariff (the European Union's "Everything but Arms" initiative and the United States' African Growth and Opportunity Act preferences are less protective against least-developed country imports).

"Tariff escalation" refers to the structure of a group of tariffs affecting products at different stages of value-adding processing. An escalating tariff is one in which the duty on the processed product is greater than the duty on the raw material, or where the duty on the finished product is greater than the duty on the semi-finished product. In many cases, the increase in the duties on an escalating tariff is also greater than the increase in the value added between each stage of production, significantly increasing the protection of factors (e.g., labour) used in value adding.

This may be more easily understood from an example. Suppose that the duty on rolled steel is 10 per cent *ad valorem* and the duty on steel fabrications (e.g., steel brackets for housing construction) is 22 per cent. In this case, the tariff escalates between different levels of value added – an increase in duties of 220 per cent (22/10). Even worse, in this example the escalation outstrips the increase in the value added as represented by the FOB wholesale price of the two goods, which is about 60 per cent.

An escalating duty tends to capture the value-adding processes in the protected market. Particularly in cases where the duty increase is greater than the increase in value-added, importers will be likely to seek raw materials abroad but processed products at home in a market where there is tariff escalation. One effect is to lock exporting countries out of opportunities to move up the value chain in accordance with their comparative advantage. Another effect is a significant increase in the degree of effective protection available to the value-adding business in the protected market, adding to the burden of the protection on consumers and other industries in that market.

Evidence from the WTO Integrated Database on tariffs and trade flows indicates that the industrial product tariff cuts in the Uruguay Round reduced, but certainly did not eliminate, tariff escalation on imports by developed countries from developing countries. There are less data available on the escalation in tariffs of developing countries, but based on overall tariff structures in those countries it is likely that the problem of escalation is as great or greater in these markets.

The harm done by both tariff peaks and tariff escalation is most directly reduced by a harmonizing tariff formula that cuts higher rates of duty more than lower rates.

5. Non-reciprocal preferences: not as attractive as they may seem

The prospect of broadly based MFN trade liberalization can appear unwelcome to industries in developing countries that depend on preferential market access to secure sales in developed countries. MFN tariff reductions tend to erode the margin of preference if the preferential rate does not move down in proportion to the MFN rate reduction. More importantly, from a commercial perspective, is the fact that it reduces

the tax advantage enjoyed by preferential sales even if the proportional difference is maintained.

The tax advantage of a preference is the difference between the tariff-paid prices (price [1+*t*]) of MFN and preferential imports. This advantage shrinks with MFN rate reductions, even if the preferential duty is cut at the same rate as the MFN duty.

Concern over the erosion of preferences has led some developing countries to consider siding with those industries in developed countries that are arguing for lower rates of tariff cut, even though this will mean maintaining higher rates of duty in both developed and developing export markets. Such countries hope that should they decide to do so, they will be able to maintain commercially significant preference margins in key developed country markets.

Tariff preferences, however, have proved to be less valuable than they may appear. In order to gain from a tariff preference, an exporter needs the capacity to divert exports to the preference-granting market and to increase sales volumes in that market. This is rarely, if ever, a feasible project under the terms of most non-reciprocal preference schemes (including the European Everything but Arms initiative), because they are typically constrained by competitiveness conditions that reduce or remove the preference once exports grow by any appreciable amount.

There may also be safeguard clauses that remove the preference when imports threaten the competitive position of domestic producers. Many developed country preferences also have strict rules of origin, with onerous documentation requirements, that limit the expansion capacity of the beneficiaries or force them to pay the MFN tariff. Finally, many of the preference schemes cover products where developing country exporters have no competitive advantage in the market place.

Evidence from several studies shows that, for these and other reasons, developing country beneficiaries typically achieve 50 per cent or less of the potential access under preferential schemes.

6. Fiscal implications of cutting import duties

Many developing countries draw at least part of their government revenues from the customs tariff, with some relying on duties for more than 30 per cent of revenue collections. When non-tariff measures are replaced by tariffs, the impact on these revenues is usually quite positive. However, the impact of subsequent cuts in tariffs is not straightforward as it differs from market to market and from product to product. In its Special Study No. 7 on “Adjusting to Trade Liberalization”, WTO quotes evidence that the impact of liberalization on developing countries’ tax revenues has not necessarily been adverse.

Although a tariff cut reduces the incidence of tax on each import item, the impact on the revenue depends on the volume of imports that would be expected to increase with the reduction of the tariff. The degree to which the volume effect offsets

or exceeds the tax-cut effect depends on the price elasticity of demand for the imported product. Where demand for a product is highly sensitive to price, the price fall due to a tariff cut would lead to a more than proportional increase in imports with a potentially positive effect on revenues. The actual impact of a tariff cut on duties is, therefore, an empirical question that has no single answer for all countries.

The revenue impact of tariff cuts can be ameliorated by macroeconomic measures taken in conjunction with the tariff reduction and, in the longer term, by broadening the tax base. The demand for imports and, therefore, revenue collection depends on factors other than the duty including exchange rates and overall economic growth (GDP). A strong growth response to broad-based tariff cuts, both in export markets and import markets, could help to sustain or improve revenues from the customs tariff. However, this growth response depends, in turn, on the appropriate management of a number of policy settings in addition to trade policy. These policy settings include macroeconomic management measures designed to smooth adjustment to changes in assistance to industry following the tariff cuts as well as distribute the gains and compensate for the losses due to reduced protection. The success of these adjustment policies is also likely to depend on the period of adjustment and the rate of reduction in import protection.

B. Negotiating proposals

Many different proposals have been made for the reduction of tariffs in DDA. Not all countries place a high priority on reducing their own protection. Some developing countries (e.g., Kenya in its submission to the negotiating group) have argued that they are unwilling to open their markets because they fear that either they will lose either newly established industries or an important source of government revenue (customs tariff), or both. It is not clear in every case whether this view amounts to opposition to any tariff cuts, since that is certainly implied in the Doha Declaration that was unanimously approved, or only to significant cuts in some developing country tariffs.

The fundamental WTO rules do not oblige any country to cut its market access barriers; but that is certainly the objective of the DDA negotiations. One way to achieve this objective, which would allow each country to decide for itself whether and how much to offer, would be to conduct many bilateral request and offer negotiations. However, there are major drawbacks to the request and offer approach:

(a) Many of the same developing countries that have declared their reluctance to consider significant tariff cuts would consider themselves at an even greater disadvantage in the context of bilateral reciprocal negotiations with much larger economies;

(b) It would likely take much longer to complete and may lead to a smaller overall outcome, as:

  (i) Each bilateral negotiation would focus on a narrow range of products of direct interest in historical bilateral trade;

(ii) The maximum depth of a cut in any tariff line by any country would be that justified by the reciprocal offers of just its (historical) principal trading partner for that product.

A variety of tariff formulas have been proposed, none of which has attracted general endorsement. However, many of the proposals have objectives or provisions aimed at achieving one or more of the following:

(a) Credit for autonomous liberalization. This would be guaranteed if the base for any tariff cuts is the bound tariff rate at or before the start of the negotiations;

(b) The harmonizing of tariff rates including the use of formulas that cut higher rates of tariff more deeply and help to reduce tariff peaks;

(c) The elimination of very low ("nuisance") duties;

(d) Avoidance of the adverse consequences of import-weighted cuts (used in the past, an import-weighted cut allows countries to achieve an average cut objective while making small or no reductions in peak rates), probably by providing for a minimum cut on each tariff line;

(e) Conversion of specific tariffs to *ad valorem* equivalent rates before reduction. Specific rates are expressed as US dollars per import unit. They act as variable duties, offsetting low world market prices and eliminating consumer gains from, for example, exchange rate variations;

(f) Accelerated reductions under a "Swiss-type" (harmonizing) formula, leading to the elimination of duties or "zero for zero" negotiated elimination of some tariffs.

In an attempt to advance the negotiations, the chairperson of the negotiating group, Ambassador Girard of Switzerland presented a paper containing some draft elements for the modalities on which the group had decided to attempt to reach an agreement by 31 May 2003. Although the members did not endorse the Chairperson's paper, it remains on the table as a significant contribution to the debate.

Chairperson's draft elements of a modalities decision

The proposals made by the chairperson are based on a formula cut in the bound rates of duties reduced in the last round of negotiations or, where a tariff is unbound, to a rate that is twice the MFN applied rate of 2001. Specific tariffs will be converted to *ad valorem* rates in advance of applying the formula. The main elements of the proposal are described below.

(a) Harmonizing tariff reduction formula

The main modality is a mathematical formula for reducing tariffs that has the form of a harmonizing or so-called "Swiss formula", that is, one that cuts higher tariffs faster than lower tariffs with the depth of cut being affected by the choice of a coefficient (to be negotiated).

(b) Built-in provisions likely to result in less than full reciprocity by developing countries

An important innovation in the Chairperson's proposed formula is that the cut in current duties in any tariff line would be proportional to the duty in that line adjusted by the simple average duty across all of the members' tariff schedule for non-agricultural products at the six-digit level of the Harmonized Tariff nomenclature.

The effect of such an adjustment would be that those members with higher average rates of duties on non-agricultural imports would be obliged to cut their individual duties on these products by less than a member with a lower average rate of duties. Since developing countries as a group have higher average tariff rates than developed countries, this adjustment mechanism would tend to result in lesser reductions by developing countries than by developed countries. Thus, they would not be obliged to reciprocate fully for the cuts made by developed countries under the same formula.

A simple experiment with the proposed formula shows that the adjustment effect dominates the outcome of the formula in different cases; the selection of a coefficient makes much less difference.

According to the Chairperson's proposal, all developing countries would have longer (unspecified) periods for implementing the formula cut, and would be permitted to maintain unbound tariff rates on up to 5 per cent of tariff lines representing no more than 5 per cent of the value of imports. Least developed countries would not be asked to make any cuts in duties but would be expected to substantially increase the binding of their current rates.

(c) Elimination of duties in some cases

In response to the mandate for particular attention to sectors of interest to developing and least developed countries, the chairperson's paper proposed the elimination of duties on electronics and electrical goods, fish and fish products, footwear, leather goods, motor vehicle parts and components, precious stones, gems and precious metals, and textiles and clothing. The elimination would be completed in three steps over equal periods (unspecified). Developed countries would complete the elimination of duties in those product areas by the end of the first period.

The reaction to the Chairperson's proposals has been mixed. Many developing countries expressed interest in the proposed method of ensuring less than full reciprocity. However, some developing countries whose average tariffs on non-agricultural products were already low either joined with some developed countries in questioning whether the formula did not reward economies that declined to participate in the liberalization of barriers achieved in earlier negotiating rounds, or liberalized their protective tariffs autonomously.

C. Contingent barriers and resistances

The Doha Declaration provides for negotiations on matters other than normal customs duties that also have an important effect on trade in non-agricultural products. Negotiations that could have direct impact on such trade are those intended to clarify and improve the rules on the imposition of anti-dumping duties. The declaration has also foreseen negotiations after the Cancun ministerial meeting on trade facilitation measures.

1. Anti-dumping

The WTO rules do not prohibit dumping; rather, they seek to limit the impact of anti-dumping duties on trade. This function has apparently become more necessary than ever, given the rapid spread of the use of anti-dumping measures by developing countries since the end of the Uruguay Round.

Although the frequent use of anti-dumping measures was for many years, prior to 1995, somewhat confined to a small number of developed economies (the European Union, the United States, Australia, Canada and New Zealand), the situation changed dramatically following the widespread binding of tariffs and the incorporation of the Agreement on Anti-dumping into the WTO's "single undertaking" in 1995. Since that time, the number of investigations initiated has more than doubled (157 initiations in 1995 and 347 in 2001). The number of anti-dumping measures put in place has followed a similar trend.

Developing country authorities initiated two-thirds of all anti-dumping investigations reported to WTO from 1995 to 2001. Furthermore, by far the largest number of developing country investigations was aimed at imports from other developing countries. China is the biggest single target of anti-dumping action. About half of all investigations begun are terminated before any final measures are imposed, possibly because no margin of dumping is found or because of insufficient evidence of injury caused to the domestic industry. The high proportion of investigations that do not lead to a positive final determination probably indicates that some of the complaints are being used to pressurize competitors and possibly to influence pricing behaviour.

The negotiations on improvements and clarification of the anti-dumping rules have included proposals:

(a) To prohibit certain investigative accounting practices that lead to higher dumping duties ("zeroing");

(b) To introduce an obligation to use the lowest anti-dumping duty necessary in order to offset the calculated dumping margin (the "lesser duty" rule);

(c) To standardize investigations procedures;

(d) To develop best practice guidelines for investigations and measures aimed at improving the transparency of the investigations process.

2. Trade facilitation – substantial benefits

Some of the greatest impediments to trade among WTO members may not be formal trade barriers but a variety of administrative practices, outdated procedures and processing delays that hinder the rapid completion of a trade transaction. These forms of trade "resistance" may include: (a) delays in the handling of cargo and transport in ports; (b) inefficient or deficient telecommunications; (c) procedural and other delays in accessing trade-finance facilities; and (d) bureaucratic inefficiencies and burdensome regulatory compliance requirements related to trade, financial or personnel movements.

Trade agreements and cooperation may reduce the impact of such trade resistance by, for example, introducing end-to-end electronic clearance of customs, shipping or insurance formalities for goods trade, or the harmonization or mutual recognition of standards applying to trade-related services (shipping, movement of sales-support personnel etc).

There is strongly suggestive evidence from World Bank-funded studies that the potential gains in manufactures trade (for example, from trade facilitation measures) may be larger than the projected gains from the reduction of tariff barriers (based on a survey of trade facilitation measures in the Asia Pacific Economic Cooperation region). In addition, business organizations such as the International Chamber of Commerce have offered strong support for cooperative action to reduce trade resistance.

The Doha Declaration recognizes the need for "further expediting the movement, release and clearance of goods, including goods in transit, and the need for enhanced technical assistance and capacity-building in this area". It provides for negotiations on trade facilitation to commence after the Fifth Ministerial Meeting in Cancun, Mexico, if an explicit consensus to do so is reached at that meeting.

IV. SERVICES SECTOR NEGOTIATIONS: ISSUES AND STATE OF PLAY

By B. K. Zutshi [*]

Introduction

The present multilateral trading system, as embodied by WTO, is the result of an intergovernmental cooperative process in rule-making and the exchange of market access concessions through eight Rounds of multilateral trade negotiations (MTNs), spread over five decades. The last Round, i.e., the Uruguay Round (1986-1994) was the most comprehensive of them all. Its outcome vastly expanded the scope of the system to cover new and non-traditional areas such as services and intellectual property rights (IPRS). Services were brought within the fold of the system under the General Agreement on Trade in Services (GATS). The architecture of GATS is given in annex I. Service sector trade liberalization through multilateral negotiations is a recent phenomenon, being less than a decade old.

The outcome of the Uruguay Round, in part, included the initiation of further negotiations in some areas after specified periods. Among other issues and areas, this covered services and came to be known as the "built-in agenda" for future negotiations. In the case of services, Article XIX (1) of GATS envisages successive rounds of negotiations for further progressive liberalization, with the first such round to begin no later than five years after the entry into force of the WTO agreement. Accordingly, services negotiations were launched in January 2000 and were called the GATS 2000 negotiations. These have since become a part of the wider round of negotiations under the Doha Ministerial Declaration.

The Doha Round has been called the "development round" because of the negotiating mandate's strong emphasis on addressing the development concerns of developing countries as well as redressing past imbalances in benefits resulting from poor and inadequate implementation of commitments taken in the Uruguay Round. Services negotiations are particularly important from a development perspective (a) for the purpose of rectifying the imbalance in the exchange of concessions in the Uruguay Round between the developed and the developing countries, and (b) from the point of view of the role of the services sector liberalization in development itself in an increasingly interdependent world, driven by spectacular developments in communications and computation technologies.

The negotiating agenda in services covers the two aspects of (a) rule-making (completing and improving the framework), and (b) the exchange of market access concessions. This paper attempts to provide an analytical assessment of the state of

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play in the negotiations as of May 2003. In that sense, it is a snapshot of an evolving negotiating landscape.

As a backdrop to the subsequent analysis and assessment of the present state of play, Section A of this paper deals with the development dimension of the services sector reflecting its importance in the domestic economies of the developing country members of ESCAP. Section B starts with a reference to the Doha negotiating mandate on services, and then analyses issues and the state of play in the negotiations in rule-making. Aspects of e-commerce relevant to services negotiations are also covered in this section. Section C deals with market access negotiations and starts with an analysis of the recently approved modalities for the treatment of autonomous liberalization. It then moves on to an assessment of liberalization under GATS so far and ends with a preliminary assessment of the request offer process and comments on some of the offers. Given the essentially bilateral nature of market access negotiations and their present stage, the assessment is tentative. Section D is on technical cooperation and capacity-building for effective participation of ESCAP developing country members in the negotiations. Section E comprises the conclusion.

A. Services sector and trade liberalization: the development dimension

One of the indicators of development itself is the status of the services sector in an economy. In today's increasingly globalized economy, it is not possible for any country to develop and prosper under the burden of an inefficient and expensive services sector infrastructure. The benefits of a strong and efficient structure services sector go beyond the sector itself. An efficient and properly functioning services sector is a prerequisite for the development of the agriculture and industrial sectors. The growing importance of the services sector is reflected in the fact that the sector accounts for more than 70 per cent[13] of production and employment in industrial societies. Many developing countries are rapidly increasing the value added of services contribution to gross domestic product (GDP).

Between 1980 and 2000, low- and middle-income countries increased their service production by 25 per cent. The share of services in economic activity (value added) presently ranges from 38 per cent in low-income countries to more than 65 per cent in high-income countries.[14] In both, developed and developing countries, the share of services in total economic activity has been growing as a result of developments in information and communication technologies and of deregulation and privatization. This is true also of the developing country member States of ESCAP. The share of services (value added) in GDP of ESCAP member States in 1990, 1999 and 2001 is shown in the statement in annex II, with a brief analysis.

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13 Sauve and Stern (eds.), 2000, *GATS 2000*, introductory chapter.

14 Maurer and Chauvete, 2002, "The magnitude of flows of global trade in services" in the *World Bank Handbook: Development, Trade and the WTO*, pp. 235-245.

This growing importance of the services sector in national output has been accompanied by an expansion of the share of commercial services in world exports of goods and services from 15 per cent to over 20 per cent in the past two decades. On average, trade in services grew at an annual rate of 7 per cent as against 5 per cent in the case of goods. It has been observed that despite the higher growth in services exports, the share of services in world trade has been smaller than its share in world production.[15] This is attributed to two factors. One, the differing characteristics of goods and services, inasmuch as services are less tradable and often must be consumed at the place of production, although this has changed dramatically due to the developments in information and communication technologies. Two, that, on the one hand, trade in goods may be inflated as the merchandise trade statistics include re-exports, and, on the other, trade in services is probably underestimated by the failure to capture important modes of delivery of services as per definition of trade in services under GATS. This implies that trade in services may have a much higher share in world exports than the present data suggest.[16]

Between 1990 and 1999, world trade in commercial services increased at an annual rate of 6.2 per cent, with growth rates in the first half of the decade significantly higher than in the second half. In case of developing countries, the first half of 1990s witnessed average annual growth rates of over 13 per cent in their service exports. In the second half of the decade though the there was a dramatic decline in the growth rates, falling well below that for merchandise and below that registered by developed countries. This reversal in growth is mainly attributable to the Asian financial crisis (1997). In Asia the growth rates of exports and imports of services fell steeply, to below 1 per cent in the second half of 1990s, to over 13 per cent (14.8 per cent for exports and 12.9 per cent for imports) in the first half. The exceptions were China and India who maintained dynamic growth, as they were less affected by the crisis. India in particular had an average annual growth rate of 20 per cent for exports, reflecting its specialization in computer and information services.

Over the past two decades, trade in services has been growing faster than trade in goods for both industrial and developing countries, with developing countries showing, on average higher growth rates than the industrial countries. Still, more than 40 per cent of world trade in services is carried on between the major traders – the United States, the European Union and Japan.[17]

Development dimension of trade liberalization in services and its contribution to growth is still a relatively unexplored area in academic studies, although several studies have been undertaken during the last few years. The scope of this paper does not permit a survey of the literature on the subject. The economic case for services liberalization, however, is essentially no different from that of liberalization of trade in goods. In fact, in the case of services there is an additional factor in that many services are inputs into production of both goods and services and thus an important

15 Ibid.

16 Ibid.

17 Ibid.

determinant of the competitiveness of the final product or service. This is particularly true of infra-structural services like telecommunications and financial services. These sectors have a significant impact on growth and efficiency across a wide range of user industries and by implication on economic performance. Technological breakthroughs in information, communication and transport technologies have vastly added to the performance of these sectors.

B. Negotiations on rule-making

Before discussing the status of negotiations in rule-making, a brief reference to the Doha mandate on services is needed.

1. Doha negotiating mandate

The mandate for services negotiations in the Doha Declaration was among the least controversial aspects of the engagement leading to that Declaration. In fact, as mentioned above, services negotiations were initiated in January 2000 (GATS 2000 negotiations) as a part of the Uruguay Round commitment (later called the Uruguay Round built-in agenda), under Article XIX of GATS. They were subsequently subsumed in the wider mandate at Doha.

The Doha services mandate takes note of the developments in the GATS 2000 negotiations. The mandate also recognizes the work to date, and reaffirms the guidelines and procedures for the negotiations adopted by the Council for Trade in Services on 28 March 2001 as the basis for continuing the negotiations, with a view to achieving the objectives of GATS as stipulated in its Preamble as well as Articles VI and XIX.

2. Negotiations in rule-making: current position

The set of rules comprising the framework agreement at the end of the Uruguay Round remained incomplete with regard to certain important aspects, such as emergency safeguard measures (Article X), government procurement (Article XIII), subsidies (Article XV), and disciplines on measures relating to qualification requirements, technical standards and licensing requirements (Article VI.4). The present status of negotiations under these provisions, and the issues therein, is delineated in the following paragraphs.

3. Emergency safeguard measures[18]

Article X.1 of GATS mandated members to enter into "multilateral negotiations on the question of emergency safeguard measures, based on the principle of non-discrimination". The results of those negotiations were to enter into effect no later than January 1998. That deadline was missed, as were many others that were subsequently set.

[18] P. Sauve, 2002, "Completing the GATS framework: safeguards, subsidies and government procurement" in *World Bank Handbook: Development Trade and the WTO*, chapter 32.

The most important and substantive item for the Working Party on GATS Rules (WPGR) is "to identify, elaborate and consolidate elements for EMS, and to address the question of feasibility and desirability of ESM". The deadline for finalizing the negotiations is 15 March 2004. The chairperson was required to report on the results of the work by 15 March 2003 while a progress review is due to be carried out by the Fifth Ministerial Conference at Cancun, Mexico in September 2003. The chairperson has since given his report (S/WPGR/9).

ESM has claimed the maximum attention and has thus resulted in the most intense engagement among members, backed by a large number of written and oral contributions on different aspects from the delegations as well as the secretariat. The annex to S/WPGR/9 contains a nine-page list of documents related to these negotiations. This is indicative of the effort directed to the negotiations. As of May 2003, however, the negotiations were stalemated, with no convergence of views on feasibility and desirability, nor on possible elements of an ESM provision. The negotiations have so far not been able to achieve any clarity about who is to be protected against what and how.

In his report of 14 March 2003 (S/WPGR/9), the chairperson noted widely differing views among the delegations on these issues:

> *"There is very little, if any, convergence on the fundamental issues, and many basic questions remain open; different views have been expressed as to whether they should be addressed, and, if so, how; and members remain divergent on issues as fundamental as the forms that an ESM might take. Attempts to address identification, elaboration and consolidation of the elements for an ESM without prejudice to the question of desirability and feasibility have not been very successful in bringing about converging on the various elements. At the same time, the discussion on the question of desirability and feasibility of an ESM has not progressed very far in the absence of converging views on the possible common elements for an ESM. In fact, discussions in recent years seem to indicate that as the discussions become more in-depth and refined, divergences of views in respect of various issues become more apparent and glaring. I would also observe that even if we were to decide to start drafting an ESM, there would appear to be no common basis on how to proceed with this task".*

What are the issues evading answers in these negotiations? In order to answer that question one has to revert to the conceptual basis of this debate. The conceptual basis is the General Agreement on Tariffs and Trade (GATT) ESM paradigm that is meant to address, under conditions of fair trade, concerns about serious injury or threat of serious injury to domestic industry of similar or directly competitive products from import surges arising from GATT obligations. The permissible remedy in such circumstances is the application of temporary import control measures on a non-discriminatory basis.

In order to transpose this in the GATS context, it is first necessary to determine what constitutes "domestic industry". Given the modal definition of trade in services, how should locally established suppliers of foreign companies be treated? Should they be included or excluded, and if excluded what are the implications for joint ventures, particularly for domestic minority shareholding? What implications does this have for national treatment?

The subsequent question is protection against what? This protection has to be against import surges, necessitating a definition of "imports" under the four modes of supply of services under GATS. Only after some clarity has been reached on what is to be controlled will it be possible to turn to the mechanics of control in order to answer the third question of how such protection can be achieved.

Defining imports is extremely difficult given the modal definition of trade in services under GATS. This is particularly so in case of mode 3, which involves foreign direct investment and the question of acquired rights. It is incongruous to characterize cross-border temporary movement of natural persons as service suppliers under mode 4 as "imports". Devising controls for different modes is even more daunting except that, ironically, it may be relatively easy to establish a link between temporary movement of natural persons as service providers and levels of employment for safeguard action purposes.

In order to take emergency safeguard action, it is necessary to establish a causal link between serious injury or a threat thereof to the domestic industry that "produces similar or directly competitive products", and the surge in imports. It has been very difficult to establish such a link in the goods sector and has proved highly contentious. It is clear from reports on deliberations in WPGR that it is proving even more difficult to get a grip on the issue in the GATS context.

From the record of deliberations in WPGR and members' contributions, a convincing economic case for ESM does not appear to have been made. Examples of actual or potential circumstances for the invocation of such a provision for economic reasons of injury or threat thereof to domestic industry have not been cited. In general terms, the Asian financial crisis of 1997 has been cited as an example of the kind of emergency situation that may have to be tackled by recourse to an ESM. It is now being increasingly recognized that its causes lay in the weaknesses in the regulatory oversight and the present international financial architecture, rather than in liberalization of the sector. In GATS there is considerable regulatory freedom and in the case of financial services, a full-fledged prudential carve out.

In respect of the political case for an ESM provision in GATS, it is argued that it enables participating countries in negotiations to make more liberal commitments than in the absence of such a mechanism because of the ability it provides to act in an emergency situation. There is, however, no evidence either within the voluminous work of the Working Party on GATTS Rules (WPGR) or in outside studies to warrant any such inference. However, perhaps the ability to take emergency action gives a measure of confidence and comfort to participants in the political economy context, which is, no doubt, of some importance in itself. The issue, however, is the balance of

advantages in having such a provision. It appears that the balance of advantage is not in favour of such a provision for the reasons discussed above.

To sum up, there is complete stalemate in the negotiations, with no common basis for undertaking any further work, at least for the present.

4. Government procurement of services

Purchases by governments for their own use are estimated at about 10 to 15 per cent of gross national product,[19] and procurement of services comprises a substantial part of this total. Hence, the importance of government procurement of services for the multilateral trade agenda.

In academic circles there is a debate[20] on the economic impact of discrimination in government practices with regard to the procurement of services. Generally, discrimination in government procurement takes the form of price and non-price preferences for national suppliers. Who are treated as national suppliers is, therefore, an important issue. It has been argued that the economic impact of discrimination depends on whether a local market is contestable through foreign direct investment and local presence. This would be particularly true of service products, which are not tradable.

Article XIII.2 of GATS requires members to enter into multilateral negotiations on government procurement on services within two years, without any timeframe for their conclusion. The Negotiating Guidelines for Services (S/L/93) envisage completion prior to the conclusion of negotiations on specific commitments. The negotiations are being held in the WPGR, as per the work programme of 22 July 2002, based on submissions from members and other available material. The WPGR chairperson was required to report on the progress of work by 30 June 2003. The Fifth Ministerial Conference at Cancun in September 2003, will take stock of progress made in the negotiations.

This issue has not, however, received anywhere near as much consideration in WPGR as ESM. There are many reasons for this difference. One is the crosscutting nature of the issue between goods and services under the plurilateral Government Procurement Agreement. A major difficulty has been the lack of desegregated data on a cross-country basis, procurement at various sub-national levels etc.

The discussions have covered a wide range of issues: the desirability and feasibility of disciplines on government procurement under GATS, the scope of the negotiating mandate and the relationship between the work of WPGR and that of the Working Group on Transparency in Government Procurement. So far, the deliberations have not resulted in an understanding on any of these issues. A brief analysis of the issues follows below.

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[19] Low, A. Mattoo and Subramanian, 1996, in *Government Procurement in Services – World Competition,* Vol. 20, No. 1, September 1996.

[20] Evenett and B. Hoekman, (2000), *Government Procurement of Services and Multilateral Disciplines in GATS 2000*, Sauve and Stern (eds.).

With regard to the scope of Article XIII.1, some members have interpreted it as a carve-out of government procurement in services from the scope of the GATS itself. Any such interpretation is not borne out by the negotiating history of Article XIII.[21] If a carve-out were intended, it would have been achieved through Article I or a separate annex. Moreover, in that case, there would have been no need for Article XIII.2. The exclusion of Articles II, XVI and XVII, particularly Article II on most favoured nation (MFN), has its genesis in the United States view that such application, in the absence of specific disciplines, would be to its disadvantage in that its trading partners would exploit its relatively open market (in the United States' view), without any reciprocal benefits. Many delegations shared the view that, in order to promote meaningful liberalization in services government procurement, a specific set of disciplines would have to be negotiated that might involve modifications to Articles XVI and XVII. Some delegations were in favour of a separate government procurement agreement, covering both goods and services. Developing countries, as a group, insisted on government procurement in services being placed squarely within the framework agreement, to enable them to take advantage of the flexible nature of the agreement to liberalize government procurement in services in consonance with their economic and development needs.

The question of desirability and feasibility that was raised by some members remains unclear. In fact, the question tends to confuse the issue. It is wholly feasible to liberalize procurement by governments of most services for their own consumption. There are provisions in GATS for taking care of all legitimate security and other concerns in such purchases. In any case, government procurement is very much on the multilateral trade agenda. The plurilateral agreement apart, the subject is being examined in the Working Group on Transparency in Government Procurement as a crosscutting issue. It has been included in the Doha Declaration, although the coverage is limited to the transparency aspects.

The European Union proposal on the subject argues for negotiating additional disciplines under Article XVIII with regard to obligations already applicable to government procurement, such as transparency (Article III) and domestic regulation (Article VI). It further invites exploration of extending the principles of Article VI.4 to government procurement by developing a set of disciplines covering not only transparency but also non-discrimination. It raises a series of questions, both on the MFN and national treatment aspects of non-discrimination. The deliberations so far have not resulted in any understanding on these issues.

A number of developing countries have considerable competitive advantages in certain services sectors, for example, software and other knowledge-based services that are consumed by developed country governments in large quantities. With domestic policy reform underway in developing countries in the information and communication sectors, more and more of those countries are gaining competitive advantages in that area. Therefore, it would be in their own interest to push for a positive outcome of the negotiations.

[21] From personal experience as India's Permanent Representative to the World Trade Organization and services negotiator.

5. Subsidies[22]

The treatment of subsidies was not settled during the framework negotiations in the Uruguay Round. No timeframe was fixed for completing the negotiations on the subject. Article XV mandates the exchange of information concerning all subsidies related to trade in services between members for the purpose of these negotiations.

The WPGR work programme on subsidies is a flexible one, with discussions based on submissions from members and available materials. It encouraged members to put forward submissions on the subject by 31 March 2003. The chairperson was to report on the progress of work by 30 June 2003 and stocktaking would take place at the Fifth Ministerial Conference at Cancun, Mexico in September 2003.

The actual negotiations are addressing a checklist of issues, covering: (a) the definition of a subsidy in services; (b) evidence of trade-distorting subsidies; (c) the extent to which existing GATS rules already discipline services subsidies or provide the means to do so; (d) a wider role for subsidies in meeting public policy objectives and the development aspirations of developing countries; and (e) the appropriateness of including countervailing procedures in the disciplines.

The response to the questionnaire on the exchange of information on services subsidies has been relatively poor. One of the reasons has been the absence of any understanding on the definition of "subsidy", as well as some disagreement about the scope of coverage of the negotiations, particularly with regard to whether the mandate was limited to trade-distorting subsidies or whether it covered all types of subsidies.

The present stage of discussions in WPGR is that of coming to grips with the issues. There is, as yet, little understanding on a possible way forward. A major difficulty is that no comprehensive information is available on the nature and extent of the existing subsidies in services, nor on their trade-distorting effects. There is, however, anecdotal evidence of incidences of subsidies in sectors such as the transportation, tourism, financial services and audio-visual sectors in some countries. Some work has been done recently by UNCTAD on subsidies in some sectors such as audio-visual.

Conceptually, it is possible to deal with subsidies in services on the basis of the traffic light approach in the WTO Subsidies Agreement. In fact, this approach is being discussed, although still in a general way, by addressing the scope for "actionable" subsidies and the parallels between the GATS and SCM agreements. There are, however, immense problems, both conceptual and methodological, in measuring and, if necessary, disciplining when distorting subsidies are identified. Application of a countervailing mechanism also appears to pose policy problems as well as conceptual problems. The issue does not appear to be ripe for negotiations at this time. Moreover, it is not clear whether there is sufficient enthusiasm among the members to seek a definitive outcome of these negotiations within the timeframe of the current negotiations.

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[22] See Gaunther, O' Brien and Spencer, "Déjà vu, or new beginning for safeguards and subsidies rules in services trade?" in *GATS 2000* for a detailed analysis of the issues in subsidies. See also P. Sauve, *World Bank Handbook*, chapter 32.

One reason for this lacklustre interest in the outcome of these negotiations may be the fact that members can protect their essential interests, even at present. The existing GATS does not leave the issue wholly uncovered. It is accepted that subsidies are "measures" within the meaning of GATS and thus obligations of MFN and national treatment are applicable. While MFN is a horizontal obligation that is applicable to all sectors and which prohibits discriminations between signatories, national treatment is applicable to sectors where scheduled commitments have been made. Unless a reservation on national treatment has been made in its schedule, a member is also obliged to provide subsidies to foreign suppliers. It should be noted that the majority of GATS members have included limitations on national treatment applying to all subsidy practices. Others have done so with respect to specific modes and specific sectors.

In any substantive negotiations on subsidy disciplines, developing countries would need to ensure an outcome that gives them the freedom to use subsidies in areas where they are the best instruments to achieve legitimate economic or social objectives.

6. Disciplines on domestic regulations: Article VI.4

Regulation is a *sine qua non* for liberalization in services, whether undertaken nationally or internationally, in order to address market failures, and public and social policy concerns. The GATS preamble explicitly recognizes the freedom of members to regulate and introduce new regulations in services.

The idea behind Article VI.4 is to address disguised restrictions. The provision mandates development of necessary disciplines relating to qualification requirements and procedures, technical standards and licensing requirements with the objective of ensuring that such requirements are:

(a) Based on objective and transparent criteria, such as competence and the ability to supply the service;

(b) Not more burdensome than necessary in order to ensure the quality of the service;

(c) In the case of licensing procedures, not in themselves restrictions on the supply of the service.

The issue was first addressed in the Accountancy Sector in the Working Party on Professional Services (WPPS). The recommendations of WPPS, led to the adoption of the Decision on Disciplines Relating to the Accountancy Sector by the Council for Trade in Services in December 1998.[23] The acceptance of the Decision by members is on a voluntary basis, for the present. Subsequently, by a decision on 26 April 1999,[24] Trade in Services Council set up a Working Party on Domestic Regulations (WPDR) to develop any necessary disciplines under the Article VI.4 mandate. The WPDR mandate is to develop generally applicable disciplines for all sectors, but it may also

[23] World Trade Organization document S/L/64, 17 December 1998.

[24] World Trade Organization document S/L/70, 28 April 1999.

develop disciplines as appropriate for individual sectors or groups, keeping open the issue of application of disciplines on a horizontal or sectoral basis.

The Working Party is currently engaged in the identification and exploration of issues relevant to its mandate. On the basis of the text of Article VI.4, accountancy sector disciplines and other WTO agreements on goods (TBT and SPS), four areas have been identified for developing disciplines: necessity, transparency equivalence and international standards. The WTO secretariat has drawn up a checklist[25] of issues on these and related issues such as the scope of Article VI.4 itself.

The negotiations on the subject have not progressed beyond the exploratory stage of identifying the types of measures that would be addressed by disciplines under Article VI.4. To facilitate discussions, a useful reference document (JOB [02/ 200, Rev. 4]) has been compiled by the WTO secretariat containing examples of the types of Article VI.4 measures that may need to be disciplined under the headings of transparency, licensing requirements, qualification requirements and technical standards. An important contribution to furthering the discussions is the submission of a draft Annex on Domestic Regulations by Japan (JOB [03/45], 3 March 2003). It is a comprehensive draft regulation covering all measures under Article VI.4, except measures regulating the temporary entry of natural persons. The document draws heavily on the accountancy sector disciplines (S/S/64).

Notwithstanding the ongoing discussions in WPGR, there does not appear to be much enthusiasm in developing disciplines under Article VI.4. Developing countries have been, and continue to be, wary of taking on obligations that entail constraints on their regulatory freedom. The United States appears to be disinclined towards a positive outcome on this issue. Their preference appears to be in favour of using the additional commitment (Article XVIII) route to handle the issue.

This does not augur well for developing countries being able to secure effective market access in areas of export interest to them. Strong and enforceable disciplines under Article VI.4 are of critical importance in exploiting market opportunities in some sectors such as professional services. The single most important outcome would be the acceptance of a "necessity test", applicable to regulatory instruments in all sectors.

7. Electronic commerce

Electronic commerce is a potential economic building block for all countries. As of now, developed societies are better able to exploit the potential than developing ones. This is largely due to what has been characterized as the "digital divide'' between them, which is the relative absence and/or poor quality of an information and communication infrastructure, coupled with a near total absence of the enabling legal and regulatory framework among developing countries. Addressing all the issues relevant to electronic commerce is outside the scope of this paper. The comments that follow are limited to e-commerce issues linked to GATS.

[25] World Trade Organization Secretariat JOB(01)/92 (5067/Rev. 1) 19 June 2001.

Electronic commerce is already covered by GATS under mode 1. However, in some aspects, it is a crosscutting issue between goods and services. The more important among such aspects are those of classification, duties, regulations and intellectual property rights. These are being considered by different WTO bodies.

The most relevant from the GATS perspective is the issue of classification of e-commerce and its fiscal implications. The subject is being debated under the auspices of the WTO General Council in a series of dedicated discussions, with the next debate having been scheduled for May/June 2003.

The debate on the classification of e-commerce transactions, as between goods and services, is now confined to the content of certain electronic transmissions. For the remainder, there is an emerging consensus on the classification of transactions between goods and services. In the case of transactions where products may be advertised, ordered and paid for electronically, but which are delivered physically, such physically deliverable products would be classified as goods subject to rules and obligations under GATT. An example of such a transaction is a physical book purchased from an on-line store. It is also accepted that all electronically delivered services are within the scope of GATS, since the agreement applies to all services, irrespective of the means of their delivery.

The situation, however, is not clear for products that can be delivered as digitized information over the Internet. In most cases, electronic transactions involve downloading information from one computer to another in the form of digitized data. The digitized content is distinct from the act of providing the content, which represents a service. The issue is whether the digital content is itself a good or a service. This issue is complicated by the fact that physical media such as books, disks, magazines and diskettes can carry the same type of information as the digitized data exchanged electronically. There is, so far, no consensus on how to apply WTO rules to electronic deliverables that can have a physical equivalent.

This is an important issue for many Internet-enabled services, but particularly so for the software sector. There is still no consensus on whether to treat software services transactions as goods or services transactions. Those who advocate such transactions being treated under GATT are looking for a greater degree of liberalization through inherently higher levels of obligations of that agreement in terms of market access and national treatment. Those seeking to classify such transactions under the GATS would want to take advantage of flexibility available under GATS in respect access commitments and national treatment. The United States has been advocating very liberal treatment for e-commerce transactions, with decided preference for their classification under GATT. On the other hand, the European Union is seeking to classify such transactions under GATS, perhaps in part due to their concerns about liberalization in the audio-visual sector where they made no commitments in the Uruguay Round.

A large number of members are undecided on their preference between the two options for want of clarity regarding the implications. The opinion is also held that the present classification systems in WTO (HS for goods and W/120 for services) do not adequately cover electronically delivered software. HS provides only for the classification of the media on which software is stored, while W/120 defines software merely in the context of its description of "computer-related services". There are suggestions that a separate classification system be conceived for the software sector, including the possibility of a stand-alone agreement, on the lines of the Information Technology Agreement under GATS.[26]

Another important issue in the goods versus services classification debate is that concerning the fiscal implications of e-commerce. A temporary moratorium on the imposition of customs duties on electronic transmissions was established in conjunction with the work programme in 1998 in order to help promote the growth of e-commerce. There has been substantial debate, still inconclusive, on whether the moratorium ought to be made permanent and binding. The two concerns around which the debate has revolved are: (a) the long-term revenue implications of a permanent and binding moratorium, particularly for developing countries, whose dependence on customs duties as a source of government revenues is significant; and (b) possible discriminatory treatment between the same products delivered electronically and in physical form, and its implications for competition.

A seminar on "Revenue Implications of E-commerce" was held in April 2002[27] under the auspices of the WTO Committee on Trade and Development. The chairperson of the seminar, reporting on the deliberations, noted that the direct effects on government revenue through tariff losses appeared to be rather small whereas the effects on the efficiency of an economy could be large.

On the issue of discriminatory treatment, those advocating liberal treatment for e-commerce argue that its implications for competition between the delivery of a product in digitized form and physical form are negligible. They also argue that businesses and consumers prefer electronic deliveries over physical ones, not on the grounds of a possible price advantage resulting from duty exemption on electronic deliveries (whose total impact on the price would be small because of the low incidence of duty), but for a variety of other reasons such as efficiency, convenience and speed of delivery. In any case, they claim, if equalizing the treatment between physically delivered and electronically delivered products is the goal, it can be achieved by the more liberalizing way of reducing the duty, if any, on the physically delivered product. The chief advocate of this view is the United States.[28]

From the above analysis, it is clear that the debate on the possible implications and the potential impact of goods versus services classification in respect of the software sector is far from concluded.

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[26] Canadian Non-Paper on the classification of software delivered electronically (Job [02]/38, 8 May 2002).

[27] Report in WT/COMTD/M/40, Annex II.

[28] Submission by the United States for the Work Programme on Electronic Commerce, W/GC/W493.

An important issue under debate in the GATS context is the so-called "technological neutrality" of means of transport used under mode 1. Some have interpreted this to mean that a member has committed the Internet service if there is a commitment under mode 1 for any sector. This is not correct. The Internet has a dual nature in this context; it is a service in itself and a mode of delivery for other services. Technological neutrality is, with reference to the Internet, a mode of delivery for other committed services under mode 1. For the Internet as a service, a separate commitment would be necessary.

The development and expansion of the Internet has vastly increased the potential for cross-border trade under mode 1. There is great potential for the participation of developing countries in this trade. The outcome on issues under negotiation in this area will also have a bearing on the ability of those countries to exploit this potential.

C. Market access negotiations

1. Autonomous liberalization: modalities for credit

Article XIX.3 stipulates modalities for future negotiations, which require negotiating guidelines and procedures to be established for each Round. Among other things, negotiating guidelines have to establish modalities for the treatment of liberalization undertaken autonomously by participants since the previous Round. The guidelines and procedures for the ongoing negotiations envisage credit being given for autonomous liberalization, based on multilaterally agreed criteria. This is also covered in the Doha Declaration.

After a prolonged process, Modalities for the Treatment of Autonomous Liberalization (hereinafter referred to as Modalities), together with the statement by the Chairperson have been approved (TN/S/6, 10 March 2003). The Modalities define an autonomous liberalization measure as well as lay down criteria for assessing the value of such measures and procedures for their application.

Important elements of the definition are that measures (a) should be schedulable and/or should lead to the termination of MFN exemption, (b) are compatible with the MFN principle, and (c) must have been undertaken by the liberalizing member unilaterally since the previous negotiations.

With regard to the criteria, the emphasis is on the liberalizing nature of the measure, the share of the sector in the total trade of the trading partner, and trading partner's share of the total trade in the sector autonomously liberalized by the liberalizing member. Other factors to be taken into consideration are the importance and impact of the autonomous liberalization measures on the liberalizing member's economy, the market potential in the liberalizing member for the trading partner, and the opportunities for the expansion of foreign participation in the sector after the measure has been introduced.

The Modalities envisage the use of qualitative and quantitative criteria or a combination thereof, as agreed bilaterally between negotiating members, for assessing

the value of a measure. The application of the Modalities can be advanced bilaterally, plurilaterally, or multilaterally, but the granting of credit will be a purely bilateral process.

A member may seek a reciprocal concession for an autonomous liberalization measure in sectors of interest to the liberalizing member. As an alternative, the liberalizing member may obtain agreement that the trading partner concerned will refrain from pursuing a request addressed to that partner. Members may also grant credit in other ways as agreed between them. It should be noted that the Modalities strongly encourage the binding of autonomously liberalized measures but do not rule out credit for such measures that remain unbound. However, in view of the history of credit for unbound liberalization in GATT and even the negotiations on these Modalities, securing credit for such liberalization appears to be a non-starter.

The chairperson's statement accompanying the Modalities stresses that newly acceded members have made commitments far in excess of the level of those made by members at the same level of development who had acceded earlier. The statement explicitly states that this aspect must be taken into account when addressing requests to newly acceded members, and that other members must give sympathetic consideration to requests for concessions from newly acceded members.

The adoption of these Modalities is seen as a significant achievement, at least inasmuch as there is now a basis for seeking credit for autonomous liberalization. There are, however, serious challenges to securing such credit and, at the end of the process, carrying out an evaluation. The challenge for a member seeking credit starts with assessment of the value of an autonomous liberalization measure, followed by the need to convince those members called upon to grant credit for such liberalization to accept that valuation. If any qualitative or quantitative criteria are proposed (such as those in the paper[29] concerning the Republic of Korea, tabled in the Modalities negotiating process), they will have to be settled bilaterally. It would be difficult to reach agreement on the assessment of the value of liberalization measures based on any objective criteria that could be equally valid for all service sectors.

A serious handicap in preparing a trade value assessment of any liberalization measure is the absence of trade data in the services sector. Trade share attributable to a liberalizing measure is a good guide to the assessment of its commercial value. This approach is traditionally used in the goods sector when assessing the value of tariff concessions as both global and bilateral data, collected and compiled on a comparable basis, are available. In the case of services, even the basis for the collection of internationally comparable data does not exist at present. Although discussions are in progress at the international level on establishing a basis for the collection and compilation of data on commercial exchanges in the services sector, it will be some time before these efforts yield results.

The next challenge for the developing countries is in deciding what to ask for in return for the substantial autonomous liberalization undertaken by them since the

[29] S(CSS)/W/126, 30 November 2001.

last Round. This is complicated by the fact that developing countries will most likely seek concessions in a narrow range of service sectors and modes of supply, some of which are highly sensitive among the developed countries, such as the temporary movement of natural persons as service providers under mode 4. However, it may be added that this particular issue is no less sensitive among the developing countries.

The above analysis should give an indication of the challenge to be faced in seeking and securing credit for autonomous liberalization. However, in highlighting this challenge it is not intended to discourage members from seeking credit; the aim is only to emphasize that time and effort are needed in making a serious bid to get credit. ESCAP member States have undertaken autonomous liberalization of a significant order since the Uruguay Round and they must seek credit for such liberalization on the basis of binding the applicable regime(s).

Turning to the chairperson's statement regarding newly acceded members, it must be acknowledged that the point made is a fair one as, indeed, acceding countries have made commitments that exceed those of the original members. However, in undertaking those commitments, the acceding countries responded mainly to the interests of the developed countries, particularly the United States and the members of the European Union. Indeed, those countries must not press the acceded countries to commit much more during the present negotiations. Whether this will constrain others from seeking liberalization in areas of specific interest to them from acceding members is a moot point.

2. Liberalization commitments so far under GATS

At the close of the Uruguay Round negotiations in 1994, initial commitments by members were at best modest, mostly reflecting a standstill position and, in many cases, even a rollback. In other words, what members did was to bind the then existing position of liberalization. In the post-Round negotiations on four sectors (financial services, basic telecommunication, maritime services and movement of natural persons), there was considerable improvement in the commitments in the financial services sector, although still not very much beyond the then applicable regimes. The most significant commitments, including future reform, by a majority of members were undertaken in the basic telecom sector. The negotiations also led to the innovative step of additional commitments (Article XVIII) being taken on regulatory principles based on the Reference Paper. Maritime services negotiations failed and were abandoned.

The extended negotiations on mode 4 commitments were, in general, not successful. Indeed, no more than a handful of countries showed real interest in addressing this issue. Only eight participants included modest changes to their commitments under this mode, most of which had been pulled from the table at the conclusion of the Uruguay Round in order to improve negotiating leverage in the extended negotiations.

The procedural requirements for granting visas and work permits remained both unchanged as the result of Uruguay Round commitments and subject to considerable discretionary powers of the issuing authorities, resulting in further erosion in access

opportunities. In the case of professional services, recognition of qualifications and verification of professional competence, without which no effective access is possible, has left much to be desired in implementation.

In terms of the overall balance of current concessions between developed and developing countries in the Uruguay Round and thereafter, developing countries have not made significant commitments except in basic services and, to a lesser extent, financial services. At the same time, they have not gained from commitments by their more developed partners, as these commitments remain limited and circumscribed in sectors and modes of export interest to the latter.

The position regarding commitments by ESCAP member States is summarized in the statement in Annex III.[30] The statement does not reflect the scope of sectoral coverage or the quality of commitments but is only a broad indication of sectoral coverage. However, it is still indicative of the sectors of perceived export interest to developing countries except perhaps for communications and financial services. In case of communications services, the motivation for multilateral liberalization was apparently the importance that telecommunication services had assumed in the development process while for financial services it was the threat by the United States of its exclusion from the scope of the agreement or MFN reservation.

3. Access negotiations in the current round: status of request offer process – a preliminary assessment

The negotiating guidelines and procedures provide for the "request and offer" mode as the principal means for market access negotiations. Paragraph 15 of the Doha Declaration required participants to submit initial requests for specific commitments by 30 June 2002 and initial offers by 31 March 2003. The word "initial" reflects the nature of the negotiating process, which entails a succession of requests and offers. In that sense, these were indicative dates. The process of making requests has continued beyond June 2002 and remains ongoing. It will overlap and continue well into the bilateral negotiating phase.

Technical preparations for engaging in market access negotiations and recording the negotiated outcome in individual country schedules has been completed. Scheduling of commitments under GATS is a complex task and calls for a comprehensive understanding of the architecture of GATS, and its specific provisions. This was recognized during the initial commitment negotiations in the Uruguay Round itself, resulting in the drawing up of guidelines on scheduling of specific commitments. However, despite these guidelines, initial commitments have been found wanting, both in clarity and precision. Examples of this in the current schedules are limitations by way of various types of "needs tests". The current schedules do not indicate any criteria for their application. One reason for this shortcoming was also the paucity of time during the Uruguay Round for a meaningful scrutiny of draft schedules.

[30] *Source:* World Trade Organization.

Building on the earlier guidelines and the actual scheduling experience in the Uruguay Round, the guidelines for scheduling of commitments for the current Round have also been approved.[31] The guidelines address two main issues: (a) what items are to be put on a schedule; and (b) how they should be entered (i.e., limitations, if any, on market access, and national treatment and scheduling of additional commitments that are not a restriction on market access and limitations on national treatment under Articles XVI and XVII). This is done with examples. In addressing these questions, the guidelines cover all relevant issues, from the scope of coverage under each mode and the relationship between different modes for effective access, to issues relating to horizontal and sector-specific commitments.

There is also a note by the secretariat, which is a summary of a presentation in a "Seminar on Technical Aspects of Requests and Offers". The presentation addressed three aspects of both requests and offers, i.e., the content, the format in which requests and offers may be submitted, and finally the process through which requests and offers could be exchanged. It is an excellent document and it should facilitate the task of exchanging requests between members and the submission of offers.

Initial requests seek a substantial outcome by way of additional sectors for liberalization, the removal of and reduction in existing restrictions, and the binding of existing unbound entries with reference to individual members' schedule of commitments. There are also requests for additional commitments under Article XVII and for removal of MFN exemptions. The requests indicate a great deal of interest, both in commitments under mode 1 as well as in the environmental and energy sectors, areas which were not covered very much in the reckoning during the Uruguay Round negotiations. In some ways, the requests are "wish lists".

Initial offers have started trickling in. By 31 May 2003, 20 offers[32] had been circulated by the secretariat, with all but seven of them being "restricted", that is, not open for distribution other than to the participants. Among the quad group, initial offers by Canada, Japan and the United States have been circulated. The European Union offer has reportedly been submitted but yet not circulated. Because of time, scope and space constraints, this paper does not attempt to make a rigorous analysis of the available offers. The observations on some of them in the following paragraphs are based on a first-glance impression and are therefore tentative in nature.

In the offers by Canada, Japan and the United States, there is little addition of content to their existing obligations in either the horizontal or the sector-specific sections. There are, of course, improvements in the recording of commitments by way of greater precision in defining the scope of various sectors/subsectors as well as in proposed conditions and qualifications to market access and national treatment obligations. The United States offer includes universal banking, which is new. (The domestic law

31 S/L/92.

32 Argentina; Australia; Bahrain; Canada; China; Hong Kong, China; Iceland; Japan; Liechtenstein; Macao, China; New Zealand; Norway; Panama; Paraguay; Poland; Republic of Korea; Saint Kitts and Nevis; Switzerland; Taiwan Province of China; the United States; and Uruguay. Only those offers by Canada, Liechtenstein, Norway, Panama and the United States are publicly available.

prohibiting universal banking in the United States has been repealed). In the case of express delivery and energy services, obligations are offered in terms of an elaborate nomenclature that the United States has been seeking from other countries. Mode 1 has been offered for binding in most sectors. In the horizontal section on MONP, there are no changes in the coverage of categories of natural persons, or in the attached conditions. The H (I) (b) worldwide quota of 65,000 for specialty occupations remains unchanged. The United States has not offered to bind the existing applicable higher-level quota of 180,000, autonomously introduced after the Uruguay Round negotiations.

In the offers by Australia, Canada, Japan, New Zealand and the Republic of Korea, there are no significant additions to the content of their existing obligations, except under mode 1. However, there is an attempt to lend greater precision, both to the scope of the sectors offered for commitment as well as their liberalizing content. There is no additional liberalizing content in the horizontal commitments under mode 4. Category coverage remains unchanged, except for changes in the definition of some categories in several offers for the purpose of greater clarity and precision.

The European Union offer reportedly includes a "model schedule" on MONP. This approach to liberalization under mode 4 has been debated for some time now in business and "think tank" circles. A model schedule is envisaged as a template around which participants could take obligations. It would also include "best practices" on transparency in regulations and other regulatory practices, including needs tests. There has been no serious and focused multilateral engagement on this approach, partly because of a certain degree of reluctance to engage domestic stakeholders such as regulators and labour. The European Union initiative could catalyze discussions on this approach to mode 4 liberalization. It is difficult to speculate on the outcome in this area at present. Emerging trends in this regard look contradictory as they are influenced by domestic and international developments, as noted below.

Critical shortages exist in certain skilled labour categories in both the United States and Europe, resulting in several countries introducing liberalized visa and work permit regimes in the past two to three years, particularly in the software sector. There is also greater awareness within service industry circles in developed countries of the need to undertake larger commitments with procedural reforms in movement of natural persons. Services industry associations, both in the United States and Europe, have proposed draft model schedules on movement of natural persons as service providers under GATS to their authorities. This is on the positive side. But a negative trend has manifested lately in the United States where moves are afoot to reduce the H (I) (b) quota and tighten L-1 visa regulations. Also, several States in the United States are proposing legislation to prevent outsourcing of government-related back-office work.

Terrorism-related security concerns have increased, which is not conducive to effecting procedural reforms in this area. In several European countries ultra-right wing political groups that are opposed to liberalization of even the temporary movement of natural persons appear to be gaining a respectable share of the vote. In overall terms, it appears that mode 4 liberalization will remain a sensitive issue and will

involve some tough bargaining. The actual outcome will also be influenced by the conditions prevailing at the conclusion of the negotiations.

These initial and conditional offers must be seen as the initiation of a long process in market access negotiations. In addition, in the spirit of requests and offers, an initial offer should provide room for later improvements. The pace of the negotiations and their possible outcome will become a part of the overall negotiating dynamics of the Round, and they will be linked to the progress and possible outcome in other areas.

D. Technical cooperation and capacity-building

Most developing countries, including relatively large ones, suffer from shortages in financial and manpower resources in several areas pertinent to meaningful participation in GATS negotiations and the exploitation of export opportunities in the service sector. The biggest problem is information asymmetries between developed and developing countries with regard to trade flows, services rules, regulations and barriers to services trade. This problem is compounded by the absence of research studies on the domestic service industry sectors.

With the approval of modalities for the treatment of autonomous liberalization, assessing the value of, and credit for, such liberalization has become very important. Technical assistance in this area will be of great benefit to many developing countries. ESCAP could consider how best the institution can help in this regard.

Several multilateral institutions such as UNCTAD and the World Bank are trying to collect and compile information on rules, regulations and barriers to trade in services. The collection of information and exchanges of views are also taking place within trading blocks and regional cooperative arrangements. One such programme is being run, with donor support, by the Caribbean countries under what is known as the Regional Negotiating Machinery.

ESCAP should undertake some initiatives in this area by organizing seminars and workshops at the regional level. WTO and UNCTAD have technical assistance programmes for capacity-building. However, the resources available are limited and need to be augmented by donor agencies through institutions such as ESCAP.

E. Conclusion

The forthcoming Cancun Ministerial will undertake a mid-term review of the progress in the Doha Round negotiations. The progress will be assessed against the mandate in each area under negotiation. In a multi-issue negotiating agenda, the pace of progress tends to vary, depending on a variety of factors, some of them related to participants' domestic political and economic concerns and sensitivities. At the same time, linkages are established between progress in different areas. This is understandable, given the diverse interests of participants. It will be no different this time.

Relatively speaking, services negotiations are on track, even though this paper reflects a lack of convergence in the views on some fundamental issues in the rule-making area. In market access, procedural aspects of the negotiating process and the technical aspects for the scheduling of commitments, both very important for a successful outcome, have been settled. One significant achievement has been the approval of modalities for the treatment of autonomous liberalization. The request offer process is well under way, although the number of submitted offers is still limited. However, this achievement is still way ahead of the market access negotiations in agriculture and merchandise trade. As the Round progresses, the pace of progress between these three sets of market access negotiations will become linked.

What are the prospects of a balanced outcome from the developing countries' perspective in the prevailing conditions? Post-Uruguay Round services liberalization presents a paradox. This period has witnessed a great upsurge in domestic policy reform in developing countries, resulting in autonomous trade and investment liberalization and privatization, particularly in infrastructure services. The main driver for this appears to be the developing countries' quest for greater integration into an increasingly interdependent world economy in order to realize their development aspirations. They see a possibility for jumping the development ladder and taking a leap into the information age by exploiting recent spectacular breakthroughs in information and communications technologies. This is particularly true of several developing country members of ESCAP. Ironically, this process of autonomous liberalization, which provides significant trade and investment opportunities for the private sector in developed countries, has resulted in the waning of interest in multilateral liberalization among developed country market operators.

The MNCs of the two major trading entities, the United States and the European Union, which are the driving force behind bringing services into the multilateral trading system, are barely in sight this time round. Why is that so? Perhaps the cost-benefit ratio for them in seeking binding multilateral liberalization has changed. The benefits of security and predictability of binding multilateral liberalization do not appear to be significant in services, unlike the case of goods. While tariffs on goods can be changed frequently and quickly (hence the higher value in terms of security and predictability), liberalization in most service sectors cannot be reversed easily and without considerable disruption to the concerned domestic service sector and the domestic economy. This is particularly true of investment liberalization in services (mode 3 under GATS). Multilateral liberalization involves reciprocal exchange in concessions. It calls for engaging stakeholders in the domestic political economy in the making of concessions demanded in exchange by trading partners as well as for convincing the political establishment of benefits over costs in doing so.

Sectors and modes of export in which developing countries are interested, and are seeking concessions from the developed countries, are politically sensitive. The private sector in the developed countries does not appear willing to undertake the necessary political effort to persuade their authorities to make the concessions, since developing countries are autonomously liberalizing sectors (for example, energy and environmental services) of interest to them, with the exception of telecommunications

and financial services (including insurance). In other words, there are no incentives for developed countries to open their markets in the sectors and modes of export interest to developing countries. This is particularly true of mode 4 liberalization and regulatory reform in visa and work permit regimes, and in qualification requirements and technical standards.

It is evident that developing countries have come to realize that liberalization can yield significant gains. They will continue with their domestic policy reform programmes in order to improve the efficiency and quality of their services sector, which is critical to their development aspirations. Paradoxically, this does not appear to augur well for a balanced outcome in the services negotiations.

This scenario seems to have generated a certain degree of negotiating pessimism among developing countries. In mode 4, contrary trends have been observed and referred to earlier in this paper. In such circumstances, it is legitimate to ask what strategic options are available for developing countries to secure a balanced outcome. Should developing countries adopt a proactive or a defensive posture? A majority of commentators and many academic studies have been advocating a proactive approach. UNCTAD, in its related studies[33] has also recommended the same approach. The author is in agreement with this view. Developing countries have to become significant and credible participants in these negotiations. They must dare their trading partners to show their hand by, for example, offering to bind the existing level of openness in most sectors and even offer future liberalization, consistent with their domestic reform agenda. It will be a conditional offer in return for liberalization concessions from developed countries against their requests. This will call for the formation of coalitions on specific sectors and issues, cutting across the North-South divide. It will also involve tough, sustained bargaining over the course of market access negotiations.

The author is of the view that developing countries are in a position to secure a balanced outcome in spite of the current poor outlook, since they are already liberalising autonomously. They should be in a position to deploy their domestic reform agenda through better domestic policy coherence and coordination, and by adjusting its timing and sequencing to dovetail it into their multilateral engagement. This should help in securing concessions in areas of export interest to the developing countries and, at the same time, facilitate the domestic reform process and enhance its credibility. The developing countries should also adopt a more liberal and forward-looking approach in actively seeking multilateral understanding in regulatory areas under Article VI.4, in the absence of which effective access opportunities in areas of their competitive advantage will not materialize, even where commitments may have been made.

If this strategy does not work, a legitimate question will then arise about the utility of GATS as an instrument for multilateral liberalization. Will it become a catalyst for genuine liberalization or remain a "grim reaper" of autonomous liberalization?

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[33] United Nations Conference of Trade and Development, 2000, "Positive agenda and future trade negotiations". See also A. Mattoo, 2001, "Developing countries in the new Round of GATS negotiations: towards a proactive role" in B. Hoekman and W. Martin, (eds.), *Developing Countries and the WTO*, Blackwell.

Annexes

I. Architecture of the General Agreement on Trade in Services

The Agreement has three elements:

(a) A framework of general rules and disciplines;
(b) Annexes addressing special considerations relating to some service sectors/modes of delivery;
(c) National schedules of initial commitments.

The supply of services is envisaged under four different modes:

(a) Cross border supply – a non-resident service supplier supplying services across borders into a member's territory;
(b) Consumption abroad – the freedom for a member's residents to purchase services in the territory of another member;
(c) Commercial presence – the opportunities for foreign service suppliers to establish and expand a commercial presence in a member's territory;
(d) Presence of natural persons – entry and temporary stay of foreign individuals in a member's territory in order to supply a service.

The Agreement covers all services in any sector except service supplied in the exercise of government authority. The scope is thus comprehensive. However, the Annex on Air Transport practically excludes from the preview of the Agreement air transport services, scheduled or non-scheduled, and ancillary services except for:

(a) Aircraft repair and maintenance services;
(b) Selling and marketing of air transport services;
(c) Computer reservations systems services.

The framework of general rules and discipline is divided into a preamble and six parts:

(a) Part I covers the scope and definition of the general rules and discipline;
(b) Part II contains general obligations and disciplines applicable to all members. Notable among these are the provisions related to most favoured nation treatment and transparency;
(c) Part III covers specific commitments (i.e., market access, national treatment and additional commitments);
(d) Part IV covers progressive liberalization and deals with negotiations of specific commitments in future as well as matters related to schedules of specific commitments and the modification of schedules;
(e) Part V governs institutional provisions regarding dispute settlement, the administration of the Agreement, technical cooperation and relationships with other organizations;
(f) Part VI contains the final provisions dealing with definitions, denial of benefits etc.

The Agreement also has eight annexes, one each dealing with Article II – exemptions, movement of natural persons supplying services under the Agreement, air transport services, and telecommunications. There are two annexes on financial services and an annex each on negotiations on maritime transport services and basic telecommunications services.

The Related Instruments are Ministerial Decisions dealing with various issues.

II. Share of services in the gross domestic product of ESCAP members/associate members

Country/area	Gross domestic product (US$ million)			Value added by services (US$ million)			Value added by services as a percentage of gross domestic product		
	1990	1999	2001	1990	1999	2001	1990	1999	2001
Developing									
High income									
Brunei Darussalam	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Hong Kong, China	74 784	158 611	162 642	55 340.16			74	85	85
Republic of Korea	252 622	406 940	422 167	121 258.60	207 539.40	227 970.20	48	51	54
Singapore	36 638	84 945	92 252	23 814.70	54 364.80		65	64	66
Low and middle income									
Bangladesh	29 855	45 779	46 652	14 330.40	23 805.08	24 259.00	48	52	52
China	354 644	991 203	1 159 017	109 939.60	327 097.00	382 475.60	31	33	33
Fiji	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Georgia	12	4 192	3 138	4.20	2 724.80	1 788.70	35	65	57
India	322 737	459 765	477 555	135 549.50	211 491.90	229 226.40	42	46	48
Indonesia	114 426	140 964	145 306	46 914.66		53 763.20	41	35	37
Kyrgyzstan	n.a.	1 629	1 525	n.a.		533.70	29	35	35
Malaysia	42 775	74 634	87 540	17 537.75		36 766.80	41	43	42
Maldives	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Mongolia	n.a.	905	1 049	n.a.		555.90	44	40	53
Myanmar	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	32	38	31
Pakistan	40.01	59 880	59 605	19.6049	29 341.20	30 398.50	49	49	51
Papua New Guinea	3 221	3 571	2 959	1 320.61	2 285.44	946.80	41	64	32
Philippines	44 331	75 350	71 438	1 950.64	39 102.00	38 576.50	44	52	54

Country/area	Gross domestic product (US$ million)			Value added by services (US$ million)			Value added by services as a percentage of gross domestic product		
	1990	1999	2001	1990	1999	2001	1990	1999	2001
Solomon Islands	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Sri Lanka	8 032	15 707	16 346	3 855.36			48	51	55
Thailand	85 345	123 887	114 760	42 672.50			50	49	50
Turkey	150 721	188 374	147 627	78 374.92	105 489.40		52	56	58
Developed									
Australia	297 204	389 691	368 571	199 126.70	n.a.		67	n.a.	71
France	1 195 438	1 410 262	1 302 793	800 943.50			67	72	71
Japan	2 970 043	4 395 083	4 245 191	1 663 2240		2 801 826.10	56	61	66
Netherlands	283 672	384 766	374 976	190 060.20	n.a.	n.a.	67	n.a.	70
New Zealand	43 103	53 622	48 277	28 879.01			67	n.a.	n.a.
United Kingdom	975 512	1 373 612	1 406 310	614 572.60	n.a.		63	n.a.	70
United States	5 554 100	8 708 870	10 171 400	3 887 870		n.a.	70	72	n.a.
Observer governments in WTO									
Azerbaijan	9 837	4 457	5 692	n.a.	1 693.66	2 390.60	n.a.	38	42
Bhutan	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Cambodia	1 115	3 117	3 384	367.95			33	35	42
Kazakhstan	40 304	15 594	22 635		9 356.40	9 733.00	29	60	43
Lao People's Democratic Republic	865	1 373	1 712	207.60	343.25		24	25	24
Nepal	3 628	4 904	5 525	1 160.96	1 814.48	2 154.70	32	37	39

Country/area	Gross domestic product (US$ million)			Value added by services (US$ million)			Value added by services as a percentage of gross domestic product		
	1990	1999	2001	1990	1999	2001	1990	1999	2001
Samoa	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tonga	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Uzbekistan	23 763	16 844	11 270	8 079.42		4 846.10	34	42	43
Viet Nam	6 472	28 576	32 903	2 588.80	12 001.92		40	42	39

Source: *World Development Report*, various issues.

Notes: Figures in italics are for years other than those specified.

It can be seen that among high-income developing countries/areas, Hong Kong, China increased service value added from 74 to 85 per cent between 1990 and 1999, and maintained the same level in 2001. In the case of the Republic of Korea, the increase was from 48 to 51 per cent between 1990 and 1999; that increased was matched in 1999-2001 with a rise from 51 to 54 per cent. Singapore registered a 2-percentage point increase from 64 to 66 between 1999 and 2001. The situation in the low- and middle-income developing countries was slightly more varied, with generally significant increases between 1990 and 1999, relative to those recorded between 1999 and 2001. However, the periods are not comparable. Notable among those that registered increases in services value added in GDP during 1999-2001 are India (46 to 48 per cent), Mongolia (40 to 53 per cent, having declined to 40 from 44 per cent in 1990), Pakistan (49 to 51 per cent), the Philippines (52 to 54 per cent), Sri Lanka (51 to 55 per cent) and Turkey (56 to 58 per cent). In the case of Thailand, the increase was a 1-percentage point from 49 to 50, restoring it to the level recorded in 1990.

III. Summary of current sectoral commitments by ESCAP members

Country/area	1	2	3	4	5	6	7	8	9	10	11	12	Total
Australia	X	X	X	X	X	X	X	X	X	X	X		11
Bangladesh		X							X				2
Brunei Darussalam	X	X					X				X		4
European Union	X	X	X	X	X	X	X	X	X	X	X	X	12
Fiji									X				1
Hong Kong, China	X	X	X	X			X		X	X	X		8
India	X	X	X				X	X	X				6
Indonesia	X	X	X				X		X		X		6
Japan	X	X	X	X	X	X	X	X	X	X	X		11
Kyrgyz Republic	X	X	X	X	X	X	X	X	X	X	X		11
Macao, China	X						X		X				3
Malaysia	X	X	X				X	X	X	X	X	X	9
Maldives	X												1
Mongolia	X	X	X	X			X		X				6
Myanmar									X		X		2
New Zealand	X	X	X	X	X		X		X		X		8
Pakistan	X	X	X				X	X	X				6
Papua New Guinea	X	X	X				X		X		X		6
Philippines	X	X					X		X		X		5
Republic of Korea	X	X	X	X		X	X		X		X		8
Solomon Islands	X		X				X		X				4
Sri Lanka		X					X		X				3
Thailand	X	X	X	X	X	X	X		X	X	X		10
Turkey	X	X	X		X	X	X	X	X		X		9
United States	X	X	X	X	X	X	X	X	X	X	X		11
Total	**22**	**21**	**18**	**10**	**8**	**8**	**22**	**9**	**24**	**9**	**17**	**2**	**170**

Notes: 1 = Business services.

2 = Communication services.

3 = Construction and related engineering services.

4 = Distribution services.

5 = Educational services.

6 = Environmental services.

7 = Financial services.

8 = Health-related and social services.

9 = Tourism and travel-related services.

10 = Recreational, cultural and sporting services.

11 = Transport services.

12 = Other services not included elsewhere.

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V. INVESTMENT AND THE DOHA DEVELOPMENT AGENDA: A LOOK AT THE ISSUES

By Pierre Sauvé [*]

Introduction

Multilateral rule-making in the area of investment has a long and somewhat uneasy history. That history has gone hand in hand with the controversy surrounding the role of transnational corporations (TNCs) in host countries' economic and political systems.[34] The relationship between trade and investment has a similarly long and troubled pedigree. Suffice it to recall that the investment provisions of the Havana Charter[35] proved to be among the most controversial, contributing to the downfall of the International Trade Organization in the late 1940s. However, since the late 1960s, due to the pressure of increasing internationalization of the world economy, countries have felt the need to cooperate in the area of investment through international rules and commitments. This has led to a steady rise in investment rule-making, which today spans the bilateral, regional, inter-regional and multilateral levels.

At their First Ministerial Conference in Singapore in 1996, WTO members decided to establish a Working Group on the Relationship between Trade and Investment (WGRTI) in order to deepen their understanding of the challenges arising at this policy interface. Since then, Asian countries have been among the main protagonists of a lively, ongoing and still far from settled policy debate, with some countries in the region actively supporting moves towards WTO negotiations in the area, while others remain among the most sceptical and, in some cases, fiercely opposed to such an approach.

At the Doha Ministerial Meeting at Qatar in November 2001, WTO members decided to step up work on trade and investment, and agreed "negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations". All the arguments in favour and against multilateral negotiations have been voiced by Asian countries. It is thus useful to review the key arguments advanced in that respect (section B of this paper). Sections C and D recall the current state of play of discussions within the WTO Working Group on the Relationship Between Trade and Investment

[*] Groupe d'Economie Mondiale, Institut d'Etudes Politiques de Paris.

[34] For a recent account of the debate, see C. D. Wallace, *The Multinational Enterprise and Legal Control: Host State Sovereignty in an Era of Globalization*, The Hague, 2002. See also United Nations Conference on Trade and Development, *Trends in International Investment Agreements: an Overview*, New York and Geneva, 1999.

[35] See United Nations Conference on Trade and Employment, *Final Act and Related Documents*, New York, 1948.

and assess what could be done (and why) on trade and investment in the Doha Round. Yet, before doing so, it is useful to recall the overall and regional contexts within which ongoing discussions in Geneva are taking place, as these may shape or constrain countries' negotiating stances. Therefore, section A begins with a short review of recent worldwide trends in FDI with a particular focus on developing countries in Asia.

A. Assessing the overall policy context: FDI trends in the world and Asia-Pacific region

Global flows of FDI, which were down by half in 2001, again fell significantly in 2002. Driving this decline was a steep plunge in cross-border mergers and acquisitions, especially in the developed world. By region of FDI destination, the plunge was concentrated in the United States and Western Europe (particularly, the United Kingdom of Great Britain and Northern Ireland), with Japan and other OECD countries largely unaffected. In the developing world, the decline in inflows was smaller but significant. According to the World Bank, net FDI inflows to developing countries fell in 2002 to an estimated US$ 143 billion from a total of US$ 172 billion in 2001 (table 1 and figure I). Among the developing regions, the fall was most pronounced in Africa. This large fall is more of a return to normalcy after exceptionally large inflows to Africa in 2001, due to a few mega-deals in Morocco and South Africa. In Latin America and the Caribbean, the fall in 2002 represented a continuation of a downward trend for the third consecutive year.

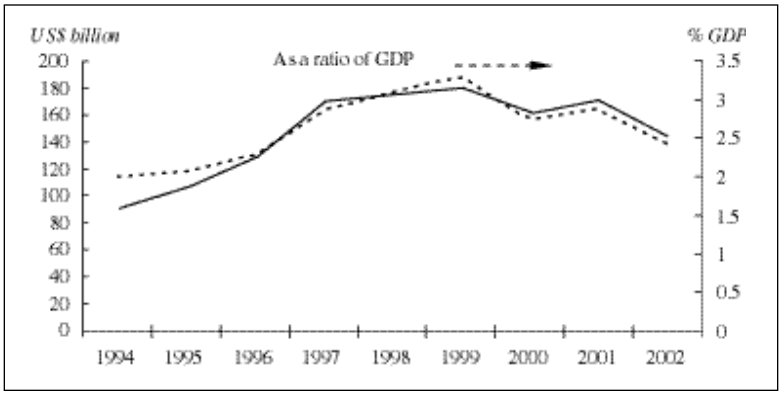
In contrast, the decline in FDI flows to the Asia-Pacific region was quite small. In fact, East Asia and the Pacific actually registered a gain, with FDI inflows rising from US$ 49 billion to US$ 57 billion and from US$ 4 billion to US$ 5 billion in South Asia. In particular, FDI flows to China and India showed significant advances. China's large domestic market, strong economic growth, increasing export competitiveness and WTO accession contributed to growing investor interest in locating or relocating operations in that country. FDI flows to India, although considerably lower than those to China, nonetheless increased by a sizeable amount, making India the largest recipient

Table 1. Net inward foreign direct investment flows to developing countries, 1998-2002

(Unit: US$ billion)

Region	1999	2000	2001	2002
Total	179	161	172	143
East Asia and Pacific	49	44	49	57
Europe and Central Asia	28	29	30	29
Latin America and Caribbean	88	76	69	42
Middle East and North Africa	3	3	6	3
South Asia	3	3	4	5
Sub-Saharan Africa	8	6	14	7

Sources: World Bank, 2003; World Bank staff estimates for 2002.



Source: World Bank, 2003, *Global Development Finance: Country Tables*; World Bank staff estimates for 2002.

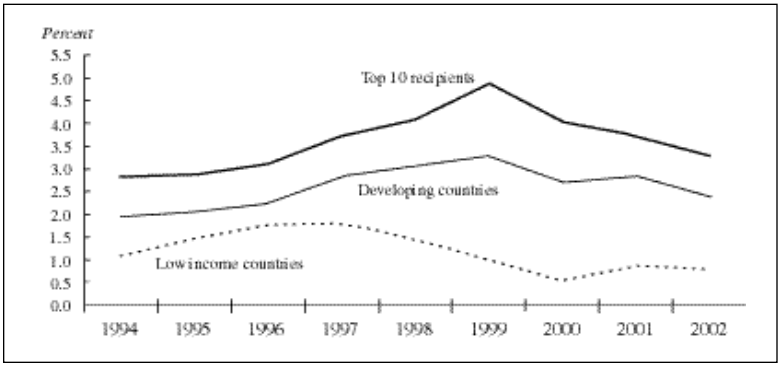
Figure I. Net inward foreign direct investment flows to developing countries, 1999-2002

of FDI flows in South Asia. The market potential, improved economic performance, growing competitiveness of information technology industries and the impetus of recent liberalization contributed to India's dominant position in that subregion. While still difficult to measure, there was little doubt that the spread of SARS would exert dampening effects on FDI and trade activity throughout the region, with China as well as Hong Kong, China and Taiwan Province of China included among the most affected.

FDI flows to the Asia-Pacific region continue to be concentrated in the North-East Asia subregion (China; Hong Kong, China; the Republic of Korea; and Taiwan Province of China) and Singapore. Together, these economies accounted for more than 85 per cent of the FDI flows to the Asia-Pacific region before the downturn. However, FDI flows to Hong Kong, China and Taiwan Province of China fell significantly during the recent downturn because firms in those countries, including TNCs, responded to the economic slowdown and industrial restructuring process by relocating production activities to lower cost locations, primarily China. In fact, China absorbed 92 per cent of FDI flows directed to the region in 2002, and 37 per cent of total FDI flows towards developing countries.

Meanwhile, the West Asian and Central Asian subregions were particularly affected by geo-political tensions, which led to a significant decline in FDI inflows. Saudi Arabia and Kazakhstan were the main recipients of FDI inflows in those respective subregions, with most of the investment going into the oil and gas sectors. The downturn has also affected FDI flows to the Pacific island countries. Under prevailing economic conditions, where global FDI is shrinking and companies are exhibiting greater caution over their investment decisions, countries with smaller markets and limited infrastructures – both of which are important constraints to FDI inflows – tend to be more adversely affected, as the case of the Pacific island countries suggests.

Despite the overall decline in FDI flows to developing countries and another rise in the share of FDI accounted for by China, there was a decline in the overall concentration of FDI. Although the share of the top 10 recipient countries remains high at 70 per cent, it has declined from about 79 per cent in 2000. FDI as a share of GDP in the top 10 recipient countries remains much higher than the average for developing countries, although it has declined since 1999 (figure II).



Source: World Bank, 2003.

Figure II. Foreign direct investment as a share of GDP in developing countries, 1994-2002

The decline in FDI activity in the Asia-Pacific region has also been uneven when looked at from a sectoral perspective. A decline in global demand for semiconductors and electronics, combined with fierce price competition and corporate consolidation contributed to the slowdown in FDI flows to those industries. The more developed regional economies, which are also more service-oriented economies, tended to attract relatively more services-related FDI than manufacturing-related FDI during the downturn. The shift towards service sector FDI is likely to have increased the benefits of FDI in the recipient countries. Many service sectors provide important inputs to production, particularly compared with the often-limited linkages between extractive industries and the domestic economy.

In the case of China, FDI is concentrated in the manufacturing sector. In the Association of South East Asian Nations (ASEAN) subregion, the share of FDI in the manufacturing sector increased from 29 per cent of the US$ 31.1 billion cumulative FDI flows in 1999 and 2000 to 53 per cent in 2001. The recent ASEAN experience highlights the fact that FDI flows to the manufacturing sector of the subregion have been more resilient during the economic downturn compared with those of the services sector. This is particularly so in the wake of the post-Internet bubble and in the light of a lesser overall level of privatization-induced FDI activity.

The sectoral pattern of FDI flows during the recent economic downturn highlights the economic strengths or competitiveness of the different countries in attracting different types of FDI. That, in turn, reflects to some extent their stages of economic development.

The success of China in attracting FDI will continue to pose a major challenge to countries within and outside the region. As China grows, so too will its demand for resources to meet its rapid industrial development and growing imports from neighbouring countries, fostering greater economic and industrial interdependence within the region.

Given the increasing number of cases of company relocations to China, a major challenge that most developing countries face, including those in the Asia-Pacific region, is how to retain existing FDI from leaving their countries. For the ASEAN region, the ASEAN-China Free Trade Area could help address some of those fears.

Regional integration efforts, regional division of labour and active regional production efforts by TNCs have already contributed to stronger intraregional investment flows. Increased intraregional FDI flows help to strengthen regional economic interdependence and accentuate the regional integration process in the Asia-Pacific region, thereby making it more attractive to, and competitive for FDI flows.

Depending on the sectors and types of FDI, regional integration can contribute to declining FDI inflows if it leads TNCs with market-seeking FDI to consolidate their operations in order to achieve production efficiency by switching orientation from national markets to regional markets. In the ASEAN subregion, existing market-seeking FDI is going through a process of consolidation. However, new types of FDI that are influenced by regional integration factors and industrial clusters have increased. Such types of FDI include regional production network operations, new regional market-seeking FDI, outsourcing and production activities that aim to maximize the efficiency of the value chain. The ASEAN Free Trade Area has encouraged an increasing number of regional production network investments and the consolidation of operations by TNCs, especially in the automobile and automotive parts sector, as well as in consumer electronics.

The downturn has also slowed the growth of outward FDI flows from the region. The value of FDI outflows continues to increase but at a slower pace. Mature Asian firms invest abroad to seek market opportunities and access to resources despite the difficult economic situation. Aside from the Asian newly industrializing economies, China and a few ASEAN countries are potential sources of FDI for the region. Outward FDI flows from those economies concentrate on the manufacturing and resource-based sectors. Greater relocations of production activities by firms are also taking place within and to the region, particularly to lower-cost locations, in order to maintain cost competitiveness.

B. Parameters of the debate on investment rules

FDI is an important economic factor in the economic development of many Asian countries. Furthermore, the Asian region maintains a leading role in the developing world in terms of attracting FDI. This may explain, in part, why at least for the best performers, multilateral rules are not a priority. Let us now briefly review how the pros and cons of multilateral rules are generally articulated.

Investment rules are multifaceted and can take the form of binding or voluntary instruments setting out different types of commitments. Since the second half of the 1990s, the conclusion of bilateral investment treaties (BITs) for the promotion and protection of foreign investments has continued unabated, encompassing more and more countries. Following the adoption of the first BIT in 1959, the number of such treaties grew steadily to 385 by the end of 1989 and then jumped to over 2,100 by the end of 2002.[36]

BITs are designed to protect, promote and facilitate foreign investment and, to date, constitute the most widely used instrument for these purposes.[37] BITs have traditionally been negotiated between developing countries seeking to attract international investment and developed countries as the principal homes to foreign investors. Developing countries, as hosts to FDI, concluded BITs in order to create a favourable climate and, in some cases, to become eligible to participate in political risk insurance programmes organized by capital-exporting countries. One of the main reasons for their popularity is that they provide flexibility to the home country, allowing the possibility to screen and channel FDI, while at the same time extending the necessary protection to foreign investors. However, it should be recognized that available empirical evidence does not suggest a significant impact of BITs on investment flows, as some developing country have received large amounts of FDI in the absence of such treaties.

The use of regional instruments on investment, including investment rules, has not reached the proportion of the BIT phenomenon, but it is still vast and diverse.[38] By July 2000, the number of Free Trade Agreements and Customs Unions had already exceeded 170[39] and a large number of them include investment provisions, as do several other trade agreements that do not aim specifically at regional integration.

At the regional level, only a few instruments such as the Framework Agreement on the ASEAN Investment Area are entirely devoted to investment. However, in the past few years, a growing number of regional instruments have included investment-related provisions of various kinds. The North American Free Trade Agreement (NAFTA), the MERCOSUR Protocols and the Common Market for Eastern

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[36] Parallel to BITs, countries have also been concluding agreements on the avoidance of double taxation. They address, among other things, the allocation of taxable income, with a view to reducing incidents of double taxation.

[37] The content of BITs has become increasingly standardized over the years. Their main provisions typically deal with: the scope and definition of foreign investment; admission of investments; national and most favoured nation treatment; fair and equitable treatment; guarantees and compensation in respect of expropriation; guarantees of free transfer of funds and the repatriation of capital and profits; and dispute-settlement provisions, both State-to-State and investor-to-State. However, and as a consequence of the sheer number of BITs, formulations of individual provisions remain somewhat varied. In particular, there are important differences between the language of BITs signed some decades ago and the more recent versions.

[38] Regional instruments are not all binding. For example, in the context of the Asia-Pacific Economic Cooperation region, norms of a legally non-binding nature relating to the admission, treatment and protection of foreign investment were adopted in the 1994 APEC Non-Binding Investment Principles.

[39] See World Trade Organization, "Mapping of regional trade agreements", a note by the WTO Secretariat for the Committee on Regional Trade Agreements (WT/REG/W/41), 11 October 2000.

and Southern Africa (COMESA) treaty are examples. The general aim of these agreements is to create a more favourable investment climate also through the liberalization of restrictions to the entry and establishment of FDI, followed by the reduction of discriminatory operational restrictions. All this has been initiated with a view to increasing the flow of investment within or between regions.

Regional instruments generally address a broader spectrum of issues but in so far as regional instruments are negotiated between like-minded governments, they may create less controversy than larger and protracted multilateral negotiations. Regional instruments use, to an even greater extent than BITs, all the panoply of traditional international law tools, such as exceptions, reservations, transition periods etc., to ensure flexibility in obligations in order to cater for the different needs and capacities of parties at different levels of development. From the perspective of developing countries, this explains why – together with the growing recognition of the links between trade and investment flows – investment rules are increasingly common in regional integration instruments traditionally concerned with mainly trade issues. Indeed, in some cases, the combination of investment liberalization and improved market access at the regional level has proven very beneficial to the developing country parties in regional integration agreements.

However, as regional instruments addressing investment issues and BITs have multiplied in number, they have also created an intricate web of overlapping commitments. This is one of the main arguments cited in favour of creating a common, multilaterally agreed framework for investment that, in the words of the WTO Doha Ministerial declaration, would "secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment". In particular, a new multilateral framework of rules anchored to the WTO system could "lock in" autonomous as well as bilaterally and regionally negotiated liberalization, thus preventing possible reversals.

On the other hand, it has been pointed out that investment rules already exist not only in BITs and regional instruments, but also at the multilateral level in the TRIMS Agreement and GATS. Existing rules may be far from perfect, but it is difficult to conceive that a clearly superior set of rules could be agreed upon in a WTO framework on investment. Furthermore, the complexity of different investment rules and regulations would persist, unless BITs and investment rules in regional instruments were to be replaced by a multilateral agreement. However, it is also true that in the current WTO system an imbalance exists between the treatment enjoyed by investors and investments in the service sectors, which is already covered by GATS rules, and that enjoyed by all other investors. Finally, introducing investment issues in WTO may increase the risk of developing countries being at the receiving end of trade retaliatory actions in the context of the WTO dispute settlement mechanism; however, such risk could be attenuated if suitable, special and differential treatment provisions were introduced.

Nevertheless, from a development perspective, the question of the appropriate rule-making "level", whether bilateral, regional or multilateral, cannot be separated

from an examination of the actual or potential content of investment rules and commitments. All investment agreements are instruments of cooperation between countries, which are entered into voluntarily. Furthermore, like all treaties, international investment agreements as such are neutral instruments. What counts to determine their impact on the development prospects of developing countries is their content; so far, the development-specific content of investment agreements at all levels is rather modest.[40] Thus, there is much scope and need to increase the attention paid to development issues in international rule-making on investment.

In the light of power and capacity asymmetries, the above is particularly true with regard to the context of multi-issue negotiations when package deal logic may prevail at their conclusion and where great care needs to be exercised to ensure that the interests of developing countries are preserved. However, it should also be recognized that negotiations at the multilateral level offer developing countries higher leverage than those at the regional and bilateral levels, provided that they are able to take common positions on substantive issues. Moreover, the multilateral level could allow, if adequate capacity-building efforts are put in place, all developing countries to participate meaningfully in the design of the rules, which are otherwise going to be increasingly shaped by a restricted number of key countries participating in bilateral or regional initiatives.

In order to pursue individual development objectives and policies, it is important to shape possible multilateral rules in such a way as to allow developing countries enough room of manoeuver. This is what goes under the notion of preserving policy space or ensuring flexibility. More specifically, the legal obligations entered into investment agreements at all levels should not unduly limit the sovereignty-based "right to regulate" of all countries. In this regard, both BITs and regional instruments have generally been found satisfactory by developing countries. This is one of the main reasons put forward by countries in the sceptics' camp.

C. Current state of play in Geneva

Paragraph 22 of the Doha Ministerial Declaration instructed the WGRTI to focus on the clarification of seven issues: (a) scope and definition, (b) transparency; (c) non-discrimination; (d) modalities for pre-establishment based on a GATS-type positive list approach; (e) development provisions, (f) exceptions and balance-of-payments safeguards; and (g) consultation and the settlement of disputes.

In WGRTI discussions to date, some members argued that this list was not a closed one and, for example, should allow for discussions of performance requirements, investment incentives or investment protection. Paragraph 22 also requires that the "special development, trade and financial needs of developing countries and least

[40] Unfortunately, it remains true that "a striking feature of BITs is the multiplicity of provisions they contain that are specifically designed to protect foreign investments, and the absence of provisions specifically designed to ensure economic growth and development." (See P. Robinson, "Criteria to test the development friendliness of international investment agreements", in *Transnational Corporations*, Vol. 7, No. 1, April 1998, p. 84). The same could be said for most other international investment agreements.

developed countries should be taken into account as an integral part of any framework, which should enable members to undertake commitments and obligations commensurate with their individual needs and circumstances".

Major controversies within WGRTI have revolved around a number of key issues, such as:

(a) The breadth of the definition of "investment" and "investors", and the (potentially far-reaching) implications thereof;

(b) The extent of transparency obligations, notably in respect of prior notification requirements;

(c) The degree and form of technical assistance required to help developing countries overcome a widely-perceived analytical deficit in this area;

(d) The operational modalities of development provisions governing the trade and investment interface in a possible WTO investment framework;

(e) The desirability of replicating a GATS-like approach to scheduling liberalization commitments, notably in respect of pre-establishment rights, as well as the links between FDI and technology transfer.[41]

While the debate on these and other issues is far from closed, it is important to recall that much progress in understanding the complex policy and rule-making challenges arising at the trade and investment interface has been achieved in the multiplicity of bilateral and regional agreements concluded since the establishment of WGRTI in 1996. To a certain degree, it is probably difficult to sustain the argument that a decision on whether or not to launch formal negotiations on investment in Cancun could be held back on substantive grounds. For the most part, the core elements of a possible investment compact in WTO are well known to member countries. The key challenge lies in being able to determine whether a political will exists to move forward on investment in the light of progress elsewhere in the Doha Agenda and, just as importantly, to assess whether what is on the table on trade and investment implies genuine, value-adding forward movement. The scope for moving forward is discussed in the following two sections.

D. Investment in the Doha Round: moving ahead?

The rising tide of FDI around the world has been, in part, a consequence of a progressive receptivity of host countries to FDI flows. Much as tariffs have fallen, so too have restrictions on incoming investments been progressively lifted, particularly in manufacturing. Governments once hostile to multinational enterprises now actively seek out their participation and even compete for it. One indicator is the change in

[41] For an excellent summary of the state of play on the Singapore issues, see the International Centre for Trade and Sustainable Development and the International Institute for Sustainable Development's *Doha Round Briefing Series: Developments since the Fourth WTO Ministerial Meeting*, Vol. 1, No. 6, February 2003. For a look at member country proposals and other documents on trade and investment at the World Trade Organization, see http://docsonline.wto.org/ under WT/WGTI/*

investment regulations. Between 1991 and 2001, 1,393 regulatory changes were introduced in national FDI regimes, of which 1,315 (95 per cent) were aimed at creating a more favourable environment for FDI (figure III). According to the UNCTAD *World Investment Report, 2002*, during 2001 alone, 208 regulatory changes were made by 71 countries, of which only 14 (6 per cent) were less favourable for foreign investors. This opens up the question of whether this evident domestic political willingness to improve investment regimes could be used to achieve some additional benefits through collective action in reciprocal market access negotiations.

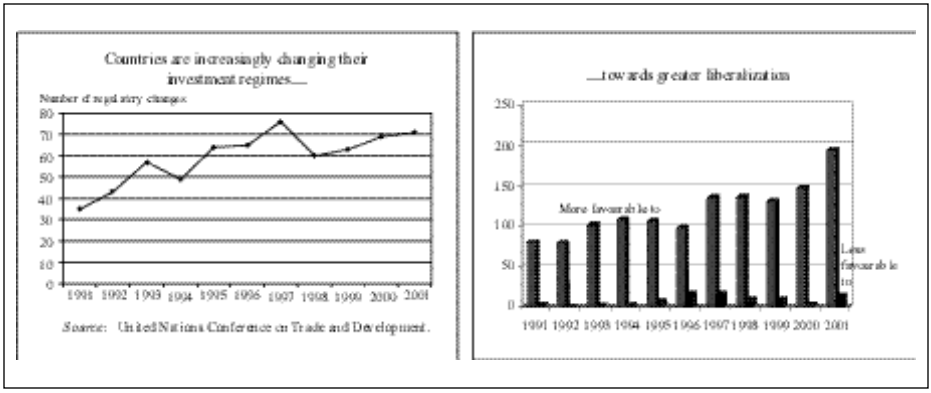


Figure III. National regulatory changes in foreign direct investment regimes, 1991-2001

The potential and challenges of collective action on investment policies become clearer if such action is broken down into five core sub-agendas. These are related to: (a) liberalizing investment to facilitate access and entry; (b) establishing clear property rights and investor protections as an incentive to invest; (c) curbing investment distortion policies that affect trade and investment location; (d) addressing a host of investment-related trade measures that distort the international allocation of FDI flows; and (e) fostering international cooperation in areas likely to promote improvements in governance.

1. Investment liberalization and market access for investment

The inclusion of investment in international negotiations may lead to greater liberalization of investment regimes than can be accomplished unilaterally. If investment is not negotiated in isolation but as part of broader set of trade negotiations, then the traditional mechanism of reciprocal access concessions can help generate support for greater openness at home and abroad. For example, exporters in developing countries who obtain improved access to foreign agricultural markets can be a countervailing force against those who resist the elimination of investment barriers in financial or transportation services. At the same time, the need to fight these domestic political economy battles makes a country a credible negotiator for improved access. The process, if successfully harnessed, can produce a double benefit, as liberalizing countries

would gain from increased competition associated with foreign direct investment and their firms would enjoy improved access to foreign markets.

Even though most foreign investment originates in wealthy countries, there may well be some scope for reciprocal bargaining even within the narrower confines of investment. This is because a growing number of developing countries are themselves becoming more active as outward investors, and so have a growing interest in a rules-based regime for investment. They tend to invest primarily in other developing countries. Estimates suggest that nearly one third of the foreign investment flows to developing countries originate in other developing countries, up from negligible amounts in the early 1990s.

These facts suggest that the potential for positive externalities through reciprocity merits examination. Coordinated efforts to liberalize investments can subsume the three key issues of transparency, non-discrimination and the addressing of a host of traditional investment-related trade measures. All three issues feature prominently in the ministerial mandate agreed upon at Doha.

(a) Transparency

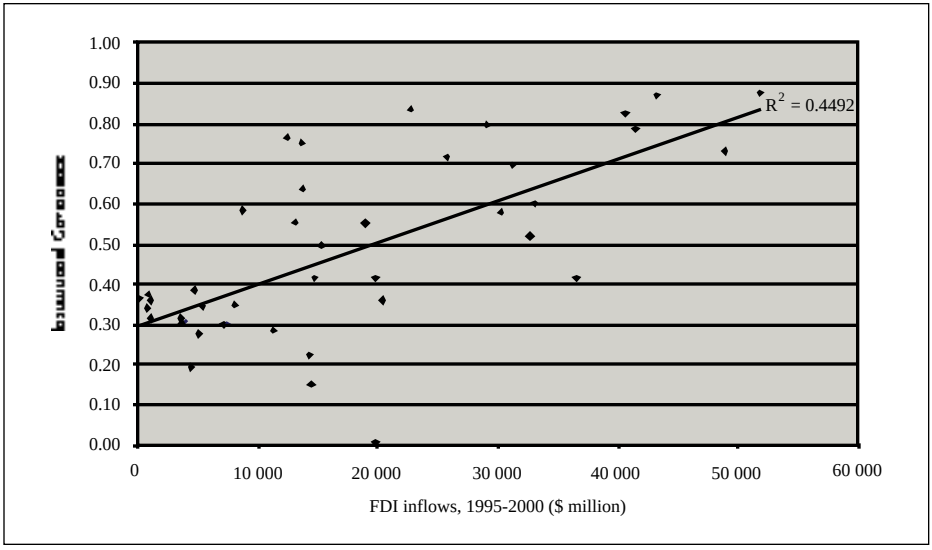
Transparency involves making relevant laws and regulations available to the public as well as notifying parties when changes are made to these laws, and ensuring their uniform administration and application. In addition, transparency can be enhanced, with likely commensurate gains in the quality of overall governance, by offering affected parties the opportunity to comment prior to the enactment of new regulatory measures. This implies communicating the policy objectives of proposed changes, allowing time for public review and providing the means to communicate to relevant authorities.[42]

A non-transparent business environment in a host country raises information costs, diverts corporate energies toward rent-seeking activities and often gives rise to corrupt practices. This weighs down both domestic and foreign businesses, although in many cases it may be particularly discouraging to foreigners who are usually less privy to locally available information. This heightens the risk involved in operating in the business environment of the host country, which either translates into higher risk premiums (in the case of the pricing of corporate assets and discounts) or imposes additional information costs on enterprises.

Case studies suggest that companies may be willing, for example, to invest in countries with legal and regulatory frameworks that would not otherwise be considered as "investor friendly", provided that they are able to obtain a reasonable degree of clarity about the environment in which they will be operating. Conversely, there appears to be certain threshold levels for transparency beneath which the business conditions become so opaque that virtually no investor is willing to enter, regardless of the extent of inducement.

[42] Providing for such *ex ante* transparency obligations is not, however, without implementation costs, particularly in countries with already weak institutional capacities.

Research by Chan-Lee and Ahn in 2001 for the ADB Institute found that "better functioning legal systems and governance, and better enforcement appear to be more important than legal origins per se in terms of their impact on development". Their study of the informational quality of financial systems and economic development constructed indices for various aspects of transparency for 55 developed and developing countries. Of particular relevance in the context of FDI is the measure of institutional governance (figure IV).



Source: J. H. Chan-Lee and S. Ahn, 2001.

Figure IV. Relationship between inward foreign direct investment and quality of institutional governance

Currently proposed rules for increasing transparency in the WTO context focus exclusively on governmental measures and conduct, but tend to remain silent about increased disclosure obligations for investors, according to Moran. This stands in contrast to provisions under the OECD Guidelines for Multinational Enterprises and the United Nations Global Compact. Many non-binding activities to increase corporate transparency are occurring outside of the WTO context. Moran reported that some 85 per cent of large United States and Canadian companies had adopted guidelines on corporate social responsibility, while 60 per cent of British firms had published codes of conduct and Japanese companies were moving in that direction with the Keidanren's recent promulgation of a Charter for Good Corporate Behaviour.

Transparency is a high priority for developing countries and is a policy that is likely to be required with new investment. However, such policies provide little scope for reciprocal externalities and do not lend themselves well to sanction-based dispute resolution procedures in legally binding agreements. Therefore, international collaborative efforts on this front should perhaps take other forms, such as by increasing developing

participation in non-binding, best-practice instruments and strengthened capacity-building for institutional development. To the extent that transparency obligations are anchored in WTO agreements, monitoring via multilateral peer review and surveillance may provide less coercive means for promoting governance-enhancing reforms in host countries.

(b) Non-discrimination

The practice of placing all foreigners and domestic sellers on an equal competitive footing is a hallmark of trade agreements. This objective is no less important in the investment field, and is indeed the guiding principle behind attempts conducted so far, primarily at the bilateral and regional levels (with the important exception of GATS at the multilateral level), at progressively liberalizing the entry and post-entry operating conditions of foreign investors into host countries. Promoting liberalization in international investment essentially boils down to securing non-discriminatory outcomes. This has both MFN (non-discrimination as between all foreign entities) and national treatment (non-discrimination between "like" domestic and foreign entities).

Departures from non-discriminatory treatment essentially take two forms in the investment field, affecting the pre-establishment phase of an investment (i.e., prior to entry) on the one hand and post-establishment operating conditions on the other. Governments everywhere have been reluctant to extend full pre-establishment privileges to all potential new entrants in every sector. This would be tantamount to achieving the investment equivalent of free trade from the outset. There is no country that affords such an unfettered right of establishment, and an important purpose of investment liberalization negotiations is to progressively reduce the range of sectors in which the right to establish is currently restricted.

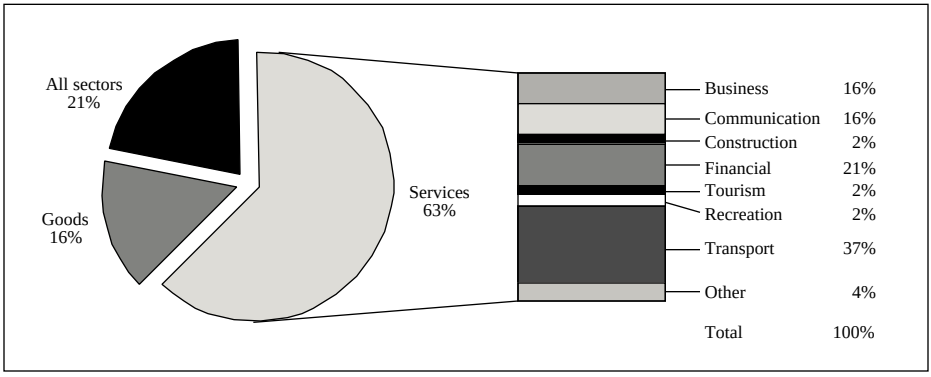
Securing non-discriminatory conditions of treatment is equally important in the post-establishment phase, as foreign investors will typically have important sunk costs and will be highly averse to sudden, unanticipated, changes in regulatory conditions that may tilt competitive conditions in favour of local competitors. Non-discrimination commitments in the post-establishment phase can thus send powerful signals to foreign investors on the credibility of reform efforts by a host country. Here again, however, international negotiations can be designed so as to allow countries to move (including through pre-commitments to future liberalization as has been done successfully under GATS) in the direction of post-entry non-discrimination in a manner and at a pace commensurate with local competitive conditions and capabilities.

By far the most contentious aspect of liberalization is the pre-establishment commitment to openness. This stems from the tendency to maintain restrictions on entry in a few sensitive sectors as well as the desire of many host country governments to ensure (through discussions on performance requirements, investment incentives and associated policy instruments) that foreign investment generates positive spillovers and creates greater linkages, both domestic and foreign.

Most countries around the world now permit liberal access by foreign investors to manufacturing. The same holds true, if to a slightly lesser extent, for mining and

agriculture. Indeed, owing to various investment incentive schemes not available to domestic firms, foreign investors in manufacturing often enjoy better than national treatment. Most governmental measures that discriminate overtly against foreign investors and restrict FDI inflows are maintained in the services area. This involves key industries such as telecommunications, broadcasting and related audio-visual services, satellite services, energy services, financial services (especially banking and insurance), civil aviation and maritime transport. An estimated 80-85 per cent of restrictions affecting international investment are maintained in service sectors. Perennially, among the most dynamic sectors of the global economy, services are also where some two-thirds of cross-border FDI has been directed in recent years.

One telling proxy of the investment liberalization potential of services is provided by the negative lists of non-conforming measures drawn up by prospective signatories of the Multilateral Agreement on Investment (MAI) identifying the sectors in which they wished to restrict access by foreign investors (figure V). A similar trend exists under NAFTA. Simply put, the market access or liberalization agenda for investment is largely services-centric.



Source: P. Sauve, 2002.

Figure V. Revealed preferences: Governments shield services more often than manufacturing from the winds of investment competition

A multilateral vehicle in the form of GATS already exists for realizing the positive externalities potentially arising from the liberalization of investment in services. The agreement has several features that are attractive to countries as they make it a potentially useful tool for widening non-discriminatory access in a reciprocal framework. By featuring a positive list approach in which countries voluntarily undertake, subject to listed reservations, sectoral commitments to liberalization, governments enjoy considerable flexibility in carving out sectors they deem to be of special national interest or which are unable to withstand too rapid a market opening (box 1).

Box 1. GATS and investment

GATS distinguishes between various "modes" of supplying services internationally. The third of the four so-called "modes of supply" covered by GATS refers to service supply in a member country by a supplier from another member country via a commercial presence. This may take place, for example, through the establishment of a branch office or a subsidiary of the foreign company. Services trade via this mode often takes place in conjunction with the fourth mode – the presence of natural persons – given that directors, managers, specialists and other key personnel often need to be deployed abroad (at least, initially) in order to manage a foreign operation.

Services trade through FDI is particularly important given the need for proximity between suppliers and consumers of services and the need to tailor service offerings to host market conditions. It is the area where by far the largest number of liberalization commitments was undertaken by WTO members in the Uruguay Round. This suggests the importance that countries attach to reaping the positive benefits i.e., high-paying jobs, human resource training, technology transfers and quality upgrading), typically associated with greater doses of FDI while retaining the freedom to regulate such activity. There is no denying that FDI raises many sensitive issues for host governments, in part because establishment involves foreign companies in a range of national rules and policy issues. However, as the data depicted in figure V reveal, the direction of change in host country FDI regimes has been strongly liberalizing during the past decade. More often than not, such policy changes were enacted in a unilateral manner.

The argument is often heard that GATS is principally an investment agreement, designed to promote the interests of large multinationals. While GATS can be described as a multilateral agreement that covers FDI in the services trade context, it is not an agreement on investment per se. It does not, for example, feature the traditional panoply of provisions on investment protection found in bilateral investment treaties. Accordingly, it cannot be portrayed, as many GATS critics have alleged, as a means of resurrecting MAI. GATS bears no resemblance to MAI. This should not come as a surprise since the GATS provisions predate those of MAI and because of the significant differences in membership between OECD and WTO.

A number of general principles common to international investment agreements (and other agreements such as GATT) govern the provision of services via a commercial presence under GATS. Non-discrimination, provided for by MFN and national treatment obligations, and transparency are two fundamental GATS principles. Free transfer of payments and policy lock-in (where commitments are scheduled) are also contained in GATS. However, GATS does not deal with some important disciplines that are traditionally included in international investment agreements, such as investment incentives, performance requirements, protection against expropriation, or compensation. Nor does it allow private parties to have direct recourse to WTO dispute settlement provisions, which is an issue that has drawn considerable attention in the NAFTA context, just as it did in the MAI negotiations.

While WTO members may, via their GATS commitments, accord market access to foreign investors, they are not obliged to do so. In addition, governments are free, should they choose to make commitments on commercial presence, to maintain existing discriminatory or quantitative restrictions. The Agreement affords no automatic right of establishment to foreign investors. The only obligations of WTO members are to schedule any existing restrictive measure they wish to maintain in sectors where liberalization commitments are voluntarily undertaken, and to ensure freedom of payments and transfers relating to investments in such sectors.

Governments can use GATS selectively to encourage investment in sectors of their choice, subject to the conditions they wish to impose or retain, including those related to technology transfers and the employment of local workers. The Agreement also permits governments to maintain foreign ownership restrictions in sectors where they have made commitments. GATS promotes greater predictability through the permanency of commitments, an important element in attracting investment for developing countries. The GATS framework also allows governments

to impose conditions that may be important to national development objectives, including those related to technology transfers and the employment of nationals.

The flexibility described above helps explain why GATS tends to be viewed as the most developmental-friendly agreement brokered in the Uruguay Round, and why a large number of WTO members feel that GATS offers the greatest scope for incrementally beefing up WTO treatment of investment. Two important considerations of a factual nature that should be taken into account in this regard are that services make up close to 70 per cent of global annual FDI flows, and account for an even greater proportion of discriminatory measures affecting cross-border investment activity.

Source: Organization for Economic Cooperation and Development, 2002.

2. Protecting investment in order to increase flows

Part of the foundation of any country's investment climate is the protection of property rights for investors. Arriving at an agreement that encourages countries to improve investor protection has the potential of improving investment flows from abroad and, at the same time, might contribute to eliciting more domestic investment. The international community in general, and developing countries in particular, might gain the three benefits described below from multilateral disciplines on investment protection.

First, an agreement on common standards would promote efficiency by carrying potentially significant economies of scale in rule-making; one multilateral agreement could become a "one-stop shop" substitute for the complex and legally divergent overlapping web of existing BITs.

Second, a multilateral regime for investment protection could help to counter-balance the bargaining asymmetries built into BITs and regional agreements conducted along North-South lines. The negotiating asymmetries that are common to bilateral agreements have, in some cases, led to treaties in which developing countries have taken on substantive obligations without any reciprocity other than the promise of increases in future private investment. However, an important caveat to this argument suggests caution; to the extent the power imbalance is redressed in a multilateral agreement in favour of weaker states, constituencies within the global business community may well, as was the case in the MAI negotiations, prefer the stronger level of investment protection flowing from BITs and lose interest in a multilateral agreement.

Third, a multilateral set of disciplines on investment protection would arguably help developing countries send a positive signal to potential foreign investors regarding the permanency of policy changes and the expected standard of treatment afforded to foreign investors.

While the above factors suggest that investment flows might increase as a consequence of a multilateral set of investment protection disciplines, care should be taken not to overstate the response of investors. The following five facts argue for caution:

- The absence of a body of multilateral disciplines on investment protection and liberalization has hardly deterred cross-border investment activity. Indeed, FDI has far outstripped trade and output growth during the past decade and a half;
- The absence of an agreement has not prevented substantial unilateral liberalization;
- A more precise indicator is the historical experiences of the bilateral investment treaties in eliciting new investment. Does the signing of BITs increase the flow of FDI? Hallward-Dreimeir found no positive association between the signing of BITs and subsequent increases in investment (box 2);
- Multilateral investment disciplines are likely to embody investment protections that are weaker than those on offer in bilateral investment treaties. In the case of WTO, this is because the Doha Ministerial Declaration reflects a significantly limited approach that clearly does not view a multilateral framework on investment as a substitute for bilateral and regional arrangements. An open question, therefore, is whether new multilateral investment disciplines that are less encompassing in protection matters than are existing bilateral or regional treaties will be seen by home country investors as adding rule-making value and induce new investment flows;
- Finally, developing countries have to weigh the potential benefits flowing from any new multilateral disciplines on investment protection against the enforcement costs and possible financial liabilities they might entail.[43] This area has received little systematic study to date despite the sudden, sharp rise in litigation and the fact that greater empirical evidence could do much to underpin sound policy choices.

[43] The extent of potential liabilities is illustrated by cases filed under NAFTA's Chapter 11 that provides similar terms as other BITs. Under the investment protection provisions of the NAFTA, the signatory governments have opened themselves to investor-state suits for changes in regulatory policies deemed tantamount to an indirect expropriation. For example, Metalclad Corporation, a US waste-disposal company, sued the Mexican Government in 1996, seeking US$90 million in damages when the state of San Luis Potosi refused it permission to re-open a waste disposal facility after a geological audit showed the facility would contaminate the local water supply. Ultimately, Mexico paid Metalclad US$ 16 million in compensation. In another case, Methanex, a Vancouver-based maker of MBTE, a gasoline additive, is suing the United States government for US$ 1 billion after California decided to phase out MBTE use because of evidence of it as an environmental hazard. In another case, Ethyl Corp. filed a US$ 250 million lawsuit in the United States to pressure Canada to eliminate the planned ban on the fuel additive MMT, whose usage is prohibited due to environmental and health concerns.

Box 2. Do BITs increase investment flows?

BITs are instruments used by home countries to protect their foreign investors, while host countries view them as a positive signal of their investment climate and an important means attracting foreign investors. BITs can provide the basis for the resolution of disputes; they can also impose potentially extensive obligations on host country governments. Against this backdrop, the question of whether BITs actually increase FDI is important.

Surprisingly little empirical work has been done to test the role of BITs in attracting FDI. In a recent study, UNCTAD found little evidence that BITs increased FDI. That work looked at a single year of investments and tested the correlation between the number of BITs signed by the host and the amount of FDI it received. Hallward-Driemeier redid such a test but applied it to 20 years of data, looking at the bilateral flows of OECD members to 31 developing countries. This covered the vast majority of FDI flows as well as those relationships that were historically the bulk of such treaties. Overall, the evidence that BITs increase the amount of FDI is, at best, weak. By the end of the 1990s, there were many more BITs and FDI had increased dramatically. However, when controlling for a time trend, there was little independent role for BITs in accounting for the increase in FDI; countries that had concluded a BIT were no more likely to receive additional FDI than countries without such a pact.

Another question is whether a BIT would draw attention to a location, leading to an increase in flows in the aftermath of negotiations. However, in comparing flows in the three years after a BIT was signed with the three years prior to the signing, no significant increase in FDI was found. A second question is whether the relative amount of FDI allocated by a source country to a particular host is affected by the presence of a BIT. The evidence here is that the conclusion of a BIT is positively associated with receiving a larger share of a source country's FDI outflows, but the result is not statistically significant.

Some countries have looked to BITs as a way of signalling their respect for property rights. In particular, if their reputation for protecting such rights is weak, they have seen the signing of a BIT as a way of assuaging the concerns of foreign investors. On the other hand, the credibility of such a signal may not be that strong. It may be that the domestic rule of law may needs to be sufficiently strong before foreigners are willing to consider the terms of a BIT as being enforceable. To test between these hypotheses, regressions were run that included measurements of the rule of law, government effectiveness and regulatory quality. These measures were then implemented in the presence of a BIT. The results indicated that in weak investment climates, a BIT would not attract additional FDI. However, in countries with stronger investment climates, the presence of a BIT does weakly increase the amount and relative share of FDI that the host receives.

Source: Hallward-Driemeirer, 2002.

Dispute settlement is another critical but yet unresolved issue that will influence the content of any multilateral agreement to strengthen investor protections. Most BITs contain dispute resolution mechanisms that allow investors to challenge government rulings before arbitration panels or international courts. In the context of WTO, however, the issue raises several complex legal issues. While there is generally little support for the inclusion of investor-State arbitration provisions in a prospective multilateral investment agreement, WTO rules on investment protection could create complications even when administered through a State-to-State dispute settlement. For example, what would be the nature of the appropriate remedy in an instance of unlawful expropriation of foreign investment? These issues have also yet to be resolved

at the regional level, notably in FTAA discussions and other regional agreements featuring a comprehensive body of investment rules.

3. Minimizing 'beggar-thy-neighbour' investment distortions

Governments routinely adopt policies with a view to affecting the location and performance of multinational investment. This policy arsenal typically takes two basic forms: (a) investment incentives, usually through tax breaks or direct transfers from the state to attract FDI; and (b) performance requirements to compel multinational companies to locate a greater part of the value-added chain in the domestic market. Even when these benefit the domestic economy, they both have the potential for adversely affecting trade and investment flows with neighbours. Therefore, further international cooperation to curb their negative effects offers potential for creating positive benefits for all.

Unlike barriers to entry that primarily affect investment in services, investment incentives and performance requirements arise almost exclusively in manufacturing. In general, performance requirements have been the instrument of choice for developing countries seeking to ensure that the activities of multinational enterprises generate the greatest possible spillovers for their economies. OECD countries have been the predominant users of investment incentives to attract investment, although in recent years a growing coterie of developing countries have followed suit.

The trade distorting effects of performance requirements (i.e., TRIMs) have been subject to negotiated disciplines for some time, both at the regional and multilateral levels. In contrast, disciplines on investment incentives are, with the exception of the European Union's comprehensive set of disciplines on state aids, considerably more limited. The Uruguay Round Agreement on Subsidies and Countervailing Measures (ASCM) introduced limited disciplines on the granting of investment incentives. These disciplines are largely indirect because they apply solely to export subsidies and other goods-related transactions; that is, a government may invoke the agreement's provisions only when certain types of investment incentives used by certain types of members can be shown to distort trade in goods.

Agreeing to disciplines on investment-distorting incentives could benefit developing countries, as it would reduce the scope for potentially zero-sum tax competition. However, progress in formulating a set of multilateral disciplines on investment incentives has been negligible to date. One reason for this stalemate is that in large federal governments, many investment incentive programmes originate at the subnational level as instruments for promoting regional development. Another reason is that many emerging developing countries have themselves become heavy users of incentives in recent years. For these reasons, investment incentives have not figured prominently among topics to be discussed in international forums, such as WTO. The ill-fated discussions in MAI were also unsuccessful in broaching investment incentives, undermining the benefits of the prospective multilateral agreement among countries that are heavy practitioners of such distortional policy instruments.

Nonetheless, competition among governments over FDI incentives is becoming endemic in many parts of the world. While developing countries often find themselves in competition with each other, few examples can be found of direct competition with developed countries. In addition, competing developing countries are often middle-income countries. Four reasons appear to explain these patterns. First, studies show that the bulk of incentive bidding activity among governments takes places within regions, rather than on a global scale. An important lesson potentially flowing from such a trend is to situate best rule-making responses at the regional rather than the multilateral level. Only a handful of developing countries situated close to developed nations are therefore likely to be concerned by such practices. The case of Mexico's auto industry under NAFTA is perhaps the most prominent example. Second, location-related competition tends to be strongest between close neighbours with similar economic conditions, factor endowments and policy regimes. Competition is also strongest in high-skill, technologically intensive industries, particularly among firms producing goods for export. Carmakers, silicon chip producers and pharmaceutical firms are among the most sought after investments. Only a limited number of higher-income developing countries are likely to fit such a category. Third, competition is only likely where investors are somewhat indifferent between alternative locations. This implies that only the relatively more advanced economies (emerging or transition economies) could have cause to bid against developed nations. Fourth, overt bidding wars between countries are relatively rare, even where they may be intense within particular countries, and are typically limited to a few sectors. They generally occur where individual projects are exceptionally large and the sectors in question are considered as a high priority for national or regional economic strategies, as in the case of automobiles or electronics.

To be sure, striving for international agreements that ban investment incentives entirely may be counterproductive as, in some cases, they can offset local disadvantages or be used to capture spillovers from inward flowing FDI. In the case of Ireland and Portugal, for example, investment incentive programmes played a significant role in attracting investment to less developed regions. In the case of Brazil, there is some evidence that incentive competition may have contributed to reducing regional disparities, since FDI in some sectors (particularly automobile manufacturing) is increasingly being located outside the traditional industrial heartland around Sao Paolo. While it is highly probable that stories of failures and excessive expenditures outnumber successes, international agreements have to contain some elements of flexibility. A first step in this regard is to address the information gap that plagues careful analysis of the trade and investment distorting consequences and stands in the way of sound policy advice.

Disciplines on performance requirements came into place multilaterally with the TRIMs Agreement in 1995. Among performance requirements, the most prevalent measures relate to local content, joint ventures (or domestic equity participation), exports, technology and employment requirements. Export and local content requirements are commonly intended in part to reduce the risk that inward investment leads to a deterioration of the current account. Moreover, export content requirements may also be part of government efforts at boosting the long-term competitiveness of the

host country's business sector, while local content requirements are designed to maximize vertical linkages and the development of local skills.

By the end of 2003, all WTO members will be required to have phased out performance requirements that were in place and grandfathered through a notification process at the time of the Agreement's entry into force. All 27 notifications of measures not consistent with the Agreement were from developing countries. Almost half of the notified measures relate specifically to the automotive sector. Many of these have already been phased out during the transition period. Ten developing country members of WTO formally requested an extension of their transition periods before non-conforming measures were repealed. Six of these had restrictions in place in the automotive sector

Even though the prevalence of performance requirements affecting trade may be limited (in sectoral terms) and declining (in quantitative terms), the developmental effects of existing WTO disciplines on performance requirements and the broad scope of prohibited measures to which such disciplines apply have received scant attention in negotiating circles. Performing a development audit of such rules could prove useful for purposes of future policy initiatives.

Discussions of possible changes to the TRIMs agreement can be associated with the review process that is mandated under Article 9 of the Agreement. WTO members face two basic choices in this regard. First, they could agree to re-open the Agreement. Such a scenario seems most unlikely. Second, they could seek clarifications on the scope of Agreement's Illustrative List of Prohibited Measures or elaborate on the length of permissible transition periods. The issue is that, even though both notifications and disputes have to date centred primarily on measures covered by the illustrative list, notably local content and (less so) on trade-balancing requirements, the Agreement arguably prohibits a greater range of, as yet, unspecified performance requirements (box 3). Introducing greater specificity into the language used could enlarge or contract the coverage of the Agreement. At present, such debates are not foreseen under the Doha Agenda.

Box 3. Disputes under the TRIMs Agreement

The WTO jurisprudence on TRIMs is very limited. In total there have been four cases in which TRIMs has been invoked before panels but only two cases in which panels have actually made findings under that Agreement. The first case concerned Indonesia's National Car programme while the second, more recent, case involved certain TRIMs applied by India in the automotive sector.

One reason for limited jurisprudence is that a number of cases have been handled through the transition clause route of Article 5. Another reason is that the TRIMs Agreement does not add much value to GATT 1994. Consequently, in some cases, panels have concluded that, having determined that a particular measure (e.g., a local content requirement) is inconsistent with Article III of GATT 1994, there is no need to examine the same measure under the TRIMs Agreement. This explains why, in the disputes between the United States and the European Union over bananas, and Canada and the United States over the terms of the 1965 Auto Pact linking the two countries, no findings were made under the TRIMs Agreement, even though that agreement was invoked by the complainants. The limited recourse to dispute settlement

under the TRIMs Agreement is perhaps also due to the existence of conflicts of interest among industries in affected countries. Brazil's TRIMs, introduced in 1996, are a case in point. They were manifestly inconsistent with the TRIMs Agreement but the United States chose not to act because of the differing interests of United States firms exporting to Brazil and relative to those United States businesses that had invested in Brazil.

Taken together, the WTO Agreements do provide limited discipline on certain types of "beggar thy neighbour" policies currently in use around the world. It appears unlikely that these disciplines will be broadened or strengthened in the near future. With regard to curbing incentives, even though potential benefits for countries exist from a multilateral accord, the regional pattern of possible tax competition and trade effects suggests that regional arrangements may offer more promising opportunities for collective international action. Multilateral efforts to improve information on investment incentives, perhaps as part of the International Monetary Fund (IMF) surveillance process, could help remedy the data lacunae that obscure adequate analysis of the extent of investment distortions.

4. Investment-related trade measures

An important challenge developing countries face on the liberalization front is the use of regional and multilateral negotiations to address a range of investment-related trade measures, both at home and, in many instances, in OECD countries. A lessened incidence of such measures could help improve domestic investment climates. Such measures range from tariff peaks and tariff escalation, to the combination (especially potent in a large number of regional trade agreements) of discriminatory sector-specific rules of origin, and the continued deployment of anti-dumping regimes beyond the achievement of free trade in goods, plus the lack of convergence in standards-related issues. Much can be done in tackling the traditional WTO market access agenda and strengthening multilateral disciplines over regional trade agreements (foreseen under the Doha Agenda) in order to improve the investment climate in developing countries as well as help in realigning global investment activity along the lines that the forces of comparative advantage should normally dictate.

5. Improving governance: how much of a WTO agenda?

Improper corporate behaviour can undermine weak institutions and perpetuate corrupt systems. The global community, and developing countries in particular, has an interest in creating standards of corporate conduct that will produce cleaner competition around the world as well as greater social accountability.

To help combat bribery and corruption, and culminating a decade of work, OECD established the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The Convention, which entered into force in 1999, currently includes all 29 OECD members and five non-members (Argentina, Brazil, Bulgaria, Chile and Slovakia) as signatories. Signatories make bribing a foreign public official a criminal offence. The Convention also encompasses non-criminal

rules for prevention, overall transparency and cooperation between countries; and it ends the practice of allowing the tax deductibility of foreign bribes.

Regional forums of cooperation have also helped. For example, the Inter-American Convention against Corruption was established in the Organization of American States (OAS) in 1996, while the Summit of Americas in April 2001 created an implementation mechanism for the Treaty.

For anti-corruption initiatives to be effective, experience shows that participation by civil society, private agencies and the public is critical. In this context, cooperative efforts in developing approaches to counter corruption by non-governmental organizations (NGOs) such as Transparency International, the Global Coalition for Africa, the Novartis Foundation, and the Public Affairs Centre, international organizations/banks including the World Bank, IMF, the Asian Development Bank (ADB), the United Nations Development Programme (UNDP) and the United States Agency for International Development (USAID) are noteworthy.

To promote corporate social responsibility amid concerns about the effects of globalization on the developing world, the United Nations adopted the Global Compact in July 2000. The Compact calls on companies to embrace nine universal principles of human rights, labour standards and the environment. It aims, in the words of Secretary-General Kofi Annan, to contribute to the emergence of "shared values and principles, which give a human face to the global market". About 100 major multinationals and 1,000 other companies across the world's regions are currently engaged in the Global Compact. In a similar vein, in 2000, OECD significantly revamped its Guidelines on Multinational Enterprises with a view to promoting greater social responsibility and sounder governance (including, for example, environmental or labour practices) on the part of corporations headquartered within the member States of the Paris-based organization.

Other multilateral programmes have a more technical focus. World Bank work on corporate governance emphasizes disclosure, transparency, the rights and treatment of shareholders and stakeholders, and the duties of board members. Using the OECD Principles of Corporate Governance as a benchmark, the World Bank prepares country corporate governance assessments for its client countries to assess their institutional frameworks for corporate governance. Moreover, the World Bank and IMF initiated the Financial Sector Assessment Programme (FSAP) and the Reports on the Observance of Standards and Codes (ROSC). Fifteen such assessments, including ones for Brazil, India, Turkey, Poland, the Philippines and Georgia have been completed under the auspices of the FSAP and the Reports on the Observance of Standards and Codes (ROSC).

These international activities do not involve trade-related disciplines or sanctions, but can have significant impact in ensuring that corporations as well as governments receive some oversight in the development process. These activities are proving effective, and the deepening of monitoring and enforcement of existing treaties and agreements is more likely to be effective than efforts to create new ones in WTO.

E. Concluding remarks: the road to Cancun

Fast-growing developing countries have typically been successful in setting up investment regimes that facilitate private investment and marshal competition to ensure growth in productivity. As with trade reform, most of the benefits from new sound investment and competition policies come from unilateral reforms of domestic policies. However, developing countries may be able to obtain additional benefits from collaborative collective actions. These can take several forms. Participating in international agreements can help lock-in reforms, strengthen their credibility, and give investors an additional positive signal. Participating in international negotiations may simultaneously strengthen the hand of domestic reformers by holding out the prospect of tangible external results of new market access in exchange for good domestic policies, and elicit reciprocal reforms among partners that create new market access opportunities.

Similarly, international collaboration can strengthen competition and thereby create a positive spill-over that benefits all countries through lower prices. Finally, international collaboration can enhance domestic reforms by fostering transparency generating information and mobilizing resources. This paper has explored the potential of international collaboration for helping developing countries consolidate positive investment climates and create positive externalities through joint action on investment and competition policy.

WTO Ministers provided one example of potential collaboration when they decided at Doha to consider launching negotiations on a multilateral framework covering foreign investment and competition. The purpose was "to secure transparent, stable and predictable conditions for long-term cross border investment" that would expand trade. Two questions therefore face the international community and developing countries in particular:

(a) What types of new multilateral initiatives on investment and competition policy can promote more – and more productive – investment and, hence, more rapid development?

(b) More specifically, which issues are best tackled through voluntary initiatives, and which are best handled through legally binding and enforceable commitments, such as those found in WTO and regional arrangements?

The overall objectives of coordinating investment policy are to expand the flow of investment around the world, minimize distortions that hurt neighbours, and help improve economic performance. Coordination might contribute to achieving these goals through four channels: (a) liberalizing investment flows to permit enhanced access and competition; (b) protecting investors' rights to ensure incentives to invest; (c) curbing policies that may distort investment flows and trade at the expense of neighbours; and (d) enhancing governance by reducing bribery and increasing corporate social responsibility.

Analysis suggests several broad conclusions:

(a) As with trade policy, unilateral reforms to liberalize foreign direct investment are likely to have the greatest and most direct benefit for the reforming country;

(b) Participation in collective agreements may indeed have benefits, but these benefits would be substantially greater than unilateral reforms if they were accompanied by expanded reciprocal market access in areas of importance to developing countries;

(c) Available research suggests that international agreements to protect investor rights cannot be expected to expand markedly the flow of investment to new signatory countries. Although much protection is already afforded to home country investors through BITs, they do not seem to have contributed yet to expanding flows of investment to developing countries. For this reason, expectations of significantly enhanced FDI inflows resulting from a new set of multilateral disciplines on investment protection should be tempered.

(d) International agreements to curb "beggar thy neighbour", trade-distorting investment policies can also benefit developing countries. One area deserving particular attention relates to heightened competition among countries to lure foreign investment. Information on the extent of investment incentives is generally inadequate for assessing their effects, and so a high priority for international collaboration is to compile such information more systematically;

(e) Collective actions to discourage improper corporate practices, such as bribery, and improve corporate social responsibility are already the subject of a broad range of cooperative international initiatives, and these can entail substantial benefits. Doubts may arise, however, as to whether WTO is the most appropriate forum in which to tackle governance and best practice-related issues.

An important element of the upcoming Cancun Ministerial Meeting will thus be whether WTO members can reach agreement on the negotiating modalities required to launch a formal set of negotiations on investment (and competition) at WTO.

Much useful work of a pedagogical nature has been pursued in the WTO WGTRI since its inception at the first WTO ministerial meeting in Singapore in 1996. Such work has, for the most part, been rooted in the considerable range of investment rule-making activity that has taken place around the world at the bilateral and regional levels. This work has accelerated since Doha, with more focused attention being given to seven core elements of a possible multilateral framework on investment (MFI).

Recent experience (i.e., the failed MAI experiment, the public policy controversies arising under Chapter 11 of the NAFTA and evolving jurisprudence under BITs) has

revealed the complexity of devising binding disciplines for investment. It should be noted that the greater part of such policy controversy has arisen in the field of investment protection, a subject that does not feature on the agenda of post-Doha discussions.

The cumulative experience and skills in negotiation and implementation acquired over the past decade by officials in a large number of key WTO member countries suggests that reaching agreement on forward movement in Cancun (without any certainty as regards the ultimate destination) is likely to rest more on political grounds – and notably be a function of the substantive contents of negotiating bargains on offer in other key areas of the Doha Agenda – than on more purely technical grounds. The challenge, accordingly, is to figure out what the Ministers should be seeking agreement on in the investment field when they meet in Cancun.

Discussions in WGRTI have seen a traditional alignment of forces on opposite sides of the policy interface, with the European Union, Japan, the Republic of Korea and Taiwan Province of China leading the group in favour of a WTO MFI, and India, Malaysia and Pakistan providing the greatest resistance. However, the broad parameters of possible investment disciplines have nonetheless begun to emerge. While still evolving, one can still speculate that an MFI may likely feature the following core elements:

- Exclusive focus on investment in primary and manufacturing industries, thus complementing existing investment disciplines for services under modes 3 and 4 of GATS. While incoherent, the resulting dual structuring (separate investment rules for goods and services) would match the outcome recently secured in the European Union-Chile FTA.
- A GATS-like hybrid approach to investment regime liberalization (i.e., positive commitments subject to negative reservations preserving existing non-conforming measures in scheduled sectors).
- Key disciplines including (a) transparency,[44] (b) national treatment, (c) market access, (d) MFN (subject to reservations to protect existing and future BITs and investment provisions in RTAs as per GATS Article V), (e) domestic regulation and the right to regulate for a public purpose, (f) exceptions (general and BoP-specific), (g) movement of key personnel (intra-company transferees), and (h) development provisions (including up-front pledges from OECD countries for greater capacity-building funding/ training on best-practice investment policy-making).
- State-to-State dispute settlement under existing DSU provisions.
- No changes to either the GATS or TRIMs Agreements arising directly from the negotiation of an MFI.

[44] One could, however, imagine a best endeavours clause and/or a financial services understanding formula-type outcome on additional prior consultation disciplines and, possibly, on issues such as a broader definition of investment, including portfolio investment, pre-establishment commitments, investment protection etc.).

- No disciplines on investment protection (left to BITs or RTAs), nor on the distorting effects of investment incentives (the incidence of which tends to occur mostly at the regional level and more rarely involves bidding activity along North-South lines).[45] Meanwhile, the absence of disciplines on investment protection would largely obviate the need for investor-State arbitration in a WTO setting.
- Key unresolved issues on which it is still hard to speculate, including the definition of covered investments and investors (i.e., narrow or broad; and FDI only or other types of assets, including portfolio investment) as well as the treatment of possible commitments on pre-establishment matters.

This paper has attempted to make sense of what is and what should be on the table, to enable Ministers to make informed judgments in Cancun. Such judgments must seek not only to raise the bar as high as possible, given the clear importance that all WTO members attach to enhancing domestic investment climates and the strongly liberalizing trend observed in domestic investment regimes in recent years. (A WTO MFI would largely be about the terms of payment for locking in and giving greater permanency to the virtue practiced on the investment policy front in recent years, providing developing countries with a negotiating advantage that they tend collectively to underestimate). However, an outcome that adds value over existing arrangements and is coherent (i.e., reflective of how trade and investment interact with one another in a globalizing environment) must also be sought.

There are grounds to believe that the negotiation agenda currently on the table fails to meet the criteria described above. Because Cancun lies only a few months ahead, it is essential that careful consideration be given to a broader range of issues than those currently being contemplated by the WGRTI. Work in the run-up to Cancun will likely be constrained by the elements featured in the Doha mandate.

A consideration of a broader range of issues than those currently under discussion in Geneva might thus prove useful in securing an improved overall bargain for the WTO membership as a whole. In particular, it could help developing countries achieve genuine progress in an area of significant export interest (movement of natural persons) in return for consolidating investment policy reforms that have been strongly liberalizing in recent years, with little evidence of policy reversal.

To contribute to such a discussion, policy makers will need to devote greater attention to issues that have to date largely been cast aside in Geneva and the national capitals. These issues include:

- What should a multilateral framework of investment disciplines tackle in a WTO setting? What is best left to bilateral or regional settings as well as to non-binding and/or non-enforceable policy initiatives?

[45] An attempt at securing greater transparency on the sectoral incidence and on the trade, investment and overall economic effects of incentive programmes would be most useful in informing future policy- and rule-making initiatives.

- What formulation of rules is most likely to add value to existing disciplines while being pro-development?
- What scope exists for designing a set of disciplines that would affirm the equivalence (both in economic and juridical terms) between the movement of capital (investment) and the movement of labour?
- Could such negotiations secure reciprocal gains for all WTO members? What complexities would need to be overcome in achieving such an outcome?
- Should the TRIMs Agreement and elements of the SCM Agreement be collapsed into an integrated MFI?
- What scope exists for embedding greater doses of variable geometry into a WTO MFI, e.g., such as between investment protection and liberalization; pre- and post-establishment; narrow versus broad definitions of investment; and developed and developing countries?
- Are current negotiating proposals up to the task? Are overall coherence in rule design and levels of ambition at risk of being sacrificed on grounds of political expediency?
- Is it desirable to have separate investment rules for goods and services? Is there a constituency for such rules outside of bureaucratic circles?
- How significant is the market access (entry) agenda in manufacturing?
- Can multilateral rules match the level of protection afforded to investors in bilateral and regional investment agreements?
- Should a WTO MFI feature recourse to investor-State arbitration?
- Can Cancun survive without a resolution of these matters?

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VI. COMPETITION POLICY IN THE WORLD TRADE ORGANIZATION: HOW TO MAKE IT A DEVELOPING COUNTRY'S AGENDA

By Deunden Nikomborirak[*]

Introduction

Competition policy is one of the four "Singapore Issues", or new issues that were introduced at the first WTO Ministerial Conference held in Singapore in 1996.[46] According to the Declaration of the Singapore Ministerial Conference, a working group is to be established to study issues raised by members concerning the interaction between trade and competition policy in order to identify possible areas that may be the subject of a multilateral framework agreement. Pursuant to the Doha mandate, in 1997, the WTO General Council established a Working Group on the Interaction between Trade and Competition Policy (WGTCP). Its task is only exploratory in nature as the declaration made it clear that no decision had been reached on whether there would be negotiations in the future, and that those discussions could not develop into negotiations without an explicit consensus on the modalities of negotiations.

At the fourth Ministerial Conference at Doha in November 2001, it was decided that until the subsequent Ministerial Meeting to be held at Cancun in September 2003, WGTCP should focus on clarification of specific issues that might form the framework for possible negotiations in the coming Round. These issues, which are spelled out in paragraphs 23 to 25 of the Doha Ministerial Declaration (see annex), are (a) technical assistance and capacity-building for developing countries; (b) provisions dealing with hard-core cartels;[47] (c) modalities for voluntary multilateral cooperation; and (d) core principles in the enforcement of competition law, which refers to non-discrimination, transparency and procedural fairness. Pursuant to the declaration, the three Working Group meetings held during 2002 were dedicated to addressing these four specific areas. Each of these issues is elaborated in detail in the following section.

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[46] Other issues include are trade and investment, transparency of government procurement and trade facilitation.

[47] Hard-core cartels refer to the most damaging type of collusive practices such as price fixing and bid rigging. The exact definition of "hard core" is not yet conclusive. However, possible definitions have been examined in the Working Group on the Interaction between Trade and Competition Policy as explained in section B of this paper.

A. Objective and rationale for having competition policy in the World Trade Organization

1. What can a multilateral competition framework hope to achieve?

The objective of a possible multilateral competition framework (MCF) is twofold:

(a) To establish competition in the domestic market in order to provide a certain degree of contestability that ensures that market access gained from trade concessions is not nullified by domestic anti-competitive practices;

(b) To discipline cross-border restrictive business practices undertaken by private companies that affect the prices and availability of goods to member States.

It is not clear which objective WGTCP should focus on, or give priority to, in the discussions. Perhaps it will be left to members to decide during the course of discussions in the working group meetings. Indeed, different objectives will give rise to different MCFs that spell out the rights and obligations of members.

Most developed countries are concerned about market access issues since most have investment interests in many developing countries that do not yet have a competition law or a competition regime that can protect foreign companies from anti-competitive practices by local incumbents with market power. Since over 50 members in WTO still do not have such a law, a multilateral agreement that would require all members to establish a national competition regime would, in effect, guarantee foreign investors a certain degree of competition in domestic markets. The regime would supposedly not discriminate between domestic and foreign companies and would have transparent procedures guaranteeing effective and fair enforcement.

Most developing countries, on the other hand, are more concerned about restrictive business practices of foreign multinationals, such as abuse of intellectual property rights, price-fixing or bid rigging, which lead to higher prices of imported products or services. Trade liberalization has increasingly exposed them to abusive conduct and practices by multinational enterprises. Unlike their more developed counterparts, developing countries have very little outward investment and thus are not too concerned about whether their national companies operating overseas are protected by a competition regime in the host country. Thus, they are not interested in instituting national competition laws dealing with domestic anti-competitive practices. Rather, they are interested in a global rule that would ban cross-border restrictive business practices that harm their economies but are beyond the reach of the domestic authorities.

The proposals and views expressed by delegates from developed and developing countries in WGTCP clearly reflect their underlying interests and concerns. Developing countries are opposed to a binding obligation to a national competition regime or the adoption of the core principles of discrimination, transparency and due process. Developed economies, on the other hand, have responded negatively to the developing

countries' proposal regarding a ban on exports and international cartels or a binding commitment to providing cooperation in the investigation and prosecution of such cartels.

2. Is it necessary to introduce competition policy in the World Trade Organization?

Existing WTO agreements include several competition-related provisions, both in GATT and GATS. However, these are limited in scope in two important ways. First, these provisions only target measures taken by the State, not by business entities, unless they are State-owned.[48] This means that private anti-competitive practices such as cartels are not within the realm of the existing WTO rules. Second, these provisions do not apply to domestic laws and regulations. In other words, there is rarely a WTO agreement that requires member parties to put in place domestic rules or regulations that protect or assure competition in the market, with the exception of TRIPs.[49]

To illustrate the limitation of existing WTO provisions in dealing with private restrictive business practices, let us examine key provisions in GATT and GATS. Article XI of GATT prohibits members from imposing quantitative restrictions as well as "measures other than duties" on importing and exporting.[50] This implies that members must not pass domestic rules and regulations that will result in a restriction of exports or imports, or "encourage" private companies to act in such a way that will restrict trade. However, should a private firm be engaged in an anti-competitive practice without the aid or prompting of the State, such a practice will not be considered a violation of WTO law. Moreover, members may condone private practices that result in input or output restrictions. For example, members may exempt cartels from national competition laws, or not have a competition law to deal with such cartels that restrict the quantity and raise prices of exports. At the same time, Article XIb of GATT applies only to government measures that may restrict the importing and exporting of goods across a border but not the production of those goods behind that border. This is because GATT is concerned mainly about trade, not investment.

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[48] Anti-dumping is probably the only provision that deals with private practices. But even in that case, there are no prohibitions. The agreement merely allows the member State whose industry is adversely affected by such practices to impose surcharges as a remedial measure.

[49] The Telecommunications Reference Paper, which is part of the Agreement on Basic Telecommunications concluded in 1997, is another pact that binds agreed parties to introducing domestic rules and regulations that will maintain adequate measures for preventing potentially anti-competitive practices from being undertaken by dominant suppliers in the market. The agreement is an extension of competition rules to international trade in services. Yet, even then, the agreement is very limited in its application. Members are free to commit or not to commit to the Reference Paper, or to commit only to certain parts of the paper.

[50] GATT Article XI: General Elimination of Quantitative Restrictions. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences, or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of another contracting party, or on the exportation or sale of export of any product destined or the territory of any other contracting party.

The general obligation of GATS does not have an equivalent provision to Article XI of GATT. However, it does have a weak provision addressing private anti-competitive practices. Article IX requires members to consult with a view to eliminating certain (private) business practices that may restrain competition. However, in practice, members have not made use of this rather general provision.

Due to the limitations of current competition-related provisions in GATT and GATS, a competition policy was introduced in WTO. Unlike trade policy, competition policy concerns private practices rather than State practices. In addition, at the national level, a national competition regime assures contestability in the domestic market, while at the global level, a multilateral competition rule can be a tool used in dealing with cross-border restrictive business practices such as cartels. Thus, competition policy can fill in the gaps not covered by other non-competition WTO agreements and address competition concerns of both developed and developing countries.

B. What are the main conclusions from the WGTCP?

As mentioned above, the three WGTCP meetings in 2002 were dedicated to the four issues spelled out in the Doha Ministerial Declaration. A brief summary is given below of the discussions in the working group, based on the WGTCP Report for 2002 (WT/EGTCP/6) that was submitted to the General Council.

1. Core principles

Core principles, which include but are not limited to transparency, procedural fairness and non-discrimination, are believed to be key elements that will foster effective and credible competition regime. The inclusion of these principles in a WTO agreement would assure traders and investors of a level playing field in competition, thereby contributing to enhanced and trade investment flows.

Transparency is often referred to with regard to the publication of laws, regulations and guidelines of general application as well as exclusions and exemptions. Members would have to ensure that these documents are available to the public either in an official gazette or journal or in electronic form on a web site. Transparency obligation may also involve mandatory notification of these elements to WTO. Many members have raised concerns that disclosure requirements that come with transparency obligations may not be workable, since competing authorities have different administrative rules regarding what type of information can be disclosed and what type must be kept secret. There were also worries that too much disclosure will impose a heavy compliance burden, particularly on developing members.

Procedural fairness ensures that parties facing adverse decisions and sanctions are given adequate basic rights to defend their cases. These include the rights to: (a) be notified that a formal investigation is pending against them; (b) submit evidence and documents, and present their views to the authorities concerned, either in writing or by participating in public hearings; (c) appeal; and (d) the protection of confidential information submitted to the authorities.

Non-discrimination is probably the most controversial principle. Non-discrimination in WTO refers to two components, most-favoured nation (MFN) treatment and national treatment. Although no competition law to date has discriminated between foreign companies of different nationalities on a *de jure* basis, issues could arise with regard to the status of bilateral and regional cooperation arrangements in competition policy. As is the case for regional or bilateral trade agreements, cooperation arrangements in competition policy imply that certain members will be treated on a preferential basis. For example, suppose the United States and the European Union have a bilateral agreement whereby mergers that affect both jurisdictions (such as that between Boeing and Airbus) require the submission of pre-merger notification and the obtaining of clearance from both competition authorities. All other jurisdictions will not be notified and will have no say in the decision. This would constitute an MFN violation. However, the view taken in WGTCP was that bilateral and regional arrangements should be allowed to continue to operate in parallel with more basic multilateral obligations.

National treatment, a general obligation in GATT, refers to equal treatment between domestic and foreign products. Article III.4 of GATT specifies that laws, regulations and requirements affecting internal sales must be equally favourable to domestic and foreign products. In GATS, national treatment is not a general obligation. Rather, it is tied to specific market access commitments that must be negotiated by service sector or subsector. For example, if country A were to make a scheduled commitment to liberalize its fixed line telephone service, then it would be obligated to remove internal rules and regulations that discriminate between domestic and foreign firms. However, if country A does not make such a market access commitment, then it would not be obligated to ensure equal treatment for foreign and domestic telecom companies. Thus, the non-discrimination obligation in GATS is much weaker than that in GATT.

The definition of national treatment as proposed by the European Union in WGTCP is slightly different from those in GATT and GATS. First, it refers to the nationality of "firms" rather than that of "products" as is the case in GATT. This implies that the non-discrimination principle discussed thus far concerns foreign investment more so than foreign trade. Second, it is applied only on a *de jure* basis, i.e., discrimination embodied in the laws, regulations and guidelines of general application. Consequently, the scope of application of the non-discrimination principle is more when compared with that in GATT, which prohibits discrimination on both a *de jure* and *de facto* basis. The reason provided is that in practice it would be difficult to distinguish *de facto* discrimination from reasonable exercises of prosecutorial discretion by the national competition authority based on objective factors. More importantly, members would be reluctant to allow an international body to review sovereign decisions made by their competition. Nevertheless, views were also expressed that if non-discrimination only applied to the letter of the law, then it would have no real effect, since most competition laws do not include provisions that provide for special treatment or privileges to national firms as opposed to foreign ones.

Questions were been also raised over whether exemptions provided for exports and international cartels would be considered discriminatory as they allowed private firms to pursue collusive practices overseas, while the very same practices were banned domestically. It would appear that the same practices, such as price-fixing and bid rigging, should be subjected to the same discipline and sanctions regardless of whether harm is done to domestic or overseas consumers.

(a) Additional principles proposed in the Working Group on the Interaction between Trade and Competition Policy

In addition to the three main core principles discussed above, two more principles were proposed and discussed by WGTCP, i.e., special and differential treatment and comprehensiveness. Special and differential treatment refers to special rights and more favourable treatment for developing countries in meeting their WTO obligations. Special and differential treatment provisions may include preferential market access (such as the generalized system of preferences), flexibility of commitments (such as the ability to impose quantitative restrictions for the purpose of establishing a domestic industry), and transitional periods in complying with WTO obligations. Several developing members believe that since the Doha Ministerial Declaration states explicitly that "full account shall be taken of the needs of developing and least-developed country participants", special and differential treatment should constitute one of the core principles of a competition regime. How such a principle will be translated into concrete measures and obligations has yet to be discussed in detail.

Another core principle, comprehensiveness, was proposed in WGTCP in response to concerns that excessive proliferation of exemptions and exclusions may undermine the value of a multilateral agreement. Although comprehensiveness is not among the WTO core principles, it is one of the four principles found in the APEC Principles to Enhance Competition and Regulatory Reform.[51] Comprehensiveness ensures a sufficiently broad application of competition principles to economic activities. It advocates that exemptions and exclusions should be designed in such a way that they minimize distortion of the competition process, and that they be subjected to periodic re-examination within the context of the overall framework agreement.

(b) Views of the members

The European Union has been a staunch advocate of a binding commitment to core principles. The proposal of a binding commitment has raised expressions of concern and reservations in the United States as well as in developing countries. The United States is concerned about the actual implementation of these rather abstract core principles. It believes that the exact scope and coverage of the principles need to be clarified and translated into concrete obligations imposed on members. For example, what does transparency involve? Does it refer to the publication of documents such as laws, regulations and guidelines? How would it apply to common law jurisdictions where court and agency decisions could have precedence and thus be part of the law? What happens if the competition authorities of members have different disclosure

[51] Accountability, transparency, non-discrimination and comprehensiveness.

standards? For example, no information concerning a pending merger can be disclosed in the United States, which is not the case elsewhere. It would be impossible to harmonize the disclosure standards and procedures.

Developing countries, on the other hand, are more concerned about the implications of a binding commitment to core principles for poorer countries that have limited human and financial resources. For a country without such legislation, the cost of drafting and approving such a law can be hefty. For those that already have such a law, the cost of compliance with the core principles, i.e., the cost of documentation, publications, notification and the establishment of procedural rules can also be equally burdensome. Many members believe that these principles should not be too prescriptive and intrusive in order to allow each member the flexibility to design its own administrative procedures that will meet these principles in ways and by means that are consistent with local legal tradition, industrial policies, institutional design and the socio-political environment. Obligations under a possible MFC should focus on "achieving the end results" rather than on "prescribing the means".

2. Provisions on hard-core cartels

Hard-core cartels refer to the most damaging type of collusive practices such as price or quantity fixing, bid-rigging and market allocation. Such practices raise prices and restrict supply, thus making goods excessively costly or even unavailable to purchasers. According to a background paper prepared for the World Bank's *World Development Report 2001*, cartel-affected imports contribute to approximately 6.7 per cent of all imports, worth US$ 81 billion, by developing countries; the cost to developing countries was an estimated US$ 20 billion to US$ 25 billion in 1997, depending on the percentage of the price mark up. The estimate was based on 16 products sold by known cartels as revealed by competition authorities in the United States and Europe. The actual figure could be much higher. Cartels of a global scale may operate secretly in many countries and thus remain elusive to national competition laws.

The WGTCP recognized that hard core-cartels undermined the potential benefits of trade liberalization and imposed heavy costs, particularly on developing members that lacked the bargaining power as well as resources and capacity to deal with such cartels. The European Union proposed that a multilateral framework on competition should comprise two elements regarding cartels: (a) the introduction of a national competition law or regime in every member country, which would include a provision prohibiting hard-core cartels; and (b) a cooperative framework that would promote the exchange of information on cartels between WTO members.

This proposal is built on the non-binding OECD Council's Recommendation Concerning Effective Action against Hard-Core Cartels that was adopted in 1998. It was proposed that OECD member countries ensured that their competition laws effectively stopped and deterred cartels, and that they cooperate with each other in enforcing the law. It was porposed, however, that exclusions and exemptions of certain sectors or practices from national competition laws be allowed. Thus, the European Union proposal is mainly an extension to other members in WTO of the OECD recommendation.

Three issues were raised in response to the proposal. The first concerned the definition of hard-core cartels. What kind of collusive practices would be considered "hard core"? Should the definition be the same for cross-border versus domestic cartels? Should the definition of hard-core cartels include or exclude government, government-mandated and private export cartels? The second issue addressed concerns of developing countries with regard to the compliance cost of a possible binding commitment to the proposed principles, in particular for members that did not yet have a competition regime. The final issue was concerned with whether the proposed multilateral framework, which was based on a voluntary cooperation between competition authorities, would be effective in dealing with international cartels whose operations transcended national boundaries.

Definition of a hard-core cartel

Currently, two definitions of hard-core cartels are to be found in non-binding agreements concerning cartels. One is the definition provided in the OECD Council's Recommendation Concerning Effective Action against Hard-Core Cartels, which includes price fixing, quantity fixing, market allocation and bid rigging. The other definition can be found in the UNCTAD non-binding recommendations of 1980 for the control of restrictive business practices, in particular cartels, known as the "Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices", or the "Set" in short. The definition of hard-core cartels according to the Set, in addition to the four types of collusive practices specified in the OECD recommendation, includes a concerted refusal to supply potential importers, collective denial of access to an arrangement or association, and collective action to enforce a cartel arrangement, such as a refusal to deal.

The possible definition of hard-core cartels has been explored by WGTCP, but no conclusion has been reached so far. Most developing countries believe that domestic and international cartels should be treated differently because of the overwhelming difference in the size of the domestic and global markets. While there appears to be possible economic and social justification for a domestic cartel, it would be hard to apply the same justification for collusive practices that transcend national borders. It is also believed that export cartels should be considered as international cartels since their practices also lead to export restrictions. However, developing countries would like to reserve the right to exempt cartels that consist of SMEs. While there appears to be no clear consensus concerning these issues, there does appear to be agreement that government and government-mandated cartels would not be covered by a possible multilateral framework in competition.

The second issue concerns whether members without a competition law and authority will be able to participate in the proposed cooperative framework designed to deal with hard-core cartels. Many developing countries are of the view that members should not be obliged to introduce national competition as more than 50 member countries still do not have such a law. For those members, the obligation to introduce and enforce such a law could be very costly and burdensome.

The third issue concerns the efficacy of the proposed provision on hard-core cartels. Some members do not believe that having a national competition law that prohibits cartels will be sufficient to solve cross-border cartel problems. As mentioned above, cartels that operate overseas are, in practice, beyond the reach of national competition law and authority. Even if the domestic competition authority finds foreign firms guilty of raising prices of imported goods or services, those firms need not comply with the remedial measures or sanctions imposed upon them. Unless those firms have assets in the imported country or the affected parties are considered important customers, there is nothing that the national competition authority or court can do when there are no reasonable substitutes for the imported products.

As the proposal was viewed as inadequate by certain members, it was suggested that perhaps WGTCP should begin to explore the possibility of having a multilateral rule that would prohibit cross-border collusive practices. Such an agreement would oblige the member States under whose jurisdictions the private companies resided to take legal action. Given that national governments are likely to be reluctant or legally unable to take action against local firms that impose harm overseas, only a binding global rule that prohibits such practices can ensure effective enforcement against cartels.

It should be noted that this particular proposal isolates the trade component of competition policy from the non-trade component. According to this proposal, the multilateral rule would apply only to collusive practices that were cross border in nature. It would say nothing about the domestic competition regime. Thus, parties to the agreement would not need to have a full-fledged national competition law or regime. They would only need to pass a "WTO compliance law or rule" containing provisions prohibiting only cross-border hard-core cartels. That is, members would only be required to take action against their own companies engaged in cross-border collusive practices that were damaging to other parties. They would not be required to take any action concerning anti-competitive practices within their own territory.

3. Modalities for voluntary cooperation

With regard to the need for multilateral cooperation in competition policy, the view was expressed that with the globalization of business activities, national borders would cease to have any meaning. Yet, the reach of a national competition law and regime remain confined to domestic jurisdiction. Thus, like international trade, effective enforcement of competition law and policy would require cross-border cooperation between national competition authorities.

Two principle types of cooperation were foreseen in a possible MCF. The first was a general exchange of experiences, knowledge etc., among competition authorities. The second would be case-specific cooperation, whereby competition authorities might exchange non-confidential information and evidence on particular cases, experiences and advice regarding individual cases. The modality of the cooperation would be voluntary and non-limited to the case of cartels.

Several tools that would be included in a voluntary cooperative framework were also discussed, including:

(a) Notification, whereby a national competition authority would alert others to certain anti-competitive cases that could affect their interests;

(b) Exchanges of information to facilitate enforcement;

(c) Mutual assistance on the enforcement process;

(d) Negative comity,[52] which requires a country to take into account the important interests of another country when considering whether to pursue investigation and formulate remedies.

It should be noted these cooperative modalities can already be found in many bilateral agreements on competition policy between various member countries such as the United States and the European Union. Unfortunately, agreements to cooperate in competition policy thus far appear to be a domain exclusive to developed economies with comparable economic status. Very few developing countries are involved in such agreements.

Some developing countries have questioned the effectiveness of a cooperative framework on a voluntary basis. Since very few developing countries possess the required skills, information and resources to enforce competition laws, competition authorities in developed countries will be less willing to cooperate with counterparts that are unable to offer reciprocal benefits. More importantly, developing countries are very rarely the source of cross-border anti-competitive practices since the size of their firms is often too small to dominate the global market. Thus, the possibility of a developed country being harmed by practices of private companies operating in developing country territory is extremely unlikely. If such a case does occur, developed countries are unlikely to be in the position to request competition authorities in developing countries to enforce the law on their behalf. Due to the asymmetry in the benefits that arise from cooperation, developing countries are likely to be treated discriminatorily under a voluntary scheme.

It was proposed that cooperation should have two tracks. The first track concerns general cooperation or cooperation involving non-trade-related anti-competitive cases, which should be on a voluntary basis. This type of cooperation should not require a national competition law and authority. Individual members should reserve the freedom to decide when they would want a competition law and authority, and thus to participate in multilateral cooperation.

[52] Negative comity principles are designed to avoid conflicts between the enforcement of different national competition laws. It implies that in the case of a transnational violation of competition law, a competition authority in a particular country may refrain from enforcing the law and leave it to the authority of a foreign country, where a significant interest of that country might be affected. In return, the competition authority in the foreign country would take into consideration the interests of the country practicing a negative comity. In contrast, a positive comity agreement refers to a situation in which a competition authority in a country harmed by cross-border anti-competitive practices would request another competition authority that is better placed to tackle the violation to carry out an investigation of the case. The positive comity principle requires highly developed and competition regimes with comparable substantive and procedural provisions.

The second track involves cross-border issues, in particular hard-core cartels. Cooperation along this track should be binding, as a non-binding alternative is unlikely to be able to solve the problem. Thus, a binding framework could be limited to trade-related aspects of competition, that is, cartels. The proposal stressed that without the assurance of clear and concrete benefits from a multilateral cooperative framework, developing countries would be reluctant to accept obligations to promulgate and enforce national competition laws.

At the same time, however, certain developing countries were apprehensive about a binding commitment to cooperate, as they were afraid that their competition authorities could be bombarded with requests from their counterparts in more advanced countries for information and assistance in investigation. Although, as mentioned above, firms from a developing countries are rarely involved in cross-border cartels, but foreign cartels may be operating secretly in developing economies to avoid the surveillance of the competition authorities in countries where they reside. It is therefore feasible that competition authorities in developing countries could be flooded with requests from their (more active) counterparts in the developed countries for assistance in the latter's investigations against cartels operating in their territories.

In the light of the obvious resource constraint that poorer countries face, should an MFC include a binding commitment to cooperate, certain special and differential treatment for developing members must be provided to ensure that compliance will not be overly burdensome for developing countries.

4. Support for progressive reinforcement of competition institutions in developing countries (Doha Declaration, paragraph 25)

Technical assistance and capacity-building is an agenda advocated by developing countries. This is because many developing countries either still do not have a competition law or face implementation problems. Thus, much technical assistance and capacity-building will be required to build technical expertise in competition analysis and effective enforcement of a competition regime in developing countries.

There was a clear WGTCP consensus that technical assistance and capacity-building would be necessary in order to strengthen institutional capacities in developing countries. It was agreed that such assistance should be long-term and tailored to the specific needs of member countries. Single programmes lasting several days, or conferences that focus mainly on general issues concerning competition law and policy are mainly ineffective since the materials presented cannot be applied at the practical level.

It was also mentioned that assistance should be aimed at building the ability of developing countries to sustain training on their own. That is, training should be tailored to training the trainers. The curriculum used for training should also be in local language and tailored specifically to the local environment. Case-specific studies have proven to be one of the most effective training modes. Better coordination among different donors was also called for. It was proposed that international

organizations such as UNCTAD could help in taking stock and coordinating bilateral assistance to ensure that these programmes were complementary and did not overlap, or were redundant.

5. Flexibility and the needs of developing country members

Paragraph 25 of the Doha Ministerial Declaration states that "full account shall be taken of the needs of developing and least-developed country participants and appropriate flexibility provided to address them". The task of WGTCP is to clarify what kind of flexibility would meet the needs of developing countries.

Two types of flexibility were proposed and discussed in WGTCP. The first was the ability to exempt or exclude certain sectors or businesses from national competition laws or regimes, in order for members to achieve other national objectives such as social, economic and industrial development. It was also proposed, however, that exemptions and exceptions must be subject to transparent procedures and periodic reviews as mentioned above. The second type of flexibility referred to compliance transition periods. That is, developing countries without a national competition law, or those with such a law but who faced implementation problems, would be allowed an extended period for phasing in the introduction and implementation of competition legislation.

Questions were raised about both types of flexibility. With regard to exemptions and exceptions, certain members expressed concern that proliferation of exemptions and exception might undermine the value of a competition regime. Thus, it was proposed that "comprehensiveness" should be included among one of the core principles to ensure that a competition regime maintained an acceptable scope of application. Views were expressed that exemptions and exceptions provided for international cartels should not be allowed as those cross-border restrictive business practices did not have any justifiable defence, be it developmental, social or economic.

With regard to the transition period, certain developing countries suggested that it be linked to an individual member's level of development rather than be given a fixed period that appeared to be arbitrary. That is, like GSP where members would "graduate" from the special preferential tariff scheme as their incomes exceeded a certain threshold, flexibility in a possible MFC should also allow exemption of an individual member from obligations to continue until the level of that member's development reached a predetermined threshold.

6. Compliance mechanism

Several compliance mechanisms exist in WTO, ranging from the "softer" ones such as consultation, to binding ones that are subject to the dispute settlement understanding (DSU). Those that have been considered in WGTCP include consultation, peer review and DSU.

Consultation can be an effective means of solving disputes as it allows parties to attempt voluntary settlement of a dispute on their own, thus helping to screen cases

that will have to go through a formal DSU that is information intensive and time-consuming. As a result, members are required to consult each other and attempt to work out a solution before resorting to DSU. At the same time, consultation is also used without the backing of DSU for weaker obligations. Experience has shown that while consultation may prove to be an efficient means of settling disputes, its non-binding nature may lead to parties not taking it seriously.

Peer review is another compliance mechanism that has been used in WTO. This non-adversarial collegial review is supposed to serve as peer pressure to encourage members to put their best efforts into complying with non-binding obligations. Currently, the only peer review mechanism in use in WTO is the Trade Policy Review Mechanism (TPRM), which periodically assesses members' laws, regulations, procedures and institutions that mainly concern trade. The reviewing committee often consists of representatives from the WTO Secretariat, the country being reviewed and examiners that are normally drawn from the peer group. The review process involves the examination of documents submitted by members as well as investigation and examination. A report is then prepared by the Secretariat for dissemination.

DSU is the main pillar of WTO. The mechanism ensures that the rights and obligations of members are in keeping with provisions of the agreements. DSU provides for the establishment of a panel of experts to resolve disputes when consultations have failed to reach a solution. Panel decisions are binding and appeals procedures are available. Non-compliance with a dispute settlement body (DSB) decision may result in the suspension of concessions and, less commonly, compensation.

The discussion in WGTCP on the compliance mechanism thus far has focused mainly on the issue of core principles. As mentioned earlier, the European Union is a staunch advocate of having a binding commitment to core principles. Developing countries, in particular those without a national competition law and competition institution, are opposed to such a commitment. A suggestion was made that a possible way forward would be a general set of principles that were binding, and a set of detailed approaches for the application of such principles in the form of non-binding guidelines or a menu of options.

With regard to other issues including hard-core cartels, cooperation and technical assistance, the assumed compliance mechanism is non-binding as explained above. The European Union proposal includes a mechanism of consultation and voluntary cooperation on cross-border hard-core cartels. Technical assistance and capacity-building is assumed to be voluntary in nature since a precedence has not been set in WTO by a binding commitment in this area.

C. Will developing countries gain from a multilateral agreement on competition policy?

Can developing countries benefit from a multilateral agreement on competition policy? The answer, of course, depends on the framework and the modalities of the negotiation.

Briefly, developing countries will gain from an agreement that will effectively ban hard-core cartels, which are estimated to cost developing countries between US$ 20 billion and US$ 25 billion annually. This amount is almost double the amount of welfare gains that would accrue to developing economies in the case of a worldwide cut in agricultural subsidies by 50 per cent, which is estimated to be US$ 13.4 billion.[53] Thus, there is no doubt that if these large annual transfers of rents from consumers in developing countries to multinational companies in developed countries can be halted or minimized, the developing world would have much to gain.

According to the author's view, a call by developing countries for a WTO law that would ban transnational private cartels would be highly justified. WTO has done much to promote free trade, but very little to ensure fair trade in order to protect smaller members with little or no economic power. The minimal approach in dealing with cartels proposed by the European Union, which entails voluntary cooperation among competition authorities, will not guarantee any benefits to developing countries. In the end, developing countries may be forced to pass and implement a national competition law that will only serve to prosecute domestic cartels and ensure market access for foreign firms operating in their territories, while blatant cross-border, anti-competitive practices will continue unabated.

To ensure that the interests of developing countries are maximized, the five positions discussed below should be considered by WGTCP when considering a possible multilateral competition framework.

1. Core principles

Much of the attention in the working group has been devoted to discussing core principles advocated by the European Union. While it has been made clear that there is no intention to harmonize national competition policies, these principles can nevertheless be seen as the first step towards harmonization of national competition laws. While these general principles indeed have merits, introducing a multilateral agreement prescribing them is not necessarily in the interest of those members that (a) do not yet have a competition law, or (b) whose enforcement procedures do not yet comply with the core principles of non-discrimination, transparency and procedural fairness, due to institutional, resource or other constraints.

First, commitment to these principles would require a national competition law, although it has been proposed that a regional competition regime, such as COMESA,[54] would be workable. However, given that a regional regime is not an option for many members, a competition regime would normally require a national competition law. While a competition regime can certainly help promote competition in the domestic market, the decision regarding how and when a country would want to have such

[53] United Nations Conference on Trade and Development, 2003, *Back to Basics*, Chapter 5.

[54] The Common Market for Eastern and Southern Africa has drafted a regional competition regime, the COMESA Regional Competition Regulations and Rules, in order to ensure fair competition within the region and that the benefits from economic integration and trade liberalization do not accrue to a limited section of the economy.

a law should not be dictated by a multilateral agreement. Rather, it should be a sovereign choice. Competition law and policy is a complex subject. If the implementing authority does not have sufficient skills, resources, information or experience, the law can be easily be used by dominant or powerful private firms as a tool to secure their market shares rather than promote competition.[55] A badly set up competition regime may also fall victim to political influences that serve to protect the interests of powerful incumbents. Thus, having a national competition law is indeed not a panacea.

Second, although the core principles are desirable qualities of a competition regime, individual member States should be able to decide how and when to adopt them. By prescribing these principles, the multilateral framework would be imposing a regime developed by more advanced countries on less advanced countries, compliance with which could be very costly. The Doha Ministerial Declaration stated clearly that any multilateral agreement should not impose an excessive financial burden on less developed members.

Third, a commitment to the non-discrimination principle that applies to the nationality of companies rather than products may undermine ongoing, sector-specific negotiations in GATS. This is because GATS does not impose a non-discrimination principle as part of the general obligation; the condition is binding only when a member country makes a specific market access commitment to liberalize a particular service sector or subsector. Thus, developing countries should be made aware of the implications of a horizontal non-discrimination commitment to competition policy on their bargaining positions and interests in other issues.

Fourth, competition law is concerned with market access for business entities that have a commercial presence in the domestic market. Thus, it is directly related to investment. As there is no agreement yet in WTO on cross-border investment, a binding non-discrimination obligation based on the nationality of firms would be premature at this time.

2. Hard-core cartels and multilateral cooperation

The second meeting of WGTCP in 2002 was dedicated to the issues concerning hard-core cartels and voluntary cooperation. In the author's view, the aggregation of these two issues in a single meeting may have downplayed the importance of cross-border hard-core cartel problems. In addition, by bundling the two issues together, voluntary cooperation was taken as a given provision for dealing with hard-core cartels, thus foreclosing other better and more effective options. Nevertheless, the inadequacy of voluntary cooperation in dealing with international cartels was recognized by certain members and WTO "prohibition" of cross-border private cartels was proposed as an alternative provision. Unfortunately, there has not yet been an opportunity to explore it in greater depth in WGTCP.

[55] An incumbent may claim, for example, that competitors are pursuing predatory pricing and thus request the competition authority to issue an order to stop the price undercutting.

According to the author's view, much work has yet to be done on assessing the various options that would effectively deal with international cartels. For example, one may examine existing provisions in GATT that deal with quantitative restrictions, or in GATS that deal with private restrictive practices, and consider what can be done to increase the scope of their applications to cover private cartels. Alternatively, one can consider the possibility of foreign companies affected by cartels to have a legal standing in a court of another member country where those firms alleged to be involved in a cartel case are registered. This option is similar to TRIPs. Alternatively, as with the United States Foreign Corrupt Practices Act, bid rigging and price fixing may be treated as being equivalent to corruption and thus be considered illegal, regardless of where they may have taken place.

3. Technical assistance

While the discussion in WGTCP confirmed that technical assistance and capacity-building would be required for developing countries, and that such assistance should be long-term and tailored to the specific needs of member countries, there was no mention of a bound commitment. In fact, there has never been a bound commitment in WTO to providing technical assistance and capacity-building, despite the fact that those needs are well recognized by all members.

An example of a costly compliance is the TRIPs Agreement, whereby developing countries are obliged to pass internal laws that protect foreign intellectual property rights of patent holders, most of which are from the developed countries. While the agreement has already resulted in a massive transfer of rents from developing to developed economies in terms of royalty fees, the cost of promulgating the law, setting up the necessary institutions and enforcement has imposed additional costs that developing countries have had to bear in order to protect the interests of mainly foreign patent holders.

According to the author's view, a multilateral agreement should not impose the burden of compliance costs on developing members any more than it does on developed members. However, should a multilateral agreement in competition policy impose similar costly obligations in terms of passing and implementing competition laws, a "competition policy fund" earmarked for technical assistance and capacity-building should be established. How much funding developed countries would be willing to commit for an extended period should be part of the negotiation, and the commitment made should be binding.

4. Flexibility and the needs of developing members

As mentioned above, flexibility in a possible MFC has been referred to as (a) the ability of members to exempt or exclude certain sector or business from national competition law and (b) a transitional period allowed for developing members who do not yet have a competition law to implement. The latter type of flexibility has been labelled as "progressive" in WGTCP, in order to reflect a gradual implementation of a possible WTO obligation among developing members. The question is, will developing countries benefit from the proposed flexibility and progressiveness?

The author does not believe that the proposed flexibility and progressiveness will meet the needs of developing countries. First, progressiveness in the form of transition periods does not necessarily benefit developing countries if the substantive elements of the pending obligations are not in the interest of such countries. For example, the TRIPs Agreement required all members to comply with the substantive provisions by 1 January 1996. Developing and transitional countries were allowed a transition period up until 1 January 2000, while least developed countries have until 1 January 2006. The delayed compliance does not make the TRIPs any more agreeable to these countries as it simply defers the heavy cost burden to a later date. Similarly, if the obligation to pass a national competition law and adopt the proposed core principles is not to the advantage of developing countries to begin with, then transition periods, however long, would offer no advantage to developing countries.

As for the flexibility to exempt a particular sector or industry from the competition law, it is a two-edged sword. First, developing countries must recognize that exclusions and exemptions do not represent a special and differential treatment for them, since developed countries are also allowed to make exemptions. In fact, these exemptions may run against the interests of developing countries, when considering the fact that many developed countries exempt export cartels and, in some cases, international cartels (in particular, shipping cartels) from their national laws. Thus, continued cartel exemptions would undermine efforts to stamp out anti-competitive cartels, which is something that developing countries would hope to achieve in a possible MFC.

In the author's view, if exemptions and exceptions from national or regional competition law are allowed, those that concern cross-border collusive practices should not qualify. This is because allowing domestic firms to be involved in cross-border collusive practices that raise prices of products sold elsewhere (as long as it is not at home) is very much a "beggar thy neighbour" policy that only serves the interests of the exporting countries while being detrimental to global trade. Such practices should be outlawed in WTO to ensure that national competition regimes do not condone practices that have negative spillovers onto other member countries.

The author believes that meaningful, special and differential treatment for developing countries should entail non-reciprocal or unilateral commitments on the part of developed economies in order to effectively deal with cartels that originate in their countries. This could, for example, include a unilateral commitment on the part of developed members:

(a) To provide cooperation in assisting developing countries in the investigation and prosecution of cartels;

(b) To remove export/international cartel exemptions from national competition laws;

(c) To comply with core principles in enforcing the law; or

(d) To demonstrate "best efforts" in dealing with cartels that are found to harm other parties by employing administrative measures to sanction export and international cartels when such cartels are beyond the reach of national

competition law of the affected parties. A peer review could be conducted to monitor actual efforts taken.

5. Compliance mechanism

According to the European Union proposal, a possible MFC would include a binding commitment to core principles and non-binding commitments to other elements including cooperation and technical assistance. It is difficult to see how developing countries can benefit from the proposed compliance mechanism. Having a national competition law will by no means promote market access for developing countries. On the contrary, it would tend to promote market access by foreign multinationals located overseas.

If the European Union succeeds in making the core principles a binding commitment, developing countries will have to mobilize resources to comply with such an agreement without any secured technical assistance, capacity-building and cooperation from more advanced members, as these elements are non-binding. What is more worrying is that there appears to be no clear logic or principle in deciding which element of an MFC should be binding and which should be voluntary. The proposed compliance mechanism assigned to each specific issue appears to be selected arbitrarily without any clear objective. How does one decide on an "appropriate" compliance mechanism?

The lack of clarity has raised many questions concerning the proposed compliance mechanism. For example, what would a binding commitment to core principles hope to achieve – market access for foreign companies or fair cross-border trade? On which element should a peer review mechanism be used? Should it be used to review members' progress on the legislation and implementation of national competition laws? Or should it be used to review whether members have put in their "best efforts" in providing technical assistance and capacity-building, or in trying to discourage or discipline cross-border collusive practices (including export cartels)? Why is cooperation in dealing with cross-border cartels voluntary?

In the author's view, clear objectives of a possible MFC have to be established, and different objectives need to be prioritized. Since WTO is very much a trade forum, despite the fact that non-trade issues such as intellectual property rights have managed to enter its domain, the strongest provisions should apply to elements with the strongest trade component. Elements that have only secondary links to trade, i.e., those that are considered "behind the border" issues, which concern domestic rules and regulations more so than trade, should have weaker compliance provisions. According to this logic, then, a binding commitment on cross-border cartels would be most appropriate, while on the core principles it should be voluntary.

6. Conclusions

The author believes that competition law *per se* does not have a place in WTO, and that the important issue should be the trade-related dimension of competition law and policy, i.e., cross-border anti-competitive trade practices, and in particular international

and export cartels. The question that should be addressed is how a multilateral agreement can help solve cross-border anti-competitive practices such as price-fixing cartels that are beyond the reach of national competition authority.

Competition law and policy is a complex subject, particularly for member countries that do not yet have such a law. Thus, developing countries are suspicious that the underlying agenda would be more about developed countries' investors seeking access to the markets of developing countries by meddling with the domestic regulatory regime, rather than a genuine commitment to establishing fair cross-border trade. If that is the case, then developing countries would need to do their homework in order to be able to counter the proposals currently on the table, to ensure that the framework and modalities are consistent with their interests.

D. Options for developing countries going forward

At the Fifth Ministerial Meeting in Cancun in September 2003, members will have to decide whether they want to include competition policy in the list of issues that will be negotiated in the next Round. There is very little time remaining and thus the following options should be considered: (a) a decision not to negotiate and to maintain the status quo; (b) continue exploring a possible MCF; or (c) a decision to negotiate.

1. Maintaining the status quo

If members cannot come to a consensus on the modality of the negotiation by the time the Fifth Ministerial Meeting takes place, competition policy will not enter the next round of the WTO negotiation. What this means is that developing countries will have no obligations related to the legislation and enforcement of a national competition law. At the same time, however, international cartels will continue to operate unabated, which means that consumers in developing countries will continue to pay billions of US dollars for overpriced imports due to cartel activities. Indeed, the status quo is definitely worrisome.

2. Continue to explore a possible MCF

There is no doubt that much more technical assistance and capacity-building in this area are required, so that developing members may better evaluate the implications of closer multilateral cooperation, or a multilateral rule regarding competition policy as stated in paragraph 24 of the Doha Agenda. Thus, the option of not abandoning the issue altogether, but instead extending the period required for members to develop a deeper comprehension of the various issues discussed would seem to be ideal. It is undeniable that since competition policy entered WTO in 1996, members that do not yet have a competition law, or are not enforcing one, have become much more aware of competition law and policy. Therefore, it would be a loss to halt the current momentum.

However, those who are advocating having competition policy included in the next round of negotiations are concerned that as WGTCP has spent six years exploring the issue, it would difficult to justify a further extension. In addition, if competition policy is not made a part of the coming negotiations, it would be decades before any substantive agreement on this issue could be expected from the subsequent rounds of negotiation.

3. Agree to negotiate

Although there appears to be no clear consensus in WGTCP on the modalities at this time, as the deadline approaches things may change more rapidly than expected. The reality is that competition policy is only one of several issues on the table. It may only be a bargaining chip used in the negotiations on other key issues, in particular agriculture. What this means is that developing countries may agree in the end to enter into negotiations on competition policy in exchange for more favourable concessions in other issues, say, agriculture. However, the author would again like to stress that international cartels can be just as costly to developing countries, if not more costly, as agricultural protection. Thus, developing countries should make their best efforts to ensure that the modalities for negotiation in competition policy are in their best interests. Competition policy need not be a developed country's agenda if the developing world can participate effectively in setting that agenda. This paper has attempted to point out ways in which competition policy in WTO can become a developing country's agenda.

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Annex

Doha Declaration: Interaction between trade and competition policy (paragraphs 23-25)

23. Recognizing the case for a multilateral framework to enhance the contribution of competition policy to international trade and development, and the need for enhanced technical assistance and capacity-building in this area, as referred to in paragraph 24, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations.

24. We recognize the needs of developing and least-developed countries for enhanced support for technical assistance and capacity-building in this area, including policy analysis and development, so that they may better evaluate the implications of closer multilateral cooperation for their development policies and objectives, and human and institutional development. To this end, we will work in cooperation with other relevant intergovernmental organizations, including UNCTAD, and through appropriate regional and bilateral channels, to provide strengthened and adequately resourced assistance to respond to these needs.

25. In the period (up) until the Fifth Session, further work in the Working Group on the Interaction between Trade and Competition Policy will focus on the clarification of: core principles, including transparency, non-discrimination and procedural fairness, and provisions on hardcore cartels; modalities for voluntary cooperation; and support for progressive reinforcement of competition institutions in developing countries through capacity-building. Full account will be taken of the needs of developing and least-developed country participants, and appropriate flexibility (will be) provided to address them.

VII. TRANSPARENCY IN GOVERNMENT PROCUREMENT IN THE CONTEXT OF THE DOHA DEVELOPMENT AGENDA

By Bisweswar Bhattacharyya[*]

Introduction

The complex socio-economic dimensions of government procurement are possibly the reasons for its exclusion from the discipline of GATT. Article III.8 of GATT provides exemption for purchases of goods by governments for their own use. In addition, GATT Article XVII.2 provides the same exemption when purchases are made through state trading enterprises. Government procurement came under GATT through a plurilateral arrangement. An Agreement on Government Procurement was negotiated under the Tokyo Round of Multilateral Trade Negotiations, which came into effect on 1 January1981 and had only 12 signatories. The Agreement provided for signatory countries to extend MFN treatment in government procurement to other signatories. The Agreement also provided for national treatment and rules on transparency.

An identical status continued under GATT 1994 and GATS (Article XIII.1). The earlier accord was brought into WTO through a plurilateral Agreement on Government Procurement (GPA) under the Uruguay Round. Plurilateral means that this is outside the single undertaking provision while GPA applies only to those WTO members who explicitly accept it.

The first WTO Ministerial Conference held in December 1996 at Singapore provided a mandate to seek a multilateral agreement on transparency in government procurement (paragraph 21):

> "We further agree to establish a Working Group to conduct a study on transparency in government procurement practices, taking into account national policies and, based on this study, to develop elements for inclusion in an appropriate agreement".

Accordingly, WTO set up a Working Group on Transparency in Government Procurement (WGTGP). The Doha Ministerial Conference took the following decision:

> "Recognizing the case for a multilateral agreement on transparency in government procurement and the need for enhanced technical assistance and capacity-building in this area, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations. These negotiations will build on the progress made in the Working Group on Transparency in Government Procurement

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by that time and take into account participants' development priorities, especially those of least-developed country participants. Negotiations shall be limited to the transparency aspects and, therefore, will not restrict the scope for countries to give preferences to domestic supplies and suppliers. We commit ourselves to ensuring adequate technical assistance and support for capacity-building, both during the negotiations and after their conclusion".

It should be noted that the mandate is very limited in its scope. Negotiations will have to be restricted to transparency rules and not include market access. However, better transparency rules may have an indirect beneficial impact on market access (box 1).

Box 1. Impact of transparency on market access

The channels through which this can work include:

(a) Supporting existing policies limiting discrimination (under national law or regional agreements), by making discrimination difficult to conceal;

(b) Improving access by foreign suppliers to procurement that is already open (for example, by improving information);

(c) Supporting future market-opening negotiations, by providing market information and making it difficult to conceal discrimination that contravenes future commitments;

(d) Controlling corruption (which both limits the impact of market-opening measures and operates as a distinct barrier to trade); and

(e) Disseminating and developing technical knowledge.

Source: Sue Arrowsmith, "Reviewing the GPA", *Journal of International Economic Laws*, December 2002.

A. World Trade Organization Agreement on Government Procurement

During the Uruguay Round (1986-1994), the GPA negotiated in the Tokyo Round was renegotiated. The new Agreement, which came into effect on 1 January 1996, is plurilateral and open only to WTO member States.[1]

The member countries currently include: Canada; the European Union member States; Hong Kong, China; Iceland; Israel; Japan; Liechtenstein; Norway; Singapore; the Republic of Korea; Switzerland; and the United States. An important development

[1] For a comprehensive discussion on GPA, see Hockman and Marroidis (eds.), 1997, *Law and Public Policy in Public Purchasing: the WTO Agreement on Government Procurement*, University of Michigan Press. For the text, see the World Trade Organization web site at www.wto.org.

is the increasing number of countries/areas that have applied for accession including Albania, Bulgaria, Estonia, Jordan, Kyrgyzstan, Oman and Taiwan Province of China. The reason for the increased interest lies, at least partially, with the pressures from outside, apart from the economic costs and benefits of GPA membership. It has been reported that some GPA members have demanded accession to the GPA as a condition for WTO membership applicants. In addition, the European Union requires its new members to join the GPA.

1. Objectives

The GPA preamble states:

> "... That laws, regulations, procedures and practices regarding government procurement should not be prepared, adopted or applied to foreign or domestic products and services and to foreign or domestic suppliers so as to afford protection to domestic products or services or domestic suppliers, and should not discriminate among foreign products or services or among foreign suppliers;
>
> "... That it is desirable to provide transparency of laws, regulations, procedures and practices regarding government procurement".

The Agreement, therefore, seeks to provide non-discriminatory treatment to foreign suppliers and establish transparency at all stages of the procurement process.

2. Scope and coverage

With regard to scope and coverage, the GPA includes the following principal features:

- It applies to all laws, regulations, procedures and practices regarding any procurement by entities subjected to the GPA. (entities are not defined but are listed);
- Procurement covers all contractual forms, such as purchase, hire purchase, leasing etc.;
- Procurement by listed entities is subject to GPA discipline only if the threshold level as defined in the Agreement is exceeded.
- In the case of procurement of goods, all are covered unless otherwise specified in the GPA Annex. Defence-related procurement of goods is based on a positive list.
- The positive list approach is also applicable to the procurement of services.

3. Transparency in GPA

The transparency rules, in a broader sense, of the GPA provide that procurement is made through a tendering system. It is normally believed that a tendering system, especially the open and selective type, fosters competition and ensures cost effectiveness

of procurement and transparency. The GPA accordingly favours those types of tenders. Article VII and Article XV are the relevant provisions.

(a) Article VII: Tendering Procedures

- Each Party shall ensure that the tendering procedures of its entities are applied in a non-discriminatory manner and are consistent with the provisions contained in Articles VII through XVI.
- Entities shall not provide to any supplier information with regard to a specific procurement in a manner that would have the effect of precluding competition.
- For the purposes of this Agreement:

  (a) Open tendering procedures are those procedures under which all interested suppliers may submit a tender;

  (b) Selective tendering procedures are those procedures under which, consistent with paragraph 3 of Article X and other relevant provisions of this Agreement, those suppliers invited to do so by the entity may submit a tender;

  (c) Limited tendering procedures are those procedures where the entity contacts suppliers individually, only under the conditions specified in Article XV.

(b) Article XV

Article XV allows limited tendering, under specified conditions, provided that it is not used with a view to avoiding maximum possible competition, or in a manner that would constitute a means of discrimination among suppliers of other parties or provide protection to domestic producers or suppliers.

There are several other provisions in the GPA that are directed towards transparency. These include:

- Article VIII (a) – qualification of suppliers
- Article IX. I – invitation to participate regarding intended procurement
- Article IX.6(f) – invitation to participate regarding intended procurement
- Article XII.2 – tender documentation
- Article XVIII – information and review as regards obligation of entities.

These provisions have four main aspects:

- Providing contract information to potential bidders at a proper time in an accessible manner.
- Prior information on contract award criteria and procedures.

- Developing a rule based system that limits discretion.
- The procedure for seeking information on whether the set rules have been observed.

B. Transparency under GATT and GATS

Article X of GATT 1947 (publication and administration of trade regulations) provides the obligations of the contracting parties in terms of transparency that, inter alia, may cover government procurement. The major obligations are:

- Article X.1. Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to the classification or the valuation of products for customs purposes, or to the rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments thereof, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them;
- Article X.2. No measure of general application taken by any contracting party effecting an advance in a rate of duty or other charge on imports under an established and uniform practice, or imposing a new or more burdensome requirement, restriction or prohibition on imports or on the transfer of payments transfer, shall be enforced before such measure has been officially published.

The GATT provision, in contrast to GPA, does not impose any obligation with respect to business opportunities or specific contract information. Similarly, firm-specific decisions are not covered under Article X. An exception is also provided to allow non-disclosure of confidential information that would impede law enforcement or otherwise be contrary to the public interest, or would prejudice the legitimate commercial interests of particular enterprises, public or private (Article X.1).

1. State trading enterprises

Article XVII of GATT deals with state trading enterprises but substantially circumscribes the obligations for "imports of products for immediate or ultimate consumption in governmental use". With regard to such imports, "fair and equitable treatment" is to be accorded. It has been observed that such treatment can be considered as equivalent to transparent treatment.

Article XVII contains an obligation to provide information, on request from a trading partner having substantial trade interest in the product concerned, on import mark-up or prices subject to the general exception of being prejudicial to public interests or legitimate commercial interests.

The understanding of the interpretation of Article XVII of GATT 1994 has introduced some obligations directed towards greater transparency. In addition, a Working Party has been set up on state trading enterprises.

2. Transparency in GATS

There is a generalized transparency provision in GATS (Article III) that covers all services as well as modes of supply. The provision broadly provides for:

(a) The publication of all "relevant measures of general application that pertain to or affect the operation" of the Agreement. There is no exemption for government procurement. If publication is not practical, information will be made available publicly by other means;

(b) A prompt response to all requests for specific information;

(c) Promptly informing WTO, at least annually, of the introduction of any new laws, regulations or administrative guidelines or changes to existing laws, regulations or administrative guidelines that significantly affect trade in services as covered under GATS;

(d) Establishing an inquiry point(s) to provide specific information upon request on items covered under item (c) above.

3. Transparency in the proposed Agreement

There is a fundamental difference in the way that transparency is seen in GATT/ WTO and the way that it can be seen in the proposed Transparency Agreement. A WTO note observes that the focus in procurement "is on transparency as such, rather than on transparency as a vehicle for monitoring market access commitments" as is the case in GATT Article X.

C. Government procurement markets

1. Estimated size of government markets

Data on government procurement markets are both scarce and non-standardized. It was estimated that the GPA opened up business worth some US$ 350 billion through government contracts for international biding. This was considered a tenfold rise over contracts subject to the preceding GATT Code. This estimated market is obviously only a part of the total government procurement market, since the GPA covers specified entities and contracts above specified threshold levels. In addition, these are other exceptions.

The most comprehensive attempt at standardized quantification of the government procurement markets was made by OECD in 2002 (box 2).

Box 2. Importance of government procurements

Government at the central and subcentral levels as well as state-owned enterprises is a significant purchaser of goods and services, and thus represents huge opportunities for international trade. While the largest opportunities, in value terms, arise in the industrialized countries, emerging economies also offer markets with considerable potential. Few studies are available on the quantification of government procurement markets, and their results are not necessarily comparable as they use different definitions of procurement.

The broad conclusions of the OECD study[56] were:

- In 1998, for OECD countries as a whole, the share of total procurement (consumption and investment expenditures) for all levels of Government was an estimated 19.96 per cent or US$ 4,733 billion while for non-OECD countries (106 was the sample size) it was 14.48 per cent or US$ 816 billion.
- The value of potentially contestable government procurement market for OECD in 1998 was estimated at US$ 1,795 billion (7.57 per cent of GDP) and for non-OECD countries at US$ 287 billion (5.1 per cent of GDP).
- Benchmarked against world trade in goods and services, the value of the worldwide contestable part of the government procurement market in 1998 was estimated at 30.1 per cent of the global merchandise and services trade.

These figures reveal that if an internationally acceptable transparency agreement on government procurement is negotiated, it will apply to a much larger market segment than what is currently covered under the GPA.

Hoekman attempted to quantify the value of business covered under the GATT Code based on data notified by the 20 signatory countries during 1983-1992. He estimated total purchases at US$ 62 billion in 1992, representing 0.42 per cent of GDP of the countries concerned.

Francies and others estimated the value of government procurement in the United States under the GATT Code, using SNA-based data for 1992-1993, at US$ 1.1 trillion, which amounted to 18.3 per cent of the GDP of the United States.

2. Implications for Asia-Pacific countries

The OECD study referred to above is the only one that has estimated the government procurement for a large sample of countries. Summary estimates are shown in table 1 and detailed national data for developing Asian countries included in the OECD sample are given in table 2.

[56] Technical notes on the methodology used in making the estimates are given in annexes II to IV of the study.

Table 1. Value and ratios of contestable government markets

Category	OECD		Non-OECD	
	Percentage of GDP	Value (US$ billion)	Percentage of GDP	Value (US$ billion)
General government	7.57	1 795.3	5.10	287.7
Central government	1.75	415.0	–	–

Table 2. Government procurement ratios in non-OECD countries/area

General government	Percentage of GDP			1998 GDP (US$ billion)
	Total expenditure	Excluding compensation[a]	Excluding compensationa and defence[b]	
Hong Kong, China	11.00	4.81	–	166.45
India	13.29	6.18	4.46	420.31
Kyrgyzstan	21.60	12.88	–	1.87
Pakistan	16.29	10.03	–	64.13
Philippines	14.29	7.38	–	82.24
Sri Lanka	17.42	9.82	8.48	15.70
Thailand	17.31	10.72	–	117.04

[a] Compensation to employees.

[b] Defence-related procurements.

An analysis of these data reveals that while, in absolute terms, the government procurement market in developing Asia may not be very high, in proportionate terms the importance is significant. For example, in Pakistan, Sri Lanka and Thailand, the percentage share (inclusive of defence) is almost equal to 10 per cent of GDP. In comparison, the average share in OECD is only 7.57 per cent. Therefore, potentially, a transparency agreement will have a greater coverage, proportionately, in those countries as well as in most other countries of Asia, compared with developed countries.

D. Issues raised in the Working Group on Transparency in Government Procurement

1. Background

The Singapore Ministerial Conference held in December 1996 decided to set up a Working Group "to conduct a study on transparency in government procurement practices, taking into account national policies, and, based on the study, to develop elements for inclusion in an appropriate agreement". The Doha Ministerial declaration states that, inter alia, negotiations for a multilateral agreement on transparency in government procurement will "build on the progress made in the Working Group ..."

WGTGP has met several times in the past six years. The major issues raised and points made were listed by the WGTGP Chairman in an informal note in 1999. They included:

- Definition and scope
- Procurement methods
- Information on national legislation and procedures
- Information on procurement opportunities, tendering and qualification procedures
- Time periods
- Transparency of decisions on qualifications and contract awards
- Domestic review procedures
- Other matters related to transparency
- Information to be provided to other governments (notification)
- WTO dispute settlement procedures
- Technical cooperation
- S and D treatment for developing countries.

2. Issues raised in the Working Group on Transparency in Government Procurement

WGTGP discussions have been wide-ranging as was expected during the study phase of the Working Group. Although very little has materialized in the form of a consensus on specific issues, greater clarity has emerged on the nature of the issues involved.[57]

(a) Definition and scope

For the purpose of the study phase, there has been a general acceptance that a "broad conception, without preconceived limitations" could be employed, subject to the understanding that the focus of the work is on transparency.

Coming to definition and scope for the purpose of rules that might be negotiated, two major points have emerged concerning:

(a) Whether a definition should be employed based on the language used in GATT and GATS; and

[57] This subsection is based on two documents prepared by the World Trade Organization: "Work of the Working Group on the Matters Related to Items I-V of the List Issues Raised and Points Made" (WT/WGTGP/W/32), 23 May 2002, and document No. W7/WGTGP/W/33, 3 October 2002, which covers items VI-XII.

(b) Whether the scope of contractual arrangements entered into by government entities should be considered to constitute government procurement.

In the case of (a), the view has been expressed that GATT Article III.8 and GATS Article XIII.2 may provide the basis for developing an appropriate definition. However, mere referencing might not be adequate. In the case of (b), the general view is that all contractual means, such as purchase, rental, leasing etc., should be covered. The most contentious issue is the extent to which concessions and build-operate-transfer (BOT) contracts should be covered and, if covered, how they should be defined.

Another major issue is the extent to which government procurement should fall within the scope of commitments on transparency in government procurement. Five main points were raised, on which divergent views were expressed. The points are discussed below:

(a) With regard to whether the rules should apply to all or only some government entities, the views expressed varied between the inclusion of all government entities (including those at the subcentral level) to only central government entities. It was also suggested that the coverage of subcentral entities by developing countries with federal government structures could be a subject for S and D treatment.
Different views were also expressed on the extent to which procurement by state trading enterprises should be covered with reference to Article XVII of GATT;

(b) On the coverage of goods and services, one view was that the proposed Agreement should cover both, while the other view was that coverage should be confined to goods, as services were covered under the work programme of services.
However, it was pointed out that the Singapore Mandate did not make any distinction between goods and services. Moreover, it was noted that, in many cases, the procurement of goods and services were closely linked;

(c) Another important point was that of the possible use of threshold values for determining coverage. The following views on this subject were expressed:

(i) The rules of a Transparency Agreement would not result in burdens that might necessitate the application of thresholds;

(ii) The use of thresholds could be reserved for only in those cases where burdens might be disproportionate to the potential benefits;

(iii) There should a minimum threshold below which a Transparency Agreement would not be applicable;

(iv) Such thresholds might be a subject for S and D treatment.

(d) On the question of whether procurement that was not open to foreign competition should be covered by the Transparency Agreement, one view

was that it was not a legitimate concern of an international agreement while the opposite view was that foreign firms had an interest in being aware of contracts in which their participation was debarred;

(e) There was discussion on whether the proposed Agreement should have a general exception clause along the lines of GATT Articles XX and XXI. While there was no unanimity, a view was also expressed that exceptions might be necessary to responding to social and developmental objectives, including procurement for public distribution system and domestic stabilization programmes. It was observed that these objectives need not be inconsistent with the objective of transparency.

(b) Procurement methods

The view that the member States should retain flexibility in the use of different procurement methods has received broad acceptance. Efforts should be directed towards ensuring transparency in the choice and use of the methods being followed rather than focusing on the conditions governing the use of a specific procurement method. However, there was a general view that limited tendering was inherently less transparent and detailed rules might therefore be required to minimize its use.

With regard to rules that might be negotiated on procurement methods, it was observed that there should be:

(a) A requirement for each member to specify in its national legislation the circumstances under which procuring entities may use different procurement methods;

(b) An obligation to ensure compliance by the entities concerned; and

(c) A general commitment that, irrespective of the method used, transparency would be maximized, to the extent possible, at each stage of procurement.

With regard to limited tendering, it was observed that "spelling out the exact circumstances and conditions justifying the use of this type of method might go beyond the scope of a Transparency Agreement and impinge upon the ability of procuring entities to use the most appropriate procurement method in the circumstances of each case". It was also observed that the additional burden might be disproportionately high in the case of limited tendering because many of the contracts would be low-value contracts.

On the use of direct negotiations between the supplier(s) and the procuring entity, it was observed that there should be flexibility in terms of its use, subject to transparency being observed.

(c) Publication of information on national legislation and procedures

Discussions centred on (a) the type of information to be made available and (b) the modalities for making it available. In the case of (a), the general view was to provide for publication of, or public accessibility to, laws and regulations. Inconclusive

discussions were also held on what other information might be covered under the publication obligation as well as the burdens and the costs of providing such additional information. It was suggested that one alternative was to ensure the availability of substantive information rather than focusing on its legal form.

With regard to (b), two approaches came out of the discussions. One approach was to require the publication of information in readily accessible media. The other was to require that information was readily accessible, without specifically requiring its publication. The advantage of the latter approach was presumed to be a reduced burden. In the case of electronic media usage, the general view was that it should be left to the members to decide.

One important issue was the language in which information was to be provided. The general view was that the obligation was to provide it in the national language.

Another important point was raised with regard to addressing the issue of whether there should be an "enquiry point" from where the required information could be obtained by foreign suppliers. It was observed that any requirement of an enquiry point should be without prejudice to the decentralized procurement system under a federal structure.

(d) Information on procurement opportunities, tendering and qualification procedures

The discussions generally endorsed the importance of timely, sufficient information on procurement as the basis of transparency. Such information should be sufficient for suppliers to assess their interests and submit bids, if they desired to participate.

In terms of the specific information to be provided, three alternatives emerged:

(a) To include a specific list of minimum requirements;

(b) To provide an illustrative list;

(c) To rely on general principles with no requirement for a description.

A crucial issue was the bid evaluation criterion with respect to preferences for national suppliers or any other measure that favoured domestic supplies or suppliers. In that regard, the following views were expressed:

(a) While the nature and extent of such preferences was not within the scope of WGTGP, advance provision of information on such preferences was essential for transparency;

(b) The rules on information should apply only to cases where foreign suppliers were eligible to participate.

In addition, there were two views concerning making information available internationally. One view was that there should be no obligation as foreign suppliers were supposed to maintain awareness of business opportunities. The other view was that efforts to disseminate information should be commensurate with the interest that a particular contract might generate.

As to the applicability of prior information to selective and limited tendering methods, the following opposing views were expressed:

(a) Some basic information should be provided, irrespective of the method of tendering;

(b) A prior information obligation should apply only to open tendering.

On the subject of specifications, two contrasting views were expressed. One view was to question its relevance to a transparency agreement. The other view was that specifications should be provided, preferably based on international standards, in a clear and objective manner.

(e) Time scale

There was broad agreement that the provision on the time scale should be formulated in terms of setting periods of time rather than prescribing minimum periods.

It was observed that: (a) the time scale should be sufficient for a supplier to seek information and submit bids; (b) there should be no discrimination between domestic and foreign suppliers with respect to time periods; and (c) specifying time periods in tender documents and making known any subsequent change to all would further transparency. One opposing view was a query as to whether time scales were relevant to the issue of transparency.

(f) Transparency of decisions on qualifications

Discussions centred on (a) qualification criteria, (b) lists of qualified suppliers and (c) the provision of information on qualification decisions.

With regard to qualification criteria, it was stressed that to ensure transparency, decisions on qualifications of suppliers should be taken only on the basis of criteria, identified and established at an early stage, and disclosed to suppliers sufficiently in advance. As to the application of qualification criteria, it was observed that these should be applied in a non-discriminatory manner even if discriminatory treatment in favour of domestic suppliers was built into the criteria. The opposing view was that application of the principles of objectivity and non-discrimination to pre-qualification criteria was outside the concept of transparency.

There was broad agreement that the system followed on listing qualified suppliers should not foreclose inclusion of new suppliers.

Concerning the provision of information, it was observed that the basis for, and process of, selection should either be publicly available or available on request. Procuring entities should, on request, provide unsuccessful suppliers with the reasons for their non-selection.

An opposing view was that providing ex-post information could be impractical in developing countries, especially when a large number of suppliers were involved.

(g) Transparency of decisions on contract awards

Discussions in WGTGP stressed the importance of evaluation criteria transparency. Such criteria should be clear, capable of objective evaluation, pre-established, and communicated and applied non-discriminately. However, it was also observed that a Transparency Agreement would not, as a rule, set out what these criteria should be. Importance was also attached to following the proper procedure for the receipt and opening of tenders in order to make manipulation difficult as well as prevent individual bidders from acquiring commercial information on other bidders on a preferential basis.

With regard to the provision of ex-post information, one suggestion was that contract award decisions might be made publicly available, at least in the case of less transparent methods of procurement. Other suggestions included leaving it to the national practices or, upon request, provide unsuccessful bidders with more detailed information about the reasons for their failure and why the award being given to the winning bidder. An opposing view was that providing such information might be burdensome and, in some cases, inconsistent with national practices.

However, it was generally agreed that information considered confidential, on the grounds of commercial or public interest, should be treated as such.

(h) Domestic review procedures

Review procedures lie at the centre of the transparency requirement in public procurement. Discussions in the Working Group revealed broad agreement that domestic review procedures fell within the domain of domestic legislation and that the primacy of national legislation should be maintained.

There were, however, opposing viewpoints as to how the issue needed to be addressed. Proponents who argued for the inclusion of this provision referred to the important role it played in ensuring overall transparency and enforcement of underlying rules. They pointed out that review procedures also helped in introducing due process and public accountability. In response, it was observed that no such provision should be included in the Transparency Agreement because a domestic review process was in place for the purpose of public accountability at the domestic level. Further, this went beyond the concept of transparency. One proposal envisaged leaving the choice of review procedure to individual members, provided the review mechanism itself was transparent and independent. Another view was that such provisions should be restricted to providing information on the national review mechanism and procedures.

An important issue deliberated in the Working Group was related to remedies. It has been observed that the review provision should allow remedies for protection of the interests of the suppliers and for ensuring compliance by the entities of the provisions on national review mechanism and procedures, as incorporated in the Transparency Agreement.

In contrast, it was observed that the remedies provision fell outside the Transparency Agreement. In addition, it was felt that a strong provision might result in restricted access to foreign suppliers, as entities might feel constrained.

An extremely important issue was whether the WTO dispute settlement system should apply to obligations for domestic review. In this connection, the distinction between the domestic review mechanism, which involves suppliers and the procurement entities under the law of a country, and dispute settlement between governments under the law and procedure of WTO was emphasized. A view was expressed that the WTO dispute settlement should only be applied in respect of obligations of governments in their capacity as regulators, that is, issues related to the consistency of laws of general application within the rules of a Transparency Agreement, and not to decisions on national review procedures concerning a specific public procurement. Another view was expressed that the provision should reflect the principle of exhausting the domestic judicial review process before making recourse to the WTO dispute settlement system.

(i) Other matters relating to transparency

One important subject discussed was related to the use of information technology to provide tender information in a cost-effective way. However, despite the obvious advantages, a view was expressed that given the wide disparity in the stages of information technology development among the members, the use of such technology could be disadvantageous to small and medium-sized enterprises in developing countries. One suggestion for taking care of this problem was that the use of information technology might be promoted in the Transparency Agreement by using a best endeavour clause.

With regard to language, it was broadly agreed that information on procurement opportunities needed to be provided in each member's official language. However, certain types of information, such as the notification of enquiry points, dispute settlements or consultations should be made in an official WTO language.

On the issue of bribery and corruption, a view was expressed that transparency could be used to reduce the incidence in government procurement. In response, it was observed that transparency, by itself, was not enough. Another view was that no explicit linkage should be made in the Transparency Agreement between transparency and corruption, and bribery, which should be dealt with through domestic legislation.

(j) Information to be provided to other governments

The issues discussed included, inter alia, notification of national legislation, the provision of information on national legislation and procurement practices on request from members, and statistical reporting.

On the important issue of enquiry points, it was suggested that each member establish enquiry point(s) and provide notification of their availability. However, it was observed that since the establishment of a single enquiry point would necessitate "close coordination among a large number of departments and agencies, it might present some difficulties....."

On statistical reporting, it was observed that such reporting should be voluntary.

(k) World Trade Organization dispute settlement procedures

It was observed that the WTO dispute settlement system applied to its transparency provisions, such as Article X of GATT. Three of the draft texts of an agreement suggested following the provisions of GATT Article XXII and XXIII and GATS Articles XX and XXIII, as elaborated in the Rules and Procedures Governing the Settlement of Disputes under WTO Agreements.

The opposing view was that subjecting a Transparency Agreement to dispute settlement would not be necessary if its obligations were of the best endeavour type. Another view was that if the WTO dispute settlement system has to apply, it would be necessary to make the Transparency Agreement a part of the single undertaking. One important point made was a question concerning the application of dispute settlement procedures in the absence of any market access commitments. A view was also expressed that it would be premature to consider this issue before the elements of the agreement had been more clearly identified and the rules prescribed.

(l) Technical cooperation and special and differential treatment for developing countries

a. Technical cooperation and capacity-building

Since compliance with the provisions of the proposed Transparency Agreement might necessitate amendments in national laws, rules and regulations as well as the setting up of new institutions, technical assistance for capacity-building would be required. Several areas where support might be needed were identified, including:

- The development and improvement of national legislation and procedures;
- Institution building;
- The provision of access to information for suppliers (including the establishment of enquiry points), particularly developing country suppliers, as to what entities in developed countries usually procure;
- The provision of information on national legislation and procedures;
- The application of information technology including assistance related to hardware, software and the expertise necessary to disseminate procurement information;
- The identification of ways in which suppliers in developing countries and small and medium-sized enterprises could participate in procurement by government entities in developed countries;
- Training;
- Divulging information on how government procurement could influence employment and development in general;

- Technical advice and other experience;
- Sharing activities such as twinning between developed and developing country agencies and study tours.

With regard to the types of provisions for possible inclusion in the agreement, one suggestion was to follow the model provided by Articles 66.2 and 67 of TRIPs. Some draft texts specified that technical assistance should be provided on request, on mutually agreed terms and conditions. They also specified the areas in which such assistance could be provided.

b. Special and differential treatment for developing countries

The discussions in the Working Group recognized the need for S and D treatment. With regard to how this issue should be dealt with, a view was that it should be reflected in the substantive provisions of the Agreement.

With regard to the types of S and D treatment, suggestions referred to transitional periods, the application of higher threshold values and exemption from coverage, for example, for entities at the subcentral level or for services. A transitional period of two years for LDCs and one year for other countries was proposed, during which the Agreement might be applied on a best endeavour basis. A view was also expressed that a standstill clause might be provided for during the transition period.

E. Developmental and business dimensions of the Transparency Agreement

1. Development dimensions

Governments often seek to achieve certain societal objectives through their procurement operations. The primary objective of any procurement activity is to secure the best deal for the resources spent. However, governments are sometimes willing to accept a trade-off between this primary procurement objective and other socially desirable, but non-procurement related objectives, hereafter referred to as secondary objectives (box 3). For example, a government may demonstrate a price preference for products sourced from the small and medium-sized enterprise sector. In such cases, the higher prices paid are justified by the logic of the societal objective of developing and strengthening small and medium-sized enterprises. Similarly, governments can give preference to an offer that has a higher domestic content with the objective of promoting indigenous supply capability.

Box 3. Primary and secondary procurement objectives

Primary	• Maximize procurement efficiency • Minimize procurement costs
Secondary	• Promote local industry • Special preference for small and medium-sized enterprises • Special preferences for state-owned enterprises • Maximize local content • Promote technology transfer • Organize offset programmes • National security considerations.

Moreover, such secondary objective(s) need not always be economic. For example, the State of Massachusetts in the United States formerly had a law (since declared unconstitutional by the United States Supreme Court) that prohibited any firm doing business with Myanmar from participating in the Massachusetts State procurement programme, due to Myanmar's human rights record.

Many countries have state policy objectives, such as preferential treatment for the disadvantage categories, embedded in procurement systems. A perusal of all such secondary objectives will reveal that some can be applied in a non-discriminatory way while, in some cases, some discrimination may be unavoidable. There are two basic but substantive dilemmas in this context (see box 4).

Box 4. Two dilemmas

The first dilemma is how to strike an appropriate balance between free trade goals and legitimate domestic and other policies of member governments. As far as domestic (internal) policies are concerned, this issue has been raised in GATT/WTO jurisprudence in the context, in particular, of technical regulations and standards. How should the balance be struck between domestic interests, such as protecting consumers and the domestic environment, and the need to control the trade-restricting effects of technical regulations and standards? In the context of trade sanctions against regimes that do not comply with human rights or environmental standards, the question of how far sanctions should be permitted in government procurement reflects a much wider debate over the permissibility and role of trade sanctions under GATT/WTO laws.

The second dilemma, which is particularly important for the GPA, given its plurilateral nature, is how to balance effectiveness with wider coverage. A strict approach to secondary policies could increase the effectiveness of the GPA in relation to covered procurement; however, it might also encourage parties to retain or add limitation on coverage, and/or deter accessions.

Source: Sue Arrowsmith, *Government Procurement in WTO*, p. 326.

Apart from these two substantive issues, the central question in the current context is the relationship between the pursuance of secondary objectives and transparency. The applicability of non-commercial factors in the decision-making process on procurement almost, by definition, adds complexity, subjectivity and possibly opaqueness. In addition, the following considerations are important in this context:

(a) There are inherent limitations to transparency as a regulatory tool. Structural factors, such as the human resource dimension in the form of procurement officials, are possibly more critical;

(b) Some element of subjective commercial judgment is inevitable in any procedure, and may also be desirable in some cases; and

(c) Even the strictest and carefully detailed procurement rules will fail if procurement officials are determined to circumvent it.

Given the extensive usage of secondary objectives, the first step towards an international agreement on transparency in government procurement will be to accept the social and legal legitimacy of those objectives, and especially the latter when MFN treatment becomes questionable.

According to Arrowsmith, "the transparency implications of these policies are not a major concern... and it is sufficient from a transparency perspective if secondary policies are formulated and publicized in advance".

Transparency in government procurement by itself should help the developing countries as it can increase foreign participation that, in turn, will promote competition as well as ensure value for money, clear decision-making and reduced possibilities of corruption. Many developing countries in the Asian and Pacific region have a large part of their government procurement financed by multilateral agencies such as the World Bank and the Asian Development Bank. The role of bilateral official aid is also significant in some countries. Procurement under these funds is already made following the rules of the funding agencies and is, therefore, subject to detailed transparency provisions.

Most governments also have domestic laws that provide for bidding procedures, directed towards several objectives, including transparency. In such a context, the developing countries need not fear that a Transparency Agreement will be detrimental to their developmental and other societal concerns, provided that the secondary objectives are allowed to operate, subject to their being transparent.

2. Business implications

Keeping in view the Doha Mandate, which clearly unlinks non-discrimination and market access commitments from the Transparency Agreement, improvement in terms of business will have to come only from one factor. Lack of transparency can be considered as a market access barrier. To the extent that the Transparency Agreement removes reduces this barrier, the import penetration of the government procurement market might improve.

What does this mean for developing countries? First, with regard to the transparency factor as a market access barrier, they may not gain anything as far as the government procurement markets in OECD countries are concerned, because many of them are already observing such procurement practices. However, the developing countries as a group may gain because of more procurement activities from within the developing countries by the developing countries, due to a higher level of transparency being imposed through the Transparency Agreement.

Second, there is the crucial issue of supply-side capability. Few developing countries have the competence to participate in global procurement programmes. This competence may become more limited because of the threshold level that may be agreed upon for the Transparency Agreement. The threshold levels of the GPA may provide some benchmarks. For central government entities, there is a common minimum threshold of SDR 130,000 for purchases of goods and non-construction services. The threshold level goes up to SDR 15 million for construction services, procured by subcentral entities. The higher the thresholds, the lower will be the response capability of companies in developing countries.

Third, despite the above observations, several developing countries in the Asian and Pacific region could participate effectively in the global government procurement market. Construction services, software design and implementation among services, pharmaceuticals and other medical supplies among goods are some examples. Countries such China, India, Malaysia and Singapore, among others, stand to benefit.

F. Negotiating strategy for developing countries

1. Reservations on the part of developing countries

Developing countries have been unenthusiastic about an agreement on transparency in government procurement. The reasons behind this attitude can be understood by analysing their response to the existing GPA. Except for Singapore and Hong Kong, China, no other developing country/area is a member of the GPA. The main reasons for non-participation are that:

- Most developing country governments have secondary objectives, as explained in section D above, which are considered important from the point of view of developmental or other social requirements. The GPA restricts the freedom of the governments to pursue such policies;
- The developing countries have limited supply capability. The developing countries have few incentives to join a WTO agreement liberalizing public procurement markets. The payoffs for developing countries are likely to be very low. Countries with smaller economies (and transition) countries with few internationally competitive firms may find that international competition will lead to a greater number of procurement awards made to foreign firms, with no compensating offset of awards to their firms in overseas procurement markets. (These need to be seen against the potential benefits.);

- Potential gains from the increased market access is expected to be positive but low because of supply deficiencies; and
- Efficiency gains arising out of lower costs of procurements. This will be proportionately higher in those countries where the domestic laws are currently inadequate and/or the share of multilaterally funded procurement to total government procurement is low.

One reason behind the Singapore Ministerial Decision to restrict the agreement to transparency was the realization that there would be asymmetry in the distribution of potential benefits between the developed and the developing countries, if a GPA type of agreement was to be made multilateral. This would be unacceptable to the developing countries.

The effective unlinking of extending national treatment to foreign suppliers and market access commitments from the Transparency Agreement was expected to take care of the reservations on the part of some developing countries. However, as the summary given in section C above of the WGTGP discussions reveals, there has been little convergence of views on the substantive elements of the Transparency Agreement. One reason for this is the continuing perception among some developing countries that the Transparency Agreement might only be the initial step towards a future multilateral GPA type of agreement, involving market access commitments.

It has been observed that both the United States and the European Union have regarded the negotiations on transparency as part of a "gradualist strategy" towards this goal. According to Arrowsmith, "if market access commitments were negotiated within WTO, the transparency disciplines already developed could operate to support these commitments. Alternatively, accepting limited transparency obligations at an early stage might lay the groundwork for participating in market access negotiations in other WTO forums, such as the GPA".

While such a threat perception may not be realistic, at least for some time, there is enough evidence in the WGTGP discussions of attempts to steer the deliberations in a way that might be seen to transcend the boundaries of a Transparency Agreement as normally perceived. The focus of the Working Group has shifted subtly, from consideration of how to make procurement practices transparent, to questions of market access about whether procurements should be open to international competition. The emphasis has shifted from rule-oriented transparency to politically oriented issues... and how far the WTO members want to go in disclosing protectionist practices.

2. Negotiating strategy for the developing countries

The position of the developing countries on the Transparency Agreement ultimately will depend on: (a) whether the agreement can be formulated along the lines they consider to be beneficial or least damaging to them; and (b) whether a relaxation of the position on the agreement can be used as negotiating leverage to secure benefits in some other negotiating issue under the Doha Development Agenda.

The main proponents of the Transparency Agreement now appear to be taking a position that wider acceptability of a set of core provisions on transparency would be the preferred objective rather than a strong rule-based system. Flexibility needs to be built in, as wide divergences in national procurement systems make "a one size fits all" strategy unworkable. However, they expect the Agreement to be legally binding and effective. This means making the Agreement a part of the single undertaking and making it subject to the WTO dispute settlement system.

Many developing countries, especially those that are relatively more underdeveloped, and LDCs, which have very little to gain from the Agreement, may find such a position equivalent to making unilateral concessions. Therefore, they may go for a position that will be exactly the opposite (i.e., making the agreement a voluntary code or guideline) and thereby taking it outside the legal, rule-bound discipline of WTO. Some countries may also stick to their oft-repeated stance that no such transparency agreement is required.

A middle position has to emerge, possibly out of the discussions in the Working Group, by the time of the Cancun Ministerial Meeting, if a consensus has to be reached in that meeting. This will involve, inter alia, several critical steps:

(a) A precise definition of "transparency" needs to be established. As the WGTGP discussions have clearly demonstrated, there is hardly any consensus on what constitutes transparency. A more compact and limited definition might help in securing a consensus;

(b) The second step is to be more precise over what is the objective of the Transparency Agreement. If the objective is limited to addressing the issue of non-transparency as a market access barrier, that needs to be clearly stated. If there are other objectives, they must be precisely defined, because the possible contents of the Transparency Agreement will depend upon the objectives;

(c) If the agreement is restricted to transparency, developing countries may not stand to lose, and, in fact, they will possibly gain marginally. This will, however, require explicit acceptance of the secondary procurement objectives that the developing countries may pursue, so long as their usage and application procedure are transparent;

(d) Developing countries should seek S and D treatment as part of the substantive provisions in the agreement, based on the experience of S and D provisions in various WTO Agreements negotiated under the Uruguay Round;

(e) It is inevitable that the developing countries will have to bear an additional burden in putting more information into public domain, developing systems for record-keeping, providing ex-post review procedures, setting up enquiry points etc. How much of that additional burden can be offset through incremental gains from procurement efficiency will depend upon the contestable government market size and the status of current, relevant

domestic laws and regulations. Obviously, the position will vary from country to country. There is, therefore, a prima facie case for seeking offsets from other negotiating issues. The leverage can come from the perceived benefits of transparency in the developing country government markets for the developed countries. It has been estimated that total government procurements, including those at the subcentral level, amounted to US$ 600 billion in the early 1990s. The OECD study referred to in section B estimated the market to have been valued at US$ 287 billion in 1998;

(f) Clearly formulated technical assistance and capacity-building should form an integral part of the Transparency Agreement.

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VIII. TRADE FACILITATION IN THE WTO AND IMPLICATIONS FOR DEVELOPING COUNTRIES

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Introduction

While the need for trade facilitation is extensively mentioned and supported, there is no widely agreed upon definition for trade facilitation. WTO defines trade facilitation as "the simplification and harmonization of international trade procedures" where international trade procedures are defined as the "activities, practices, and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade" (ESCAP, 2002). International organizations such as the Economic Commission for Europe (ECE), UNCTAD and APEC, as well as various authors all use slightly different definitions, which emphasize different aspects of trade facilitation.

Sohn (2001) defined trade facilitation as "all activities or policies that reduce transaction costs arising from eliminating or simplifying excessive and complex procedures, practices and processes related to trade, thus increasing efficiency, which results in increased trade" (Sohn and Yoon, 2001). The most intuitive definition may be that given by Staples (2002), who stated that "trade facilitation involves reducing all the transactions cost associated with the enforcement, regulation, and administration of trade policies. It has been referred to as 'plumbing' of international trade". In the end, the objective of trade facilitation is to "reduce the cost of doing business for all parties by eliminating unnecessary administrative burdens associated with bringing goods and services across the borders" (Staples, 2002).

These definitions make it clear that trade facilitation refers to a wide variety of activities, such as import and export procedures (e.g., customs or licensing procedures, customs valuation, technical standards, health and safety standards etc.), which include: (a) administrative procedures, especially paperwork and information submission; and (b) transportation and shipping; and insurance, payment mechanisms and other financial requirements. Since many countries are utilizing new information technology and methods of electronic commerce, trade facilitation also deals with information technology issues.

Sohn and Yim (1998) made the point that while trade liberalization dealt with increasing market access for goods and services and opening the economy to foreign investment, trade facilitation was a much wider concept. They noted that this was because the latter dealt with eliminating or reducing inefficient administrative, technical, and physical restrictions to trade, while establishing or striving for cooperation and

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more harmonization between trading partners (Sohn and Yim, 1998). Thus, the concept of trade facilitation includes concepts discussed under trade simplification, trade efficiency, and even electronic data exchange (EDI) and electronic commerce (ESCAP, 2002).

Because trade facilitation is such a wide concept, many parties are involved in one or more of its aspects. Because of the wide range of interests and trade facilitation instruments involved, hundreds of organizations – private, public, regional and multilateral – are involved in the discussions on, and implementation of, trade facilitation. Some of the private international organizations that deal with trade facilitation include the International Chamber of Commerce and transport industry associations, which often set formal and informal international shipping standards.

Public organizations include all government agencies that deal directly or indirectly with trade. Some countries maintain public or semi-public agencies that seek to facilitate trade such as the PRO organizations in the United Kingdom of Great Britain and Northern Ireland (SITPRO), Sweden (SWEPRO) and Japan (JASTPRO). There are also public or semi-public organizations that focus on trade facilitation through electronic means such as EDI France and Tradegate (Australia).[58]

Regional organizations include the Economic Commission for Europe (ECE), which has made major contributions to the development of trade facilitation, and APEC whose major goals include trade and investment liberalization and facilitation (TILF) as well as business facilitation. SECIPRO is a regional organization encompassing eight national PRO organizations in South-East Europe.

The most important multilateral public organization that deals with trade facilitation may be the World Customs Organization (WCO), which establishes, maintains and promotes international instruments for the harmonization and uniform application of efficient and effective Customs systems (ESCAP, 2002). However, while WCO oversees a large part of what constitutes trade facilitation, there are still many areas for which it has no responsibilities since trade facilitation includes areas outside the traditional responsibilities of Customs. Other multilateral public organizations that oversee aspects of trade facilitation include the International Monetary Fund, the World Bank, the United Nations Industrial Development Organization (UNIDO), OECD (2002a), UNCTAD, the United Nations Commission on International Trade Law (UNCITRAL) and WTO.

It can be argued that trade facilitation is not a new topic to GATT/WTO. Several of the Articles in GATT 1947 as well as the various WTO Agreements encompass the ideas of trade facilitation. The relevant GATT articles and WTO agreements include (ESCAP, 2002):

- GATT Article V (Freedom of Transit)
- GATT Article VII (Valuation for Customs Purposes)

[58] For details about PRO organizations and their work on the transparency aspects of trade facilitation, see Yang, 2003.

- GATT Article VIII (Fees and Formalities connected with Importation and Exportation)
- GATT Article IX (Marks of Origin)
- GATT Article X (Publication and Administration of Trade Regulations)
- Agreement on Implementation of Article VII of GATT 1994 (Customs Valuation Agreement)
- Agreement on Import Licensing Procedures
- Agreement on Pre-shipment Inspection
- Agreement on Rules of Origin
- Agreement on Technical Barriers to Trade (TBT)
- Application of Sanitary and Phytosanitary Measures (SPS).

GATS and TRIPs also include several trade facilitation measures, although they are not directly related to trade in goods. GATT Article XXIV (Customs Unions and Free Trade Areas) can also affect trade facilitation. However, in 1996, in the first WTO Ministerial Meeting, trade facilitation became a separate topic of discussion within the context of WTO. Currently, trade facilitation is one of the "Singapore Issues" that may become subject to negotiations in the Doha Development Agenda following the September 2003 Ministerial at Cancun.

The following sections explore the status and implications of trade facilitation negotiations in WTO. Section A presents the status of trade facilitation in WTO while section B explores some of the development and business implications of trade facilitation in ESCAP countries. Section C presents some recommendations.

A. Trade facilitation negotiations in the World Trade Organization[59]

1. Trade facilitation in the World Trade Organization[60]

The 1996 WTO Ministerial Meeting in Singapore instructed WTO to "undertake exploratory and analytical work, drawing on the work of other relevant international organizations, on the simplification of trade procedures in order to assess the scope for WTO rules" in trade facilitation. Thus, trade facilitation is known as one of four "Singapore Issues". However, the work on trade facilitation was specifically assigned to the Council for Trade in Goods, whereas separate working groups were established for the other "Singapore Issues". Thus, trade facilitation is the only one of those issues that does not have an independent working group for discussion and negotiation.

Between 1997 and 1999, the Council for Trade in Goods gathered information on various aspects of trade facilitation from several regional and multinational organizations such as WCO, UNCITRAL and ECE. Several WTO members presented

[59] Sections A, B and C are an expansion of Yang, 2003b.

[60] This subsection is based on Sohn and Yoon, 2001 and Yang, 2002.

papers on their experiences with various aspects of trade facilitation, and seminars were held to educate WTO members and explore different aspects of trade facilitation.

During the preparations for the 1999 WTO Ministerial in Seattle, several members, including the European Union, Japan and the United States, made official submissions to WTO, advocating the launch of negotiations on trade facilitation as part of the new WTO Round, despite the insistence by some members that more study was needed. However, as widely known, the meeting was unable to agree on the new agenda for the Seattle Round and the negotiations was not started.

There was one notable development for trade facilitation in the Seattle Ministerial Meeting. The range of discussions on trade facilitation was reduced. The 3 December 1999 working draft[61] reads in part: "Building upon WTO principles, the negotiations shall be aimed at maximizing transparency, expediting the release of goods and reducing, simplifying, and as appropriate, modernizing and harmonizing border-crossing requirements, procedures and formalities. In this context, the negotiations shall also consider specific measures to enhance the implementation of GATT 1994 Articles V, VIII, and X, and where appropriate, complement and expand the applications of provisions in other relevant WTO agreements". While this draft agreement was never formally approved by the Ministers, discussions on trade facilitation since 1999 have concentrated on issues related to those three Articles.

In the 2001 WTO Ministerial Meeting in Doha, attempts were again made to include trade facilitation, together with the other Singapore Issues in the agenda for the new round of negotiations. Again, it was considered likely that agreement on trade facilitation would be a part of the negotiating agenda. However, the members could not reach a consensus. Reportedly, some members objected to treating some of the Singapore Issues individually rather than collectively.[62] Thus, with regard to trade facilitation, the Doha Ministerial Declaration states that:

> "Recognizing the case for further expediting the movement, release and clearance of goods, including goods in transit, and the need for enhanced technical assistance and capacity building in this area, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations. In the period until the Fifth Session, the Council for Trade in Goods shall review and as appropriate, clarify and improve relevant aspects of Articles V, VIII and X of the GATT 1994 and identify the trade facilitation needs and priorities of members, in particular developing and least-developed countries. We commit ourselves to ensuring adequate technical assistance and support for capacity building in this area".

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[61] A working draft of the Ministerial statement, dated 3 December was released on the website of *Inside US Trade*, a trade-related weekly periodical, during the Seattle Ministerial Meeting. The draft indicates that negotiations on trade facilitation would have been a part of the new round of negotiations.

[62] "Trade facilitation, procurement bumped from immediate WTO agenda", *Inside US Trade*, 23 November 2001.

There are two items to note about the declaration. First, the negotiation cannot begin until the WTO members explicitly agree on the modalities of negotiations at the Cancun Ministerial Meeting. Some countries argue that the declaration implies that negotiations must start at that time, subject only to an agreement on modality. However, other members argue that if a consensus on modality cannot be reached, negotiations cannot begin.[63] Second, as currently written, the Doha Declaration appears to limit the discussion to GATT Articles V, VIII and X. Some WTO members have called for the inclusion of rules of origin in the trade negotiation banner, but other members oppose the inclusion since there is a separate forum for rules of origin in WTO, and the subject has not been included in the Doha Declaration.[64]

The current state of trade facilitation in the Doha Development Agenda (DDA) carries some fundamental problems. First, it is not entirely clear whether negotiations can begin after the 2003 Cancun Ministerial Meeting, since the members must form a consensus on modality of negotiations. Even if a consensus can be formed, the current negotiation schedule calls for the completion of all negotiations by the end of 2004. Thus, negotiations must be completed within one year unless the members agree to extend the deadline for negotiations. Thus, the negotiations must proceed very quickly.

Throughout 2002, four meetings were held in the Council for Trade in Goods to discuss concrete issues dealing with trade facilitation. Many members made submissions on what issues should be considered in an agreement on trade facilitation. The suggestions concerning Articles V, VIII and X are summarized below. Due to the complexity of the issues involved, it will be easier to consider Article X first, then Article VIII, and finally Article V. Subsequently, some general issues of disagreement among WTO Members on trade facilitation will be discussed.

2. GATT Article X

Article X deals with "Publication and Administration of Trade Regulations". It also contains provisions on administrative review mechanisms. Article X is the chief article in GATT dealing with transparency of the domestic trading system. WTO (2002a) examines various legal issues dealing with Article X and it lists the basic obligations as:

(a) Publishing its trade-related laws, regulations, rulings and agreements in a prompt and accessible manner (paragraph 1);

(b) Abstaining from enforcing measures of general application prior to their publication (paragraph 2); and

(c) Administering the above-mentioned laws, regulations, rulings and agreements in a uniform, impartial and reasonable manner. In this context,

[63] "Note from Qatar chairman yields uncertainty on new WTO issues", *Inside US Trade*, 23 November 2001.

[64] While there is a Committee on Rules of Origin within the Council of Trade in Goods, the Rules of Origin are currently not a part of the DDA negotiations.

parties are required to institute or maintain tribunals or procedures for, inter alia, the prompt review and correction of administrative action relating to customs matters (Paragraph 3).

Article X is the area where members are most likely to reach a quick agreement, since transparency is not a particularly controversial issue, and many WTO agreements have well-established provisions on transparency. As pointed out in OECD (2002b), transparency, especially the availability of information, allows market participants to fully understand the conditions, constraints, benefits and costs of entering and operating in a market. Ideally, time and flexibility should be given to allow the market participants to adjust to potential changes. Transparency is paramount in enhancing the openness of the market, allowing market participants to take maximum advantage of the opportunities created by WTO rules and commitments.

Most countries already have mechanisms in place for making trade-related information systematically available through a widely accessible medium. Several countries publish compendiums either in print or on-line. However, in many countries, secondary regulations and administrative guidelines are often not officially published before they go into effect. In addition, while laws and regulations may be published, in many cases, the methods of implementation are not available in print, and the market participants lack practical information on customs and border-related processes and operations. Some countries try to remedy this shortcoming by publishing a Customs handbook and brochures on such issues as duty drawbacks or clearance procedures. Many countries also use enquiry points, help desks or hotlines to disseminate information and give practical advice where possible.

In 2002, five WTO members, Canada, the European Union, Japan, the Republic of Korea and the United States, submitted papers concerning trade facilitation and GATT Article X.[65] The recommendations made in the submissions can be divided into four categories:[66] (a) availability of information; (b) advanced rulings; (c) establishment of consultation and feedback mechanisms; and (d) the establishment of appeals procedures.

(a) Availability of information

Numerous recommendations have been made in the context of availability of information, but most are straightforward. They include expanding the scope of the information required to be published under GATT Article X. Such additional information includes:

- Specific decisions that have general application
- Information on Customs and other agency processes

[65] World Trade Organization documents G/C/W/363, G/C/W/376, G/C/W/377, G/C/W/379 and G/C/W/384.

[66] Classifications, (though not the discussions) are based on Organization for Economic Co-operation and Development, 2002a.

- Conditions and qualifications for different forms of Customs treatment such as Memoranda of Understanding between Customs and operators, and criteria for authorized trader status
- Right of appeal procedures
- Fees and charges
- Port, airport and other entry-point procedures dealing with border-crossing trade
- All multilateral, regional and bilateral agreements affecting international trade policy. Administrative guidelines should also be published.

The information should also be provided in a simple and accessible manner, so that it is easy to comprehend. The information should be available non-discriminately via a widely accessible medium and any fees charged should be commensurate with the costs of providing the information. These information-related recommendations tend to encode panel rulings of GATT Article X, redress some of the shortcomings of GATT Article X as revealed by the panel rulings, or give useful concrete information on the operations of trade-related administrative procedures that can be used directly by traders.

In addition, some submissions state that perhaps the management plans of Customs and other government agencies related to the implementation of WTO commitments should be made available. One submission raised the idea of allowing members to take administrative actions, decisions or rulings affecting importers or exporters only where a legal basis to do so had been established. That idea is often used in regulatory reforms to reduce the capriciousness of working-level bureaucrats and officials. Most submissions also advocate the idea of establishing a single, unified enquiry point where traders can obtain information and ask any questions that they may have. Many submissions advocate requiring a standard and adequate period between the adoption of a regulation and its entry into force unless there are overriding reasons not to do so. Providing this grace period will give traders time to adjust to the new regulation.

Another interesting idea suggested by the submissions was that the WTO Secretariat should be notified about the media through which information would be made public, so that it could maintain a list of media from which members could obtain up-to-date information on laws and regulations.

(b) Advanced ruling

Advanced rulings refer to government authorities issuing various rulings on imports and exports of specific shipments or consignments based on information provided by traders before the goods themselves actually reach the border. Advanced rulings allow higher predictability for traders, and reduce the time taken in Customs procedures since the shipment need not wait until decisions are cleared. Currently, advanced rulings dealing with origins of shipments are often used in many countries. Some

countries also have binding advanced rulings on tariff classifications. In addition to these two areas, some other areas where advanced rulings can be used include applicable duties, taxes and import licensing requirements.

Advanced rulings should be binding; that is, the authorities cannot change their rulings when goods actually reach the border. However, in cases where traders deliberately submit false or incomplete information, the ruling may be revoked.

There were some differences between submissions on the confidentiality of information submitted for advanced ruling. One submission argued that the information submitted should remain confidential; however, in some countries, advanced rulings are made public so that other traders can utilize the advanced ruling for their own shipments.

(c) Consultative and feedback mechanism

An important aspect of regulatory transparency is allowing the regulated party to have an input in how a regulation is formed, in order to reduce the costs to the regulated party while increasing the efficiency of implementation. A widely recommended mechanism is a consultative and feedback mechanism for gathering ideas from the regulated party during the formation of laws and regulations. Most submissions recommended the establishment of a consultative/feedback mechanism. One submission advocated adopting the relevant WCO Kyoto Convention provisions. Another submission advocated provisions that included: (a) an early notice of proposed regulations; (b) a requirement that a public consultation process be launched to give interested persons an opportunity to make their views known; (c) a requirement that an analysis be made to explain what the regulatory proposal was meant to achieve and what alternatives had been considered; and (d) a requirement for pre-publication of the draft regulation in the official gazette.

(d) Review and appeals procedures

Article X requires the establishment of administrative or legal review procedures. Most submissions included ideas for making that provision more substantial. Most submissions advocated the idea of a non-discriminatory legal right of review and appeals against rulings and decisions by Customs or other agencies. While the initial appeal could be made to the higher authority within the same agency or another body, if the appeal was not satisfactory, traders should have recourse to an appeal to a separate judicial or administrative body to ensure fairness.

Many submissions also advocated the idea requiring the members to establish a standard period for minor appeals, and the wide dissemination of information related to appeal procedures. One submission argued that goods should normally be released, with the possibility for duty payment to be left in abeyance pending the outcome of an appeal, subject to the payment of a surety, guarantee or bond.

3. GATT Article VIII

Article VIII deals with "Fees and Formalities Connected with Importation and Exportation". This is the primary Article of GATT dealing with the administrative aspects of trade and, thus, is perhaps the most technical, wide-ranging, and difficult of the three Articles under examination. WTO (2002b) examines various legal issues dealing with GATT Article VIII. It lists its basic obligations as:

> "Article VIII seeks to limit the costs and complexity of the importation and exportation process by imposing specific legal obligations on members with respect to the fees and charges that may be charged in connection with importation and exportation, and the penalties that may be imposed for minor breaches of customs procedures as well as by explicitly recognizing the need to reduce the number and complexity of import and export-related fees and formalities".

Article VIII requires each WTO member to ensure that:

(a) The non-tariff fees and charges that it imposes on or in connection with importation or exportation: (i) are limited in their amount to the approximate cost of the regulatory activities performed by that member in connection with such importation or exportation; and (ii) do not represent indirect protection of domestic products, or taxation of imports or exports for fiscal purposes (paragraph 1);

(b) Upon request by another member or by the relevant WTO body, it reviews the operation of its laws and regulation in the light of the provisions of Article VIII (paragraph 2); and

(c) It does not impose substantial penalties for minor breaches of customs regulations or procedural requirements, in particular when such breaches are the result of mistakes that are easily rectifiable and do not result from fraud or gross negligence (paragraph 3).

In Article VIII, members also recognize, but undertake no explicit obligations to meet:

(a) The need to reduce the number and diversity of the fees and charges addressed by Article VIII;

(b) The need to minimize the incidence and complexity of import and export formalities, and decrease and simplify import and export documentation requirements.

In 2002, seven members (Canada; Colombia, the European Union; Hong Kong, China; Japan, the Republic of Korea and the United States) made submissions dealing with Article VIII.[67] One submission detailed the need for a work programme covering the following activities:

[67] World Trade Organization documents G/C/W/394, G/C/W/397, G/C/W/398, G/C/W/400, G/C/W/401, G/C/W/403 and G/C/W/425.

(a) Preparation of a glossary for terms in Article VIII which help to define its scope and interpretation;

(b) Preparation of an inventory of measures adopted by Members under Article VIII;

(c) An analysis of the relationship between Article VIII and other WTO agreements;

(d) A review of international standards on documentation and procedures;

(e) The exchange of information on experiences with streamlining procedures and rationalizing costs;

(f) Preparation of a comprehensive technical assistance and capacity-building programme;

(g) The exchange of information between members and international organizations on systematizing Customs and other national agencies, as well as electronic data transmission.

Another submission pointed out the principles that such an agreement should maintain. These principles included "least trade restrictiveness and necessity" of formalities and documentation requirements, the use of international standards and harmonization, reviews, simplicity and modernization, neutrality, consistency and predictability. One submission listed problems that the agreement should address.

The other four submissions suggested various provisions for inclusion in the agreement that would deal mostly with four areas:[68] (a) the simplification of border-related documentation and the standardization of documentary requirements; (b) the streamlining of regular border procedures and the use of simplified clearance procedures; (c) coordination between border agencies; and (d) automation of customs procedures.

(a) Simplification of border-related documentation and standardization of documentary requirements

The simplification of border-related documentation implies that the authorities will not impose a greater documentary burden on traders than necessary. That includes items such as abolishing excessive documentation requirements (e.g., consular invoices) and the acceptance of commercially available information, as well as the acceptance of copies or documents rather than insisting on originals. In cases where different domestic agencies require the traders to submit information to each agency separately, simplification may involve consolidating the information submission into a single national window, where the traders submit information only once, and the information is then distributed to the relevant government agencies. Such consolidation will require close cooperation between domestic government agencies, and may require the establishment of an electronic database.

[68] The categories (though not the discussions) are based on OECD, 2002c.

Standardization of documentary requirements involves all members requiring the same, or a similar, set of documents for Customs procedures. While specific examples were not offered by the submissions, other documents sometimes referred to establishing an international standard for documentary requirements. Individual members may require additional documents, but only when strictly necessary and in keeping with the terms of the agreement. Another aspect of document standardization is standardizing the form and layout of the document itself; that is, making each document look the same across all members. In short, all countries will have a standardized layout for their documents; for example, regardless of which member a trader is dealing with, the name of the trader will always be written on the top left side, and the address of the trader directly below. The forms will be flexible enough so that if a member legitimately requires specific information not required by other members, there is a place in the layout to include such information. The United Nations has already has drawn up such a standardized layout called the United Nations Layout Key, and several members, including the European Union, have already based their documents on that layout.

(b) Streamlining of regular border-crossing procedures and simplified clearance procedures

The submissions on this category included proposals for allowing streamlined special procedures for authorized persons such as frequent traders who have appropriate records of compliance in the past and satisfactory systems for managing their commercial records, in exchange for authority to have goods released quickly. Another suggestion was that traders could be approved for "fast track" procedures that would require the minimum of official intervention at the borders. Such fast track procedures could include:

(a) The provision of minimal information at the time of releasing goods;

(b) Clearance at the premises of the declarant or other inland locations;

(c) The ability to submit a goods declaration covering multiple transactions over a certain specified period;

(d) Self-assessment and accounting of duties and taxes by an authorized person;

(e) The ability to make goods declarations by bookkeeping entries in the commercial records of an authorized person.

The use of such special or fast track procedures involves the use of at least some type of risk management system, where the emphasis on goods that are not likely to carry a risk is reduced and efforts are focused on those goods that do carry a risk.

The simplification and standardization of import and border procedures based on international standards and instruments such as the WCO Kyoto Convention, and the progressive modernization of Customs administrations based on the WCO Customs Modernization Programme and the Arusha Declaration would be helpful. Simplified release and clearance procedures could involve such provisions as:

(a) Simplifying the data required for rapid release (followed by the later submission of more detailed data, and/or periodical submission of data and company auditing):

(b) Pre-arrival processing and post-auditing techniques;

(c) Enhancing the security provision (bonds, financial guarantees or surety bonds) or other forms of collateral to ensure that the obligations to Customs by importers, exporters, warehouse operators or international transporter of goods are properly discharged.[69]

Members could consider drawing up a list of agreed types of simplified procedures for adoption. Members could also agree to establish, notify and, within realizable targets, progressively reduce domestic processing times for goods release.

Some members use a system of "authorized traders" where certain traders are authorized to complete paperwork and inspect the goods on behalf of traders and Customs. In such cases, a border authority usually only carries out random checks to see whether these authorized traders are carrying out their duties faithfully. Other members may use another system of "authorized traders" whereby those traders with a good record and little risk are allowed to undergo a simplified clearance procedure. In both cases, the system should be carried out in a transparent, objective and non-discriminatory fashion.

A system allowing for an express clearance or immediate release of large volumes of small consignments, such as personal letters and documents, and low-value, non-dutiable or low-dutiable consignments such as gifts, could also be considered.

In the case of fees and charges, one submission pointed out the need for further studies on how the number and diversity of fees may be reduced.

Another interesting idea given in one of the submissions was that instead of each domestic agency administrating its Acts and/or regulations independently at the border, they could set up a consolidated building and protocols so that all border-related administration and its implementation, such as shipment inspections, would be carried out only once at one physical location. Such consolidation would, however, require close cooperation between domestic border agencies.

(c) Coordination between border agencies

The ideas submitted by members on this subject included both coordination among domestic border agencies and coordination between border agencies of different members. In the case of domestic coordination, as stated above, the information-gathering procedures could be unified under a single window so that instead of having to deliver the same information to several different agencies, traders would only have to submit the information once. In addition, as stated above, the domestic agencies

[69] For example, such a system could be used to secure the payment of duties and taxes where payment is deferred or where goods are provisionally released, pending completion of final clearance procedures.

could coordinate or consolidate the implementation of their operations so that the traders need go through border procedures just once at a single location.

The coordination among border agencies of different members could operate in a similar way. Mechanisms could be set up so that the data gathered by each border agency could be shared with others; such mechanisms would require international coordination in terms of the types of information gathered, the method of storage and method of delivering the information. These methods could be electronic in nature, in which case a standard for electronic gathering and delivering of information may also need to be formulated.

An interesting idea often mentioned, although not explicitly listed in the submissions (perhaps because it would be impossible to enforce such provisions in a WTO agreement), is the idea that the border control facilities of two adjoining members could be consolidated so that both members would be able to carry out their procedures simultaneously in a single location. In other words, instead of the trader undergoing the border procedures twice, once in the exporting country and once in the importing country, the procedure could be carried out as a single operation.

(d) Automation of Customs procedures

Many of the provisions listed above could be enhanced by the use of automation and information technology. Most submissions recognized that developing members might not have the capacity to carry out large-scale reforms to automate Customs procedures, but they also recognized that automation could bring great benefits. OECD (2002c) pointed out that members who started introducing automation later could benefit from increased technology and reduced costs of both hardware and software while also avoiding some of the mistakes that the early reformers had made. This would lower the costs to the late starters to a great degree than was commonly believed.

4. GATT Article V

Article V deals with Freedom of Transit; that is, when a member is neither the exporting country nor the importing (consuming) country, but rather when a good merely travels through that country's territory. WTO (2002c) examines various legal issues dealing with, and lists the basic obligations of, GATT Article V as detailed below.

Article V calls on parties to allow the freedom of transit by requiring them to comply with a number of specific obligations. Paragraph 2 sets out the basic requirement for freedom of transit and further requires that "No distinction shall be made that is based on the flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances related to the ownership of goods, vessels or other means of transport". Paragraph 3 allows parties to require in-transit traffic to enter at the proper Customs House, while at the same time stipulating the obligation not to impose "any unnecessary delays or restrictions".

Obligations regarding the nature of charges or regulations that a member may legitimately impose are set out in paragraphs 3 to 5. As a rule, traffic in transit will be exempt from customs duties. Furthermore, such traffic is to be exempted from "all transit duties or other charges imposed in respect of transit, except charges for transportation or those commensurate with administrative expenses entailed by transit or with the cost of services rendered" (paragraph 3).

This means that a member may legitimately impose only two kinds of charges on traffic in transit: (a) for transportation and (b) for administrative expenses caused by transit or services rendered. However, even here (as well as in the case of other permitted formalities and regulations), such charges must be reasonable[70] (paragraph 4) and non-discriminatory (paragraph 5). The general principle, therefore, is that transit traffic will not be a source of fiscal revenue.

Finally, Members are required to treat products that have been in transit through the territory of another party no less favourably than they would have treated them had they been transported from their origin to their destination without passing through the territory of such other party (paragraph 6).

As various discussions on Article V have pointed out, in cases of transit, a member need not carry out extensive border procedures such as when a member is either an exporting or an importing country. Rather, that member should carry out a minimal amount of procedures required to ensure that the goods have entered and left its territory properly, the goods do not threaten the health and safety of its population, and the goods are not illegally imported into the territory. In this sense, Article V is closely related to Article VIII, in that both deal with border procedures.

Three members (Canada, the European Union and the Republic of Korea) made submissions in 2002 dealing with Article V.[71] The issues raised in those submissions can be divided into three categories:

(a) The simplification and standardization of transit procedures and related documentary requirements;

(b) Non-discrimination between modes of transport, types of consignment or individual carriers; and

(c) The strengthening of international cooperation with respect to transit.

The specific provisions are summarized below. Due to the nature of transit, some measures suggested by the submissions are similar to the measures suggested in the submissions for Article VIII, and are therefore are not be included in the following summary.

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[70] An interpretive note on Article V, paragraph 5, reads: "With regard to transportation charges...refers to like products being transported on the same route under like positions". A report of the Technical Subcommittee states "... the word 'charges' includes charges for transportation by government-owned railroads or government-owned modes of transportation" (United Nations document E/PC/T/C.II/54/ Rev. 1, p.10, as cited in World Trade Organization, 2002c).

[71] World Trade Organization documents G/C/W/422, G/C/W/423 and G/C/W/424.

(a) Simplification and standardization of transit procedures and documentary requirements

The submissions argued that there was a need to limit undue documentation requirements and customs formalities for goods in transit. One submission argued explicitly that the requirements on goods in transit should be less than those for goods being exported or imported for consumption. In addition, a case could be made for differentiating goods in transit and goods undergoing transshipment[72] within a country, where requirements for goods in transit not undergoing transshipment may be lessened. One submission also argued for a use of "surety bonds" in cases where Customs might require security to be furnished for goods passing through its territory. Simplification of customs regulations and procedures for goods in transit would also require the use of risk management principles, so that traders with good records could be subject to special procedures. Transparency and clarification of allowable fees and charges, as well as their amounts, could also be important.

(b) Non-discrimination between modes of transport, types of consignment or individual carriers

One submission pointed out the problem of discrimination between different modes of transit, types of consignment or individual carriers. The geographical and physical conditions of a country might mean that one form of transport (air, waterway, road, rail, pipeline for oil etc.) would be easier than the other methods. However, some members implicitly or explicitly try to encourage or discourage the use of certain methods of transport for various reasons such as the protection of the environment; however, there may be scope for WTO members to examine whether such discrimination is desirable. In addition, some members limit the methods for transporting certain goods through its territory. Usually, in such cases, only government-designated carriers are allowed to transport goods through the country. In some cases, the limitation is due to reasons of security and safety guarantees. However, in some cases, the limitation may be to protect domestic operators. WTO members may wish to make a list of those goods for which their governments can designate domestic carriers.

Another sensitive problem deals with non-discrimination of carriers. In many countries, members refuse to allow transit via non-national transport operators. For example, freight drivers, carrying goods from one country are not allowed to drive into another country. There is a requirement for the driver to be changed during transit. One submission pointed out that such a national operator requirement might be inconsistent with Article V, and that perhaps a guideline or clarification needed to be made. However, the submission also recognized that this particular issue might be more appropriately raised in the context of GATS, and not under the trade facilitation agreement subject to GATT.

[72] Changing the method of transportation for goods in transit within the territory.

(c) Strengthening international cooperation with respect to transit

Transit of goods may be a regional issue, especially for inland countries. Thus, the regional aspect should be recognized. Harmonization of transit policies among WTO members can also increase the speed of goods in transit.

5. General issues

In addition to the Article-specific issues described in the previous subsections, there are some general questions dealing with an agreement on trade facilitation, three of which are discussed here.

The first general issue is whether the agreement should mandate the use of the dispute settlement mechanism (DSM). Most members who advocate formal negotiations on trade facilitation, either explicitly or implicitly, favour the use of DSM should a member fail to carry out the provisions of the agreement and the failure results in loss of benefits for other members. However, many members believe the use of DSM will result in unacceptable burdens, since they have not yet established firm fundamentals of trade facilitation in their economies. In addition, it is unlikely that any differentiated treatment or technical assistance will be sufficient to enable them to establish the fundamentals within the time frame that is likely to be established during the negotiations. This problem is perhaps the fundamental reason why so many developing WTO members are reluctant to start negotiations on trade facilitation.

The second general issue concerns the possibility of making the trade facilitation agreement plurilateral, that is, applicable only to some members who sign the agreement, rather than multilateral. Given the lack of enthusiasm and even some strong opposition to negotiations on trade facilitation, some advocates of trade facilitation have suggested informally the possibility of a plurilateral agreement on trade facilitation. For trade facilitation, forming a plurilateral agreement may be difficult for several reasons, two of which are mentioned here. First, plurilateral agreements usually operate on a reciprocal basis, that is, the benefits are only available to the other signatories. However, for some of the provisions of the agreement, it will be very difficult or even impossible to carry out the provisions on a reciprocal basis. For example, it may be impossible to increase the availability of information only to the signatories of the agreement.

Furthermore, while there have been some cases where plurilateral agreements have successfully developed into multilateral agreements, there have also been some notable failures such as the WTO Government Procurement Agreement (GPA). Many WTO members have expressed reluctance to sign the WTO GPA because it includes many legal and regulatory provisions that seem excessively burdensome and inappropriate to many members. However, it is proving difficult to make substantial modifications to those provisions because the current signatories have already modified their domestic legal and regulatory systems in order to comply with the GPA. Thus, plurilateral agreements may "lock-in" regulations in a trade facilitation agreement, which will make it difficult for developing members to join later on, since the agreement will be

written by and for advanced economies, and may not include appropriate provisions or considerations for developing economies.

The third point is a relatively minor disagreement over what form the agreement should take: whether the agreement will be a formal "Agreement" on trade facilitation, or an "Understanding" on the implementation of Articles V, VIII and X. In terms of actual effectiveness, the form of the agreement makes little difference, but the form may affect how the members see the trade facilitation agreement. If it is a formal "Agreement", the members may consider it a totally new obligation in addition to the existing WTO Agreements. Then, during negotiations, the members may feel somewhat freer to add additional topics or go into greater depth than if the agreement were to be an "Understanding". On the other hand, if the agreement is an "Understanding", the members will feel that the agreement should deal only with items that are directly related to Articles V, VIII and X, which may limit new suggestions.

6. Status of discussions in the World Trade Organization

Currently, the discussions in WTO are facing several problems. While there appears to be some convergence of issues, the level of details in the submissions varies widely. Some suggestions in some submissions, especially those on technically oriented issues in Articles V and VIII, are very specific, as they deal with detailed issues such as "authorized traders" and the actual categories of information required by the government authorities. On the other hand, some suggestions in some submissions deal only with the widest principles such as the principles of non-discrimination and no unnecessary trade restrictiveness. There does not yet seem to be an agreement, even among those members who advocate an agreement, concerning the relevant level of detail; whether the agreement will be principles-oriented; or whether the agreement will list detailed regulations limiting members' laws, regulations and procedures; and if so, in which specific areas. If the agreement is too detailed and too specific, it also risks overlapping with the WCO Kyoto Convention.

Further, while most members have emphasized the need for special and differentiated treatment as well as technical assistance, without a more specific idea of the level of details that the agreement will involve it will be difficult to agree on what specific special and differentiated treatment and technical assistance the agreement will require.

Most members who advocate an agreement on trade facilitation also argue that the agreement should include some recourse to DSM. The use of DSM would seem to indicate that the members who advocate the trade facilitation agreement see a need for at least some substantial provisions in addition to principles. However, many developing members have expressed their reservations on the use of DSM in a trade facilitation agreement, arguing that should the details in the agreement prove too much of a burden, they cannot agree to the use of DSM. Thus, DSM and the level of details in the agreement are closely interrelated.

In considering these problems, the situation of the current negotiations may appear very difficult. However, a part of the reason why the outlook for the present

situation seems somewhat pessimistic is that formal negotiations have not yet begun. Thus, members are merely suggesting all ideas that they want the agreement to include. Once negotiations begin and draft agreements are made, the level of details – and thus the use of DSM as well as, the amount of S and D treatment and technical assistance – can be made more consistent with each other. However, such a realistic discussion may be difficult unless the negotiations begin formally, or at least until the members who advocate the agreement submit draft agreements rather than just a list of the items they want the agreement to include.

B. Development and business implications for ESCAP member countries

According to OECD (2002a), trade facilitation has gained importance in recent times as a result of:

(a) The progressive reduction of tariffs and substantive non-tariff barriers in international trade through successive GATT rounds, thus bringing other frontier crossing costs into new prominence;

(b) The intensive and progressive application of "just-in-time" techniques by manufacturing industries and the growth of integrated global supply, production and distribution systems in the hands of multinational companies, thus casting new importance on finely-timed transport arrangements;

(c) The inability of procedures and information flows associated with traditional port-to-port and surface transport operations to cope with the advent of rapid containerized through-movement and jet airfreight;

(d) An increasing perception in the World Bank and other aid agencies that poor quality frontier and payment procedures and associated inefficient practices are having pronounced adverse effects on the ability of traders, carriers, agents, ports and airports in developing countries to play a full role in global trade expansion.

Staples (2002) emphasized the fact that trade facilitation should be perceived as a method of reducing the cost of operating customs regimes while at the same time, attracting importers and investment. He also cited a speech by Vito Tanzi, the former director of the International Monetary Fund's Fiscal Affairs Department, on major problems in trade facilitation and customs reform as well as possible solutions and reforms. Tanzi identified six major problems:

(a) Obsolete customs procedures that have not kept pace with the developments in transport and technology;

(b) Inadequate legislation that makes it difficult to introduce changes that are required for adjusting to new ways of doing business;

(c) A misplaced belief that computerization is the answer to all problems;

(d) Inadequate attention to the organization and staffing needs of a modern administration;

(e) The lack of understanding of the need for coordination and cooperation between tax and customs administration (as well as other government agencies); and

(f) High levels of corruption.

Tanzi then pointed out flowing solutions and directions for reform:

(a) Make customs administration technology-based;

(b) Rely more on post-release audits;

(c) Forge a closer working relationship with the Tax Department (and presumably other government agencies);

(d) Promote service orientation and good relations with the trading community; and

(e) Inculcate professionalism and a high level of integrity in customs administration (and presumably) other border procedures.

Staples (2002) mentioned the following strategies for making customs administration and border procedures more efficient:

(a) Comprehensively redefine the operational role and the procedures of customs;

(b) Adopt innovative and flexible management systems;

(c) Strive for autonomy in the management of resources;

(d) Privatize functions that can be effectively performed at lower cost by the private sector;

(e) Invest in human resources; and

(f) Establish firm management control, especially as it relates to integrity.

It is doubtful that any country will find any of these goals objectionable on their own merit. Increased transparency and efficiency of customs procedures and border procedures, as well as other issues covered by trade facilitation, are policies that most WTO members would find desirable to implement. However, those members may have some legitimate questions on whether the topic should be covered under the framework of WTO, and whether a WTO agreement on trade facilitation will help implement the necessary reforms and procedures. However, the history of GATT and WTO has proven that having a multilateral, enforceable agreement can help the implementation of reforms. Thus, it is up to the members themselves to negotiate the inclusion of individual provisions that can help the process of domestic reform.

Some members may also have some concern that trade facilitation measures will reduce customs or fiscal revenue. That concern should not be important. Trade

facilitation does not mean making illegal activities such as tariff evasion easier. Rather, it means that the member economies should restructure their trading infrastructure to place more emphasis on those areas with greater risk. Having many people assigned to watch over unnecessary paperwork will not help to stop illegal activities. What will help is reassigning those people to inspect risky consignments more carefully.

In addition, the reduction of costs made possible by trade facilitation will improve the efficiency of Customs, tariff collection and the domestic economy. For example, computerization and the use of EDI by Customs have increased efficiency and duty collection. According to OECD (2001), the introduction of such technology in Bolivia raised duty collection in that country by 11 per cent (25 per cent when the applied reduction in tariff rates is taken into account). OECD (2001) also cited UNCTAD reports that demonstrated the successful introduction of the ASYCUDA system in various countries such as the Philippines, where Customs revenue rose by more than US$ 215 million, Sri Lanka where revenue rose by more than US$ 100 million and Panama, where revenue rose by 3 per cent despite a 50 per cent cut in tariff rates.

Unfortunately, there are no comprehensive global studies either on the level of the economic cost of inefficient trade infrastructure or the benefits of trade facilitation. There are, however, scores of suggestive results from business surveys and studies, which hint at the size of potential benefits of trade facilitation. According to results cited by Sohn and Yoon (2001), on average, import procedures require more than 60 different documents, with 80 per cent of the information required being duplicated in several documents. Between 20 and 25 per cent of the cost and delays in import procedures can be traced to such excessive requirements for documentation and information. ECE and UNCTAD research results state that between 2 and 10 per cent of the transaction costs of international trade can be traced to excessive information requirements.

Sohn and Yoon (2001) cited various studies that estimated the costs of various inefficiencies in trade infrastructure and the possible benefits of trade facilitation. The Cecchini Report, published by the European Union in 1988, was based on a survey of businesses that attempted to measure the losses due to administrative costs, delays in Customs, as well as losses due to various regulations dealing with border and customs procedures. The survey suggested that the total administrative costs related to trade were about 1.5 per cent of the total value of trade, and that the amount of government expenditure designed to strengthen Customs control was between 0.1 and 0.2 per cent of the total value of trade. Further, in addition to these direct costs, the indirect costs of administrative regulations, including the relevant opportunity costs were estimated to be between 1 and 3 per cent of the total trade volume. In all, total losses due to regulations were estimated to be about 5 per cent of the total volume of trade.

In “Columbus Ministerial Declaration on Trade Efficiency”, published by UNCTAD in 1994, the preamble stated that the transaction costs of international trade amounted to between 7 and 10 per cent of total trade. The Declaration estimated that should reforms take place in financial and insurance services, transportation, customs,

business information provision and telecommunications, there should be cost savings amounting to between 2 and 3 per cent of total trade.

The 1995 Australian Productivity Commission report entitled "The Impact of APEC's Free Trade Commitment" stated that if the inefficiencies in import administrative procedures were reduced so that the cost of importing was reduced by 5 per cent, such efficiency measures should result in an APEC-wide welfare improvement of US$ 216 billion.[73]

The 1999 APEC Economic Commission Report entitled "Assessing APEC Trade Liberalization and Facilitation" estimated that trade facilitation based on the Manila Action Plan Agenda (which covers a wider range of issues than WTO) had increased APEC regional welfare by about US$ 460 billion, and that further trade facilitation measures would increase regional welfare by another US$ 640 billion.

Sohn and Yoon (2001) also cited Republic of Korea-specific examples. The introduction of an on-site customs facility at Incheon port was expected to reduce the costs of undergoing customs procedures by W 22.4 billion (approximately US$ 18 million). The introduction in 1993 of a "paperless trading system" based on the United Nations EDIFACT system has reduced the associated costs of trading by 81 per cent for exports, and 79 per cent for imports, and resulted in an annual savings of W 578 billion (approximately US$ 481 million) for traders.

OECD (2001) stated that estimates of trade transaction costs in various studies ranged from 2 to 15 per cent of the total transaction value,[74] and cited several results dealing with the costs and benefits of trade facilitation.

Documentary and information preparation costs can be surprisingly high. The European Union's "EU Cost 306 Final Report" (1989) estimated that documentation costs could range between 3.5 and 7 per cent of the value of the goods traded, rising to between 10 and 15 per cent of trade if typing or other errors were included. International Changer of Shipping estimates that 10 per cent of the total cost of moving goods is related to the preparation and transfer of information.

Delays in the inspection process or delays in port can also incur major costs. In 1980, the Indian National Transport Policy Committee estimated that road haulers wasted between 30 and 46 per cent of effective travel time on inspection formalities at various internal state borders. OECD (2001) cited a 1999 report by Guasch and Spiller who argued that monopolies held by port service providers as well as inefficient regulations of port operations gave rise to implicit tariffs of between 5 and 25 per cent in Latin America. A report by Limao and Venables in 2000 concluded that transport costs paid by median landlocked countries were around 50 per cent higher than the

[73] If there are further efficiencies due to reforms in standards and certification procedures, the opening of the government procurement market, and other regulatory reforms, so that the costs of importing are reduced by 10 per cent, the regional welfare benefit would rise by a total of US$ 442 billion.

[74] In comparison, the World Trade Organization estimate of the post-Uruguay Round weighted average tariff on industrial goods (excluding petroleum) in developed countries was 3.8 per cent.

costs paid by median costal countries. Their results were buttressed by a 1995 World Bank study, which showed that the final prices of imports for some African landlocked countries were between 30 and 80 per cent higher than the value of goods, FOB. In the case of timber and coffee exports by those African countries to Europe, for example, the CIF prices are 70 and 180 per cent higher than the FOB values, respectively. The International Road Transport Union (IRU) estimated that between 1 and 7 per cent of total road transport costs in Western Europe and between 8 and 29 per cent of road transportation costs in Central and East European countries were lost due to customs formalities (World Trade Organization, 1998).

In addition, there are costs due to the lack of predictability. According to a 2001 Thai survey, 74.4 per cent of the respondents said that they paid bribes in order to facilitate customs clearance. The aggregate loss from such bribes is estimated to be Baht 400 million (about US$ 10 million).

In 1973, the London Chamber of Commerce estimated that harmonization of documents with the United Nations Layout Key cut documentation costs by more than 50 per cent compared to a conventional form-by-form process. SITPRO estimated in 1998 that a paper-based purchase order could cost US$ 200 to generate and process whereas its electronic equivalent could cost as little as US$ 20. The Air Transport Association of America has estimated that a paper-based air waybill costs US$ 6 while an electronic waybill costs less than US$ 1.

A 1998 survey by Japan's MITI indicated that feasible cost reductions from narrowly defined trade facilitation was around 2 per cent of import prices for most of the Asian developing economies, although the specific impacts differed among economies and sectors.

OECD (2001) emphasized that trade facilitation measures usually benefited small and medium-sized enterprises more than large businesses, since the large businesses have the scale and resources to deal with difficulties in trade and customs procedures. A 1987 report suggested that in Europe, the compliance costs for a consignment were between 30 and 45 per cent higher for firms with fewer than 250 employees than for large companies. Presumably, since the size of businesses is smaller in developing countries, and since those businesses typically have fewer resources than those in advanced countries, global trade facilitation measures should help the developing country businesses more than advanced country businesses.

Similarly, the potential for improvement is higher for developing countries, since many developing countries have not yet incorporated many of the trade facilitation measures operating in advanced countries.

There also have been some attempts to build on these survey results, in order to see what the national and regional improvement in total welfare would be if trade facilitation measures were put into effect. The most recent, comprehensive attempts to estimate the total welfare from trade facilitation measures may be those by Kim and Park (2001) and the Korea Institute for International Economic Policy (KIEP) (2003), which were undertaken on behalf of the APEC Economic Committee. In those reports

(which shared some parts of the approach and data), surveys of businesses in the Republic of Korea and APEC asked for estimates of the problems and costs related to customs procedures, standards and certification, and the movement of business persons in trading with other APEC economies.[75] Then, based on the survey results, a range of likely reductions in costs was estimated, and the trade effects of a reduction in the tariff-equivalent were estimated using the GTAP computable general equilibrium (CGE) model. Kim and Park surveyed Korean firms and estimated the trade effects for the Republic of Korea only, while KIEP expanded the methodology to include firms in APEC economies.

According to Kim and Park (2001), 34 per cent of the survey respondents in the Republic of Korea claimed that complex customs and tariff administration acted as trade barriers. The category ranked second, below high tariffs (43 per cent of the respondents), and above import restrictions and quotas (27 per cent), licences (27 per cent), standards (23 per cent), and the movement of businesspersons (18 per cent). In the sub-categories of complex customs and trade administration, the respondents pointed out delays in customs (38 per cent of respondents agreed that it was a trade impediment), customs valuation (36 per cent), rules of origin (36 per cent), sanitary and phytosanitary measures (27 per cent), pre-shipment inspection (23 per cent) and price verification (13 per cent) as serious problems.

In its survey of businesses in the APEC economies, KIEP (2003) found 29.8 per cent of the respondents claimed that complex customs and trade administrations were impediments to trade. Again, the category was ranked second behind high tariffs (32.1 per cent), and ahead of restrictions and quotas (28.2 per cent), business mobility (23.7 per cent), standards (16 per cent) and licences (13 per cent). In the sub-categories of complex customs and trade administration, the respondents listed delays in procedures (36.6 per cent), customs valuation (31.1 per cent), rules of origin (28.2 per cent), sanitary and phytosanitary measures (25.2 per cent), pre-shipment inspections (20.6 per cent) and price verification (15.3 per cent) as serious problems. Both Kim and Park (2001) and KIEP (2003) pointed out that a lack of information among traders about customs laws and regulations of other APEC economies were major problems. In addition, administrative backwardness and a lack of professionalism were also cited as serious problems.

A similar survey by the Asia-Pacific Foundation of Canada found that an even a higher percentage (53 per cent) of respondents claimed that complex customs and trade administration were trade impediments. In that survey, complex customs and trade administration ranked first in a list of trade impediments.

According to Kim and Park, the range of reductions in transaction costs associated with improvements in customs procedures ranged from 5.2 to 10.6 per cent for companies in the Republic of Korea, while KIEP gave the range for APEC firms as 2.9 to 7.4 per cent. Based on these results, Kim and Park and KIEP calculated the effects on exports

[75] Note that while the APEC definition of trade and investment facilitation includes standards and certification, and movement of businesspersons as well as customs procedures, the current World Trade Organization area of discussion under trade facilitation only includes customs procedures.

and imports in the event that APEC trade facilitation measures reduced the impediments by half. For customs procedure reform, Kim and Park estimated that exports by the Republic of Korea should increase between 1.39 and 2.5 per cent while imports should increase between 1.45 and 2.61 per cent. The upper ranges of these estimates are similar to a 5 per cent tariff decrease. KIEP used several different scenarios in estimating the effects of trade facilitation.[76] Under various scenarios where the trade costs for APEC member economies were reduced between 2.9 and 7.7 per cent,[77] the regional gains in GDP ranged from 0.64 per cent to 1.3 per cent over the base value, or US$ 101 billion to US$ 204 billion. As a result, the effects of trade facilitation were deemed greater than the effects of trade liberalization.

C. Policy recommendations

There is little doubt that trade facilitation, by itself, is something that most members would find advantageous to pursue. The question then is whether trade facilitation should be pursued within the context of WTO and, if so, what time schedule should be followed, in what detail, and at what level of obligation and coverage.

First, given the importance of trade facilitation, it would be desirable for WTO to be involved in trade facilitation in some way. WTO and GATT are already involved in several aspects of trade facilitation through GATT Articles V, VIII and X in addition to other Agreements.

Since one of the advantages of WTO over other multilateral organizations is the existence of DSM, it would make sense to allow the use of DSM in some way, especially as that would also allow the WTO Agreement to be differentiated from the WCO Agreements. The WTO Agreement can guarantee the minimum amount of trade facilitation measures, while the WCO Agreements can act more as suggestive guidelines, providing layers of trade facilitation obligations. As stated, the WTO Agreement on trade facilitation can list the underlying basic principles behind the implementation of Articles V, VIII and X as well as a minimal set of provisions while the WCO-revised Kyoto Convention can serve as common guidelines. The existing Kyoto Convention and its appendices can also serve as guidelines, although in a less universal fashion, since signatories to the existing Kyoto Convention can opt out of certain of the appendices.

The use of DSM can also be limited to cases where there is a consistent and systematic pattern of problems in complying with a provision of the Agreement. Members may not use DSM for a single, isolated incident.

At this stage of the debate, it may be desirable for the WTO discussions to remain firmly on the subjects covered by Articles V, VIII and X, since trade facilitation is such a wide topic. Once members feel free to add additional subjects, the number

[76] Note that the Korea Institute for International Economic Policy (2003) uses the Asia Pacific Economic Cooperation definition of trade facilitation, which encompasses a wider range of trade impediments than the World Trade Organization research agenda for trade facilitation.

[77] The Korea Institute for International Economic Policy (2003) assumed different rates of reductions for industrialized, newly industrialized and industrializing members.

of items covered in the negotiations could quickly reach unmanageable levels. For this reason, it may be better to pursue the Agreement in the form of an "understanding on implementation" rather than a formal separate agreement.

In fact, it may be better to pursue three separate understandings on implementation, one each for Articles V, VIII and X. There are several reasons for such a negotiating strategy. First, as explained above, the level of discussion is much more advanced for Article X than for Articles V and VIII. In addition, transparency issues covered in Article X may be less controversial and less technical than those covered under the other two Articles, since most members already have in place various transparency mechanisms; there are also precedents in other agreements. Thus, it may be easier for the members to agree on various aspects of S and D treatment and technical assistance as well as on the conditions of usage of DSM. Having three separate understandings will also make it easier for developing members to design more flexible coverage and S and D treatment for each Article. In addition, Kim and Park (2001) and KIEP (2003) implied that transparency measures could have great effect in reducing the costs and burdens of trade related transactions.

For developing countries, it will probably be desirable to pursue a multilateral agreement, with or without the use of DSM, rather than a plurilateral agreement. Given that trade facilitation is a subject that may require an extensive multilateral regulation on domestic regulation, it would be better for all members to provide an input into the negotiations and final drafting process rather than have a limited number of signatories responsible for drawing up the agreement and, even more importantly, revising the document in the future. As stated above, many developing and even advanced WTO members find the plurilateral WTO GPA, which also involves extensive multilateral regulations on domestic regulations, inappropriate for their needs. This is because the GPA regulations were designed and drawn up for the government procurement systems of the signatory members, which currently include only a few developing countries and no LDCs.

Thus, the authors of this paper suggest a single set of trade facilitation negotiations for three separate Understandings in the Doha Development Agenda:

(a) An Understanding of Implementation for GATT Article X;

(b) An Understanding of Implementation for GATT Article V; and

(c) An Understanding of Implementation for GATT Article VIII.

Given the very limited time for negotiations and the state of the current discussions, the authors believe that it may be possible for members to agree on a binding Understanding for Article X before the established DDA deadline, which also encompasses the usage of DSM with appropriate S and D treatment and technical assistance. While it may be possible to complete the Understandings for the other two Articles, their completion will probably be much harder than the completion of an Understanding for Article X. Perhaps non-binding guidelines for Articles V and VIII can be drawn up and implemented in the DDA context, which can serve as starting points for discussions in the next round of trade negotiations. For developing members, having such multilateral

guidelines that can serve as starting points for discussions for the future could be a better alternative than letting the advanced members draw up a plurilateral agreement that may be (or become) unsuitable for developing members.

At this stage of the discussions, the role of those developed members who advocate a trade facilitation agreement is clear: They must present a draft agreement for discussion, which sets out the principles and level of details that they desire. In addition, the draft agreement should show which areas the advocates of trade facilitation feel should be the subject of DSM.

When the draft agreement is submitted, the developing members should carefully examine the document, and point out the problems and shortcomings. The developing members should make it clear which provisions can be carried out relatively quickly, which provisions will require time, which provisions require technical assistance, and which provisions will be impossible to carry out. In that way, the developing members can shape the document to reflect their needs and preferences. If the developing members let the trade facilitation agreement become a plurilateral agreement, they will lose the chance to shape it, which may in future prove harmful, both to developed and developing members.

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IX. ACCESSION TO THE WORLD TRADE ORGANIZATION AND DEVELOPMENT STRATEGIES: EXPERIENCES EMERGING FROM THE ESCAP REGION

By Tiziana Bonapace[*]

Introduction

The Economic and Social Commission for Asia and the Pacific (ESCAP) is known for its rich heterogeneity and sharp contrasts; throughout the region, globalization success stories abound of phenomenal surges in international trade and investment flows, accompanied by rapid development of information, communications and technology as well as transport networks. These success stories coexist with countless other stories of endemic poverty and increased marginalization of the poorest economies. Regardless of where in this spectrum the countries of the region lie, the thread that links them all is a desire to share in the prosperity that globalization offers through a more equitable integration into the world economy. Countries have followed various strategies to integrate into the world economy.

Trade based on the rules of a universal, open, predictable and non-discriminatory multilateral trading system is a key component of the development strategy that the region has followed. However, almost half of the region's members are not WTO members, and early accession to WTO has become an issue of importance to the region; gaining membership to WTO is a precondition for the more effective integration of the region into the global economy.

The purpose of this note is to consider the common regional experiences emanating from the accession process. The note considers these countries' problems and needs, and proposes ways in which regional cooperation could facilitate the accession process.

A. Status of ESCAP members in the World Trade Organization

Since the establishment of WTO in 1995, its 18 newest members are mainly economies in transition from Central and Eastern Europe. So far, no least developed country (LDC) has acceded to WTO, even though some applied for membership more than a decade ago. The same holds true for Pacific island countries.

Twenty-four of the 53 members of ESCAP are not WTO members, accounting for about half of the world's countries that are not WTO members. Currently, 13 of the 53 ESCAP members are in the process of WTO accession, of which six are LDCs (Bhutan, Cambodia, the Lao People's Democratic Republic, Nepal, Samoa and Vanuatu) and six are economies in transition (Azerbaijan, Kazakhstan, the Russian Federation,

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Tajikistan, Uzbekistan and Viet Nam). Tonga, a developing Pacific island country, is also in the process of acceding to WTO (table 1). Eleven ESCAP members have no WTO status. The reasons for this vary, but in many cases the small size of the country and limited trade opportunities mean WTO membership is not a priority, at least for the time being.

These countries are at different stages of the accession process. By current indications, Cambodia is expected to sign most of the bilateral agreements in the near future and is set to become the first LDC to join WTO. Nepal is also at an advanced stage of negotiation, after the process accelerated markedly over the past year. Vanuatu completed its accession negotiations in 2001, but the terms of the package are still under consideration by the Government of Vanuatu. Other countries such as Bhutan, Samoa and the economies in transition are at an intermediate stage of accession (table 2).

It is a well-acknowledged fact that all acceding countries of the region have experienced significant problems in their accession to WTO. At the same time, in all acceding countries of the region, commitment to WTO and early membership remains a high national priority. Accession has become a sensitive issue in the multilateral trading system; it is seen as a litmus test of the resolve of developed countries to allow the poorest among them to participate in the multilateral trading system on fair and equitable terms**.**

What is the problem? Is there a systemic bias against LDCs and other developing countries in the process of accession?.

Broadly, two main categories of problems can be distinguished from the experiences of the region. One is linked to the accession process itself, the other is linked to the acceding countries' domestic processes of policy-making and ownership of reforms.

B. Accession process

1. Direct costs and indirect costs

It is widely acknowledged that the accession process is too demanding and too drawn-out. Acceding countries are overburdened with the excessively cumbersome and tedious documentation requirements of this process. The result is that significant financial, human and administrative resources are used up. In terms of the actual costs involved, the amounts vary, depending on how drawn-out the processes become; however, without exception, huge costs are involved. In resource-strapped economies this raises disturbing questions about opportunity costs. Would such investments not have yielded higher benefits if allocated more directly to the needs of the poor? What are the returns on such a heavy investment in acquiring WTO membership? When official development assistance (ODA) is used to meet these costs, is it a zero-sum calculation? In other words, does ODA allocated for accession come at the expense of other sectors? The experience emerging from this region underlines the importance of each

Table 1. ESCAP member and associate member governments and their membership status in the World Trade Organization

ESCAP members [a]

Regional members				Non-regional members		
WTO members	**WTO observers** [b] **in the process of accession**	**No WTO status**	**GATT Signatories, 1994**	**WTO members**	**WTO observers**	**GATT Signatories, 1994**
Australia *Armenia* **Bangladesh** Brunei Darussalam China Fiji *Georgia* India Indonesia Japan *Kyrgyzstan* Malaysia **Maldives** *Mongolia* **Myanmar** New Zealand Pakistan Papua New Guinea Philippines Republic of Korea Singapore **Solomon Islands** Sri Lanka Thailand Turkey	Azerbaijan **Bhutan** **Cambodia** *Kazakhstan* **Lao People's Democratic Republic** **Nepal** *Russian Federation* **Samoa** *Tajikistan* Tonga *Uzbekistan* **Vanuatu** *Viet Nam*	**Afghanistan** Democratic People's Republic of Korea Islamic Republic of Iran **Kiribati** Marshall Islands Micronesia Nauru Palau *Turkmenistan* **Tuvalu** **Timor-Leste**	Australia Bangladesh Brunei Darussalam Fiji India Indonesia Japan Republic of Korea Malaysia Maldives Myanmar New Zealand Pakistan Papua New Guinea Philippines Singapore Solomon Islands Sri Lanka Thailand Turkey	France Netherlands United Kingdom United States	–	France Netherlands United Kingdom United States
Subtotal 25	13	11	20	4	–	4
Total 49				**Total 4**		

ESCAP associate members

WTO members	WTO observers in the process of accession	No WTO status	GATT Signatories, 1994
Hong Kong, China Macao, China	–	American Samoa Cook Islands French Polynesia Guam New Caledonia Niue Northern Mariana Islands	Hong Kong, China Macao, China
Total 9			

[a] Countries designated in bold are least developed countries, while those given in italics are economies in transition.

[b] Countries that have been granted observer status must start accession negotiations within five years of becoming observers.

Table 2. Status of the WTO accession process in ESCAP developing and least developed countries (as of May 2003)

Applicant country	Nepal[a]	Cambodia	Viet Nam	Vanuatu	Tonga	Lao People's Democratic Republic	Samoa	Bhutan
Process application	May 1989	Dec. 1994	Jan. 1995	July 1995	June 1995	July 1997	Apr. 1998	Sept. 1999
WP[b] established	June 1989	Dec. 1994	Jan. 1995	July 1995	Nov. 1995	Feb. 1998	July 1998	Oct. 1999
Memorandum	Feb. 1990 Aug. 1998	June 1999	Sept. 1996	Nov. 1995	May 1998	Mar. 2001	Feb. 2000	Feb. 2003
Questions and replies	June 1999 June 2000 Oct. 2001	Jan. 2001	Mar. 1998 Aug. 1998 Apr. 1999 July 1999 June 2000 Aug. 2001	May 1996 Oct. 1997 May 1998	Nov. 2000		Aug. 2000	
First WP meeting	May 2000	May 2001	July 1998	July 1996	Apr. 2001		Mar. 2002	
Most recent WP meeting	Sept. 2002	16 Apr. 2003	12 May 2003	29 Oct. 2001				
Tariff offers	July 2000	Dec. 2001		Nov. 1997 May 1998 Nov. 1999	Apr. 2001		Aug. 2001	
Services offers	July 2000	Dec. 2001		Nov. 1997 Nov. 1999	Apr. 2001		Aug. 2001	
Agricultural data	Sept. 1998	Dec. 2001		Sept. 1999 Oct. 2001	Apr. 2001		Aug. 2001	
Draft WP report		Ongoing		Sept. 1999 Nov. 1999				
WP adopts report				Oct. 2001				
General Council adopts report								
Membership								

Source: WTO document WT/LDC/SWG/IF/II/Rev. 2, 19 April 2001.

Note: Applicants are arranged in order of application date.

[a] Nepal's GATT accession negotiations were suspended and resumed under WTO.

[b] WP: Working Party.

and every individual country answering these questions according to its particular national development priorities and strategies, before the accession process begins.

Long time lags from 5 to 10 years in the accession process expose aspiring WTO members to a host of indirect costs as well. Marginalized economies are denied the opportunity to play a more influential and decision-making function in an institution that has a determinant role in the course of globalization. It also implies that the trade policies and development strategies that acceding countries design or implement will not have the stability and predictability that WTO membership offers. Similarly, competitive exports of those acceding countries (and many acceding countries in the ESCAP region have already carved out competitive niche markets) are more vulnerable to the imposition of sudden and arbitrary imposition of non-tariff measures. Losses in export earnings sustained by a small country could be huge.

Finally, the long-term strategic development interests of such countries are affected, since many of them may eventually direct their attention to regional and bilateral trade negotiations. The hope is that these arrangements will be easier to conclude, offer more immediate benefits and serve as stepping stones to WTO. While this may well be the case, preferential liberalization provides economically inferior results compared to multilateral liberalization. Over and above economic interests, long-term strategic interests may also be affected, as preferential trade agreements often go hand in hand with foreign policy objectives, the long-term effects of which are difficult to gauge. In contrast, the multilateral trading system is rules-based and less likely to be captured by such linkages.

2. Working Party and negotiating dynamics

The experience of acceding countries with working party meetings can hold important insights for ESCAP member countries that are in the relatively early stages of accession, such as Bhutan and Samoa.

The most common complaint from acceding countries of the region is that the Working Party process is too inquisitorial and invasive. The fact-finding methods used are frequently repetitive and uncoordinated. Often the Working Party follows routine procedures and asks standard questions without differentiating across countries, or it picks up issues that are hardly relevant or central to the accession process of the aspiring country. WTO-aspiring countries from the region wish to see the “one size fits all” approach changed into an approach that reflects greater sensitivity to the unique cultural and historical heritages, as well as their socio-economic vulnerabilities.

But perhaps it is in the bilateral process that the most difficult experiences of ESCAP members are to be found. Accession negotiations, contrary to market access negotiations among existing WTO members, are one sided; being outside the system, applicants have no rights. Furthermore, existing members do not grant reciprocal concessions. Consequently, the tendency is for WTO members to try and extract maximum concessions from acceding countries. At the same time, acceding countries have approached accessions with the objective of liberalizing or giving away as few concessions as possible. Initial offers frequently entail very few substantive liberalization

commitments, because the objective often is to retain "negotiating chips" during further Rounds in order to obtain improved market access to members. Undoubtedly, these dynamics have contributed to the complexity and difficulties of the negotiations by many countries.

Having said this, it is important to note that the experience of the ESCAP region shows that accession is not risk-free for existing WTO members. There are systemic risks on both sides. If existing members push acceding countries too hard on their offers, acceding countries may have to suspend their accession process. Alternatively, if acceding countries make commitments that they cannot implement, increased implementation problems result that give rise to tensions and disputes. Some might contend that WTO members could turn a blind eye when such problems arise. This raises issues concerning precedents, which WTO members are always unwilling to establish. In all cases, the credibility and integrity of the system and the accession process are undermined.

3. What can be done?

Numerous suggestions have been made on how to improve the accession process itself. A more simplified format for preparing the memorandum for the foreign trade regime has often been identified as a good starting point for streamlining the process. Furthermore, as many of the Working Party activities consist of clarifying and reaffirming with participants their adherence to commitments contained in WTO agreements, it has been suggested that Working Party activities should be rationalized by concentrating on a negative list approach, i.e., placing the focus only on applicants' departure from the rules, or the negotiated exception to commitments. Applicants would be subjected to all WTO commitments, including transitional periods, unless exceptions are agreed to between the applicant and the member, and then only to the extent that it is negotiated and agreed upon. It has also been suggested that the chairperson of the Working Party should have an enhanced role that would ensure rationalization of the working procedures.

As far as bilateral negotiations are concerned, the European Union for example, envisaged the possibility of reducing or even eliminating bilateral negotiations. In its 1999 "fast track" proposal, one of the European Union suggestions was that the Working Party could agree on broad minimum criteria that LDCs should meet as part of its accession process. For example, in industrial tariffs LDCs could bind at 30 per cent across the board over a maximum five-year period. In services, LDCs could be asked to make commitments in at least three sectors.

The proposal did not get far, mainly due to concerns of other WTO members that were of a systemic nature. These arguments, to a large extent, revolved around the integrity of the multilateral system; accession of new members should strengthen not weaken WTO. Acceding countries should know the rules, and have institutions and laws in place that will ensure that agreements are implemented. To do otherwise, it was argued, would undermine WTO credibility – a condition of fundamental importance in a system that is member-driven and which relies on voluntary adherence to the rules. Some were of the view that this would set precedents that might have implications for how negotiations would be conducted in future Rounds.

The counter-argument is that those countries account for less than 1 per cent of world trade and therefore have limited systemic impact. Implementation credibility is much more dependent on how existing WTO members, particularly how large trading powers, are implementing their agreements.

So far, no agreement has been reached on any of these proposals.

Nevertheless, two substantial developments have emerged, indicating a more flexible approach. First, paragraph 48 of the Doha Declaration opens up negotiations under its mandate to acceding countries. While the Declaration lacks specificity, it would imply that the commitments made by an acceding country as part of its terms of accession are an integral part of the negotiations. It is often said that acceding countries are trying to join a moving target. In other words, they are not acceding on terms determined by the results of the Uruguay Round, but rather on terms influenced by the expectations of the current Round. The terms of accession should thus form an integral part of the negotiations, and LDCs should not be made to "pay twice".

Second, in December 2002, the General Council adopted Guidelines that seek to ensure that the accession process is simplified, accelerated, and not made more burdensome than necessary for LDCs. There are signs that the Guidelines are having some positive effect, although individual country experiences seem to vary. A view has been expressed by LDCs that the successful accession of Cambodia, and possibly Nepal, by Cancun is the litmus test of the resolve of WTO members to endure effective implementation of these Guidelines.

4. Returning to economic fundamentals

Overall, it would appear that recently acceded countries have made extensive liberalization commitments that go beyond those made by existing members during the Uruguay Round. Furthermore, it would appear that each newly acceding country is expected to make commitments that go beyond its predecessor. Since most of the countries that remain outside WTO are LDCs and vulnerable developing countries, the question arises as to whether there is a systemic bias against those countries? This is a difficult question to answer accurately because with possibly one or two exceptions, there are no developed countries in the process of accession, and therefore no developed country standards against which commitments can be measured compared. More fundamentally, however, there is perhaps little value to be gained by acceding countries in assessing their WTO commitments against what other countries have negotiated. A return to more fundamental economic questions is more important.

A core question that emerges for acceding countries of the ESCAP region is to what extent the terms, conditions and speed by which a country is acceding to WTO is inducing national-level policy reforms that will promote economic and social development? In other words, instead of asking the question "what level of commitments should be expected of LDCs as new members, compared to existing members?", the question should be "what commitments should be expected of applicant countries in the light of their development priorities and their administrative capacity?"

Take for example, the implementation of TRIPs, a vast undertaking that requires extensive legal and legislative development, as well as financial resources, before compliance is achieved. Is this in the best interests of LDCs, given their numerous other pressing economic and social needs? It seems clear that this is not a priority for LDCs of the region. More seriously, implementation of far-reaching commitments in the agreement could divert scarce resources from other important expenditures on education or health services, where long-term returns may be greater. WTO members should thus allow LDCs to avail themselves of reasonable transition periods commensurate with their development needs. The accession process should also focus more on those policy reforms from which acceding countries can benefit economically. WTO members should therefore provide the lead by focusing on those sectors of developmental interest to LDCs and forego insistence on compliance that has little meaning for the situation of LDCs. For example, a measured opening up of some of the backbone infrastructural services, e.g., the financial, telecommunications and transport service sectors, could significantly improve supply capacities, productivity and export competitiveness for LDCs, as is the case in a number of other areas, e.g., in textiles and agriculture where deregulation and liberalization could lead to immediate and longer-term gains. In short, place the focus on main market access issues and downplay side issues.

The accession process should also contain an inbuilt means of rewarding countries for undertaking trade liberalization measures during the accession process. This could be along the lines of credit for autonomous liberalization agreed to in the services sector. It would provide an incentive for countries to continue with autonomous reforms, irrespective of the accession process. Otherwise, acceding countries may be tempted to position liberalization reforms to extract maximum negotiating leverage during the accession process. Considering the long periods involved in the accession process, this could delay urgently needed domestic reforms.

C. National ownership and domestic policy-making

The experiences emerging from the ESCAP region underline the importance of political commitment at the highest level to the accession process. By and large, in virtually all acceding countries, this commitment remains intact. All acceding countries are of the view that the magnitude of changes that WTO membership induces in policy, legislation and regulations will not be implemented unless this high-level commitment is present.

Similarly, governments should direct and maintain ownership of the accession process, at each and every stage. Donor or consultant-driven processes that do not take national ownership into account will also not succeed. Countries may then find themselves unprepared for the adjustment costs that liberalization brings, and the ensuing backlash may result in some governments abandoning reforms.

Trade liberalization reforms have complex linkages that conflict across sectors. Therefore, before a government enters into WTO accession negotiations, national development objectives should have been clearly set out and there should have been

broad agreement on the economy-wide policy measures that are required to achieve those objectives. The accession process can then be used as a means of inducing reforms and achieving those objectives. In other words, WTO accession should not be seen in isolation. Rather, it should be seen as an integral part of a country-led development and poverty reduction strategy.

As in all countries, trade liberalization reform in LDCs is among the most difficult types of reforms to implement. Typically, the costs of liberalization are immediate, often severe and sector-specific, whereas the benefits accrue over time, are dispersed across sectors and are difficult to trace back to the initial trade reforms. How are these difficulties to be reconciled?

There is a need for a broad political consensus among a wide range of stakeholders. The more decentralized the political decision-making process is, the more important this aspect becomes. Mechanisms for dialogue, consultation and participation among stakeholders – planners, trade officials, business interests, development practitioners and civil society advocacy groups – on accession problems need to be put in place. Parliamentarians have a special role to play. Government support measures for overcoming adjustment costs associated with WTO membership are then more likely to be forthcoming, while entire societies are more likely to agree with the reforms once they gain a better understanding of the costs and benefits involved.

In short, WTO accession needs to be based on a combination of top-down decision-making and bottom-up consultations. In other words, top-down liberalization could eventually be seen as a means of locking in economy reform packages that are, at least in part, based on bottom-up mechanisms.

D. Role of ESCAP in facilitating the accession process

All acceding countries have received large amounts of technical and financial assistance at the national level, given that each accession is country-specific and unique to the dynamics of that country. Relatively less attention has been paid to regional perspectives and the potential role of regional cooperation in facilitating the accession process. Nevertheless, following the long and often dramatic accession experience of the ESCAP region, a body of regional expertise has emerged. Considering the similarity in economic structure and experiences of many of these countries, ESCAP felt it was important to tap into this expertise and promote its sharing. ESCAP, as the regional expression of the United Nations, has established an informal network. The aim is allow governments to examine the experience of other governments that are applicants, have recently acceded or are more experienced developing countries. The network meets once or twice a year, through ESCAP organized seminars or as part of WTO/ESCAP trade policy courses.

In future, the network should be expanded to include the views and experiences of developed countries with acceding countries. ESCAP can provide an informal and open venue in a non-negotiating environment for enhanced understanding. The network should also seek to stimulate a mutually supportive regional and national dialogue, so

that the accession process becomes part of a wider economic reform programme that is owned and shared by member countries. It has also been suggested that ESCAP, in collaboration with the WTO and UNCTAD secretariats, could draw up best practice experiences, particularly with regard to the implementation of the 2002 Guidelines, which could be shared among countries at the regional level.

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COUNTRY STUDIES

AN ASSESSMENT OF THE IMPACT OF THE WORLD TRADE ORGANIZATION ON BHUTAN*

Introduction

Bhutan is at a critical juncture in its progress with unprecedented political and economic reforms taking place. On the political front, there is a transition from a monarchy to a democratic system based on a written Constitution. On the economic front, Bhutan has begun its accession to WTO, indicating a desire and willingness to undertake broader economic reforms and enter into that multilateral trade organization. These reforms will complement each other and a successful outcome of the two will have immense beneficial impact on Bhutan.

Application for WTO membership symbolizes Bhutan's desire to liberalize its economy and benefit from the rights and privileges conferred to WTO member countries. Global economic integration is increasingly viewed as an economic and a political necessity rather than a matter of choice. This is evident from the growing membership of WTO with 145 members and 30 countries in the process of accession.

Section A of this paper discusses the broad theoretical benefits of WTO membership with regard to small countries. Section B assesses Bhutan's economy and economic policies pertaining to trade. Section C discusses the impact of WTO membership on the industrial, agricultural and service sectors and intellectual property rights (IPR) as well as the social and cultural impact of WTO membership on Bhutanese society.

A. World Trade Organization

1. Small States and the World Trade Organization

Smallness in national unit size carries both advantages and disadvantages: (a) advantages in terms of social cohesion and mutual understanding and, hence, in flexibility of response to external shocks; and (b) disadvantages in terms of the lack of diversification as well as the unit cost of infrastructure and some public goods (including human capital). Again, disadvantages in international bargaining power are apparent from smallness, whether in bilateral or multilateral negotiations, or vis-à-vis multinational corporations; yet, again there are also advantages, in that concessions may be more readily secured simply because they are less costly to the counter party.

Current development theories contend that infrastructure together with integration into the world economy is essential for economic development. Small countries such as Bhutan face considerable challenges, as the cost of infrastructure provision is very

* Prepared by the Centre for Bhutan Studies, Thimphu and reviewed by ESCAP.

high, and successful integration is constrained by several structural and locational problems associated with smallness and remoteness. The high costs of infrastructure provision makes small countries heavily dependent on external assistance for capital investments.

There is a paradoxical relationship between small States and international trade. On the one hand, international trade makes it possible for a small country to exist and even thrive as trade enables it to be politically independent while depending on external trade for its economic needs. On the other hand, small developing countries as "price takers" in the global market often face adverse terms of trade and are vulnerable to exogenous shocks. Under modern economic conditions, some very small States are among the most prosperous national units (for example, Iceland, Luxembourg and Singapore) and some appear barely viable (for example, Djibouti or Guinea-Bissau) while there are a large number in between that could grasp or let slip such opportunities.[78]

Although cautious and gradual, Bhutan's social and economic modernization process has transformed Bhutanese society in many ways. Successful economic development polices, rising education levels, foreign trade, travel and the mass media have changed the public's perception from being very "Bhutan-centric" to having a more global outlook. National development priorities have also shifted from the creation of basic infrastructure to addressing relatively more complex economic issues such as economic diversification and employment generation.

In view of these dynamic changes, the State is compelled to look beyond national and regional boundaries to address the emerging economic needs and become a vibrant actor in the international area. The authorities are convinced that globalization is inevitable and irreversible, and that the benefits of economic liberalization will outweigh the costs in the long term. WTO membership is, therefore, viewed as an important means to attract foreign investment, boost the private sector, generate employment, enhance competitiveness of Bhutanese goods and services, and diversify Bhutan's export markets.

2. Accession to the World Trade Organization: benefits and challenges

Popular publications contend that WTO membership confers numerous benefits on small developing countries by promoting a rule-based trading system in order to create a "level playing field" for all members. A summary of the main benefits of WTO membership is given below.

(a) Market access

WTO membership will confer on Bhutan stable and predictable access to the markets of other member countries, based on the principles of reciprocity and non-discrimination. In accordance with the Most Favoured Nation clause and the principle of "single undertaking", Bhutan can enjoy the benefits of multilateral trade

[78] Small developing States that have prospered in recent decades without specific advantages such as oil or other mineral wealth include Fiji, Mauritius, Seychelles and Gambia.

without having to negotiate individual trade agreements with each and every member country. The national treatment clause will ensure that Bhutanese goods are not discriminated against through the use of tariff and non-tariff barriers. MFN and national treatment are of particular interest to small countries as this grants protection from unilateral pressures arising from larger countries.

(b) Enabling economic reforms

Bhutan will have to make binding commitments and pursue economic reforms to ensure that its laws regulations and policies are non-discriminatory, transparent and WTO consistent. For example, in many developing countries, there are vested interest groups that have monopoly access to natural resources such as minerals, forest products and tourist resources. Such groups collect monopoly rents from privileged access and impose severe costs on the national economy.[79] External commitments often help governments to overcome domestic anti-reform coalitions as other WTO member countries can contest such discriminatory and non-market-based policies.

(c) Bridging the credibility gap

As a member of WTO, Bhutan will have to pursue economic reforms and establish appropriate institutions to meet WTO obligations. This will help to overcome the credibility gap in attracting foreign investment, as WTO membership will provide a powerful guarantee of the Government's policy direction.

(d) Dispute settlement mechanism

The access to a rule-based dispute settlement mechanism (DSM) is recognized as one of the greatest benefits to small countries, as small countries can challenge even larger trading partners if the latter adopt measures that are not consistent with WTO provisions.

(e) Shaping the future of trade

Membership in WTO will give Bhutan a voice in helping to shape the future direction of international trade. This is particularly emphasized in WTO as each country has one vote, symbolizing an egalitarian approach to decision-making unlike the World Bank and the International Monetary Fund where the votes are weighted according to contributions, giving richer countries more power.

(f) Freedom of access

Although never an adequate substitute for good neighbourly relations, Article V of the GATT provides freedom of access. This is of particular importance to landlocked countries such as Bhutan, Nepal, the Lao People's Democratic Republic and Cambodia.

[79] R. J. Langhammer and M. Lucke, "WTO negotiations and accession issues for vulnerable economies", Discussion Paper 2001/36, United Nations University and World Institute for Development Economics Research, July 2001, p. 3.

(g) Special and differential treatment for developing countries

WTO confers special and differential treatment (S and D) for developing and least developed country (LDC) members. There are over 150 provisions covering a wide range of developing country concerns such as: greater market access in agriculture and manufacturing; flexibility in meeting WTO commitments, including longer periods; and greater opportunities to resort to safeguard measures to protect their economies and access to technical assistance. As Bhutan is still an LDC, early accession will enable Bhutan to benefit from the provisions of S and D treatment.

(h) Technical assistance

WTO is a complex legal agreement that requires skills in trade diplomacy as well the capacity to undertake complex negotiations. Small countries such as Bhutan lack trained personnel who can adequately understand the legal, political and economic aspects of WTO membership as well as its obligations and rights.[80] Therefore, Bhutan can benefit from technical assistance offered by WTO, ESCAP, UNDP, UNCTAD, the Bretton Woods institutions and other bilateral donors in tackling these issues.

While the above benefits are compelling, the experiences of many developing countries show that there is a deep dichotomy between the theoretical benefits of WTO membership and the practical challenges of meeting WTO obligations. This is especially pertinent for small developing countries, which have limited financial and human resources.

Although important, market access is meaningless if countries cannot gain commercially by benefiting from market entry, which is dependent on competitiveness. Small economies such as Bhutan cannot fully benefit from market access due to supply side constraints, dis-economies of scale, high transportation costs,[81] and lack of export diversification. (This issue is dealt with in detail in Section B). On the other hand, the reciprocal nature of the WTO Agreement implies that Bhutan must provide market access to other countries by progressive tariff reduction. This will lead to increase in imports, and enhance short-term current account deficits, heightening external vulnerability if exports cannot be enhanced proportionately.

One of the primary obligations of WTO membership for Bhutan will be the harmonization of Bhutan's national laws, regulations and administrative procedures with WTO agreements. Under GATT, Bhutan must make tariff-binding commitments and progressively liberalize the services sector as per the GATS commitment. In accordance with TRIPs, Bhutan must ensure that domestic laws provide at least minimum IPR protection. If such laws do not exist yet, adequate legislation must be framed and enacted. Bhutan will also be required to establish appropriate institutions to meet WTO requirements for sanitary and phytosanitary measures as well as technical standards

[80] Ibid., p. 9.

[81] Ricardo Hausman stated that estimates showed that a median landlocked country paid 50 per cent more in transportation costs than a median coastal country, in "Prisoners of geography", *Foreign Policy*, January 2001.

and Customs procedures etc. Estimates show that the total cost of compliance will be some US$ 130 million for developing countries.[82]

Membership in WTO, it is claimed, will enhance Bhutan's credibility and attract foreign investors to Bhutan. While such credibility is necessary, it is not a sufficient condition to attract investment, as investors look for high returns to capital, and access to cheap production, flexible labour markets and large markets. Foreign investors will be attracted to sectors where Bhutan offers comparative advantages such as power-intensive industries and tourism.

DSM appears to be the most beneficial tool for small developing countries that lack bargaining power. In practice, this mechanism has limited use for small countries, as the ultimate tool of enforcement of rights and obligations is trade retaliation. The costs of retaliation are proportionately higher for small economies as it could result in the loss of a large export market compared to larger economies whose exports to small economies are nominal.[83] Furthermore, it is expensive for developing countries to pursue dispute settlement, as they have to hire trade lawyers from private firms. The minimal cost of hiring the services of trade lawyers is estimated at US$ 300,000.[84] This is a prohibitively high amount for a small country such as Bhutan.

WTO does not have a standard procedure for accession. Article XII of WTO merely provides a broad outline of the rules of accession. Thus, the specific terms of accession are negotiated between the applicant and the incumbent member countries. Although this provides a degree of flexibility, the lack of a clear accession procedure has proven problematic for many countries. For example, some acceding developing countries have been asked to bind all tariffs while the incumbents have relatively high shares of their non-agriculture tariff lines unbound.[85] The stalled accession of Vanuatu is a case in point.

The above discussion shows that there is deep incongruity between the theoretical benefits and the realities of small countries in the WTO system. The obligations of membership are mandatory and impose heavy financial and social costs. On the other hand, the rights and benefits accruing from WTO membership are diffused, long-term, and contingent on efficiency and cost competitiveness. Furthermore, the ability to exercise the rights conferred by WTO membership is dependent on the availability of financial and human resources and the economic influence of a country.

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82 J. M. Finger and P. Schuller, 1998, *Implementation of Uruguay Round Commitments: The Development Challenges*, World Bank Research Department, Washington, DC.

83 Although Ecuador won the banana dispute with the European Union, the former did not impose the authorized sanctions of more than US$ 200 million as it would have been a "pinprick" for European exporters while substantially raising the cost of essential imports from the European Union. Williams Frances, "WTO minnows cry foul on mediation" *Financial Times*, 24 October 2002.

84 Williams Frances, "WTO minnows cry foul on mediation", *Financial Times*, 24 October 2002.

85 M. Bachaetta and Z. Drabek, 2002, "Effects of WTO accession on policy-making in sovereign States: preliminary lessons from the recent experience of transition countries", Staff Working Paper DERD 2002-2003, World Trade Organization, Geneva.

B. Impact of World Trade Organization accession

Trade liberalization has a profound impact on the allocation of economic resources as well as the distribution of income. On the import side, trade liberalization increases competition for domestic firms while on the export side, removal of export taxes and other incentives can create new market opportunities. Trade is beneficial to sectors that are efficient, competitive and able to adjust to new market competition, and adversely affects the weak sectors of the economy that lack the capacity to adjust to the new competitive circumstances. WTO membership and economic liberalization are often contentious in countries such as China and India, which have large public sector enterprises, protected markets, strong labour unions etc.

Accession to WTO signifies Bhutan's willingness to ensure that its domestic laws, regulations and administrative procedures, particularly those pertaining to trade, conform to WTO agreements. The impact of WTO membership is dependent on Bhutan's ability to reap the opportunities offered by trade liberalization and manage the changes induced by WTO membership. Hence, it is important to understand Bhutan's economic realities including resource endowments, the characteristics of the external sector and the economic policy environment in order to assess the impact of WTO membership on Bhutan.

1. Bhutan's economic realities

While Bhutan has achieved significant socio-economic progress in the past few decades, the progress in the real economic sector has not been as impressive. Apart from donor-funded infrastructure works and the establishment of a handful of government initiated, power-intensive industries, there has been minimal growth in the manufacturing sector. Rapid social development and population growth, coupled with weak growth in the private sector, has led to the emergence of new concerns such as unemployment and the need for economic diversification.

GDP growth, estimated at 6 to 7 per cent per annum, is largely driven by the hydropower sector as well as the transport and construction subsectors related to the construction of large hydropower projects and donor-funded infrastructure projects.

(a) Economic structure

With a population of about 700,000 people, a land area of 47,000 km^2 and an estimated GDP of about Nu 25 billion (US$ 518 million), Bhutan is a small economy by all measures.[86]

Similar to many small countries, the public sector in Bhutan is dominant due to late modernization, a weak private sector, the high cost of infrastructure and the need to provide numerous public services that are indivisible. Government expenditure accounts for almost half of GDP while donor-financed capital investments represent

[86] Population and land area reflect the size of economic endowments while GDP reflects market size and is an indicator of domestic demand.

almost half of government expenditure. The civil service is a major source of formal sector employment and the construction sector is dependent on contracts related to government or donor-funded activities.

While structural changes have occurred in the past two decades, a modern economic sector has not developed as indicated by table 1. The rudimentary domestic transport infrastructure and the fact that Bhutan is landlocked leads to high transportation costs, posing a significant barrier to competitiveness for Bhutanese goods. The nearest seaport at Kolkota, India, is about 700 miles from Bhutan. As most exports comprise low value-added, bulky commodities such as mineral products or perishable agriculture produce, cheap and efficient transport is essential. Air transport is also limited due to the country's small fleet of two aircraft and the operational limitations of the only airport at Paro.

Table 1. Sectoral share in GDP at 1980 prices

Sectors	1980	1990	2001	GDP growth, 2001
Agriculture	55.7	44.1	32.9	3.2
Mining and quarrying	0.6	0.9	1.3	19.4
Manufacturing	3.2	7.0	7.1	7.3
Electricity	0.2	9.1	10.2	12.3
Construction	7.9	6.1	12.1	17.5
Wholesale and retail trade, hotels and restaurants	10.9	6.0	5.8	7.2
Transport and communications	4.3	7.6	9.6	4.0
Finance, insurance and real estate	6.3	9.4	10.5	8.8
Community and social services (government)	10.8	9.9	10.5	6.4
Total	100	100	100	6.6

Source: Central Statistical Organization, *National Accounts Statistics Report 2002*, Thimphu.

A strong and vibrant financial sector is a prerequisite for private sector development. However, the financial sector in Bhutan is small, comprising two commercial banks, and two non-bank financial institutions (an insurance company and a development bank). The financial intermediation is limited to simple lending and deposit operations. In the recent past, the financial sector has experienced excess liquidity due to the lack of investment opportunities in Bhutan. This is attributed, in part, to high interest rates, high collateral requirements and conservative lending practices with limited products on offer from the banks.[87]

The narrow range of domestic resource endowments and a lack of economy of scale have severely limited the industrialization process. The Government aims to attract FDI to establish export-oriented industries such as light electronics. However, the high import contents of such assembly line products require skilled labour and reliable transport networks as for "just in time" production systems, both of which are areas where Bhutan lacks competitiveness.

[87] World Bank, *Bhutan Private Sector Survey, 2002*.

Hydroelectricity is the main economic resource of Bhutan, with a potential to generate 30,000 MW of electricity. Currently, Bhutan has a total installed generating capacity of 420 MW, of which the Chhukha Hydro Power Corporation accounts for the largest output with a capacity of 336 MW. This sector comprises 11 per cent of GDP and accounts for 45 per cent of the total domestic revenue (2001 figures), the single largest source of domestic revenue amounting to Nu 1,818,500 (US$ 39.2 million) in 2001. The dominance of this sector will increase with the commissioning of the 1,020 MW Tala Project in 2005. Almost 90 per cent of the electricity currently being generated is exported to India; the export tariffs are bilaterally negotiated at a political level and the payments are received in Indian rupees.

The excessive economic dependence on the hydropower sector and market concentration in a single market exposes Bhutan to external economic shocks arising from political or geo-structural sources. In addition, the hydropower sector itself can neither generate employment nor create backward linkage effects in the economy. The availability of cheap electricity has, however, led to the development of certain power-intensive industries in the towns bordering India.

Table 2. Comparative prices in South Asia for industrial electricity usage

Country	Price per kW/hr (US cents)
Bhutan	1.7
India	
Delhi	7.7
West Bengal	7.2
Assam	7.6
Bihar	5.6
Pakistan	6.2
Bangladesh	6.1
Nepal	8.2
Sri Lanka	6.1

Source: World Bank, *Bhutan Private Sector Survey 2002*.

The advantages for the private sector include free access to the large Indian market, access to cheap labour from India, stable labour relations and labour market flexibility, low electricity prices, and good governance in the country.

(b) External sector

Like many small economies, Bhutan is a highly open and trade-dependent economy, with trade comprising 65 per cent of its GDP. Bilateral trade with India dominates Bhutan's external trade, signifying limited diversification of export markets. This creates a mismatch between the imports and exports from third countries, as 20 per cent of imports are denominated in convertible currency while less than 5 per cent of exports earn convertible currency. Thus, the direction of trade has several policy implications for foreign exchange and foreign direct investment policies.

The Bilateral Free Trade Agreement governs trade in goods between India and Bhutan, and all transactions are conducted in Indian rupees and Bhutanese ngultrum. The ngultrum is pegged to the Indian rupee at parity and the latter currency circulates freely in Bhutan as legal tender. Such an arrangement restricts independent monetary policy, creates trade diversion and has disadvantages of being pegged to a non-reserve currency; however, the advantages, which include the provision of a platform for stable trade with India, currently outweigh the costs.

The sale of electricity comprises almost 50 per cent of the exports from Bhutan to India. Other major exports include mineral and chemical products, wood and wood products, fresh fruit and vegetables. Imports from India include chemicals, minerals and mineral products, and heavy machinery used in industry and the construction of hydropower plants. Bhutan also imports most of its consumer goods from India.

Since 1980, Bhutan also has had a Preferential Trade Agreement with Bangladesh. This is the second largest export market for Bhutan, accounting for 4 per cent of exports and less than 1 per cent of its imports. Trade with Bangladesh is denominated in US dollars. In 2001-2002, imports from Bangladesh amounted to US$ 1.7 million while exports to Bangladesh totalled US$ 4.5 million, resulting in a trade surplus. The major exports include fresh fruit, vegetables and minerals while imports include garments and consumer products. Apart from tourism, the earnings from exports to Bangladesh comprise a major source of hard currency for Bhutan. Efforts are also currently underway to sign a free trade agreement with Bangladesh.

While Bhutan is a signatory to the South Asian Preferential Trade Agreement (SAPTA), there has been minimal progress on that front. This is apparent from the fact that intra-South Asia Association for Regional Cooperation trade accounts for less than 5 per cent of the region's share of world trade.[88] This is mainly attributed to the lack of trade complementarities, the economic dominance of India, poor infrastructure and Indo-Pakistan tensions.

The volume of imports from third countries such as Japan, Singapore, Thailand and the United States has increased in the recent years. Imports from Thailand almost tripled from Nu 105 million in 2000 to almost Nu 290 million in 2001 and this trend is expected to continue. The major import items from third countries include motor vehicles, computers, and other manufactured and consumer goods (see annex II). For a small economy, even the purchase of a single item can have a visible impact on trade statistics. Imports from countries such as Germany are directly related to development aid as table 3 shows. Similarly, there was a one-time marked increase in imports from the United Kingdom in 2000. This was mainly due to the purchase of aircraft spare parts from British Aerospace for the national airline.

One of the major consequences of WTO membership will be Bhutan's obligation to trade with China on an MFN basis. Currently, there are no direct trade relations with China, as most merchandise trade is carried by sea via Hong Kong, China. The

[88] Kanes, "Future of SAPTA", *The Island/Upali*, 14 April 2002, www.origin.island.lk

Table 3. Direction of trade

Category	Nu million			US $ million	Percentage
	1998	1999	2000	2000	2000
Exports					
India	4 175.64	711.22	4 376.95	97.40	94.83
Bangladesh	194.68	209.45	164.77	3.67	3.57
Others	85.30	67.29	74.10	1.65	1.61
Total	4 455.62	987.96	4 615.82	102.71	100.00
Imports					
India	3 620.00	845.28	7 462.60	166.06	81.95
Japan	410.23	260.36	305.21	6.79	3.35
Germany	72.02	0.00	28.29	0.63	0.31
United States	42.72	22.44	34.33	0.76	0.38
United Kingdom	33.17	31.28	205.41	4.57	2.26
Singapore	398.34	997.88	251.36	5.59	2.76
Thailand*			105.84	2.36	1.16
China*			71.78	1.60	0.79
Bangladesh*			49.26	1.10	0.54
Nepal*			24.66	0.55	0.27
Others	939.90	677.64	567.55	12.63	6.23
Total	5 516.37	834.88	9 106.29	202.63	100.00

Source: Department of Revenue and Customs, *Bhutan Trade Statistics 2000*, Thimphu.

* Until 2000, data for these countries was included within that for others.

establishment of trade relations with this northern neighbour of Bhutan will have a tremendous economic and social impact if direct trade routes are opened through the Himalayan passes. Assuming the presence of a stable trade and transit route on land via Nepal and India, imports from China will provide direct competition to Indian merchandise. However, the advantages of cheaper imports could be significantly reduced for Bhutan if the payments for imports from China have to be made in convertible currency.

Although there are several structural limitations and external sector vulnerabilities, the Government has followed prudent policies to ensure a sound macroeconomic environment. Bhutan pursues a conservative fiscal policy. Domestic revenues have to cover recurrent expenditures, and capital expenditure is largely determined by the availability of external assistance. The external debt is mainly comprised of government loans from the Government of India for power projects, and from the multilateral financial institutions for investment in priority infrastructure works such as roads, schools, education infrastructure etc. The total outstanding debt is US$ 331.7 million, of which 55 per cent comprises Indian rupee loans and the remaining US$ 147.9 million as convertible currency. The debt service ratio stands at 3.5 per cent.[89]

[89] Royal Monetary Authority, *Selected Economic Indicators 2002*, Thimphu.

The balance of payments is an important indicator of a country's economic performance and is particularly relevant to small countries such as Bhutan that have a high exposure to the international economy through openness to trade.

Table 4. Balance of payments

(Unit: Nu million)

Item	1999	2000	2001
A. Current account	1 130.0	44.1	-406.5
Goods	-3 087.3	-4 490.4	-4 371.7
Exports	4 987.9	4 615.8	4 708.6
Imports	-8 075.2	-9 106.3	-9 080.3
Services (financial, travel, government service, transport, communication, post and insurance)	-465.8	-55.2	-17.6
Credit	828	1 570.3	1 530.3
Debit	-1 293.9	-1 625.5	-1 547.9
Income (deposits,)	451.9	622.8	372.2
Credit (deposits)	550.4	718.5	436.3
Debit (debt servicing)	-98.5	-95.7	-109.1
Current transfers	4 231.5	3 966.9	3 655.7
Credit (grant aid, trust funds)	7 547.9	7 018.2	6 956.9
Debit (worker remittance, aid-related remittance)	-3 316.6	-3 051.3	-3 301.2
B. Capital account	811.4	2 308.6	2 849.5
Foreign direct investment	0.0	0.0	86.8
Net official flows (concessional loans)	811.4	2 308.6	2 762.7
Other loans	0.0	0.0	0.0
C.Net errors and omissions	-352.3	-1 228.7	-777.1
C. Overall balance	1 589.1	1 124.1	1 665.9

Source: Royal Monetary Authority, *Selected Economic Indicators 2001*, Thimphu.

Although Bhutan has experienced persistent deficits in the merchandise and services account, the current account has been in surplus due to the inflow of external aid. The capital account has been in surplus due to concessional loans. Although the balance of payments is positive, such a position is not sustainable if economic productivity and export competitiveness are not enhanced in the real sector. Currently, the imports are funded mainly through aid and loans.

The gross international reserves stand at US$ 322.7 million, of which US$ 253 million is denominated in US dollars and the rest in Indian rupees.[90] The total reserves are estimated to be sufficient to support 20 months of imports, which by international norms is more than adequate. However, these reserves have been built over time with savings from foreign aid and loans, since convertible currency export earnings are only 25 per cent of the outflows for imports. The foreign currency reserves form an important insurance for a small country such Bhutan, which faces external sector vulnerability.

[90] Royal Monetary Authority, *Monthly Statistical Bulletin*, January 2003, p. 5.

(c) Economic policy environment

A vibrant private sector is a prerequisite for successful economic integration. Since the 1980s, the Government has pursued several privatization, divestment and de-monopolization policies. Several tax incentives have also been introduced to encourage investments in manufacturing and services sectors.

Various efforts are underway to increase exports that earn convertible currency given the limited diversification of trade. For example, the Government has waived corporate income tax on income earned in convertible currency for manufacturing units, information technology industries or services and agriculture produce.[91]

Due to the shortage of skilled domestic labour, over 50,000 Indian nationals are employed in Bhutan in the construction sector. The Government, on the other hand, has adopted strict arbitrary limits on the number of immigrant labourers allowed as a result of political obligation. However, the lack of consistency in government policies related to labour, taxation and licensing is also perceived as a constraint by the private sector.

As a result of economic weaknesses and vulnerabilities on the external front, the Government has been compelled to adopt cautious and conservative policies pertaining to foreign exchange, FDI and taxes. While these policies reflect the economic realities of Bhutan, WTO membership will have an impact on the provisions that are not consistent with the WTO agreements.

(d) Foreign exchange regime

While there is full convertibility between the ngultrum and rupee on the current account, restrictions apply on capital account transactions. However, restrictions are imposed on both the current and capital account convertibility with regard to other currencies. Foreign exchange controls on the current account apply to traders and holiday travellers, although this is to be revised with the eventual abandonment of those controls. The four categories of current account controls include: (a) ceilings on amount of foreign exchange that commercial banks can hold; (b) limits on foreign exchange requirements for importers; (c) limits on foreign exchange earnings that exporters can retain in foreign currency; and (d) limits on foreign currency that business people or private travellers can take out of the country.

Capital account controls relate to investment and borrowing abroad and include controls on FDI, and offshore investment and borrowing. Offshore investors have to obtain permission from the Royal Monetary Authority to invest or borrow from abroad.

(e) Foreign direct investment policy

In December 2002, the Government approved the Foreign Direct Investment Policy (FDIP) with a view to fostering private sector development, generating employment, enabling the transfer of capital, technology and skills, and enhancing

[91] Ibid.

convertible currency earnings. In the case of Bhutan, FDI is understood to be investments made in convertible currencies only. Prior to the policy, limited foreign investment was allowed in the banking, tourism and industrial sectors on a case-by-case basis. Table 5 shows existing foreign investment in Bhutan.

Table 5. Summary of foreign investment in Bhutan

Sector	Local partner (LP)	Foreign partner (FP)	Year	Ownership distribution		
				FP	LP	Public
Finance	BoB	State Bank of India	1971	20.0	80.00	0
Manufacturing	BFAL	Marubeni Corp (Japan)	1990	20.0	40.12	39.88
Finance	BNB	Asian Development Bank	1996	20.1	27.20	52.77
Tourism	BTCL	Aman Resorts (Singapore)	2001	60.0	30.00	10.00
Tourism	BIC	Ms HPL (Singapore)	2001	60.0	30.00	10.00

Source: Royal Monetary Authority, *Monthly Statistical Bulletin*, January 2003, Thimphu.

Note: BoB – Bank of Bhutan; BFAL – Bhutan Ferro Alloys Limited; BNB – Bhutan National Bank; BTCL – Bhutan Tourism Corporation Limited; and BIC – Bhutan International Company.

FDIP sets out the broad parameters for foreign investors by delineating areas and size of investments, skills transfer requirements and the need to comply with the Foreign Exchange Regulations. Section 7 (a) relating to the Foreign Exchange Regulations stipulates: (a) foreign currency requirements for import of capital goods must be met out of foreign equity; (b) repatriation of profits and dividends must be balanced by net foreign exchange earnings; and (c) repayment of foreign currency loans will be permitted subject to prior approval of the loans by the Government.[92] (A full list of the sectors open to foreign investment is given in annex I).

While the adoption of an FDI policy is significant, it is still deemed conservative. This reflects the cautious approach of the Government of Bhutan to ensure that local entrepreneurs are not disadvantaged.

(f) Tariff regime

As Bhutan is an import-dependent economy, there has been minimal compulsion to protect the domestic economy with import tariffs or quantative restrictions. The tariff regime comprises the Bhutan sales tax (BST) and Customs duty. BST is imposed on all imports and on the sales of hotels, restaurants and cement. The BST rate ranges from 0 to 15 per cent with higher rates of 50 per cent being applied to alcoholic and tobacco products. In accordance with the Free Trade Agreement with India, Indian exporters can claim BST as a rebate against the Indian sales tax, thus nullifying the impact of BST on Indian imports.

[92] Government of Bhutan, "Foreign Direct Investment Policy", December 2002, p. 5.

Customs duty has five non-zero rates, i.e., 10, 20, 30 and 50 per cent for non-alcoholic beverages and beer, and 100 per cent for tobacco and alcoholic beverages. The customs duties for most goods fall within the 10-30 per cent range. Imports of raw materials are exempt from BST. Customs duty is waived on imports of industrial plant, machineries, their spare parts and raw materials if the final product has at least 40 per cent value addition and/or the convertible currency earned by the company during the year covers at least the cost of the raw materials. Bhutan's tariff rate on imports of industrial products is well within the 20 to 40 per cent range as applied to such products in most developing countries.[93]

Unlike many countries, which depend on import duty for a substantial portion of national revenue, the proceeds from import duties in Bhutan are nominal at less than 2 per cent of the total revenue. Customs duty is used to discourage imports of products such as alcohol and tobacco, and to conserve convertible currency reserves by controlling the imports of luxury goods from third countries that require payments in hard currency.

However, certain GATT-consistent quantative restrictions, as allowed under Article XX, are imposed in Bhutan on imports of the following products: arms and ammunitions; explosives; endangered animal and plant species; banned chemicals; hazardous scraps; secondhand vehicles; gold and silver; plastic carry bags; and drugs and pharmaceutical products. Similarly, export restrictions are imposed on endangered plants and animal species; antiques; narcotics and psychotropic substances; and raw timber. Quota restrictions apply on imports of liquid petroleum gas and kerosene, although this practice will be discontinued in the near future.

C. GATT and the impact on trade in goods

The impacts of multilateral trade on Bhutan's economy will be transmitted via the following avenues:

(a) The impact of foreign competition on domestic firms;

(b) The impact on export performance arising from greater market access opportunities;

(c) The impact on domestic laws and regulations due to WTO obligations.

It is difficult to assess the impact of WTO on Bhutan's agriculture, industries and services, as tariff binding is dependent on bilateral negotiations conducted between the acceding country and the existing member countries. This therefore limits the study to making broad theoretical assessments of the impacts of WTO accession.

[93] GATT Secretariat, "The results of the Uruguay Round of multilateral trade negotiations, market access for goods and services: overview of the results", November 1994.

1. Impact on the industrial sector

Bhutan has a small industrial sector (including manufacturing and mining) that is dependent on processing agriculture, mineral and wood-based industries as shown in table 6. This sector employs about 12,500 people, corresponding to about 5 per cent of the labour force.[94]

Table 6. Licences in the manufacturing sector

Subsector/type	Total licences	Employment (%)
Agro-based	116	20
Forest (wood)-based	317	18
Mineral-based	46	47
Others	90	18
Total	569	100

Source: Ministry of Trade and Industries, 2002.

A few large-scale, energy-intensive industries in Bhutan process cement, calcium carbide and ferro-silicon. As electricity comprises almost 60 per cent of the cost of production in the case of ferro-silicon, cement and calcium carbide, these industries derive a comparative advantage from the availability of cheap and reliable hydroelectric power. Most of these products are exported to India (annex II). The recently established Coca-Cola bottling unit also exports 90 per cent of its products to the Indian market.[95]

Trade liberalization through WTO seeks to reduce tariffs, remove quantative restrictions and expose domestic industries to foreign competition. In the case of Bhutan, almost all modern consumer products are imported with India being the dominant source of those imports. Given the high import dependence, and the lack of a viable domestic manufacturing sector, there has been minimal inducement to protect the manufacturing sector. This is evident from the fact that customs duty accounts for less than 2 per cent of total domestic revenue.

Table 7 is indicative of the duty and tax imposed on goods similar to those that are manufactured in Bhutan.

As table 7 shows, moderate levels of tariffs are applicable on imports that compete with the domestic industries. Indian imports can, however, claim a rebate on BST, based on the Free Trade Agreement with India. Thus, Bhutanese firms are effectively in competition with Indian firms as most of the above listed manufactured goods are destined for export to the Indian market (see annex II). However, the Bhutanese firms enjoy comparative advantages arising from cheap hydropower and ready availability of minerals and forest products.

94 Central Statistical Organization, Labour Force Survey, 1999, Thimphu.

95 *Financial Express* web site: http://www.financialexpress.com/fe_full_story.php?content_id=27571

Table 7. Comparison of tariff levels on products of interest to Bhutan

Products	Bhutan			India
	Sales tax	Customs duty	Total tariff	Total tariff[a]
Cement	5	20	25	30
Calcium carbide	5	10	15	30
Ferro-silicon	–	5	5	30
Particle board	10	20	30	30
Wooden furniture	10	30	40	30
Distillery products	50	100	150	182
Polythene pipes	10	0	10	30
Plaster of Paris	10	30	40	25
Plywood	20	5	25	30
Polymer products	0	10	10	30

Sources: Department of Revenue and Customs, Bhutan Trade Classification Customs Tariff and Sales Tax Schedule, January 2002; and *Customs Tariffs of India, 2002-2003,* 35th Edition, Centax Publications, New Delhi.

[a] This does not include the various state taxes and supplementary charges. In the case of calcium carbide and ferro-silicon, the applicable anti-dumping duties are not included.

Given the high level of integration with the Indian market, the pace of liberalization in India will have greater impact on these industries compared to Bhutan's accession to WTO. There is concern that calcium carbide exports from China were driving down the price in India, thereby posing a threat to Bhutan's calcium carbide exports. In 2000, India imposed an anti-dumping duty on calcium carbide originating from China and Romania at a rate of US$ 13.88 and US$ 24.29 per metric ton (mt), respectively.[96] Similarly, ferro-silicon originating from China and Russia is subject to an anti-dumping duty of US$ 764 per mt.[97] This has shielded the prospects of two major industries that continue to enjoy protection in India.

WTO member countries could, in future, contest the fact that industries in Bhutan receive an electricity subsidy.[98] Similarly, tax exemptions granted for industries that earn convertible currency could also be contested as an export subsidy. However, as an LDC, Bhutan would be exempt from the rule prohibiting subsidies until it reaches export competitiveness.[99]

In most cases, trade liberalization helps to lower the cost of imported inputs, thereby increasing the competitiveness of exports. However, in Bhutan, most inputs including plant and machinery are exempt from sales tax and customs duty. Raw

[96] Notification 77/2000- CUS, 26 May 2000, *Customs Tariffs of India, 2002-2003,* 35th Edition, New Delhi, Centax Publications.

[97] Notification No. 672001 cus 25 June 2001.

[98] As per the WTO definition, a subsidy is granted when a government confers a benefit by providing goods or services for less than the prevailing market price.

[99] A country is said to have reached export competitiveness in a product if it has attained a share of 3.25 per cent in the world market for two consecutive years: *Business Guide to the World Trading System*, International Trade Centre, Geneva, p. 130.

materials imported from India are already exempt from BST, and raw materials imported from third countries are exempt from customs duty if the importing firm earns convertible currency.[100]

As existing manufactured or semi-manufactured products are bulky and have a low value-added component, any competitiveness in third country markets due to a comparative advantage of cheap energy will be offset by high transportation costs. Therefore, it is likely that India will remain a major trading partner with Bhutan. However, it is imperative to adopt export-oriented policies in order to capture the benefits of market access and diversification.

Unlike the above-mentioned large-scale industries that are dependent on the Indian markets, numerous small and medium-sized enterprises (SMEs) exist that mainly serve the domestic market. One example is the small and medium-sized wood-based industry comprising 56 sawmills and 65 furniture workshops. Other SMEs include handicrafts, handmade paper and incense manufacturing businesses.

In the case of the wood-based industry, Bhutan enjoys a comparative advantage in the availability of cheap timber at prices ranging from US$ 65-US$ 102/m^3 compared with international prices of US$ 126-US$ 238/m^3. The labour costs are also competitive at US$ 89 per month compared with US$ 136 in Bangladesh and US$ 156 in the Philippines.[101] However, the lack of technology and economies of scale as well as low productivity levels cannot compete effectively with imported furniture from Thailand despite high tariffs of 40 per cent. Any further reduction in tariff will increase competition for the Bhutanese industries.

The SMEs have so far managed to survive despite competition from India. Most SMEs are involved in niche products such as furniture, handmade paper, handicrafts and incense manufacturing, which have a ready market in Bhutan. As niche products, incense and handmade paper have also gained small markets in Europe, East Asia and North America. However, these provide a negligible export contribution given the low value added component and small quantities involved.

2. Impact on the agriculture sector

Agriculture in Bhutan comprises about 33 per cent of GDP and is a source of livelihood for almost 80 per cent of the population. Prospects for agriculture productivity growth are limited due to the rough terrain, poor soil quality and the limited availability of arable land, which amounts to approximately 7 per cent of the country's total land area. Although Bhutan is a nation of farmers, with 80 per cent of the population living in the rural areas, there has been no pressure to protect the farming sector due to the lack of commercial orientation in this sector or an effective farm lobby. In Bhutan, the small family-operated farms, with an average size of 3.4 acres, are only able to provide a subsistence existence at best for farm households. The farmers produce rice, wheat,

[100] Ministry of Finance, *National Budget Report, 2002-2003*, June 2002, Thimphu.

[101] A detailed discussion on this issue can be found in the *Bhutan Private Sector Survey, 2000*, World Bank, Washington, DC.

maize, potatoes, barley and buckwheat, depending on the altitude of the farms. With a growing population, the grain deficit has also increased, as reflected in increasing imports of food. In 1998, 34,813 mt of rice, 6,369 mt of wheat, 3,449 mt of wheat flour and 1,960 mt of maize were imported.

WTO membership will theoretically confer greater market access to Bhutanese agricultural products. However, increased market access is unlikely to benefit Bhutan, as competitiveness in the agriculture sector (as is the case in other sectors) will be determined by scale, technology and transport costs; these are all areas in which Bhutan suffers significant disadvantages.

On the other hand, Bhutanese consumers will have access to a wide variety of food commodities, as is already evident from the availability of Thai rice and Australian apples in the market. Any surge in imports without a commensurate rise in exports will place pressure on the convertible currency reserves.

The agriculture sector is conventionally protected by restricting imports through high tariffs and quantative restrictions, the provision of subsidies to producers and subsidized exports (table 8). Bhutan does not impose any tariff on imports of essential agriculture commodities from India, the main source of agriculture imports. In addition, no measures are used to impose quantative restrictions. Customs duty is levied on imports from third countries with the main objective of conserving the convertible currency reserves rather than protecting the agriculture sector. If Bhutan has to gradually reduce customs duty on third country imports, it is likely that food imports from those countries will surge and place immense pressure on Bhutan's convertible currency reserves. The volume of imports from third countries will be determined by the ability of such agriculture products to compete with Indian produce after considering the high transportation costs from the nearest seaport in Kolkota, India.

Table 8. Comparison of tariff rates on products of interest to Bhutan

Products	Bhutan			India
	BST	Customs duty	Total tariffs	Tariff
Cereals	0	20	20	60-100
Processed foods	15	30	45	30
Apples	0	20	20	50
Oranges	0	20	20	40
Cardamom	5	20	25	70

Sources: Department of Revenue and Customs, Bhutan Trade Classification Customs Tariff and Sales Tax Schedule, January 2002; and *Customs Tariffs of India, 2002-2003,* 35th Edition, New Delhi, Centax Publications.

Government intervention in the farming sector has been limited to the provision of hybrid seeds and extension services, subsidized farm machinery and the construction of irrigation channels. The Government does not provide price support to the agriculture sector.

On the export side, WTO obliges members to remove export subsidies. In Bhutan, income from exports of those agriculture products that earn convertible currency is exempt from income tax. While this could be construed as a subsidy, Bhutan will be allowed to retain this subsidy as an LDC. As a LDC, Bhutan can also make higher tariff-binding commitments in the agriculture sector.

As the scope for large-scale farming is limited, Bhutan has to explore special niche markets for its agriculture produce. For example, an entrepreneur has started exporting local "red rice" to health food stores in the United States while others export fresh mushrooms to Japan and Singapore. However, Bhutanese farmers are not able to benefit fully from such niche markets due to supply side constraints associated with a lack of marketing skills, technology and high transportation costs. The ability to benefit from market access as a result of WTO membership will be contingent on overcoming these bottlenecks and fulfilling the stringent criteria that WTO members impose through sanitary and phytosanitary regulations.

With the unstoppable trend of rural urban migration, increased access to education and cheap food imports, it is likely that the farming population will shrink in the next two decades. The higher profit margins in cash crop production will encourage people to move away from traditional production to the cultivation of fruit and vegetables. This trend will have a direct implication on the Land Act of Bhutan, which states that paddy land cannot be converted to other uses. As much of the paddy land is in flat valley areas that are also the most suitable places for construction of high-density residential buildings, the higher returns on real estate in the urban areas will also place pressure on the Government to reconsider the provisions of the Land Act. Such pressure in conjunction with party politics in the future will inevitably compel the Government to either relent to pressure or provide some form of subsidy to keep the farmland from being utilized in other ways.

In the future, Bhutan's membership in WTO could provide greater impetus for employment opportunities in the modern sectors, drawing people away from the farms. Once the market economy expands, and economic and social transactions are monetized in the rural areas, modern sector employment that provides monetary remuneration will then become more attractive than subsistence farming. This could change the economic and social landscape of Bhutan.

The major cash crops of Bhutan are apples, oranges and cardamom, mainly cultivated in the western and southern areas of the country. These cash crops also have vibrant export markets in Bangladesh and India. In 2000, the export earnings from the three crops totalled some Nu 260 million while exports of fresh vegetables accounted for Nu 134 million. As the exports to Bangladesh are denominated in US dollars, this sector is one of the few sources of hard currency earnings in addition to tourism.

Given the relatively higher returns from cash crop exports, the Bhutanese have made sizable investments including increasing applications of scientific methods. Almost 90 per cent of apple production is in the Thimphu and Paro valleys while the dominant

orange producers are in southern Bhutan.[102] Businessmen, local landlords and civil servants who have better access to information and technology own most of the orchards. Such benefits will extend to rural farmers once road access is improved to the remote areas of the country. The Government provides support in marketing these types of produce in the regional markets. In November 2002, Sri Lanka agreed to provide duty-free access to apple exports from Bhutan under the SAPTA Agreement.

A reliable transport network in the country is crucial for these perishable products as the best quality fetches premium prices in the export markets. As India and Bangladesh are the major markets, the infrastructure and political situation in the bordering areas and the liberalization of the agriculture sector will have a direct bearing on the export of agriculture products.

3. Trade-Related Investment Measures

In accordance with GATT requirements, Bhutan will have to phase out any Trade Related Investment Measures (TRIMs) that are not consistent with GATT Article III and XI, i.e., national treatment and general elimination of quantative restrictions. The prohibited TRIMs include: (a) local content requirements; (b) foreign exchange balancing requirements; (c) trade balancing requirements; and (d) domestic sales requirement. For example, the foreign exchange balancing requirement stipulated in Bhutan's FDI policy, although important to conserving hard currency, is TRIMs inconsistent. Bhutan will have to notify WTO on the use of prohibited TRIMs and adopt a progressive removal.

D. GATS and the impact on the service sector

Bhutan's main service sectors comprise construction, transport, telecommunications, tourism and hotels, and the retail trade. The high growth rates in the transport and construction sectors are related to the construction of large hydropower plants in the country. Publicly funded infrastructure works including the construction and repair of roads and housing complexes dominate the construction sector. Although passenger transport services have been de-monopolized, there has been limited completion among the transport operators due to low passenger volumes. To ensure reasonable fares, the Government regulates them. Passenger transport vehicles are exempt from both BST and customs duty.[103] In addition, these receive interest subsidies for the purchase of new passenger vehicles.

As Bhutan's service sector is small and nascent, it is unlikely that there will be any tangible benefits for the country from GATS. The primary benefits from service sector liberalization will accrue to developed countries, which have a strong service sector. Tourism is perhaps only the service sector that may be of interest to foreign firms in the near future. The entry of foreign suppliers could have a positive catalytic impact on the private sector in Bhutan. For example, foreign banks will be able to

[102] Ministry of Agriculture, *Renewable Natural Resource Statistics, 2000,* p. 38, Thimphu.

[103] Ministry of Finance, *National Budget Report, 2001-2002*, June 2001, p. 17, Thimphu.

provide Bhutanese entrepreneurs with better services and more sophisticated financial products. However, it is unlikely that foreign suppliers will rush to Bhutan's small service market, given the limited demand for services and the high cost of delivery of services.

1. Impact on the tourism sector

As an important service sector for Bhutan, the impact of GATS on the tourism sector deserves mention in some detail. Bhutan enjoys an exceptional comparative advantage in the sector due to its unique culture and pristine natural environment. The tourism sector is the single largest source of convertible currency earnings, with significant backward linkages in the economy and potential for employment generation. The sector was liberalized in 1999 and currently there are about 100 tour operators. However, it is unbalanced with more than 50 per cent of the market share dominated by the top six travel agencies. Currently, this sector provides direct employment for 500 regular employees and over 2,000 temporary workers. The tourist numbers vary from 6,000 to 7,000 visitors annually, earning close to US$ 10 million per year.

Following a "high value, low volume" tourism policy,[104] the Government administers tariffs in the tourism sector ranging from US$ 165 in the low season to US$ 200 in the high season per person per day.[105] The tour companies must pay 35 per cent of the daily tariff to the Government as royalty fees. The convertibility currency receipts of the tour operators are channelled through the Royal Monetary Authority, which retains the convertible currency and pays the ngultrum equivalent to the tour operator.

Currently, foreign investments in the tourism sector are limited to the hotel or resort construction sector, as tour operation licences are restricted to Bhutanese nationals only. Foreign investment in this sector will help to improve the quality of services in the hospitality industry as well as allow investments in hotels of higher standards. Partnerships with foreign companies will also boost the marketing efforts of the local companies in the foreign countries.

However, under GATS, the tourism sector liberalization also includes the opening of distribution marketing and sales of tourism-related services. With liberalization, Bhutan's large tour companies could effectively monopolize the industry through partnerships with major international companies that control tourism-related sectors including hotels, airline reservation, information systems, thereby reducing the market share of the small tour companies.

Other countries could challenge the administered tariff system as being a non-tariff barrier. The onus will be on the Government to prove that such a tariff is a necessary safeguard measure consistent with WTO membership. Furthermore, as foreign companies will want to repatriate profits earned in convertible currencies, Bhutan cannot restrict the profit repatriation of such currencies. The cultural and

[104] This has recently been changed to a "high value, low impact" policy.

[105] This tariff is inclusive of food, lodging, transport and guide services.

environmental policies of Bhutan could also be undermined if the large foreign companies and their influential local counterparts, if any, place pressure on the Government to open more areas for mass tourism.

2. Impact on the hydropower sector

Hydroelectricity is the main economic resource of Bhutan with a potential to generate 30,000 MW of electricity. Currently, Bhutan has an installed capacity to generate 420 MW, of which the Chhukha Hydro Power Corporation is the largest (336 MW). Similar to the oil-rich States of the Persian Gulf, the hydropower sector is an important national resource. This sector contributes 11 per cent of GDP and accounts for 45 per cent of total domestic revenue (2001 figure), the single largest source of domestic revenue amounting to Nu 1,818.5 million (US$ 39.2 million) in 2001.

Although an important source revenue, the hydropower sector is neither able to generate productive employment nor help in diversifying the export market apart from supporting a few power-intensive industries. The scope for competition among the generating units is limited due to the administration of preferential export tariffs and the single market in India. The wide difference in the capacities of the companies (Tala, 1,020 MW; Chhukha, 336 MW; Kurichhu, 60 MW; and Basochhu, 22 MW) also affects the competitiveness of the smaller power companies.

The power generation units are government-owned companies. The Bhutan Power Corporation formed in 2002 is responsible for the utility functions including transmission and distribution services. Foreign companies are unlikely invest in the transmission and distribution services in the country due to the high costs caused by the difficult terrain, scattered settlements and low population density. If this sector is opened to foreigners, it is possible that foreign energy companies will be interested in generating hydroelectricity for sale in neighbouring countries that suffer from energy deficits. Given its proximity, India is a captive market. However, the opportunities for private firms to benefit from power exports will depend largely on the pace of electricity sector reforms in India, particularly the State Electricity Boards.[106]

E. Impact of TRIPs

Intellectual property protection (IPP) is a new area in Bhutan and the fundamental laws, including the Copy Right Act and the Industrial Property Act (including designs, patents and trademarks), were only enacted in 2001. Bhutan is already a signatory to the following international agreements related to IPP:

- Convention on establishing the WIPO, 1994
- Paris Convention on Protection of Industrial Property, 2000

[106] The existing electricity export arrangements with India are based on bilaterally administered tariff rates. The generating unit sells power to the Power and Grid Corporation of India Ltd. (PGCIL), a public company, which in turn sells the power to the State Electricity Boards. The payment is also made by PGCIL to the generating company in Bhutan.

- Madrid Agreement Concerning International Registration of Marks, 2000
- Protocol related to the Madrid Agreement Concerning International Registration of Marks, 2000.

Bhutan must ensure that its domestic laws pertaining to IPR protection conform to the minimum standards set by TRIPs. Bhutan is also obliged to sign the Berne Convention for Protection of Literary and Artistic Works (copyright) and ensure that adequate domestic laws are enacted to cover areas such as the protection of geographical indication, layout designs of integrated circuits and undisclosed information including trade secrets. The penalties for IPR infringement must also be spelt out and adequate to deter violation of the obligations.

In addition to the legal obligations, Bhutan must establish appropriate institutions to ensure transparency and facilitate registration of intellectual property. The current institutions must be significantly strengthened to meet the legal, administrative, procedural and reporting requirements of WTO. For example, it is obligatory for members to make certain notifications to the TRIPs Council to allow members to review each other's legislation and ensure transparency of each member's IPR policies Bhutan lacks legal expertise to frame laws pertaining to IPP and ensure compliance to WTO Agreements. The costs of establishing institutions and computerized databases for registering trademarks, patents etc. are prohibitive for many developing countries. Bhutan will also be obliged to prohibit the production or import of counterfeit and pirated goods. This will require training and awareness creation among the Bhutanese people as well as extra vigilance of the Customs personnel at the in the ports of entry and exit. These obligations pose significant financial costs for small developing countries.

While obligations are mandatory and expensive, the tangible benefits of TRIPs will accrue to Bhutan only if there is are vibrant domestic sources of innovation, invention and creation that require international IPR protection. The benefits of TRIPs are marginal for small developing countries such as Bhutan, as the research and development capacity is non-existent and the artistic industries currently have a limited domestic market.[107] The contention that IPR is "technological protectionism" is convincing, as the advanced industrialized countries are a source of most of the innovations. Estimates show that the OECD countries led by Germany, Japan and the United States account for more than 80 per cent of research and development expenditure, and about 90 per cent of the patents taken out and over 90 per cent of the technology fees received in the past three decades.[108]

The establishment of transparent laws and binding regulations will set the basis for protecting Bhutanese entrepreneurs and artists from IPR infringement in Bhutan as well as abroad. For example, the Copyright Act 2001 protects the IPRs of local artists

[107] Countries such as India with a large non-resident population abroad have great interest in gaining copyright protection for their audio-visual industries.

[108] N. Kumar, 2003, "Intellectual property rights, technology and economic development: experiences of Asian countries", *Economic and Political Weekly*, Vol. 38, No. 3,18-24 January 2003, p. 210.

in Bhutan from duplication and sale of their works without consent, but this does not accord the artists any protection abroad. Once Bhutan becomes a signatory to the Berne Convention, the IPRs of the Bhutanese artists will be recognized in all signatory countries. In the past two years, two cases of domestic copyright infringement have been reported pertaining to the local audio-visual industry.[109] However, those cases have not been pursued due to the lack of IPR awareness in Bhutan and the reluctance to pursue litigation in a small society.

One of the main areas of interest to Bhutan is the protection of the country's traditional knowledge from commercial exploitation by foreign companies without acknowledgement and compensation. Although important for many financially poor but knowledge-rich developing countries, TRIPs does not have provisions for protecting traditional knowledge. Similarly, there have been numerous cases of "bio-piracy" by companies based in developed countries by patenting the use of biological resources from developing countries.[110] In order to prevent theft of traditional knowledge, it will be important for Bhutan to study and document existing patterns of traditional knowledge including textile designs, indigenous medicine etc.

Since Bhutan depends on India for most technology-related products such as pharmaceuticals, fertilizers, machinery etc., the imposition of TRIPs obligations on India will invariably affect Bhutan. For example, in the case of pharmaceutical products, Bhutan currently enjoys access to cheap medicines from India as the patent laws in India recognize process patents and not product patents. As India is obliged to follow both product and process patents under the TRIPs Agreement, the prices of medicines are projected to increase by between 182 and 225 per cent at the end of the transition period in 2004.[111] This will have a significant impact on the cost of delivery of health services in Bhutan, particularly as those services are provided completely free of cost by the Government. There is some respite since the vast majority of drugs are out of patent protection. However, this excludes medicines for emerging diseases such as auto-immune deficiency syndrome (AIDS), cancer, renal problems and cardiac failure. The ability of developing countries to develop such drugs under a lax process patent will be constrained by the TRIPs Agreement.

The costs of implementing TRIPs obligations far outweigh its benefits for a country such as Bhutan. In fact, Bhutan cannot benefit from the transition period accorded to LDCs as such concessions are availed only to those countries that were WTO members on 1 January 1995.

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[109] T. Gyeltshen, 2002, "Music video brings copyright issue into focus" 5 August 2002, and "Song theft may be the first copyright case", 1 February 2003, Kuensel, Thimphu.

[110] In 1995, for example, there was an attempt in the United States to patent the use of turmeric for healing wounds. However, this was challenged successfully by India, as the use of turmeric is a case of traditional knowledge that is not new.

[111] N. Kumar, "Intellectual property rights, technology and economic development: experiences of Asian countries", *Economic and Political Weekly*, Vol. 38, No. 3, 18-24 January 2003, p. 220.

F. Macroeconomic impacts

1. Balance of payments

Theoretically, economic liberalization and a possible decline in foreign aid receipts will lead to a worsening of the current account balance and the balance of payments if it is not offset by private capital inflows export sector growth. While the current account balance with India is likely to be favorable with increased electricity exports from Tala Hydropower Project and the projected increase in the electricity tariff, trade deficit with third countries will increase due to enhanced propensity to import as a result of lower tariffs. This trend will place significant pressure on the hard currency reserves.

Article XVIII of the WTO provides Balance of Payments safeguard measures for developing countries when it deems a threat of decline of its monetary reserves or is of a view that the monetary reserves are not adequate to cover its foreign exchange payments. This however, is a temporary measure and is not granted automatically. The country seeking such a safeguard has to fulfill several administrative procedures stipulated by the WTO. While such measures may be necessary to prevent undue use of such safeguard, such administrative procedures are of great financial burden to small LDCs.

2. Impact on national revenue

There is widespread perception that globalization impinges on the traditional spheres of government activity such as taxation, public spending, income redistribution and macroeconomic policy. This is pronounced in the case of WTO membership, as governments have to ensure conformity of national laws and rules to the various WTO Agreements. Trade liberalization leads to the decline of domestic revenues, particularly for countries that depend heavily on import tariffs. This impact is greater if the decline in import revenue is not offset by accompanying increases in taxes from others sources resulting from enhanced exports.

Bhutan's membership in WTO will undoubtedly have an impact on national revenue. The national revenue of Bhutan can be categorized as tax and non-tax revenue as shown in table 9.

Unlike many developing countries, import taxes contribute a miniscule 2 per cent of the total revenue in Bhutan. This reflects the dominance of Indian imports (which are tax- and duty-free), the generally low level of import tariffs as well as the exemptions granted for government/donor-funded projects, and exemptions in imports of plant and machinery. Although not established thoroughly, the under valuation of goods by importers also contributes to leakages. Therefore, tariff reduction will have minimal impact on the national revenue. Apart from the hard currency concern, further import tariff reductions may help to overcome the trade deflection that favours

Table 9. Summary of national revenue in Bhutan

Category	1998/99	1999/2000	2000/01	As % 2000/01 revenue
Total tax revenue	1 459.570	2 198.860	2 200.630	47.11
Direct tax	913.920	1 273.190	1 525.680	32.66
Corporate income tax	594.342	833.249	919.539	19.68
Business income tax	71.924	134.764	231.954	4.97
Salary tax	30.805	56.550	65.845	1.41
Health contribution	16.292	19.783	22.215	0.48
Royalty	193.743	221.788	275.867	5.91
Rural tax	6.814	7.051	10.255	0.22
Indirect tax	545.646	925.679	674.953	14.45
Bhutan sales tax	224.492	299.878	351.401	7.52
Export tax	19.799	9.371	13.554	0.29
Excise duty	184.647	470.325	130.273	2.79
Tax on motor vehicles	45.155	58.949	60.219	1.29
Import duty	44.171	57.946	76.623	1.64
Business professional licences	11.697	12.429	18.530	0.40
Other tax revenue	15.685	16.781	24.353	0.52
Total non-tax revenue	2 087.930	2 182.270	2 470.890	52.89
Administrative fees and charges	56.821	71.557	80.932	1.73
Capital revenue	86.298	71.360	76.055	1.63
Revenue from goverment departments	445.547	564.413	310.520	6.65
Dividends	970.612	1 222.490	1 296.090	27.74
Transfer of profit	526.358	248.193	705.608	15.10
Other non-tax revenue	2.291	4.259	1.684	0.04
Total	3 547.490	4 381.140	4 671.520	100.00

Source: Ministry of Finance, national budget reports.

Indian goods, although most third country products are often cheaper and better in quality.[112]

The single largest source of national revenue is from transfers of dividends from government shares in the industrial, financial and power sectors amounting to 27 per cent of total revenue.[113] The proceeds from the Chhukha Hydropower Corporation contributed more than 90 per cent of the total dividend earnings in 2001.

The Corporate Income Tax (CIT) is the second largest source of revenue with a 19 per cent contribution to total revenue. The proceeds from the Chhukha Hydropower Corporation form almost 70 per cent of total CIT. The other sources of CIT include major industries, financial institutions, and the tourism and construction sectors.

[112] This is true in the case of many electronic and technology-related goods.

[113] The data for this section were obtained from the *National Revenue Report*, Ministry of Finance, 2000-2001.

The third largest source is from the transfer of profits from Bhutan Lotteries and the return on overseas investments by the Royal Monetary Authority comprising 15.5 per cent of total revenue. The Royal Monetary Authority contributes to about 80 per cent of the total transfer of profits.

The Bhutan sales tax, with a total contribution of 7 per cent of the total revenue, is the fourth largest source of national revenue. This comprises tax on goods imported from third countries as well as sales of cement, and hotel and restaurant services. The provisions of BST may have to be reviewed, as the current practice of exempting most domestic products from BST will not be consistent with the principle of national treatment applicable under WTO.

By assessing the four largest sources of domestic revenue, almost 75 per cent of the revenues are dependent on the profits of the hydropower sector and Royal Monetary Authority operations. Although an indication of poor economic diversification, there is some solace as WTO membership is unlikely to affect these sources of domestic revenue.

Economic liberalization in India could marginally affect national revenue indirectly if the export performance of the Bhutan's industries (BFAL, BCCL and PCAL) is affected due to competitive pressure in the Indian markets, leading to declining CIT and dividends from these companies.

The other subtle effects of liberalization include erosion of the Government's power to collect taxes due to a long list of "fiscal termites gnawing at the foundation of tax regimes".[114] This list includes cross-border shopping, increased mobility of skilled labour, growth of e-commerce, the expansion of tax havens and intermediate trade within multinational companies. With such enhanced mobility of tax sources, the less mobile factors such as unskilled workers and the rural sector are likely to be adversely affected.

3. Institutional impacts

As WTO is a complex legal agreement, Bhutan will require both legal and economic expertise to handle its WTO affairs professionally. This is pertinent, as most of the concessions that a country seeks will depend on the ability to negotiate such concessions. The establishment of WTO cells in the Government and the posting of staff to Geneva will be costly. To meet transparency requirements of GATS, specific offices will also have to be established as points of enquiry.

In order to ensure minimal trade distortion, WTO countries are obliged to establish institutions to ensure compliance with the Agreements on Technical Barriers to Trade (TBT), Sanitary and Phytosanitary Standards (SPS) and enquiry points for GATS. Although these agreements may not be immediately necessary for a small developing country such as Bhutan, considerable expenses will be incurred in training

[114] V. Tanzi, 2000, "Globalisation and the work of fiscal termites", International Monetary Fund Working Paper 00/181, Washington, DC.

competent technical personnel as well as the procurement of equipment and establishment of laboratories.

G. Sociocultural impact of the World Trade Organization

Currently, an intense global debate is ongoing on the impact of globalization on the nation State, as globalization impinges on those areas considered traditional domains of governments. WTO, as one of the most powerful agents of globalization, has overwhelmingly constrained the policy options of governments as the national laws, policies and administrative procedures have to conform to the WTO Agreements. Countries must abide by the market principles and any attempt to diverge is illegal and subject to challenge by other members. Thus, the latitude of governments to pursue certain social goals through subsidies, quotas etc. is limited. At least it may prove to be a barrier to trade.

Although orthodox theories claim that trade liberalization enhances welfare, experience in other countries shows that, without appropriate policies, the vulnerable sections of society are marginalized further. Although a simplistic analogy, just as trade benefits the strong sectors of an economy, WTO membership will benefit the Bhutanese elite and skilled workers. For example, market access in agricultural products will benefit cash crop exporters more than subsistence farmers. In fact, it may marginalize the latter if government interventions favour export sectors and fail to protect subsistence farmers from cheap imports. Similarly, economic liberalization and foreign investment will enhance employment and income opportunities for well-educated and skilled workers far more than for poorly educated, unskilled people.

If the government gradually phases out the free health services, the impact of TRIPs on the pharmaceutical sector in India will directly affect the poor people in Bhutan, as they may not be able to afford expensive medicines. Global economic integration allows mobile factors of production such as skilled workers to transfer their income sources from taxation. This will place extra burdens on the unskilled workers and rural economies as their sources of income are less mobile. Furthermore, a reduction in social sector expenditure, for market-oriented reasons, will also adversely affect the poor.

Economic liberalization marginalizes the vulnerable sections of society, especially the poor and women, if adequate social safety nets are not in place. Fortunately, in Bhutan there is no societal and legal discrimination based on gender. In fact, employment opportunities for women may increase in the future with the expansion of the service sector and potential investments in assembly line jobs.

There is also ample literature on the impact of globalization on local traditions and culture. Such impacts are magnified in the case of those traditional societies such as Bhutan that have not had colonial ties and are rapidly modernizing. Bhutanese have been exposed to the outside world through travel abroad, literature, visits of foreign tourists and, more recently, through television and the Internet. As a medium

of mass communication, the introduction of television in 1998 has had a profound impact on Bhutanese society and culture.

WTO, as an agent of globalization, will accelerate the pace of change, as it will open the economy to external ideas, goods and services. Market values such as consumerism and individualism accompanying economic modernization will challenge traditional Bhutanese values such as the joint family system, the tradition of gift giving, and the extension of support to poorer relatives through the education of their children, care of elderly and other informal social safety nets.[115] These networks and norms, also referred to as social capital, serve as potent mechanisms for providing a social safety net, cohesion, harmony and collective action. As market values displace these traditional values, the State has to ensure that adequate institutions and policies are in place in order to protect the poor who will be marginalized as an unintended consequence of economic liberalization.

Economic liberalization will also lead to the emergence of the newly rich, a class of entrepreneurs whose positive energies could lead to productive investments and employment generation. On the other hand, historical evidence shows that the emergence of the newly rich invariably involves the emergence of corruption and nepotism.[116] Thus, it is important to ensure good governance with proper institutions and procedures so that public sector employees are not susceptible to such forms of malpractice. Although corruption in Bhutan is not yet a rampant phenomenon, the country is vulnerable with the politicization of public office, the emergence of new power centres and new wealth, and the general disillusionment of the people with the declining quality of the delivery of public services.

Bhutan has a distinct advantage as a late developer, since it can learn from the experiences of others and adopt international best practices. Its modern public institutions are still in the formative stage as is evident in the Constitution that is being drafted. Thus, Bhutan has the ability to chart a future course of change that is realistic and beneficial to all Bhutanese people, without having to resort to political bargaining or violent means to bring about change.

The WTO requirement for transparency and strong legal, institutional and procedural mechanisms will be beneficial, as it will undo the current practice of deciding on many issues on a "case-by-case basis". Such crony capitalism inevitably leads to sub-optimal economic outcomes due to extensive rent seeking behaviour and its bias in favour of the social, economic and political elite. The establishment of fair and transparent ground rules and accountability to an intergovernmental organization such as WTO will not only break the implicit monopoly culture but also enable all budding entrepreneurs to participate in the , based on competition and efficiency.

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[115] T. Wangyal, 2001, "Ensuring social sustainability: can Bhutan's education system ensure intergenerational transmission of values", *Journal of Bhutan Studies*, Vol. 3, No. 1.

[116] S. P. Huntington, 1968, *Political Order in Changing Societies*, New Haven, Yale University Press.

H. Conclusion

WTO membership will have wide-ranging social, cultural and economic impacts on Bhutan. Application for WTO accession symbolizes the policy decision to open the economy to external competition and reap the benefits of a multilateral trading system. The tangible benefits arising from market access will materialize only if Bhutanese firms can compete in the international markets. While benefits are diffused and long-term, Bhutan has to bear the immediate costs of accession including policy adjustments, the establishment of institutions and the risks of exposure to the international economy.

The competitiveness of Bhutanese firms abroad will depend on FDI and the transfer of technology and skills in high value-added sectors. However, FDI is currently constrained by a conservative foreign exchange policy, necessary for a country with a limited capacity to earn convertible currency. On the other hand, most of the exports from Bhutan, including electricity, are destined for markets in India where the earnings are in a non-reserve currency. The most tangible benefits of WTO accession for Bhutan will be contingent on the pace and depth of liberalization in India and the capital account convertibility of the Indian rupee.

Given the limited tangible benefit as well as the inherent costs and risks of economic liberalization, it is imperative that the impact of WTO on Bhutan is clearly understood in view of the existing supply side constraints and the external factors that will determine the country's successful integration. The impact, beneficial or adverse, will depend on the success of the private sector as well as the ability of Bhutan to negotiate accession on terms that are most relevant to Bhutan's realities rather than on theoretical benefits conferred by WTO.

Economic liberalization also has far-reaching social and cultural impacts, particularly for traditional societies. It will be vital for the State to manage such transitions properly with appropriate institutions and policies as it could lead to marginalization of vulnerable sections of society as well as the emergence of corruption and nepotism. In view of the rapid political and economic reforms currently taking place, Bhutan is at a crucial stage on the road to development. The country can either ride on the peak of the wave and become a success story or let the opportunity slip away and join the ranks of failed States, thus jeopardizing its security and sovereignty.

Annexes

I. LIST OF SECTORS OPEN TO FOREIGN DIRECT INVESTMENT

The FDI Policy states that the following manufacturing areas are open to FDI with a minimum investment of US$ 1 million, of which foreign investors can hold up to 70 per cent equity:

- Mineral processing
- Forestry and wood-based industries
- Agriculture and agro-processing
- Livestock-based industries
- Light industries including electronics
- Engineering and power-intensive industries.

The open sectors listed above, with the exception of the last two, all fall within the area of processing primary products in which Bhutan has a comparative advantage resulting from its natural endowments. Power-intensive industries are also feasible as Bhutan has abundant and reliable hydropower resources.

With a minimum required investment of US$ 500,000, the service sectors open for FDI include:

- Tourism including hotels
- Transport services
- Roads and bridges
- Education
- Business infrastructure
- Information technology
- Financial services
- Housing.

Source: Foreign Direct Investment Policy, December 2002, Government of Bhutan.

II. TOP 10 INDUSTRIES AND DIRECTION OF SALES IN BHUTAN, 2001

Industry	Sales in million nu	As % of total sales of top 10 industries
Penden Cement Authority Ltd.	763.9	25.3
Exports to India	316.0	
Exports to other countries	0	
Sales within Bhutan	447.4	
Bhutan Calcium Carbide Ltd.	675.9	22.4
Exports to India	509.4	
Exports to other countries	0	
Sales within Bhutan	166.4	
Bhutan Ferro Alloys Ltd.	579.0	19.2
Exports to India	579.0	
Exports to other countries	0	
Sales within Bhutan	0	
Bhutan Board Products Ltd.	294.1	9.7
Exports to India	255.8	
Exports to other countries	0	
Sales within Bhutan	38.3	
AWP Distillery	283.8	9.4
Exports to India	74.0	
Exports to other countries	0	
Sales within Bhutan	209.8	
Eastern Bhutan Coal Company	141.0	4.7
Exports to India	8.3	
Exports to other countries	50.5	
Sales within Bhutan	82.2	
Bhutan Fruit Products Ltd.	111.6	3.7
Exports to India	87.0	
Exports to other countries	6.9	
Sales within Bhutan	17.7	
Druk Satair Corp Ltd.	98.3	3.3
Exports to India	74.6	
Exports to other countries	8.9	
Sales within Bhutan	14.9	
Bhutan Polythene Company	46.9	1.6
Exports to India	11.5	
Exports to other countries	0	
Sales within Bhutan	35.3	
Bhutan Agro Industries Ltd.	27.9	0.9
Exports to India	13.3	
Exports to other countries	1.8	
Sales within Bhutan	12.7	
Total	3 022.4	100
Exports to India	1 929.4	64
Exports to other countries	68.1	2
Sales within Bhutan	1 024.9	34

Source: Royal Monetary Authority, *Selected Economic Indicators 2002*, Thimphu.

III. COMPOSITION OF TRADE WITH INDIA IN 2000

Annex table IIIa. Top 10 imports

Items imported	Million nu	%
Products of chemical industries	1 659.34	22.24
Mineral products	1 227.84	16.45
Machinery and mechanical appliances	966.94	12.96
Base metals and base metal products	791.69	10.61
Transport equipment	503.85	6.75
Cereals, vegetables, fruit, nuts, coffee, tea and spices	502.37	6.73
Prepared foodstuffs	422.22	5.66
Wood and wood products	238.77	3.20
Animal products	209.89	2.81
Vegetables fats and oil	168.61	2.66
Others	939.70	12.72
Total	**7 462.61**	**100.00**

Annex table IIIb. Top 10 exports

Items exported	Million nu	%
Electricity	2 189.60	50.03
Mineral products	527.40	12.05
Products of chemical industries	485.50	11.09
Base metals and base metal products	449.95	10.28
Wood and wood products	250.64	5.73
Cereals, vegetables, fruit, nuts, coffee, tea and spices	197.73	4.52
Prepared foodstuffs	194.37	4.44
Miscellaneous manufactured articles	45.56	1.04
Stone, plaster, cement and asbestos products	12.54	0.29
Plastic and rubber products	10.77	0.25
Others	12.91	0.29
Total	**4 376.97**	**100.00**

Source: Department of Revenue and Customs, *Bhutan Trade Statistics, 2000,* Thimphu.

IV. COMPOSITION OF TRADE BY BHUTAN WITH OTHER COUNTRIES IN 2000

Annex table IVa. Top 10 imports

Items	Million nu	%
Machinery, mechanical appliances, base metals	1 268.050	77.15
Plastic and rubber products	84.601	5.15
Mineral oil and fuel	66.930	4.07
Whiskies and processed food	46.075	2.80
Textiles	43.863	2.67
Wood pulp products	38.055	2.32
Miscellaneous manufactured articles	28.087	1.71
Medicines and pharmaceuticals	20.572	1.25
Wood products	12.548	0.76
Products of chemical industries	9.111	0.55
Other products	39.904	2.12
Total	**1 643.685**	**100.00**

Annex table IVb. Top 10 exports

Items	Million nu	%
Vegetables and fruit	117.884	49.35
Mineral products	74.700	31.27
Processed food	14.254	5.97
Textiles	13.952	5.84
Household items and personal effects	9.844	4.12
Machinery	4.188	1.75
Wood pulp products	3.211	1.34
Handicrafts products	0.515	0.22
Philatelic products	0.250	0.10
Wood products	0.084	0.04
Other products	0.030	0.00
Total	**238.885**	**100.00**

Source: Department of Revenue and Customs, *Bhutan Trade Statistics, 2000,* Thimphu.

CAMBODIA*

Introduction

Accession to WTO is part of the general strategy of Cambodia's trade policy, which is directed towards the effective integration of the country into the world economy and global trading system. This strategy is reflected in numerous government policies, and in particular, the Government of Cambodia's Development Triangle Strategies of building peace and stability, economic integration, and poverty reduction. The Government recognizes the role that trade plays in promoting growth and reducing poverty. Increased trade, promoted by liberalization policies, acts as a powerful stimulus to economic growth; an open trade regime will therefore lead to higher rates of economic growth. Trade may facilitate international diffusion of knowledge, thereby speeding up growth. In many ways, trade may even occasionally substitute for aid in the development process.

Membership in WTO will enable Cambodia to reap the full benefits of global market access through:

(a) The application of best practices and non-discriminatory conditions for access of Cambodian goods and services to foreign markets;

(b) Promoting the development of export opportunities for the country and the diversification of exports;

(c) Ensuring a sufficient degree of protection for domestic producers within the framework of an open economy, and based on the norms and rules of the WTO.

In his introductory presentation at the Globalization Conference, the Secretary of State for Commerce Sok Siphana made the following remarks:

> ".....Globalization is here to stay. Countries and companies alike must accept that reality. Cambodia has long enjoyed its natural resources without having derived much benefit from them in terms of economic development; therefore, it is time now to seek wealth through the market place. The massive restructuring of political boundaries, the opening of new consumer markets, historic trade agreements, and the World Trade Organization have created unprecedented opportunities for opening new marketplaces and there has never been a more opportune time for Cambodian companies to capitalize on these globalization trends. Countries should not forget that their best chance of development is to be part of an integrated world economy. I believe that Cambodian

* This study was prepared by the Ministry of Commerce, Government of Cambodia, and reviewed by ESCAP.

political leaders are quite conscious of this reality, particularly during the second term of the Royal Government. With peace restored and the economy stabilized, we can perceive throughout the accession process a strong political commitment coming from the very top, the Prime Minister himself, to achieving this ultimate policy objective, that is, to become a member of WTO".[117]

This paper is an attempt to put into perspective Cambodia's objectives, aspirations and views on the overall WTO accession process and, in particular, on the institutional, economic, social and cultural reforms that prospective WTO membership is kindling.

This paper seeks to demonstrate the positive and negative experiences of Cambodia in its process of accession to WTO. The lessons and experiences gained from the accession process are discussed, and the obstacles encountered and measures taken to overcome them are analysed. The paper attempts to provide overviews of:

(a) The lessons learnt from the current accession process, and good practices that could benefit other developing countries of the region;

(b) The Government's institutional set up and mechanisms for policy coordination that prospective WTO membership is motivating;

(c) The mechanism for creating national ownership of WTO reforms among all parties that are affected by WTO reforms;

(d) The impact that WTO membership is expected to have on overall domestic economic performance, with particular emphasis on FDI and the benefits and costs that the Cambodian business community can expect;

(e) The impact on different social sectors and groups of the population;

In addition, keeping in view the above analysis, the paper recommends appropriate negotiation strategies including those based on regional cooperation among the developing countries of the ESCAP region, to ensure that the terms of accession are compatible with national development objectives.

A. Overview of lessons learnt from the current accession process and the good practices that could benefit other developing countries of the region

1. Cambodia's unique historical relationship with GATT[118]

Cambodia previously enjoyed a special status within GATT due to the country's former relationship with France, and it came very close to acceding on its

[117] Conference Proceedings: Globalization Conference: Business and Law, Preparation for WTO Accession: Experiences and Lessons Learned, June 27-28, 2001, Phnom Penh.

[118] This section is extensively drawn from a detailed analysis by Dr. Craig Van Grasstek, "Laws and policies of the United States of America concerning the accession of Cambodia to the World Trade Organization", United Nations Conference on Trade and Development, 8 February 2000, Geneva.

own. While it must be stressed that the country's former status in GATT has had no direct bearing on its current efforts to accede to WTO, the matter is worth exploring for its historical significance. Had Cambodia taken full advantage of the opportunities discussed below, the country could have been a founding member of WTO.

The country's previous colonial status could have facilitated Cambodia's accession to GATT. Under the terms of Article XXVI.5(c) of GATT 1947 – which now has no equivalent in WTO – countries such as Cambodia were permitted a relatively easy entry into GATT. Former colonies of GATT contracting parties could acquire *de facto* GATT status upon their achievement of independence. A country could then convert that *de facto* status into full GATT contracting party status by succession, a process that involved much less stringent scrutiny of its trade regime and fewer new commitments than did the ordinary accession process of GATT Article XXXIII. Some countries acceded to GATT shortly after gaining independence, while others waited years before taking this step. Cambodia qualified for this route to accession, insofar as France did apply GATT rules to Cambodian trade while the country was a protectorate, and duly informed GATT of this fact upon Cambodia's independence. The option expired with the end of GATT, however, and Cambodia – like all other countries that are still outside the system – must now meet the more rigorous requirements of WTO accession.

Cambodia did indeed enjoy *de facto* status as a GATT contracting party, as did other former colonies of France. While some former colonies rejected both this status and the prospects for GATT contracting party status, Cambodia made a very serious effort to accede to GATT on its own, following the more difficult approach of negotiating under GATT Article XXXIII.[119] The country took this approach in order to avoid adopting the tariff commitments that France had already made in GATT negotiations. The country went so far as to finalize negotiations with the existing contracting parties over the terms of its protocol of accession, which were formally concluded on 6 April 1962.[120] Although the Geneva side of the process was concluded, Phnom Penh never completed the domestic ratification procedures. The readily available historical sources do not indicate whether a formal decision not to proceed was made, or whether this inaction can merely be attributed to a lack of interest. One might speculate, and a thorough search of the diplomatic archives might confirm,[121] that accession was rejected in part because of domestic political turmoil, and in part as a reflection of the

[119] "Difficulty" is a relative concept. Article XXXIII negotiations were more difficult in the sense that this approach required the country to make tariff concessions to existing GATT contracting parties, which was not required under the more permissive terms of Article XXVI.5(c). The extent of the demands that were made upon acceding countries in the early 1960s was far less extensive than those made of acceding countries during the final 10 years of GATT, which, in turn, were less demanding than the requirements that WTO applicants must meet today.

[120] See "Protocol for the accession of Cambodia", in GATT, *Basic Instruments and Selected Documents*, Eleventh Supplement, 1963, pp. 12-16. Note that this document does not include the annexes to the Protocol (which would consist primarily of the tariff concessions that Cambodia made in the negotiations over its accession).

[121] These archives are apparently no longer available in Cambodia, having been destroyed during the Khmer Rouge occupation of Phnom Penh. It is possible that the archives of France, the United States or other interested parties might shed some light on why Cambodia opted not to complete the process of accession; surviving statesmen from that period might also be able to offer insights.

country's efforts to assert its political neutrality. It was during that same period that then Prince Sihanouk most actively sought international recognition of Cambodian neutrality. The decision in 1963 to reject any additional foreign assistance from the United States should be viewed in this context, and the same may be equally true for the aborted accession.

As recently as 1992, one former GATT official argued that Cambodia could still accede to GATT under the terms of the protocol that it had negotiated 30 years earlier. Robin Davies based this suggestion on the fact that the 1962 Protocol of accession placed no time limit on the country's conclusion of its domestic ratification procedures. "One can argue", Davies suggested, "that the Protocol remain(ed) valid in law (as of 1992). In other words, despite the passage of 31 years, Cambodia could become a GATT member 30 days after affixing its signature to the Protocol".[122] Whether that position would have been sustainable is debatable, but in any event the point is now moot. The 1962 Protocol expired with GATT itself in 1995, and is irrelevant to Cambodia's WTO status. The country now faces the same process of accession as other countries.

2. Target is to be the first least developed country to accede to the World Trade Organization

On 8 December 1994, Cambodia applied for accession under Article XII of the Agreement Establishing the World Trade Organization and a Working Party on Cambodia's accession was established on 21 December 1994.[123] On 21 May 1999, Cambodia submitted its Memorandum on Foreign Trade Regime (MFTR) to the Accessions Division of WTO, based on which four main trading partner countries[124] submitted a total of 179 questions, most of which overlapped or were of a procedural nature. Cambodia completed the answers and submitted them to the WTO Secretariat on 8 November 2000, opening the way for the convening of the First Working Party (FWP), which took place on 22 May 2001, and the simultaneous start of the first round of bilateral negotiations with several interested members. Motivated by these early successes, Cambodia committed itself to an aggressive accession agenda for the second and third Working Party meetings held in February 2002 and November 2002, respectively. At the third Working Party meeting, the focus was on the review of the Factual Summary. Cambodia will return to Geneva for the fourth and, hopefully, the last Working Party meeting in April 2003 to review the accession report. At the rate that the accession process is moving, Cambodia stands a great chance of becoming the first LDC to accede to WTO by the Fifth WTO Ministerial Meeting in Cancun, Mexico in September 2003.

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[122] Robin Davies, "Cambodia and the GATT", *Journal of World Trade* Volume 26 Number 5 (October, 1992), p. 96.

[123] Letter of the Minister of Commerce No. 088/MC of 19 October 1994.

[124] Japan, EU, USA, and Australia.

3. Lessons learned from Cambodia's accession process: challenges for the future

(a) Complex documentation and negotiations

Cambodia's imminent accession to WTO constitutes a major challenge for the country. Cambodia is required to prepare voluminous and complex documentation regarding its trade regime for goods and services, and will engage in lengthy negotiations with the WTO member countries, both at the bilateral and multilateral levels. While it is acknowledged by many WTO members that Cambodia has made great progress in preparation for its bilateral negotiations, it still suffers from shortcomings in the area of agriculture negotiation. In the Services Offer, Cambodia needs to further its understanding on the policy and economic implications arising from the various services sector commitments such as telecommunications, financial services and professional services etc. Moreover, Cambodia needs to ensure that its concessions and commitments made under the WTO accession process are consistent with other international obligations (e.g., IMF or World Bank loan conditions) and compatible with those made, or to be made, under regional trading arrangements such as ASEAN or the Bangkok Agreement. For that matter, frequent consultations with other member countries of regional trading arrangements will be needed to avoid later conflict.

(b) Commitments to domestic reforms

WTO accession requires thorough understanding of the WTO Agreements ranging from trade in goods and services to trade-related intellectual property rights and trade-related investment measures. Cambodia will also have to carry out legislative reforms to achieve conformity with the implementation requirements of the WTO Agreements, including the adoption of an ambitious National Programme of Legislation of more than 40 new laws. It is worth noting, however, that Cambodia is quite conscious of (a) the central role of legal and judicial reforms in the overall national development agenda; (b) the fact that these reforms are being undertaken to foster the development of a vigorous private sector to better respond to the regionalization and globalization of world trade as well as make the Government more accountable to its own citizens.

Progress made in the legislation process efforts of Cambodia towards WTO rules compliances includes the adoption of key intellectual property rights laws such as the Law on Marks, Trade Names and Acts of Unfair Competition, the Law on the Protection of Patents, Utility Model Certificates and Industrial Designs, and the Law on Copyrights. In the field of investment, the adoption of the amended Law on Investment, the Insurance Law, the Land Law, the Law on Corporate Accounts, Audit and Accounting Profession, the Forestry Law, the Electricity Law have been achieved.

In the pipeline for adoption are the Business Enterprises Law, the Insolvency Law, the Secured Transactions Law, the Commercial Arbitration Law, the Customs Law, the Tourism Law, the Negotiable Instruments and Payment Transactions Law, the Civil Code and the Civil Procedure Code. For the immediate future, the preparation of

key trade legislation on rules of origin, anti-dumping, countervailing and safeguards is being undertaken.

In the field of administrative and judicial enforcement, it has been seen that with the enactment of its Trademarks Law, Cambodia was able to enforce and protect the intellectual property rights of well-known marks belonging to multinationals such as British American Tobacco, Sheraton and McDonalds, among others.

In recognition of the strategic value of financial sector development, the Government adopted the Financial Sector Blueprint for 2001-2010, which outlines a long-term vision and strategy for sequencing policy reforms in order to develop the financial system over the next 10 years. The Financial Sector Blueprint addresses key policy issues and proposes reform agenda in the banking and non-banking sectors, contractual savings, and interbank/money and capital markets as well as the basic infrastructure in order to underpin the development of the financial sector.

4. Capacity-building

The tasks described above are extensive, and despite all the efforts and political will displayed so far, Cambodia as an LDC cannot afford to complete everything within a short timeframe. Apart from the time factor, there is also the cost factor. Currently, Cambodia has no real experiences in the implementation issues and is uncertain as to the costs, both financial and social, of implementing trade-related regulatory reforms and fitting these new laws and institutions into its development strategies. In addition, Cambodia cannot yet estimate the revenue that will be lost as a result of the concessions it must make.

To meet immediate costs, Cambodia needs to mobilize the necessary resources, both financial and in kind, to cover expenses associated with the accession process, including attendance at meetings, missions to Geneva and bilateral missions, and, to a smaller extent as a non-English speaking country, the costs of translation services.

So far, Cambodia has benefited from its status as a Pilot Scheme country under the Integrated Framework for Trade-related Technical Assistance to LDCs (IF) by securing some of the trade-related capacity-building necessary for improving knowledge and implementation of trade rules, and to better exploit the improved market access for its exports. Developed nations have extended technical assistance to Cambodia on a fast-track basis in some specific areas where immediate compliance with WTO rules is needed in line with the pledges made in numerous political statements. These include the Millennium Development Goals (September, 2000), the Statement of Quad countries regarding WTO rules and their implementation (May, 2001), the WTO Fourth Ministerial Declaration in Doha, Qatar in November 2001, the Financing for Development (FfD) Conference (March, 2002) and the World Summit for Sustainable Development in Johannesburg, South Africa in August 2002.

As a result, Cambodia has been able to mobilize substantial technical assistance from many developed WTO members, both for the preparation of its WTO compliance

legislation agenda and other supply side capacity-building. For example, technical assistance has been provided by:

(a) Canada, for preparing the rules for the Commercial Arbitration Centre and the drafting of the law establishing the Commercial Court;

(b) Australia, as support in the drafting of the Laws on Anti-Dumping, Countervailing and Safeguards, SPS legislation and implementing regulations, and the Rules on Geographical Indications;

(c) Austria, for financing, through UNIDO, the preparation of the TBT and industrial standards legislation and implementing regulations;

(d) France, for the drafting of the Law on Geographical Indications, and the Criminal Code and Criminal Procedure Code;

(e) The Asian Development Bank for drafting the Law on Secured Transactions and the establishment of a public registry for secured transactions, and the drafting of the Law on e-Commerce;

(f) The European Union for technical assistance in bringing into operation the WTO legal compliance unit at the Ministry of Commerce.

B. Overview of the government institutional set up and mechanisms for policy coordination

Cambodia has sought to design its trade policy framework while bearing in mind that its implementation will unlikely be very successful unless that strategy and its supporting plan of action have received a large measure of support from all key stakeholders: government policy-makers, business sector actors, development partners and civil society. To achieve such support requires a process of strategy formulation that engages the three key partners directly in the formulation process itself. It is only in this manner that stakeholders can identify realistic goals, take full measure of their respective commitments and become true "owners" of the strategy.

1. Early days of trade policy formulation

After the *Preliminary Concept Paper* of the "Pro-Poor Trade Strategy for Poverty Alleviation in Cambodia" was adopted by the Council of Ministers on February 2, 2001, the Royal Government mandated the Ministry of Commerce (MoC) to put in place and lead an interministerial steering committee to follow-up on the formulation and implementation of the strategy.[125]

Subsequently, a number of actions have been taken at the country level principally to explain and build consensus around the concept of a pro-poor trade sector strategy. For example, the MoC made a substantive presentation of the concept of a pro-poor trade sector strategy at the Government's semi-annual retreat for senior government

[125] Subdecree No. 18, 13 February 2001.

officials (approximately 500 senior officials) and at the National Conference II, which was held from 12-14 March 2001 (Approximately 700 senior officials participated). Initial steps have been taken to explain the objectives of a pro-poor trade sector strategy to the business community through meetings of the seven working groups organized under the Government-Private Sector Forum initiative. MoC has also promoted the need for a pro-poor trade sector strategy through the national media, including national television. MoC has had individual discussions with a number of bilateral donors to explain the intent of and the need for the pro-poor trade sector strategy. Key elements from the *Preliminary Concept Paper* also have been incorporated into the draft SEDP-II and the Brussels Plan of Action. MoC has used the opportunity of the UN LDC III meeting in Brussels to further explain its effort to the international community.

The growing importance of the trade mainstreaming process was reflected in the expansion the steering committee on 28 March 2001 to include high level policy makers at the secretary of state level for 5 key ministries such as Commerce; Economy and Finance; Agriculture Forestry and Fisheries; Public Works and Transport; Women's and Veteran's Affairs; at the under secretary of state level for 3 ministries such as Industry, Mines, and Energy; Tourism; Social Affairs, Labor, Vocational Training and Youth Rehabilitation; and key representatives from the banking sector and the private sector.

2. Other intra-governmental policy coordination mechanisms

Other mechanisms to ensure country ownership are a partnership framework which builds upon existing mechanisms established by the Government, namely: the inter-ministerial Council for Social Development (CSD), and the Consultative Group (CG) process. CSD is the government's agency mandated with poverty focused policy and programme design, and monitoring of implementation. It is composed of representatives from economic and line ministries and its works is central in steering the preparation of the national Poverty Reduction Strategy (i.e. SEDP II and PRSP), and the monitoring of process, inputs, intermediary outputs and outcomes in close coordination with sectoral and local level monitoring systems. The work of CSD includes ex-ante impact assessment of major policy reforms (macroeconomics, sectoral and budgetary). The trade sector reforms will closely coordinate with the work of the CSD, by providing critical policy-level sector inputs in preparation of the PRS and programme level performance data.

Cambodia has also developed a relatively intensive system of consultations with donors – especially when compared to other developing countries. This includes the formal Consultative Group (CG) meetings and the bi-annual post CG consultations. The CG process includes working groups involving donors and government and focusing on specific reform areas (e.g. fiscal reform, social sectors, public sector reforms, demobilization, governance including legal and judiciary reform, and natural resources management). These mechanisms are critical in ensuring that national stakeholders and donors at all times develop and work from a shared vision of objectives and goals. The 2002 CG meeting has formally integrated the issue of trade in its work process.

3. World Trade Organization-specific institutional mechanism

After Cambodia applied for accession in October 1994, the government established a focal point under the Ministry of Commerce to deal with the WTO Secretariat and an Interministerial Committee, chaired by the Minister of Commerce, was also established to carry out research studies on the potential, opportunities and challenges facing Cambodia in the accession process. On July 2001, the Government appointed its senior economic advisor to the post of Ambassador to the Permanent Mission of Cambodia to WTO. With the pace of accession accelerating, the Prime Minister appointed on 29 August 2001 a large think tank comprising of over 100 senior officials in the government to assist in matters related to Cambodia's accession to WTO. Moreover, on 27 July 2001, to ensure further economic and trade policy coherence, the Prime Minister appointed the Minister of Commerce, in addition to his current commerce portfolio, to the position of Vice-Chairman of CDC in charge of private sector investment, and to the ministerial portfolio in charge of Greater Mekong Subregion (GMS) economic cooperation programme.

C. Overview of mechanism to create national ownership of World Trade Organization reforms among all parties affected by such reforms

1. Government and private sector partnership: government-private sector forum

Cambodia believes that the benefits from WTO membership mainly arise from improved access to international markets but that they may only be perceived in the long run, and provided the country has developed a competitive export sector, improved coordination among concerned government agencies strong enough to protect the rights and interests of the country in the complicated system of the WTO, created dynamic commodity producers who are able to realize their commercial benefits from WTO membership.

Cambodia is considered to have one of the most favorable policy approaches towards the private sector. It has a formalized procedure through which the Government and private sector are able to hold dialogue. Importantly, the private sector believes that action does result from their participation in the fora. At the peak is the Government-Private Sector Forum chaired by the Prime Minister, six sessions of which have been held in Phnom Penh over the last three years. Seven business-government sectoral working groups have been formed to address sector-specific problems on an ongoing basis, namely:

- Agriculture and Agro-Industry
- Tourism
- Manufacturing and Distribution
- Legislation, Taxation, and Governance

- Services including Banking and Finance
- Energy and Infrastructure
- Processing for Export.

Each sectoral working group is run by a committee including ten members: six from the business community and four from the government. The fora do provide opportunities for IF related leadership dialogue involving the Government and the business sector. The secretariat of the Government Private Sector Forum is currently receiving some assistance from the IFC.

2. Networks of trade support institutions

Cambodia is in the process of formalizing its networks of trade support institutions capable of providing a number of services to exporters: trade policy information and commercial intelligence; export promotion and marketing; product development; financial services; and training. This network is a departure from the traditional approach, in which the Ministry of Commerce has attempted to meet most of the trade support service needs of exporters. A wide range of entities, both from the private and public sector, capable of providing trade support services have been brought together, although still at the informal level and on an ad hoc basis, including: consulting firms, packaging design consultants, freight forwarders and shippers, commercial banks and other financial institutions that offer trade credits and guarantees, chambers of commerce, training institutions (universities and business schools), investment promotion agency, small business development agencies, research and development organizations, overseas commercial representatives, enterprises and professional associations (manufacturer, exporter, and product sector associations), and sector-specific export councils.

Examples of successful trade support institutions have begun to appear in Cambodia, like the National Codex Committee which was created to help enterprises meet technical standards and packaging requirements of export market, the formation of Enterprise Development Cambodia (EDC) which supports private sector development via the development of the Provincial Rice Millers' Associations and the National Federation of Cambodian Rice Millers' Associations, the Brick and Tile Manufacturers, and the Rural Electricity enterprises, and other business development services. Sector-specific private business associations have also been formed like farmer producing and marketing associations for tobacco, fragrant rice, bananas, soybeans, and castor seed production. In the tourism sector the Tour Guide Association in Siem Reap, the Hotel Owners Association, and the Cambodian Association of Travel Agents were also established.

3. Civil Society Stakeholders

In parallel an extensive awareness campaign with other civil society stakeholders was initiated, including the holding of international conferences, seminars and special condensed lectures within the national academic circles. These initial efforts are impressive and provide a basis for deepening the synergies thus far developed among trade sector stakeholders under the leadership of the MoC.

D. Impact that WTO membership is expected to have on the overall domestic economic performance, with particular emphasis on FDI and benefits and costs that the Cambodia business community could export

Globalization does not come without difficulties, particularly for Least Developed Countries (LDC) like Cambodia. The 1997 regional financial crisis while sparing Cambodia from its direct immediate effects had nonetheless affected indirectly the country as seen from the sharp drop of foreign direct investment from the region. The ratification of the US-Vietnam Trade Agreement by the US Congress has no doubt created some uncertainty as to the flow of FDI away from Cambodia. China's entry into the WTO has dramatically changed the dynamic of regional trade. The phase-out of Multi Fiber Arrangement (MFA), or the elimination of quantitative restrictions on textile trade, by 2005 will further intensify the pressure on Cambodia to become more competitive in the textile and clothing industry. Moreover, the recent political upheavals in a few other ASEAN countries did not bore well in term of confidence of investors in the region.[126]

Successes or failures of Cambodia will depend to a large extent not only on its ability to balance its rights and obligations under the multilateral trading system but as well on how well the country could position itself to take advantage of the broad opportunities and challenges of regionalism and globalism. In other words what is the 'Competitiveness' paradigm of Cambodia in the light of these global trends. As Michael E. Porter in his famous book, *The Competitive Advantage of Nations*, eloquently put it: "...Countries that improve their standard of living are those in which firms are becoming more productive through the development of more sophisticated sources of competitive advantage based on knowledge, investment, insight, and innovation". Stacey Lindsay has taken this notion further by extending this 'Competitiveness' paradigm to the political leadership at the national level also. He believes that these mental models were the chief obstacles that impede, or the chief elements that promote, the creativity and efficiency necessary for competitiveness and economic growth.

In this perspective, Cambodia is a good example of country that has, despite its dramatic past and existing shortcomings, emerged as a vibrant economy thriving on the above concept. From the early days of national rebuilding from the ashes of genocide, to capitalizing on its comparative advantage based on cheap labor and exploitation of natural resources, to embracing controversial value-added labor-textile export linkages – *thus creating a precedence in the annals of textile negotiations*, to defining new dynamic strategic value-adding alliance with its neighbors Thailand and Viet Nam, to optimizing its national branding as the Seventh Wonder of the World new tourism destination combined with our open skies policy, to capitalizing on a highly interactive form of Government-Private Sector Dialogue, to projecting the value as

[126] Sok Siphana, "*An Emerging Economy – Will Sweeping Changes Brush Aside The Common Man*?" Keynote Speech at the Conference on "The Challenge of Providing Medical Care to the Developing World" Organized by Hope Worldwide/University of Southern California/Harvard AIDS Institute, Phnom Penh, February 10, 2001.

a new organic agricultural country, to protecting intellectual property rights, and to revolutionizing the concept of trade mainstreaming for poverty reduction and economic development. In sum Cambodia, with this 'Competitiveness' paradigm in place, is prime to ride the trend of regionalism and globalism.

1. Effects of WTO accession on the Cambodian Textiles and Clothing Sector

Cambodia's current export base remains narrow. Exports of garments dominate the sector (nearly $1,303 million in 2002 out of the total foreign trade of $1,467 million) followed by three or four products and services – tourism, sawn timber, remittances of expatriate Cambodian workers, and rubber. Other exports are small, though a number show strong promises (e.g. shoe manufacturing, rice, fish, specialty agriculture and agro processing, handicraft). Destination markets of current exports are also limited: the United States, the European Union, Singapore, Thailand, Malaysia are the dominant destinations. See tables 1 and 2.

One of the most recent newcomers in the international trade of garments has been Cambodia-a non-WTO member country and an LDC. It is has been one of the fastest growing garment exporters over the past 8 years – in 1995 the exports of garments were about USD 26 million and in the years 2000 to 2002 the corresponding annual figure exceeded USD 1 billion. In early 2002 Cambodia ranked number 16 amongst the top suppliers of garments into the U.S. market.

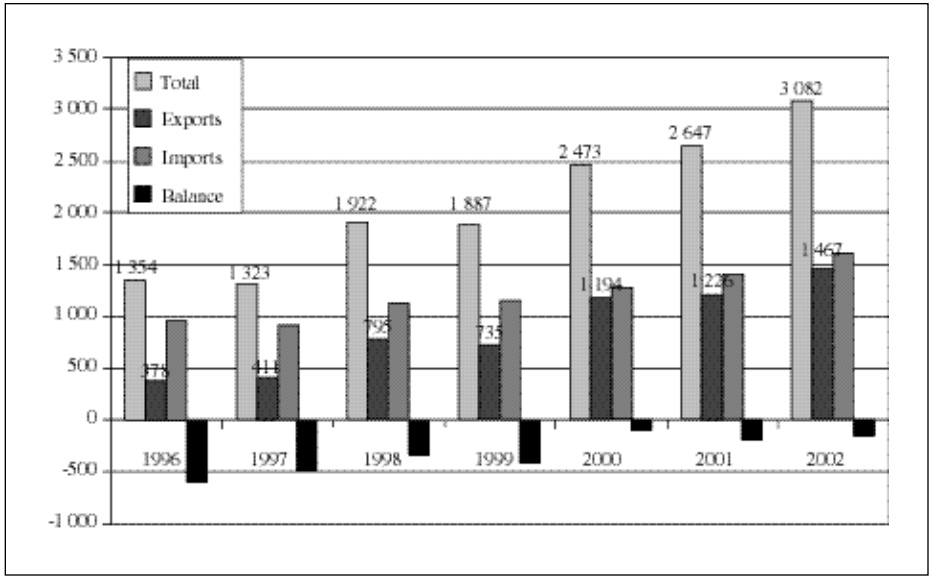

Figure 1. Cambodian foreign trade, 1996-2002

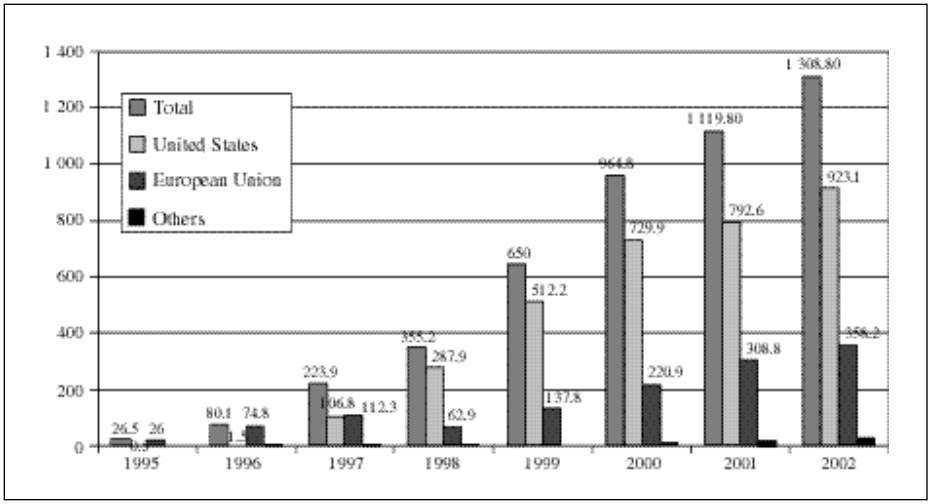

Figure 2. Cambodian exports of garments, 1995-2002

With the impending expiry of the Multi-Fiber Arrangement (MFA) in January 2005, Cambodia may loose its competitive edge in the garment export sector, not to say the prospect for loss of thousands of jobs. However, accession by Cambodia to the WTO before the expiry of the MFA can bring a certain level of level playing field in the sector.

Cambodia is today an established supplier of low price, medium quality garments, employing around 220,000 workers in almost 185 factories, out of which only 23 are Cambodian-owned. Almost 90 per cent of the garment manufacturers are foreign-owned, coming from Hong Kong (China), PR China, Singapore, Taiwan (Province of China), South Korea, Malaysia, Thailand, Indonesia, Bangladesh, England, Germany, Australia, Canada and the United States. These are investors, which also operate companies in other Asian, African and Latin American low-cost countries. After 2004, the determining factors of these investors to choose appropriate locations depend mainly on costs and lead-time requirements.

However, this tremendous success is based purely on the fact that other countries were restrained in their exports due to quotas and moved to Cambodia. The absence of quotas to the European market has attracted investors of other Asian countries, which are, for the moment, limited by quotas for their own exports. Since Cambodia has practically no production of fabrics or accessories it has been fully dependent on imported inputs for her garment exports. Most of the necessary fabric supplies are coming either from some other ASEAN countries or Hong Kong, Singapore, Taipei or South Korea.

2. Impact on WTO Accession on Cambodian Export Diversification

In consultation with trade sector stakeholders, Cambodia has worked hard both to boost the productivity of its current exports and to move up the value-chain. For example, improvements in rice seeds, irrigation, and farming methods would go a long way in increasing both labor and land productivity and strengthening Cambodia's export capacity in this product. Likewise, Cambodia has begun making a shift to higher value agricultural production (spices, nuts and seeds, fruits, etc.) and more processing (e.g. milling of exported rice, extraction of essential oils, processing of wood etc.) which would also bring more value from exports to the country. In this regard, bringing the country trade regime in line with the WTO rules and disciplines, lowering the costs of trade facilitation, strengthening the trade promotion capacity, improving the investment environment are some of the areas Cambodia needs to look at carefully to implementing its export led growth strategy.

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LAO PEOPLE'S DEMOCRATIC REPUBLIC*

Introduction

The experiences of many developed and developing countries have shown that trade can be an engine of growth that leads to poverty reduction, which is a target of the development process many countries. In this regard, many developing countries have expressed their intention to pursue trade liberalization by increasing their integration into the world economy. This includes the Lao People's Democratic Republic.

Since 1986, the Lao People's Democratic Republic has opened its doors to participation in the global system by introducing the New Economic Mechanism (NEM), thus switching from a command model of economic management to one that is market oriented. By taking into account the limited resources of the country, the Government of the Lao People's Democratic Republic has decided to gradually integrate its economy into the world economy.

A further step in the country's economic reform after the adoption of NEM was to integrate and liberalize trade with the region. As a result, the Lao People's Democratic Republic became a member of the Association of the South East Asian Nations (ASEAN) on 23 July 1997. The experience in acceding to ASEAN as well as the ASEAN Free Trade Area (AFTA) has led the Lao People's Democratic Republic to recognize that significant benefits are to be gained from membership of the World Trade Organization (WTO). The Government has therefore decided to take the process of economic integration a step further by applying for WTO membership.

A. Overview of the current accession process: lessons learnt and good practices that could be of benefit to other developing countries of the region

1. Process of accession to the World Trade Organization

The Lao People's Democratic Republic lodged its application to accede in late July 1997. In February 1998, official observer status was granted. At the same time, the Working Party on Accession by the Lao People's Democratic Republic was established, chaired by the former Australian ambassador to WTO. With assistance from the United Nations Development Programme (UNDP), the Lao People's Democratic Republic formulated its plan for accession. Under that plan, the Lao People's Democratic Republic lodged its Memorandum on the Foreign Trade Regime in March 2001 and received a consolidated set of 263 questions from Australia, the European Union and the United States in early 2002.

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The Lao People's Democratic Republic has to respond to three main categories of questions related to economic policies, legal framework and trading rights. The questions appeared in the three pillars of the WTO Agreements such as trade in goods, trade in services and intellectual property protection. Some questions have been raised for the purpose of seeking more clarification while others are difficult to answer because they imply future commitments that Lao People's Democratic Republic will have to undertake. Therefore, careful consideration is needed when answering the latter type of questions.

With that in mind, the Ministry of Commerce of the Lao People's Democratic Republic, as the coordinating agency for WTO accession, distributed the questions to the line agencies concerned. The process of answering these questions is almost complete. The first draft of the replies was revised after informal consultations with a foreign expert and an UNCTAD independent consultant. However, many difficult tasks demanded by the WTO members have yet to be completed, including the completion of WT/ACC/4 (agriculture), WT/ACC/5 (services), WT/ACC/8 (TBT and SPS) and WT/ACC/9 (TRIPs). Feedback was circulated between the Ministry of Commerce and the line agencies to ensure that they are satisfied. The final draft has been finalized by the Ministry of Commerce and is about to be submitted to the Government for approval before transmission to the WTO Secretariat.

One observation from this exercise is that the process took longer than expected. This was because some line agencies were unable to provide the right replies to the questions while others appeared to lack an understanding of WTO principles. An alternative would have assigned a team of three persons to prepare all the responses to the questions and then forward them to the line agencies for feedback.

2. Lessons learnt and good practices

The accession process differs from one acceding country to another depending on each country's capacity to set the pace for accession. In the case of the Lao People's Democratic Republic, the process is still in the early stage of fact-finding. However, some lessons and good practices have been learnt that could be of benefit to other acceding countries in the region.

3. Lessons learnt

(a) Strong political commitment

Accession is not the task of any one ministry or organization; it involves the whole country because it affects every economic sector linked with trade liberalization. In this regard, the commitment should be made from the highest to the lowest level. It has to be maintained throughout every stage of the process in order to secure the ownership of each stage and make sure that it is in line with the national development objectives of the country. Without that commitment, the accession process will not be transparent and will lack the support of all concerned.

(b) Coordinating work among the line agencies is essential

Experience shows that it is indeed a very difficult task for an acceding LDC that lacks skilled human resources, particularly in the areas that are involved in the accession work. However, despite such difficulties, coordinating work for accession is necessary as ways must be found to make it proceed smoothly and efficiently. Otherwise, the accession process will be stalled when it comes to the process of bilateral negotiations. The Government, having realized this important fact, has established mechanisms to facilitate the coordinating work among line agencies. This issue is elaborated more in section B below.

(c) Most critical issue: human resource development

The human factor is considered to be the most important factor and a key to the success of every activity, including the process of developing market-based economies and establishing supporting international trade agreements. Utilizing integration into the global trading system in this way requires officials in the economic agencies to have knowledge of the economies that being liberalized.

In those government agencies with economic responsibilities there is a shortage of skilled staff who are knowledgeable about the economic aspects of the market system. This is a fundamental constraint on their capacity to prepare policies that will enable the Lao People's Democratic Republic to secure the full benefits from integration into the global trading system.

If the Lao People's Democratic Republic is to reap the maximum benefits of trade and investment expansion, more needs to be done than just satisfying the formal requirements of accession to AFTA or WTO. In addition to being able to manage public policy efficiently, a more extensive understanding is needed of international trade issues and domestic policies that support expansion of trade and investment. Therefore, the capacity of government officials and those concerned in the private sector to fulfil these objectives needs to be enhanced. Generally speaking, it will be necessary to develop human resources particularly with regard to officials handling WTO-related matters. This should be done systematically both through short-term and long-term training.

4. Good practices

(a) Enhancing networking among acceding countries

The establishment of networking among acceding countries would be a very helpful mechanism. Since the accession process of each country is different, an opportunity to share experiences will enable countries to learn good lessons and attempt to avoid weaknesses that other acceding countries have experienced. The enhancement of networking could be in the form of regional workshops such as the one initiated by ESCAP in February 2002. Additionally, networking could be enhanced by conducting study tours to partner countries with similar political and trade regimes. By doing so, the respective countries would have an opportunity to interact and share their practical

experiences in depth as well as explain how they handled any difficulties experienced in negotiating their accession. In this regard, the Lao People's Democratic Republic has already conducted two very useful study tours, one to Vietnam and the other to China.

(b) Study tour to the World Trade Organization Secretariat

A study tour of the WTO headquarters proved to be a very useful way of gaining practical experience, particularly for those least developed, acceding countries that were unable to establish their own missions in Geneva. Although such tours can very useful, they are also very costly. However, by requesting assistance from international organizations, this type of study tour can be organized. The Lao People's Democratic Republic has undertaken such study tours with the assistance of UNCTAD. Study tours not only provide practical experience on how the first working party is conducted, they can also provide an opportunity to meet and establish networking with WTO members for exchanging views and observing their position with regard to the accession of the Lao People's Democratic Republic.

(c) Maintaining membership ownership

To ensure that the expected benefits can be realized, an acceding country should be able to maintain ownership of its membership. This means that the acceding countries have to conduct any activities required by the accession procedures mainly by themselves. This does not mean that there is no need for external assistance. Due to the complexity of WTO and the fact that LDCs have very limited resources, they need both technical and financial assistance. However, in the context of maintaining membership ownership, they should not totally depend on external assistance provided by international experts. It would be good practice to write a memorandum on the foreign trade regime and try to answer the questions raised by their own officials. By doing so, officials can learn about the trade regime of their own countries and whether that regime is in compliance with the WTO principles as well as consider policy adaptation as it becomes an obligation and commitment. Of course, due to the constraints mentioned above, this issue will not be an easy task for an acceding LDC such as the Lao People's Democratic Republic. However, for the benefit of the whole country and in order to secure its interests that are derived from accession, it should maintain membership ownership, even if it means the process will take longer than anticipated.

B. Overview of the government institutional structure and mechanisms for policy coordination required for prospective World Trade Organization membership

As mentioned in the introduction, the Lao People's Democratic Republic has decided to gradually integrate its economy into the world trading system, starting with regional economic integration as was the case with its accession to AFTA, which required some important trade policy reforms, particularly in the area of tariffs. However, the range of obligations that would be created by WTO membership could be much more extensive than was the case with AFTA.

The process of accession to WTO is also much more complex. There are two basic requirements: (a) satisfying other WTO members by adapting or adjusting domestic rules to meet the basic obligations of the WTO Agreements; and (b) negotiating with other WTO members on market access, i.e., the further opening of the Lao People's Democratic Republic's market in goods and services. It is understood that the demands on LDCs to meet such requirements are usually more lenient than they are for other countries. Nevertheless, that is only in principle; in reality, new members are expected to demonstrate more than a political commitment.

Applicants first need to provide, in considerable detail, information about their laws and regulations that affect trade in goods, services and intellectual property. They need to indicate how they will alter such laws and regulations if they are not in conformity with WTO rules. They are also required to enter a process of negotiation with WTO members on what changes they are willing to make on barriers to trade and services. Accession will not be approved until these processes have been completed.

A large number of the country's government agencies will be affected by accession to WTO. Preparation for accession therefore requires extensive internal coordination and a thorough review of policies in many departments. The Government needs to anticipate requests to open up markets as well as be prepared to amend national policies or adopt new ones. A range of government commitments is necessary if the process is to succeed. In this regard, the Lao People's Democratic Republic had a similar experience with its AFTA accession.

Even though the Lao People's Democratic Republic gained some experience from its AFTA accession, negotiations on WTO accession are creating heavy demands that exceed the institutional management capacity of the Government. To handle the work involved, the Government has established a strategic management system in order to ensure that the necessary institutional set-up and mechanisms for facilitating policy coordination among the government agencies concerned in order to support the WTO accession process.

Institutional structure and mechanisms

Given the number of government agencies involved, the overall programme has to be fully endorsed by the Government and needs to be the responsibility of a very senior minister. At the highest level, the Government has set up a National Steering Committee (NSC) chaired by the Deputy Prime Minister; who is also the Minister of Foreign Affairs, with the Minister of Commerce as deputy chairman. The NSC mandate is to directly lead the preparatory work for accession to WTO. The 19 members of the committee, who are mainly ministers, comprise the government agencies affected by accession. As the ministers have extensive duties, a five-member Standing Committee to help and support the NSC has also been established, headed by the Deputy Minister of Commerce. The other members are also deputy Ministers from the key Ministries concerned. A secretariat, comprising officials at the director-general level from 19 government agencies and chaired by the Vice-Minister of Commerce, has been established for day-to-day administrative work.

The secretariat works under the direction of the NSC. The Vice-Minister of Commerce was also appointed as the lead negotiator for the accession process. He has the operational responsibility for the programme and is responsible for the negotiations over WTO accession. The Director-General of the Foreign Trade Department was appointed as deputy to the Vice-Minister with responsibility for policy development and coordination among agencies through an interagency accession committee. A small unit has been established within the department to deal with foreign trade policy matters including WTO work. The head of the unit reports directly to the Vice-Minister of Commerce. Since the unit comprises a limited number of professional officers, dealing with the work related to WTO accession has imposed significant demands on the unit staff.

C. Overview of mechanisms for creating national ownership of World Trade Organization reforms among all parties concerned

Accession to WTO is not a simple matter; it is like joining a wealthy club, with the applicant having to pay an admission fee in exchange for the benefits that come with membership. The fee, in terms of resources, has to be shared by a large number of agencies concerned with work related to accession. They include:

- The Ministry of Commerce
- The Ministry of Finance (Customs administration)
- The Ministry of Foreign Affairs
- The Ministry of Industry and Handicrafts
- The Ministry Agriculture and Forestry
- The Science Technology and Environment Organization (intellectual property)
- The Ministry of Construction, Post, Transport and Communication
- Committee for Planning and Cooperation
- The Bank of the Lao People's Democratic Republic
- The Ministry of Justice.

Most of the country's government agencies have very limited knowledge of WTO. Therefore, there is a need for effective mechanisms for creating national ownership of WTO reforms, which are outlined below.

First, the officials of the concerned agencies need to be trained to ensure that they have adequate technical knowledge of WTO and its requirements. Through such training, they will be able to understand the impacts that WTO reforms will have on their own agencies. In addition, various workshops and seminars should be held to discuss those impacts and find ways to minimize any adverse effects. In that way, the

capacity of the officials will be enhanced and a sense of national ownership will emerge.

An able negotiating team will need to be created, comprising skilled negotiators drawn from the agencies concerned. Preference may need to be given to those who have had previous experience through the AFTA accession negotiations as well as coordination with the existing administrative framework that was created such as the National AFTA Unit and other focal points that are currently handling AFTA issues. The same framework could be easily adapted to handling WTO accession. Much of the knowledge acquired from trade issues in AFTA could be relevant to WTO.

As mentioned in section B, the secretariat for accession to the WTO holds regular meetings during which work is allocated to the agencies concerned and minutes are maintained. The secretariat members are expected to present a progress report at each subsequent meeting on the work assigned at the previous meeting.

Establishing networking with educational institutions such as universities and economic institutes is another mechanism that could also help to create national ownership of WTO reforms. By including WTO basic principles and agreements in the curriculum of the universities, students and professors would be able to study, discuss, share views, undertake research and produce publications on WTO issues. Through these means, it would be possible to disseminate information and create national ownership of WTO reforms throughout the country. The formation of a partnership with universities and economic institutes would also help those officials handling WTO-related work to attain a clear perception and understanding of the results of analyses and studies carried out by their academic partners. It would also help to sharpen their negotiating skills in defending the country's interests.

In the Lao People's Democratic Republic, various studies have been conducted in areas that will be affected by WTO-related reforms (i.e., Customs, agricultural policy, technical regulations, and sanitary and phytosanitary regulations). In addition, all relevant laws and regulations have been reviewed to identify areas of non-compliance with WTO Agreements, and recommendations made on what changes are needed and how they should be made. Carrying out additional impact studies on affected sectors would be useful.

The impacts of WTO reforms are discussed in the following section.

D. Expected impact of World Trade Organization membership on overall domestic economic performance, with emphasis on foreign direct investment and benefits and costs to the Lao business community

The long-term strategic goal of the Lao People's Democratic Republic is to graduate from the group of LDCs by 2020. To this end, the country must strive to reduce poverty through sustainable development with equity. Due regard is being given to the efficient and sustainable use of the natural resources and the protection of

the environment. Export-led growth, the linkage between trade and development, trade and investment, pro-poor trade strategy, industrialization and modernization are foremost in the minds of the country's strategists and policy makers.

Current overall economic performance is still below the target GDP growth rate of 7 per cent per annum. Although the economy is continuing to expand, it is characterized by some weaknesses such as excessive budget deficits, current account deficits, inflation, low productivity, underemployment and rural poverty. WTO membership will have both positive and negative impacts on the country's overall economic performance. WTO membership advantage should mean guaranteed MFN access to other members' markets. If exports can grow through this channel, domestic economic activities can be put into full swing. Income generation and higher employment opportunities as a result of prosperous investment and business opportunities will alleviate poverty. Fiscal revenues will improve. The increased purchasing power of the population and increased government spending will contribute to national economic growth. To justify this expectation, the situation and the performance prior to WTO accession is discussed below.

Lao People's Democratic Republic was established in late 1975. In 1986, the Government decided to switch from the then command type of economy to a market-oriented economy. In 1988, legislation underlying such reform was introduced, following which the national economy grew at a steady annual average of 6.4 per cent for almost a decade.

During the period under consideration, the reforms resulted in a huge and unprecedented inflow of capital, technology transfer and expertise into the country in the form of FDI. Total approved FDI in 1992 amounted to US$ 335.1 million with a corresponding real FDI inflow through the banking system of US$ 7.8 million. The peak was reached in 1994 with an approved amount of US$ 2,598.3 million, following which it declined annually to reach US$ 1,292.65 million prior to the 1997 regional economic crisis. Unfortunately, the pre-crisis level of FDI has not been achieved. The economic crisis has, to a certain extent, changed the national and regional situation in terms of growth. This also proves that economic interdependence between countries also creates a negative impact.

The Lao People's Democratic Republic's economy depends to a large extent on foreign trade, even though it has always recorded a negative trade balance. Together with official development assistance, FDI income from the tourism and other services subsectors forms an important source of foreign exchange that complements export earnings. Although market reform in the Lao People's Democratic Republic has not yet been completed, it can be said that the process of trade liberalization has taken place, privatization of state-owned enterprises is at an advanced stage and the level of tariff protection is among the lowest in the developing country group.

It is obvious that the expansion of international trade and foreign economic relations, coupled with trade liberalization in the domestic market, has had a positive impact on the national economy, particularly overall economic performance. In a sense, this means that integration with the global trading system has already occurred

and the country has started to reap the benefits. The problem now is how to accelerate and deepen the process through accession to WTO.

The concept of free and fair trade prevails in the current global trading system. More gains from international trade are sought through supranational institutions such as WTO, which can administer the system and act as a forum for trade negotiations, especially with regard to reducing tariff and non-tariff barriers to trade, and solving trade disputes through a more effective dispute settlement mechanism.

In addition, countries now tend to group together in preferential bilateral, regional or multilateral trading arrangements. Those who do not follow these practices are either isolated or suffer from a lack of competitiveness in the newly globalized trading environment. These trading blocs are treated as a larger market area that can attract more investment. The organization of international labour with more effective resource allocation for mutual benefits and economies of scale can take place together with the harmonization of standards and rules.

The national economic development of any country cannot be undertaken effectively do without this cooperation and exchange in the flow of trade. The need to integrate itself into the regional and global trading systems is being increasingly felt by countries such as the Lao People's Democratic Republic. Thus, the WTO accession process is in itself a reform catalyst, and it will support the efforts of the Lao People's Democratic Republic to redirect economic activity towards working as a market economy. Without this catalytic effect, the long-term development objective will not be met since the benefits in terms of market access and FDI inflows lie in membership of either regional or global trading arrangements. With this in mind, the Government has pursued the policy of regional integration as a means of further developing the national economy.

The year 1997 was a milestone in the process of regional integration for the Lao People's Democratic Republic, since it in that year the country gained membership of ASEAN. However, the benefits of AFTA as well as its impact still leave something to be desired due to the deferred entry into force of the members' tariff reduction scheme. For the Lao People's Democratic Republic, the commitments made under AFTA will form a testing ground for the national economy to cope with the changing trading environment in the region prior to full integration into the global trading system.

Due to the small size of its domestic market, low domestic saving rate and the fact that it is landlocked, the Lao People's Democratic Republic will face development problems unless it manages to attract a huge amount of FDI and establish the capacity to produce for export. Making the country's trading system more transparent and predictable, coupled with MFN status that is granted to WTO member countries on a reciprocal basis by major global markets, is assumed to be part of the rationale for joining WTO. Of course, this depends on a number of issues, but it generally makes it easier for a foreign investor to invest in a WTO member country than elsewhere.

To better anticipate the positive impact of FDI on the Lao People's Democratic Republic, reference to the Cambodian case seems to be relevant. Currently, garment exports by the Lao People's Democratic Republic, mainly to the European Union countries, total an estimated US$ 100 million per annum. Prior to receiving MFN, Cambodia's exports to the United States were insignificant; subsequently the figure has increased to some US$ 1.2 billion per year. The Lao People's Democratic Republic has not yet achieved normal trade relations with the United States, and it is considered that such a relationship would help the country accede to WTO. Should the Lao People's Democratic Republic achieve such a situation, the first consideration is the surplus in the trade balance and eventually the balance of payments. In addition, the exchange rate could prove to be in favour of the local currency while the multiplier effect of increased income generation within the domestic economy could have positive impact.

Employment means income, which, in turn, means higher purchasing power. This flow of revenue will help to generate income in related subsectors, which will finally help to boost the overall national economy. In such a case, fiscal revenue will be derived mainly from taxes rather than import duties; however, as the economy expands, the collection of taxes will come from a much broader base. Therefore, WTO accession is expected to create a positive chain reaction for the whole economy. This does not mean that WTO membership alone can ensure the increase of FDI inflow. However, to attract FDI, a number of conditions must first be met such as improved facilities, incentives, favourable legislation, more promising returns on investment, political stability, abundant natural resources and low labour costs.

The FDI flow may not follow the pattern of neighbouring countries. For example, in the garment sector, the Lao People's Democratic Republic may not be able to compete with more populous countries in the region since it is a labour-intensive industry, but at least the present capacity can be retained with WTO accession. The reason is that from 2005 onwards, with the phasing out of the MFA, garment exports by the Lao People's Democratic Republic will face stiff competition. Thus, relying on GSP alone will not only be inadequate, it will also endanger the country's garment industry. Thus WTO membership will, to a certain extent, ensure the survival of this industry.

Based on the assumption that WTO will bring more FDI into the country, investment in the following subsectors, which are either resource-based or necessary in terms of complementarity, is likely to benefit from integration:

- Hydropower
- Mining
- The tourism industry
- Export-oriented agricultural and wood processing, and other manufacturing industries
- Infrastructure-related construction
- Trade-supporting services such as multi-modal transport and logistics

- Communications
- Banking and finance
- Insurance
- Marketing intermediaries
- Consultancy
- Educational and health services.

It appears that some major investment projects, especially hydropower and mining, are blocked as far as sources of finance are concerned because some development partners still unfairly regard the Lao People's Democratic Republic as a "non-market economy". In addition, the Government has not successfully completed all bilateral trade and investment negotiations with member countries.

Investment in the services sector will increase based on liberalization commitments as a whole or as part of a concession. With regard to agricultural products, according to Kym Anderson, "import quotas are being tolerated within WTO, and there is at least the theoretical possibility that an acceding country might be given some share in that preferential trade". Thus, as soon as the Lao People's Democratic Republic joins WTO it will gain opportunities to negotiate both for shares of in-quota sales and lower tariffs on out-of-quota sales of products of interests to its exporters.

Naturally, there are pros and cons. Those who question why the Lao People's Democratic Republic wants to join WTO, when the country has nothing much to sell, forget that market opportunities emerge out of market access. They may also point out that WTO is very demanding and that a huge amount of resources are required to implement WTO Agreements, especially for LDCs. While no quantification of the resource demands of accession is made in this paper, reference is made to one World Bank study by Finger who noted that it would cost a typical developing country some US$ 150 million to implement the requirements under WTO Agreements on Customs valuation, sanitary and phytosanitary requirements, and intellectual property rights. This amount is equivalent to the annual development budget of many LDCs.

The Lao People's Democratic Republic is still at an early stage in contemplating this issue, but what the country is facing is the need to meet expenses such as fees related to its observer status, the costs involved in establishing a permanent mission in Geneva, travel and participation in various meetings, training and carrying out various studies. Fortunately, the country has been able to benefit from foreign assistance right from the beginning of the process.

Under an initial project funded by AUSAID and managed by UNDP, the Government was able to hire international consultants to draft the Memorandum on the Foreign Trade Regime of the Lao People's Democratic Republic, and to conduct some studies as well as seminars, workshops and training, translate WTO documents, and attend meetings abroad. This initial project is reaching its conclusion. A subsequent project, costing Euro 1 million and financed by the European Union, will focus on:

(a) WTO accession assistance;

(i) The strengthening of government human resources capacity;

(ii) The review and revision of legal framework; and

(iii) Assistance in responding to TBT and SPS questions by the WTO Working Group.

(b) Institutional Support (international trade course at the National University of the Lao People's Democratic Republic).

In this connection, in order for the concept of universal WTO membership to materialize, and to integrate LDCs fully into the multilateral trading system, the international community could assist in reducing the huge burden faced by LDCs in acceding to WTO. Such help could be given in the form of: multilateral and bilateral aid; the implementation of measures to support the WTO work programmes (particularly in the areas of accession), market access, trade-related technical assistance and capacity-building; and diversification of the LDC production and export base.

Having said this, the negative effects of WTO accession also need to be considered. Local production entities and service providers including state-owned enterprises, especially those that have been protected by the State, will be exposed to world competition. They risk being unable to survive in a competitive environment. Preventive measures, as long as they are consistent with WTO rules, can be anticipated on the grounds that locally made products might be undersold by imports. At its present stage of development, the national economy is still vulnerable to the effects of totally free exposure to market forces. However, past experience shows that the national economy is quite resilient and flexible in terms of overcoming the negative impacts of market-oriented changes.

Costs and benefits to the Lao business community

WTO accession will affect the business community as resource allocation begins to take place according to the country's comparative advantages. There will be more efficient allocation of resources among the different sectors. The market will become more open to businessmen. Outlets for local products will be expanded and businessmen will gain more by going international.

The main concern is that constraints on the supply side of the economy could emerge. Certain industries may not be able to survive due to fierce competition in the globalized trading environment. They should consider reconversion or downsizing their activities and go for niche markets or merge in order to create more powerful entities. In such an emerging competitive context, the business community, particularly the private sector, will have to reorganize and become more efficient in order to survive and grow. For example, retail business that is currently reserved for Lao nationals may have to compete directly with foreign-owned department stores following WTO accession. Experience in other countries has shown that traditional retail businesses can be adversely affected. In the case of the Lao People's Democratic Republic,

the effect might be slightly different in that the winners in the competition will be the low-cost leaders.

At present, local business practitioners, for lack of a ready export market, focus more on the domestic market. Exports of more valued-added items should substitute for the exports of raw material or primary commodities. Diversification of activities or partners will be essential. The development of entrepreneurship should be promoted to the fullest extent. Business development should concentrate on improving competitiveness.

With regard to the prospects for agricultural export expansion after WTO accession, especially horticultural and floricultural products, success will depend on the ability of producers to raise the quality and uniformity of their commodities. Similarly, they will need to ensure timely deliveries of exported products and meet international standards in order to overcome SPS barriers in importing countries. In the agricultural trade, investments in trade-related infrastructure are needed in order to implement the SPS agreement. Moreover, business entities will have to compete on a level playing field. Interest groups will not be able to lobby the Government in order to circumvent the WTO rules.

E. Impact on different social sectors and groups of people

Trade has been accepted as the door through which all social and economic sectors pass to become integrated into the multilateral trading system in this era of globalization. Both sectors will feel the impact of such globalization.

Acceding countries expect to gain market access. They also need to become involved in the setting of rules for the world trading system in order to protect their interests during the negotiation process with stronger trading partners. At the same time, they also need to have access to the dispute settlement mechanisms when necessary. Market access leads to more FDI in the production, trade and services sectors, which results in the economic growth that is essential to poverty alleviation.

In the case of Lao People's Democratic Republic, the population growth rate is currently 2.3 per cent per annum. Consequently, the population within the employment age group is also increasing, which means that the labour force is increasing every year. If the expansion of employment opportunities does not keep pace with the population growth, unemployment will be unavoidable. Chronic unemployment is a social problem. At present, those engaged in agriculture represent about 80 per cent of the workforce while some 20,000 workers are employed in the garment sector. When acceding to WTO, the prime interest of the Lao People's Democratic Republic, in terms of market access, will be in the agriculture, textiles and clothing sectors, while other sectors remain to be exploited. LDCs suffer from inadequate market access to developed countries due to various constraints. Agriculture in developed countries is still highly protected by tariffs, subsidies and many other forms of non-tariff barriers. This places LDCs and developing countries in a disadvantageous position with regard to competing on the world markets.

Moreover, the service subsectors such as education, health, tourism, telecommunications, transport, construction and finance also deserve liberalization as the process of socio-economic development moves forward. The Lao People's Democratic Republic, like any other developing country, will observe changes in the pattern of GDP composition with the shift from agriculture to the industrial and services sectors. The projected changes in the relative positions of the agriculture, industrial and services sectors in 2010 are 36.6, 31.5 and 31.9 per cent of GDP, compared with the present rates of 51.3, 22.6 and 26.1 per cent, respectively.

As the industrial and services sectors develop, a rural exodus will enhance urban population growth. As a result, the accession to WTO will affect the social sectors such as education, health, culture, labour and social welfare. As to whether the total impact will be positive or negative, and to what extent that impact will be felt, remains to be seen. However, such change can be anticipated, and preventive and remedial measures prepared. The education and health sectors will be open to FDI, and will thus have to be modernized and upgraded in order to meet international standards. Healthy, well-educated and well-trained people are a prerequisite for economic development.

The country's culture will also be affected since the nation will reach a crossroad where different cultures will meet. As a WTO member, the country will no longer be isolated. A steady cultural exchange will take place. However, every country tends to preserve the peculiarities and uniqueness of its culture. Therefore, it is hoped that in the Lao People's Democratic Republic the change will be manageable since the Government is rather strict in this regard. The effects of modernization will be felt more in terms of the physical and technological aspects of the national culture. It is realized that the temptations of modernization, especially the westernisation of Asian culture, are difficult to resist among the younger generation. A range of examples can be observed in other Asian countries. Some have been more successful than others in preserving their national cultures as their economies have developed, especially when the people themselves are deeply committed to religion and the history, customs and traditions of their country.

Ways in which various groups of people will be affected

Apart from the shift in the occupational pattern from the primary to the secondary and finally the tertiary sector (that is, when farmers become industrial workers, then entrepreneurs and businessmen), groups of intellectuals and an elite will emerge.

It should be noted at this point that the population of the Lao People's Democratic Republic, although totalling only 5.2 million (2000 figure), comprises three main ethnic groups: Lao Loum, Lao Kang and Lao Soung, which are subdivided into 47 ethnic minorities. Lao, the language of the Lao Loum, which is the majority group, is the national language. Under government policy, all ethnic groups enjoy equal rights, live together peacefully and are allowed to develop themselves. It is the opinion of the authors that WTO accession will contribute to the country's poverty reduction programme given the direct linkages between trade and growth, and growth and poverty

reduction. This will not occur spontaneously, but should be carefully considered. If proper preparations for WTO accession by LDCs are not ensured, the result will be the deference of accession to a later date due to a lack of capacity-building, competitiveness and adequate resources for implementing the WTO Agreements, or even a decision to withdraw in order to avoid damage and losses.

One problem that often arises is unequal income distribution that economic growth brings. In this sense, certain groups will presumably reap the benefits of accession, whereas some others will still lag behind. For example, in the Lao People's Democratic Republic, village tourism is promoted as one component of cultural tourism, whereby tourists are encouraged to visit localities where ethnic minorities actually live. If these people are forced to lead a primitive life for the sake of attracting tourism, they will not gain much benefit from any influx of tourists in terms of income growth. Since WTO requires acceding countries to adopt trade policy reforms, the concept of pro-poor trade sector strategy must be considered and negotiated during the process of WTO accession.

In this connection, further studies are needed in order to assess the likely impact on different sectors. Even in developed countries, certain groups of people still fear globalization and free trade as was demonstrated during the Seattle Ministerial Meeting. It is quite possible that certain groups of people will feel that they have been left out of the process, since the Government as the policy maker is a WTO member; however, business operators and other stakeholders may not understand the rules of the game. Close consultation with businesspeople, the creation of public awareness, and capacity-building among policy makers, business operators and other stakeholders are necessary tools for coping with the possible negative impacts of accession. The people most likely to be affected are those who are unable to survive the resultant international competition.

F. Recommendations for appropriate negotiation strategies

Negotiation strategies should include those based on regional cooperation among the developing countries of the ESCAP region in order to ensure that the terms of accession are compatible with national development objectives.

At present, supply side constraints do exist, but with membership of WTO, market access opportunities will pave the way for FDI in the infrastructure sector, which will, in turn, attract more FDI in export-oriented activities. The same logic applies with regard to the liberalization of the services sector, although action plans and commitments have yet to be worked out for each sub-sector. Most of the services sector activities are related to trade support or trade facilitation. This means that the sector has the potential to boost trading activities. The undeniable fact is that while the Lao People's Democratic Republic is recording a chronic trade deficit in goods, it has gained a surplus in the services balance in the past few years. The problem is how to further liberalize the subsectors in order to gain more benefits that will enhance domestic supply and export competitiveness. The experiences of some countries have

shown that it is better to open up those subsectors that the local investors are not in a position to develop on their own, rather than protect them.

One more point that needs to be stressed is that WTO membership can help alleviate the problem of being landlocked by improving the transit rights under the freedom of transit (Article V of GATT 1947). This right is enforceable under the WTO dispute settlement mechanism. This issue is particularly pertinent to the situation in the Lao People's Democratic Republic as well as other landlocked countries of the ESCAP region. In the future, Lao People's Democratic Republic will be transformed to a land-linked country in the Greater Mekong subregion. In the process of accession, the Lao People's Democratic Republic wishes to point out to other landlocked countries that it wishes to jointly raise the issue and negotiate for such rights. Second, the Lao People's Democratic Republic should make every effort to become a transportation hub for the subregion.

The analysis in this paper focuses more on the favourable aspects of WTO accession for LDCs. However, the reverse side of the coin has not sufficiently been touched upon. In fact, LDCs could be successfully integrated into the global trading system only if the developed member countries take the lead in liberalizing their foreign trade regimes by (a) removing their protective tariff and non-tariff barriers, and (b) reducing agricultural subsidies that restrict imports from developing countries. These developed member countries should set an example to the poorer LDC members by liberalizing their trade policies and accepting competition, the virtues of which they often preach to LDCs. More efficient resource allocation could be obtained from the consequent international division of labour. At the same time, they should augment technical and financial assistance as well as provide special and differential treatment for less developed countries.

Accession to WTO will create benefits as well as challenges. WTO membership is applicant-dependent. As a matter of fact, no LDCs have joined WTO since 1995. Nevertheless, the number of small countries that have recently concluded the accession process suggests that the smaller a country is, and the more liberal its regime, the faster its accession process.

In December 2002, the WTO General Council adopted guidelines, proposed by the WTO LDC subcommittee, that seek to streamline and simplify the accession of LDCs. The guidelines cover four main areas: market access, WTO rules, the accession process, and trade-related technical assistance and capacity-building. This appears acceptable and it should facilitate and accelerate the negotiations of acceding countries. Since the accession process of the Lao People's Democratic Republic is still at an early stage, at present it cannot be said that the guidelines are useful. However, if Cambodia is able to accede to WTO at the fifth ministerial conference in Cancun, that will, to some extent, indicate that the will exists among WTO members to put the guidelines into practice.

In addition, special and differential treatment is very important for all LDCs, including the Lao People's Democratic Republic, since it will help to build up the capacity of the Lao People's Democratic Republic to observe its rights and obligations

under the WTO rules as well as enable the country to share some of the benefits derived from the multilateral trading system. Therefore, it is crucial that special and differential treatment be made more effective during the accession process. The Lao People's Democratic Republic suggests that the first LDC to accede to WTO after 1995 should make every possible effort to negotiate and accept the terms of accession that are not beyond the related guidelines set forth in the document WT/COMTD/LDC/12. In doing so, it would make the special and differential treatment more effective for those LDCs that subsequently accede.

In the case of the Lao People's Democratic Republic, the reason for faster accession is basically that the cost of protection is too high for the country (for example, the provision of subsidies and the small size of the national economy). This means reduced market access. As the Lao People's Democratic Republic is a country in transition, and because the accession process has entered its second stage (i.e., questions and answers), delays may occur since the rules and regulations required by WTO accession have not yet been put in place.

Within the context of the laws and the operation of government institutions, the extent to which the government agencies are involved in the regulation of economic activity needs to be clarified. Transparent rules and criteria will be put in place in order to leave little room for administrative discretion, especially in the import regime. Second, there are some issues related to the jurisdiction and capacity of national agencies to implement policies on which commitments are being made. The present domestic legal framework needs to be strengthened, and the introduction, or a commitment to do so, of the necessary legislation will have to be undertaken. The fundamental concern is one of governance, i.e. the authority and capacity of agencies to implement commitments made, in the context of WTO accession, regarding those laws and regulations that affect international trade. A related concern has to do with the enforcement of such laws, especially the role and jurisdiction of local authorities with regard to commitments made by the national authorities in the context of accession negotiations.

The following paragraphs do not necessarily reflect the position of either the Foreign Trade Department or that of the Ministry of Commerce. By taking all this into account, and from the perspective of the authors, the recommended strategies for WTO accession by the Lao People's Democratic Republic should include:

(a) The creation of public awareness, familiarization with WTO rules as well as the benefits and challenges of accession, and the involvement of key stakeholders;

(b) Capacity-building among government officials in the ministries concerned, and the establishment of the negotiating team;

(c) Trade policy and institutional reforms;

(d) The enhancement of competitiveness at the microeconomic level; and

(e) A mixed or combined trade liberalization accession strategy.

1. Rationale for recommending the mixed or combined trade liberalization accession strategy

The initiation of the trade liberalization process by the Lao People's Democratic Republic dates back to 1986. Another important milestone in the liberalization process was reached in 1997 when the country joined the ASEAN community. However, in that same year, the Lao People's Democratic Republic was unexpectedly hit by the Asian economic crisis, the result of which was unprecedented high inflation that required government intervention.

The next major advance by the Lao People's Democratic Republic within the AFTA framework will be the reduction of its tariffs for most goods by 2008. The Government has divided its import tariff lines into an Inclusion List (2,098 items), a Temporary Exclusion List (1,291 items), a Sensitive List (88 items) and a General Exception List (74 items).

Goods on the Inclusion List will see their tariffs reduced to between 0 and 5 per cent by 2008. The Temporary Exclusion List will have to be split into five equal portions and transferred to the Inclusion List annually, with the reduction of their tariffs to zero per cent being completed by 2005. The Sensitive List, which consists of agricultural and agro-processing products, will undergo tariff reduction not later than 2015.

The above facts clearly illustrate the ongoing trade liberalization process that is part of the Lao People's Democratic Republic's commitments under the Common Effective Preferential Tariff scheme of AFTA. Since this liberalization will continue during the process of accession to WTO, these commitments will hopefully become multilateral.

With regard to negotiating strategies and regional cooperation, the Lao People's Democratic Republic believes that ASEAN membership will prove useful in facilitating its accession process to WTO on the grounds that the experience has provided basic multilateral negotiating skills to Lao negotiators and laid down a foundation for policy reforms that are WTO supportive. The reason for this confidence is that of the 10 members of ASEAN, seven are already WTO members; only the three newest members (Cambodia, the Lao People's Democratic Republic and Viet Nam) are still in the process of WTO accession. ASEAN supports the accession of its members by not raising any questions and by offering training on WTO agreements and principles to its acceding members. As in the case of other regional economic cooperation arrangements, ASEAN was formed under the principles of Article XXIV of GATT. Therefore, a regional approach is considered to be one way of facilitating accession to WTO by the Lao People's Democratic Republic in view of the learning and sharing experiences that such an approach can provide.

With regard to whether minimum liberalization is appropriate or not, a small LDC such as the Lao People's Democratic Republic has little leverage in market access negotiations; thus, the potential benefits to be obtained through such a strategy may be very small. At the same time, maintaining protection through relatively high

tariffs and protecting agriculture and services sectors imposes costs on the country's own economy. A more liberal trade regime following accession could be beneficial ultimately.

In this connection, if the Lao People's Democratic Republic opts for binding tariffs at levels higher than those applied and few commitments regarding agriculture and services, it will face the risk that interest groups may in future exert pressure for additional protection. At the same time, it may produce uncertainty about trade policy among the country's trading partners.

As far as the maximum or unilateral liberalization strategy being made a part of the accession process, the authors do not recommend it due to the lengthy process of liberalization. For a transition economy, time to adjust and adapt is required. The WTO rules have provided for special and differential treatment for LDC members, reflecting the different levels of preparedness for their compliance with WTO rules. Moreover, the LDC economies are generally too fragile to be suddenly exposed to world competition and also too vulnerable to be subjected domestically to market forces. In this regard, no country is pursuing a truly liberal trade policy. Even developed countries are still protecting and subsidizing agriculture, while LDCs find it too costly to pursue similar strategies.

Therefore, the most appropriate strategy will be somewhere in the middle or in the form of a combined strategy. It means that national trade interests should be protected, based on a cost-benefit analysis. However, this must be in line with WTO requirements as the Lao People's Democratic Republic supports freer and fairer trade.

In the case of other ESCAP members, it is suggested that sufficient preparation, capacity-building, institutional arrangements and trade policy reforms need to take place together with the strengthening of competitiveness among business operators and other stakeholders. The above steps should precede or be part of the accession process.

2. Regional cooperation among ESCAP member countries

WTO is member-driven and the large majority of its members are developing countries whose objective is national development. Mutual assistance, networking among trade negotiators and corresponding institutions and stakeholders in ESCAP member countries are all crucial to the exchange of information, the protection of common regional interests and the maximization of benefits stemming from WTO membership. Hence a common stance should be taken when negotiating under WTO such as linkages between trade and development, trade and poverty reduction, and trade and investment. Special and differential treatment for LDCs should be made more substantial and practical, for example, by making the rules less stringent for new or less developed members. Developed country members should pay more attention to new members, such as through the provision of increased technical assistance to developing countries, particularly LDCs.

NEPAL*

Introduction

Although the Task Force for Trade and Commercial Policies formed by the Government of Nepal during 1974-1976[127] recommended the integration of the country into the multilateral trading system, it only occurred when Nepal formally applied for membership in GATT in 1989. In that year, Nepal's bilateral trade and transit agreements with India, a major trading partner, were terminated and remained stalemated, thus creating created uncertainty for Nepal's foreign trade. Against that backdrop, Nepal realized that the essence of GATT membership was essential to ensuring predictable and stable trade relations with its partners, including protection under GATT Article V[128] on transit rights. However, efforts to obtain membership in GATT lost momentum after Nepal signed a new bilateral treaty with India in 1990 that reinstated the status quo in trade and transit provisions. Therefore, the urgency for Nepal to become a GATT member faded. In 1995, after a hiatus of about five years, Nepal resumed the process of accession to WTO and the existing working party on Nepal's accession to GATT 1947 was converted to a WTO Accession Working Party.[129] Subsequently, in 1995, WTO offered observer status to Nepal.

As a pre-requisite to the accession procedure, Nepal submitted a Memorandum on Foreign Trade Regime to the Working Party in 1998. The WTO Secretariat circulated the Memorandum to WTO members and sought their comments and questions by 15 October 1998. The comments and queries put forward by WTO members regarding Nepal's economic policies, existing laws (including the framework for formulating and enforcing policies affecting foreign trade in goods and services) and trade-related intellectual property rights were forwarded by WTO to Nepal in January 1999. Nepal responded to the queries in two phases during 1999 and 2000.

The first meeting of the Working Party[130] was held on 22 May 2000 in Geneva, resulting in additional queries from WTO member countries. In response to the development of the first Working Party meeting, in July 2000, Nepal submitted schedules of tariff concessions and initial commitments in the services sector. Subsequently, in

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* Prepared by the Trade Promotion Centre, Kathmandu, and reviewed by ESCAP.

127 Ananda P. Shrestha (ed.), 2000, *WTO Globalization and Nepal*, Nepal Foundation for Advanced Studies and the United States Embassy, Kathmandu.

128 GATT Article V states that there will be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, as well as traffic in transit to or from the territory of other contracting parties.

129 On 31 January 1995, the WTO General Council decided to continue the existing Working Party on the Accession of Nepal to GATT 1947 as a WTO Accession Party with the following reference: "To examine the application of the Government of Nepal to accede to the World Trade Organization under Article XII, and to submit to the General Council recommendations that may include a draft Protocol of Accession".

130 The Nepalese delegation was headed by the Minister of Commerce Ram Krishna Tamrakar.

September 2000, the Nepalese team[131] participated in the second round of negotiations in Geneva with interested member countries on market access, based on Nepal's schedules of tariff concession and initial commitments in the services sector. The latest development, in September 2002,[132] was the second meeting of the Working Party (table 1). The meeting reviewed the market access negotiations in goods and services, discussed the legislative action plan and considered the next steps in the work of the Working Party, including the technical assistance needs of Nepal for the purpose of accession to WTO.

Table 1. Status of Nepal's accession process to the World Trade Organization

Process	Date
Application	May 1989
Working Party established	June 1989
Memorandum	August 1998
Questions and replies on the Memorandum	June 1999 October 2001
Working Party meetings	May 2000 September 2002
Tariff offers	July 2000 May 2002
Services offers	July 2000 May 2002
Agricultural data	September 1998 July 1999

Note: Nepal's accession negotiations under GATT 1947 were suspended and resumed as WTO accession.

Nepal is now at a latter stage of the accession process. The process, particularly for LDCs, is the main issue of interest to Nepal as it guides commitments in market access and other fields. It also determines the starting point for future negotiations. Nepal can barely afford to prepare an institutional and legal framework or provide adequate skilled human resources to carry out the negotiations in its favour. The Integrated Framework for Trade Related Technical Assistance for LDCs (IF), as endorsed at the WTO Doha Summit has a special bearing on Nepal's capacity-building for overcoming the existing supply side constraints (as an internal factor) and its ability to negotiate expeditiously (as an external factor) in trade development.

A. Lessons learnt and good practices

During the initial stage of preparing for accession, Nepal received assistance from UNDP to enable an international consultant to be engaged in preparing a country

[131] Secretary of the Ministry of Commerce, Mohan Dev Panta led the negotiation team.

[132] Minister for Industry, Commerce and Supplies, Purna Bahadur Khadka led the delegation.

Memorandum on Foreign Trade. The project for Nepal's accession to WTO[133] commenced, with UNDP assistance, in July 1999. One of the core functions of the project was to support the Government through counselling and strengthening its negotiating capacity during the accession process. The project is coordinated with the WTO Division at the Ministry of Industry, Commerce and Supplies with regard to conducting studies and creating awareness of the implications of WTO on Nepal's various specialized sectors of the economy. The project has, so far, produced comprehensive study reports on the impact of WTO on Nepal's merchandise trade, agriculture, textiles and clothing, and customs valuation. It has also examined the WTO Agreements on SPS,[134] TRIPs,[135] and the services trade as well as domestic legislation related to the WTO system. As part of the awareness campaign, in partnership with major stakeholders, the project organizes information seminars/workshops and interactions on the multilateral trading rules under the WTO regime in different parts of the country. Publications containing general information about the WTO system and its scope, including complicated agreements such as TRIPs and AOA,[136] have been published by the project in Nepalese for the benefit of the public.

Private sector involvement has increased in business interactions and institutional mechanisms in preparation for WTO accession, and the feeling of national ownership is intensifying. The Federation of Nepalese Chambers of Commerce and Industry (FNCCI), the apex body of the Nepalese private sector, and the Garment Association of Nepal (GAN), a commodity association vulnerable to WTO agreements on textiles and clothing, have already set up WTO cells within their organizations in order to keep abreast of WTO mechanism development and future courses of action. This has greatly helped in disseminating information and maintaining a dialogue with the Government on WTO issues. However, their role in business advocacy still lags behind that played by the business communities in neighbouring countries.

Until recently, the Nepalese business community gave little importance to its role in government negotiation with WTO, mainly because of the lack of awareness as well as shortsightedness. The private sector sidelined the WTO system as an "academic issue". Although late starters, business associations such as FNCCI have started to exercise their role in the negotiation process regarding the terms of accession.

Nepal appreciates the Doha Ministerial Declaration, which gives LDCs a fast track to WTO membership. It acknowledges the commitment made to preferential market access and concessions during the transitional period as well as special and differential treatment to LDC products. The General Council's recent approval of the guidelines to facilitate LDC accession to WTO can be viewed as a major breakthrough. In contrast to this attitude, the bilateral market access negotiations in the accession process have sought commitment beyond mandatory provisions of WTO from Nepal,

[133] The project, headed by the Joint Secretary of the Ministry of Industry, Commerce and Supplies, in the capacity of project director, has a national programme manager for the overall functioning.

[134] Agreement on Sanitary and Phytosanitary Measures.

[135] Agreement on Trade Related Aspects of Intellectual Property Rights.

[136] Agreement on Agriculture.

regardless of its economic development level. Nepal is still facing demands from the key WTO members regarding tariff binding and the offer of the services sector that are inconsistent with the country's economic status and not comparable to other countries in the region.

Nepal probably has the most liberal tariff structure among South Asian nations and other developing countries. Since the early 1990s, the Government has liberalized its foreign trade regime by reducing import tariff rates and delicensing exports and imports. This is underlined by Nepal's unweighted average tariff rate, which is less than 9 per cent[137] and the reduced peak tariff rate, which is currently 40 per cent.[138] There are only five existing tariff slots for imported goods[139] and most of the import items fall within the duty slot of 10-20 per cent. There are a significant number of tariff lines at zero per cent. To simplify the customs administration, additional duties were abolished in 1994.

The negotiating parties have been reluctant to recognize the unilateral liberalization of the tariff structure of Nepal. They are demanding lower bound rates in nationally sensitive sectors such as agriculture. During the latest round of negotiations, Nepal showed greater flexibility in the binding of industrial product tariff lines, although it has stuck to its commitment to bound agriculture tariffs[140] at higher rates than those being applied. By recognizing the sensitivity of agriculture in terms of the national economy, that is, share of GDP, employment opportunities, rural livelihood and the geo-political situation, Nepal has shown less flexibility in binding agricultural tariffs at the applied rates. Addressing the complicated issue of bilateral negotiations, Nepal has adopted the strategy of trading off low tariff rates and other benefits with trading partners. The strategy has also meant reducing applied rates on products having lower potentiality among domestic industries. Based on this modality, tariffs have been bound high for imports similar to products of established domestic industries, with lower binding for products that are similar to potential industries and lower applied rates for non-potential industries. The impact of tariff reduction on government tax revenue (table 2) has also been given the utmost importance while negotiating the tariff bindings.

The developed countries have also been demanding greater commitments from Nepal in the case of the service sector. Nepal has extended the services subsectors in its national schedule from three initially to a wider range of offers[141] in accordance

[137] The unweighted average customs duty was 15.5 per cent in the early 1980s and 8.8 per cent prior to the pursuit of trade liberalization by the Government in 1992 and 1993.

[138] The pre-liberalization peak tariff rate, which was as high as 225 per cent, was reduced by more than 50 per cent during the early phase of liberalization. Currently, the maximum tariff rate is 40 per cent; however, some products are subject to special rates of 80 per cent and 130 per cent.

[139] The existing tariff slots are 5, 10, 15, 25 and 40 per cent.

[140] Nepal has an average of 40 per cent bound tariff rates for most agriculture products. The applied rate for the majority of agriculture products falls below the 5 per cent tariff line.

[141] The services subsectors offered by Nepal cover business services (including professional services and computers), financial services, telecommunications, health services, tourism and travel, transport, educational services, and construction and engineering.

Table 2. Contribution of customs duties to total tax revenue

(Unit: NRs million)

Year	Total tax revenue	Revenue from tariffs	Share of tariff revenue in tax revenue (%)
1985	3 150.8	1 065.1	33.80
1990	7 284.1	2 684.9	36.86
1995	19 660.0	7 017.9	35.70
1996	21 668.0	7 327.4	33.82
1997	24 424.1	8 309.1	34.02
1998	25 926.6	8 499.9	32.78
1999	28 753.0	9 517.5	33.10
2000	33 152.5	10 813.3	32.62
2001	38 865.0	12 552.1	32.30

Source: Nepal Rastra Bank.

with the demands of WTO members participating in the negotiations. While extending the services sector, Nepal has pursued a policy of attracting FDI and conditional commitment approaches in less competitive sectors. However, pressure is being placed on Nepal by negotiating countries for a full commitment in wider areas of the services sector. This goes against Nepal's terms of accession despite WTO rules on special and differential treatment for LDCs.

B. Government institutional set up and mechanism for policy coordination

In 1998, Nepal gave the highest priority to coordination among government ministries and departments by establishing a high-level committee to prepare for accession to WTO. The Committee, headed by the Secretary at the Ministry of Industry, Commerce and Supplies, comprised the Secretaries of the Ministry of Industry, Commerce and Supplies, Ministry of Law, Ministry of Finance, Ministry of Agriculture, Ministry of Foreign Affairs, and Ministry of Tourism and Culture as well as representatives of the Nepal Rastra Bank (central bank) and the National Planning Commission (NPC). The committee is responsible for providing policy issues to the Government regarding the fields and sectors of the economy that are relevant to WTO. The main objective of the committee is to represent all line ministries and government institutions having a direct link with WTO-related agreements. The objective is to ensure coordination needed for facilitating negotiations and policy formulation concerning Nepal's economy and foreign trade under the WTO regime.

The Ministry of Industry, Commerce and Supplies is principally responsible for formulating and enforcing trade-related policies, including WTO membership. The ministry's major areas of responsibility include the implementation of trade policy, the establishment of bilateral, regional and multilateral trade relations, and the development of capable manpower for internal and external trade enhancement. It is also empowered

to conduct surveys of internal and international trade prospects as well as the management of cost-effective transportation including the country's multi-modal transit and trade facilitation programme.

The Department of Commerce handles the registration of trading firms, the issuing of licences (wherever required) and the authorization of goods to be imported or exported. The ministry owns an autonomous body, the Trade Promotion Centre (TPC), the function of which is to advance market and product development for international trade. The main activities of TPC include: the publication of overseas trade statistics; (b) international market and price information; (c) trade-related human resources development; and (d) documentation and dissemination of information regarding the global trading environment, including the WTO system and regional trading issues. The National Bureau of Standards and Metrology, under the ministry, has been designated as an enquiry point regarding the WTO-related technical barriers to trade.

Another important function of the Ministry is the development of policies on foreign investment and technology transfer, industrial promotion and protection, and trade- and industry-related patent and trademark protection. The policy on the supply of essential and basic goods as well as the supervision of the market and pricing mechanism also come under the purview of the ministry. A separate WTO Division within the Ministry actively coordinates preparations for WTO accession with line ministries.

The Ministry of Finance is closely associated with international trade matters as it enforces customs duties and taxes, monitors the balance of payments situation, and implements monetary and fiscal measures. The Ministry of Agriculture bears the major responsibility for farm productivity, subsidies and support, plant quarantine and food research. These activities are closely linked with the WTO agreements on agriculture and sanitary and phytosanitary measures. By including all line ministries and agencies, the committee expects to receive counselling in formulating policies in the areas that are relevant to the WTO mechanism. To strengthen coordination further, the Government is considering the establishment of WTO focal points in all ministries and government entities concerned.

C. Mechanism for creating national ownership of World Trade Organization reforms

The significance of accession to WTO is largely considered to be the core of Nepal's objective of achieving multilaterism and globalization. Initially, the stakeholders (including the business community) attached little importance to their involvement in the multilateral negotiations or to the impact of globalization. Clearly, that indicated the mistaken and uniformed attitude among Nepalese stakeholders that the national ownership of WTO reforms rested only with the government.

It is true that business entities have no status under the provisions of WTO, at least directly. It is the Government that participates directly in WTO negotiations. However, business interests in WTO member countries drive the trade agenda. This is

why the Nepalese business community and other stakeholders cannot afford "rational ignorance" about the multilateral trading system under WTO in this age of globalization. The scope of WTO has been extended from trade in goods to trade in services and trade-related intellectual property rights. Even the Nepalese business community has begun to understand that the substance of national laws and regulations that are directly applicable to their transactions are determined by different WTO agreements and decisions. Therefore, they have sought more detailed information about the changes in the global trading environment and specific regulatory areas affecting their interests. This information cannot be acquired without knowledge of the reforms in WTO or other multilateral trading systems. Complaints have been frequently heard from the business sector that the Government lacks transparency and that access to information about Nepal's status in the negotiations regarding WTO accession needs to be made easier. This has contributed to the lack of interest exhibited by other stakeholders.

However, the situation is changing as stakeholder intervention has increased noticeably during the latter part of Nepal's accession process to WTO. During the Doha Summit, the Nepalese delegation included a representative from the business community.[142] This was the first time that the Government had taken such a step. In order to increase the sense of national ownership among the political parties, in March 2001 Parliament were briefed on WTO issues.[143] The role of business associations and other stakeholders in advocacy has increased by regular interactions and the organization of public forums on WTO. The three major mechanisms identified for creating national ownership of WTO reforms in Nepal are easier and timely access to WTO information, government-private sector partnership and a network among stakeholders. The first mechanism is crucial to the efforts of the Nepalese business community to prepare business strategies and stay tuned to the future regulations on market access. For example, it is necessary for the business community to be fully acquainted with applicable and bound tariffs under WTO. Other WTO rules that are of direct importance to businessmen include provisions on agreements on agriculture and textiles and clothing. The WTO mechanisms on subsidies, anti-dumping and countervailing measures, sanitary and phytosanitary measures, rules of origin, and trade-related aspects of intellectual property rights will also have a major impact on the competitive position of Nepalese traders in the respective markets. Both the Government and the private sector have yet to develop an effective mechanism for accelerating the flow of information on complicated WTO issues, particularly those issues mentioned above.

In addition, the need for an institutionalized government-private sector partnership with regard to WTO developments in Nepal has been recognized. The business sector is not well equipped, with either qualified experts or an efficient institutional mechanism for implementing a fruitful dialogue with government bodies on various aspects of the issues. This has meant that the Nepalese business community is unable to influence

[142] A representative of the Federation of Nepalese Chambers of Commerce and Industry was included in the Nepalese delegation.

[143] The programme organized on 27 March 2001 by Nepal's Accession to WTO Project provided a forum for the representatives of major political parties in the Parliament to become acquainted with the latest developments on WTO and Nepal's accession process.

WTO negotiations. If this weakness persists, the Nepalese business sector may be deprived of access to available WTO mechanisms for defending their interests, such as the dispute settlement body (DSB), after the country accedes to WTO. Obviously, the lack of communication between the business community and the Government during WTO negotiations needs to be alleviated.

To reinforce the communication and consultation process, a national network is needed among stakeholders, as this will help to build technical and operational capacities regarding WTO and the multilateral trading regime. The network should include exporters, importers, producers, business associations, trade experts and academics, and trade journalists. Other players such as labour unions, professional associations, social issues activists, consumer forums, NGOs, and INGOs are also becoming increasingly involved in building awareness on WTO issues. The national network will be crucial to building synergies among network members in order to develop a sense of national ownership. This is underscored by growing persuasive activities undertaken by business groups and other stakeholders that are aimed at influencing the Government in its policy-making strategies regarding international trade.

D. Impact of World Trade Organization membership

The accession of Nepal to WTO is imminent, and it will result in both benefits and costs to the economic development of the country. The benefits and costs of WTO membership can be observed vis-à-vis Nepal's policy reform and trading environment as well as opportunities for, and obligations to, market access, erosion of preferences, risks posed by technical barriers and the ability to defend trade interests. Separate impacts on the social and related sectors of Nepal will follow.

1. Macroeconomic policy reform and stable trade relations

Since the beginning of the 1990s, the international trade policy and environment has significantly changed in Nepal as globalization has been pursued together with trade and investment liberalization. However, the bilateral relationship with India has a special bearing on Nepal's economic policy reform and trading environment, as the former dominates the latter in overall trade volume (table 3).[144] In addition, Nepal's trade with third countries is based on arrangements made in the bilateral transit agreement with India. Both the agreements have intermittently been a major factor in influencing stable trade transactions with India as well as third countries. Nepal has to give importance to the bilateral trade relationship with India, vis-à-vis its commitment to the regional and multilateral trade relationships. Thus, membership in WTO is expected to provide stability and predictability in Nepal's external trade regime.

[144] India's share of both export and import values of Nepal, which were above 90 per cent until the early 1970s, declined significantly to the 40 per cent range in the 1980s. This change was attributed to Nepal's trade diversification strategy. During the 1990s, the figure declined further due to the bilateral trade treaty favouring Nepal's exports to India. However, India's arbitrary imposition of border duties on Nepal's exports in the late 1990s favoured Indian imports and threatened Nepal's exports. India's share of Nepal's exports (FOB) and imports (CIF) in 2000/2001 was 47.7 per cent and 41.2 per cent, respectively. India's share of the total trade volume stands at 43.3 per cent.

Table 3. Foreign trade by Nepal

(Unit: NRs million)

Description	Exports (FOB)	India	Other countries	Imports (CIF)	India	Other countries
1970/71	400.6	395.2	5.4	699.1	616.8	82.3
	(100.0)	(98.7)	(1.3)	(100.0)	(88.2)	(11.8)
1975/76	1 185.8	893.7	292.1	1 981.7	1 227.1	754.6
	(100.0)	(75.4)	(24.6)	(100.0)	(61.9)	(38.1)
1980/81	1 608.7	992.4	616.3	4 428.2	2 179.2	2 249.0
	(100.0)	(61.7)	(38.3)	(100.0)	(49.2)	(50.8)
1985/86	3 078.0	1 241.1	1 836.9	9 341.2	3 970.9	5 370.3
	(100.0)	(40.3)	(59.7)	(100.0)	(42.5)	(57.5)
1990/91	7 387.5	1 552.2	5 835.3	23 226.5	7 323.1	15 903.4
	(100.0)	(21.0)	(79.0)	(100.0)	(31.5)	(68.5)
1995/96	19 881.1	3 682.6	16 198.5	74 454.5	24 398.6	50 055.9
	(100.0)	(18.5)	(81.5)	(100.0)	(32.8)	(67.2)
2000/01	5 744.7	2 730.4	29 940.6	113 386.3	46 662.3	667
	(100.0)	(477)	(52.3)	(100.0)	(41.2)	240.0
						(58.8)

Source: Nepal Rastra Bank and the Federation of Nepalese Chambers of Commerce and Industry.

Note: Figures in parenthesis are percentages.

WTO membership will safeguard Nepal's interests, and will help to devise and pursue economic reform programmes with the assurance of a predictable and stable environment. As a small economy, Nepal does not possess enough strength to influence market access negotiations; therefore, the principles and rules of trade agreed upon are especially important to devise a trade policy based on comparative advantage. It will ultimately help to divert exports and attract FDI. This is possible only through the WTO system, which combines reciprocal market access and negotiation based on the MFN (most favoured nation) clause and national treatment, both based on the non-discrimination principle.

As stated above, Nepal has pursued a trade and investment regime based on the market mechanism. Therefore, there is a need for greater stability of the macroeconomic variables affecting international trade to surmount external payment problems and trade imbalance. The WTO can assist Nepal to achieve these objectives by providing a framework of rules that support appropriate domestic policies. It can offer direct technical assistance to Nepal's export and import efforts through WTO technical support programmes, and by providing stable market access to Nepal's exports and a process for resolving trade disputes. Moreover, Nepal, being a landlocked nation, gets a special place in WTO provisions regarding transit rights for stability in trade relations with India and overseas nations.

2. Market access opportunities and obligations

The commitment made by the developed countries regarding market access for imports under the Uruguay Round matters to Nepal, considering the export product composition. There has been a structural change in Nepal's export product composition from primary products to manufactured goods (table 4). Those products are directed mainly towards the developed countries such as the United States and the European Union. This is chiefly because they have ensured more secure and open markets for LDC exports under various understandings reached during WTO negotiations. The main features of market access commitments by these countries include the expansion of tariff bindings to 99 per cent of imports and the reduction of the trade-weighted average tariff.[145] It is estimated that once the agreed tariff reductions have been fully implemented, the proportion of merchandise imports entering under the preferential market access will increase in the United States, the European Union and Japan,[146] all important markets for Nepalese exports.

Nepalese exporters have also been provided with an equal opportunity to increase their share in the global market as a result of WTO commitments. Nepal is concerned more about the assurance by developed countries of expanded duty-free access of industrial imports from the developing countries, and particularly from LDCs. Considering the features of market access commitments, WTO membership should

Table 4. Share of manufactured goods in total exports by Nepal

(Unit: NRs million)

Year	Total exports	Manufactured goods classified chiefly by materials
1974/75	889.6 (100.0)	28.1 (3.16)
1975/76	1 185.8 (100.0)	104.7 (8.83)
1980/81	1 608.7 (100.0)	254.3 (15.81)
1985/86	3 078.1 (100.0)	899.9 (29.24)
1990/91	7 387.5 (100.0)	4 312.3 (58.37)
1995/96	19 881.1 (100.0)	10 455.7 (52.59)
1996/97	22 636.5 (100.0)	11 028.6 (48.72)
1997/98	27 513.5 (100.0)	11 637.1 (42.30)
1998/99	35 676.3 (100.0)	13 539.6 (37.95)
1999/2000	49 822.7 (100.0)	15 838.7 (31.79)
2000/01	57 244.7 (100.0)	18 968.6 (33.14)

Source: Nepal Rastra Bank.

Note: Figures in parenthesis are percentages.

[145] The trade-weighted average tariff will be reduced by 40 per cent from the pre-Uruguay Round level of 6.2 per cent to the post-Uruguay Round level of 3.7 per cent.

[146] The imports under duty-free have been projected to increase from 10 to 40 per cent in the United States, from 24 to 38 per cent in the European Union, and from 35 to 71 per cent in Japan.

provide Nepal an opportunity to aim for a stable external trade policy strategy with the combined objective of comparative advantage and competitive edge. The security of market access should encourage investment and investment planning by Nepalese export industries under greater conditions of certainty. This would encourage Nepalese industries to expand and diversify the production base with a greater export orientation, if national policy favours it.

On the other hand, the tariff binding commitments that Nepal has to make as an obligation are important to the country's imports and industrial development. Tariff bindings will give security to importers and domestic industries, ensuring stable prices of imported raw materials. That will help in facilitating price determination by Nepalese industries. WTO rules that seek imports to be allowed in without further restrictions after payment of duties, and the obligation to ensure that other national regulations applied at the border conform to the uniform rules laid down by the agreements, will facilitate imports. These provisions will guarantee that importers and domestic industries are able to import materials without delay and at the most competitive prices.

3. Trade in textiles and clothing

The WTO rules have liberalized trade in textiles and clothing, and agriculture, which the developing countries and LDCs consider to be an important market access commitment made by the developed countries. Regarding textiles and clothing, poorer countries are expected to benefit from changes in trade flows, investment and the location of production induced by the new provision. Although the impact of new provisions in textiles and clothing is not related directly to WTO membership, it is worth mentioning because the impact has been just the opposite in Nepal's case. The effect of new arrangements in textiles and clothing can be observed with respect to the two groups of countries. Some countries will realize the benefit immediately from the new provision as they have a strong comparative advantage and whose market access has been tightly restricted by the MFA. On the other hand, there are countries that have been induced by MFA restrictions to enter the global trade in textiles and clothing without possessing a true comparative advantage.

Nepal belongs to the second category. Thus, the liberalized market under the WTO provision is making it difficult for Nepal to adjust. The situation has been threatening Nepal's employment, investment and trade positions. In this case, membership in WTO can help Nepal to form an alliance among the second group of textiles and clothing exporting countries in order to defend their interests. It is also important to realize that Nepal cannot avoid the post-MFA adjustment problem by remaining outside WTO.

4. Provisions in agriculture trade

Nepal's membership in WTO can be pressed from the point of view of the potential promotion of agricultural production and trade. Under the Uruguay Round negotiations, WTO members consented to liberalize farm trade by making commitments to reduce border protection, including the assurance of discouraging trade distorting

agricultural subsidies and government support. Accordingly, they agreed to reduce tariffs, substitute non-tariff barriers under tariffication, and cut subsidies and government support.[147] Nepal is expected to benefit from these provisions in two ways. First, it will gain increased market access opportunities for farm products. Second, it will be given an opportunity to enhance farm output by controlling imports because Nepal, as an LDC, is exempt from commitments to liberalize agriculture by reducing export subsidies and government support. The benefits to the country in terms of its GDP are, however, expected to be marginal as Nepal is an inefficient producer and a net food importing country at present. Agricultural products do not play a significant role in its export trade.

Nepalese traders can benefit under the changed global farm trade situation only if they add value to their products by processing, grinding, blending and good packaging. However, this will require the application of more scientific post-harvest and processing technology and practices, which Nepal's agriculture sector currently lacks. It is, therefore, necessary for Nepal to enhance agricultural production by surmounting supply constraints in order to gain fully from the changes brought about by new rules in the global agricultural trade.[148] However, the policy of tariff escalation in developed countries may hinder Nepal's potential to export processed farm products.

5. Services sector offer

As part of the next market access commitment, Nepal needs to open up its services sector by assuring non-discriminatory and national treatment to foreign service suppliers. Nepal has offered a number of sectors including business services (including professional services and computers), financial services, telecommunications, health services, tourism and travel, transport, educational services, and construction and engineering. It requires Nepal to be transparent and to establish an "enquiry point" as an obligation. It is widely realized that by liberalizing the services sector, manufacturing sectors can benefit from efficient service industries that can provide the required inputs. Thus, Nepal is expected to benefit from a lower input cost in its manufacturing and agricultural industries as a result of liberalizing the services sector. Even though this will pose stiff competition for domestic suppliers, it will create healthy competition and result in higher quality and lower cost service inputs (transportation, telecommunications, financing, and professional services), which are important to Nepalese manufacturers in becoming price, quality and delivery competitive. However, Nepal needs to be cautious in wider liberalization of the services sector due to the potential impact on domestic employment and the balance of payments situation.

[147] Developing countries proposed enhanced flexibilities rather than specific, prescribed policies through a "Development Box", targeting low-income, resource-poor farmers and secure supplies of "food security crops", and allowing developing countries, inter alia, to exempt these food security crops from their commitments and maintain or renegotiate high tariffs on them.

[148] Currently, agriculture accounts for barely 10 per cent of Nepal's export value, and is concentrated largely on bordering India, which favours primary product exports under the bilateral trade treaty between the two countries. Exports of agricultural products are insignificant in terms of both volume and value.

6. Erosion of preferences

One of the issues that concerns Nepal regarding the effect of tariff reduction as a market access commitment is the erosion of preferences. Nepal enjoys preferential market access under GSP for almost two-thirds of its export commodities, and almost every major importing country grants GSP treatment to Nepal.[149] However, Nepal expects to benefit only marginally from a reduction in tariffs and other trade barriers mainly because of two reasons. First, Nepal is concerned about the loss of tariff preferences as MFN rates fall. Second, the net gain from GSP benefit to Nepal is still trivial because the industrialized nations are reluctant to give complete duty-free access to all LDC products, including Nepalese exports. Based on export volume and simplicity, Nepal benefits most from the European Union's GSP scheme under the "Everything but Arms" (EBA) scheme. The EBA scheme is attractive to Nepal for two reasons: the scheme includes all products of interest for export by Nepal, and it provides the facility of derogation from the European Union's GSP rules of origin for Nepalese apparel. These provisions provide Nepal with many opportunities to increase the export growth rate.

However, the GSP scheme has some limitations that Nepal should take into consideration. The GSP scheme is discretionary in application. It does not guarantee market access preference without some uncertainty as it is unbound and unilateral. For example, the GSP scheme often excludes sensitive items that are exported by Nepal, including textile items, apparel[150] and agricultural products. It is also understood that GSP is conditional, seeking social or political compliance, such as respecting core labour standards and environmental labelling. Sometimes GSP eligibility is based on strict rules of origin criteria, such as with textiles and clothing. Unlike the bound MFN tariffs, the GSP scheme can be withdrawn unilaterally without tendering any justification. The impact of preference erosion to Nepal is further intensified by its supply side constraint and the constant deterioration of export commodity prices on the international market.

7. Challenges of countering technical barriers

Nepalese exports are frequently impeded by the increasing use of environmental protection measures, other social clauses and growing consumer sensitivity to food safety in international markets. As with many developing nations, Nepalese exporters also consider these measures to be protectionist and discriminatory devices. It is important to perceive that the WTO provisions allow member countries to develop and enforce measures to protect human and plant health under the SPS Agreement, and the provisions regarding the application of product quality labelling requirements under the TBT Agreement.[151] Nepalese traders are unaccustomed to these measures, which

[149] Nepal benefits from the GSP facility in Australia, Canada, the European Union, Japan, New Zealand, Norway, Switzerland, the United States and the Eastern European nations, such as the Czech Republic, Hungary, Poland and the Russian Federation.

[150] For example, the United States does not provide a GSP facility for Nepalese apparel. Instead, the product is subject to higher tariffs, ranging from 17 to 30 per cent.

[151] Agreement on Technical Barriers to Trade.

are actually intended to reduce the risk of technical barriers and facilitate international trade. They should understand that the SPS and TBT Agreements are there to defend their rights and interests in the use of sanitary and technical regulations. To benefit from such provisions, Nepal has to put together an institutional set-up and legal framework by expending huge amounts of financial and human resources.

With regard to the SPS provision, Nepal should have well-equipped laboratories and adequate technical manpower of international standards. Nepal lacks a fully developed infrastructure in the areas of product standards, conformity assessment, quality and metrology. As an obligation upon its accession to WTO, Nepal has to establish an "enquiry point" to provide information on these issues. The Government has designated the National Bureau of Standards and Metrology as the national enquiry point for the WTO/TBT. The National Bureau of Standards and Metrology has made some organizational changes with regard to a laboratory accreditation scheme, quality and environmental management system certification and industrial metrological activities. However, it lacks human and financial resources to meet TBT requirements. Nepal has enacted several laws with respect to the protection of human, animal and plant life as well as laws on product standards in the interest of public health and security.[152] However, the prevailing laws need to be amended or new laws enacted so that they are in conformity with the SPS and TBT rules.

8. Cost and benefit of respecting intellectual property rights

The TRIPs Agreement is one contentious issue with regard to Nepal's accession to WTO. The economic arguments in favour of TRIPs for Nepal have been based upon the increased trade flows and transfer of technology and FDI. It is believed that TRIPs will lead to a higher volume of trade, particularly "high-technology" trade. Proponents also believe that Nepal's compliance with TRIPs, which will guarantee the protection of intellectual property (IP), will encourage the transfer of technology and foreign investment. It is also believed that the improvement in IP protection in international trade transactions could result in some substitution of trade for investment. However, Nepal needs to make substantial changes in its legislative and enforcement mechanism, including an institutional set-up with infrastructure and skilled manpower, which is considered a tough obligation.

Although Nepal's IP laws do not cover all areas of TRIPs, the existing legislation includes laws on patent, design and trademark, and copyright protection.[153] Nepal needs to develop other laws on IP related to geographical indications, layout/designs of integrated circuits, and the protection of undisclosed information. This requires a huge financial and human resources investment. Upon Nepal's accession to WTO, the developed member countries can make technology and financial assistance available for the preparation of domestic legislation on the protection and enforcement of intellectual

[152] Nepalese laws, such as the Food Act. (1976), Animal Feed Act. (1976), Plant Protection Act. (1972) and Nepal Seed Act. (1988) deal with the protection of human, animal and plant life, whereas the Nepal Standard (Certification Mark) Act. (1980) is concerned with product standards.

[153] The Nepalese laws related to enforcing intellectual property rights are the Patent, Design and Trademark Act. (1965) and the Copyrights Act. (1965) that has been replaced by the Copyrights Act. (2002).

property rights (IPRs) and the prevention of their abuse. The developed member countries can also provide support for the establishment or reinforcement of relevant domestic offices and agencies in addition to training personnel. Apart from Nepal's difficulty in preparing fully-fledged IP legislation, TRIPs is expected to adversely affect, inter alia, agricultural input prices, access to cheaper medicines and the protection of plant varieties.

9. Defending trade interests

As mentioned above, Nepal is not in a position to defend itself against any unilateral action taken by its trading partners over its exports. Consequently, it has been facing strict border regulations and has to comply with uncompromising buyers' requirements, most notably environmental and social clauses, that are imposed arbitrarily. This has posed a serious threat to the ability of Nepal to develop sectors that have a comparative advantage. There is also a possibility that Nepal will face discriminatory anti-dumping and safeguard measures as its exports to importing countries increase. When considering such a vulnerable situation, the only option open to Nepal is the internationally acceptable contingency measure within the WTO framework. In additional, it can defend its trade interests under the DSB procedure when disputes arise. Nepal can benefit from the WTO provisions on safeguards intended to protect domestic industries against a surge in imports that result in balance of payments difficulties and a threat or damage to those industries.

The measures that Nepal could apply, within the purview of WTO, are higher tariffs, quantitative restrictions, anti-dumping duties and countervailing duties. If Nepalese exports face such actions in importing countries, the cases can be challenged by the DSB in order to defend trade interests. To be able, to exercise its rights and defend itself against such actions, Nepal needs to make some preparations such as national legislation regarding safeguards, countervailing duties and anti-dumping measures in order to be able to face unfair trade practices. The other obligations may be the presentation of technical and legal arguments, and strict compliance with procedures within specific and usually short time limits. The Government may be required to assist the private sector in exercising trade rights by providing the compilation of information, data collection, and the preparation of arguments. Nepal can have access to the WTO committees ensuring information on actions affecting member countries' exports and rights.

Without qualified expertise and an institutional set-up regarding WTO and trade law, Nepalese enterprises cannot avail themselves of such provisions. For example, it is understood that Nepal will not gain easy access to the DSB procedure given the dearth of relevant expertise in the country and institutional and financial arrangements. As the private sector cannot access the DSB procedure directly, it will have to approach the Government to take up any cases in order to defend its trade interests. Hence, Nepal needs to develop a mechanism for taking its cases to the DSB, under the government-private sector partnership approach, before joining WTO. That would help Nepalese traders to avoid hurdles, including administrative and financial complications, while pleading their cases at the DSB.

E. Social repercussions

It is equally important for Nepal to assess membership in WTO with reference to the social and other sectors in the country. As stated above, the business implications of WTO membership offer both opportunities and obligations. The crux of the issue is not whether Nepal should get membership in WTO but how to adjust to the WTO system expeditiously. The social aspects of WTO membership are often overlooked in Nepal. It may be because the WTO system is directly related to the country's trade and economics. It is admitted that Nepal's membership in WTO will give broader market access to its exports. From the point of view of comparative advantage, Nepal can expect an increased flow of foreign investment and technology, more employment opportunities and greater generation of income.

When acknowledging these benefits, it is also necessary to evaluate the direct and indirect implications for the social sector, particularly with respect to workers, deprived people and rural development. WTO membership is intended to give security to goods and services as well as investment traded at the international level. As international competition becomes an important factor, the Nepalese economy will become capital-oriented, and labour-intensive production methods will be downgraded. It will thus be imperative to consider possible negative effects on employment opportunities. Equally important, consideration must be given to the displacement of small and indigenous raw material-based industries, affecting the rural employment and income situation. As domestic market prices rise, the cost of living may become intolerable for many people, thus exacerbating the extent of poverty in the country. Nepal is a rural-based economy that contributes significantly to the livelihood of the majority of the population. With the country's adherence to the WTO mechanism, there is a danger of isolating the rural economy.

WTO is working on new issues related to environmental and labour standards. Both issues can affect the foreign trade of Nepal and other developing countries if they emerge as non-tariff barriers to the exports of those countries. However, these problems cannot be surmounted through refusing to join WTO. Since Nepal's membership in the organization is inevitable, the social sector and other stakeholders must speak out in defence of their interests in order to reduce any possible negative impact arising from WTO membership.

F. Recommendation of appropriate negotiation strategies

Despite the emphasis placed by the WTO Doha Summit on accelerating negotiations with acceding LDCs, no LDC has obtained WTO membership since its establishment.[154] With respect to the accession of the LDCs, the General Council approved guidelines to facilitate the integration of the world's poorest countries into

[154] The process of Cambodia's entry into WTO is in the final phase following a meeting of its WTO Accession Working Party on 14 November 2002. Therefore, Cambodia is expected to be the first LDC to become a World Trade Organization member.

the global economy by streamlining their WTO accession procedures.[155] The decision on the guidelines is viewed as representing a major breakthrough and contributes substantively to facilitating the accession of the LDCs to WTO. The agreed text identifies guidelines for four areas: market access, WTO rules, the process, and trade-related technical assistance and capacity-building.

Flexibility in terms of accession

Nepal has already completed two rounds of negotiations through the Working Party on the terms of accession. Nepal did not experience any serious complications during the negotiations as the economy and trade policies had been reformed to make them compatible with the WTO system. The only challenge it had to face was reforming some laws[156] to make them consistent with WTO agreements. In principle, the situation should have been made easier for an LDC such as Nepal by permitting flexibility in the negotiations on the terms of accession. However, in practice, the demands made by the negotiating countries have actually raised the standard of the terms, thus delaying Nepal's accession.

The accession process is unilateral in procedure. Nepal does not possess the economic strength needed to bargain during the negotiations. However, it is necessary to address national development policy objectives while making the negotiations. Taking the situation into consideration, Nepal has put forward terms of commitment commensurate with its economic development level; a transitional period commencing from the date of accession; and the operation of the best endeavouring clauses under WTO. Such objectives should be clearly defined so that the concessions and commitments made fall within the parameters of these policies. For that, Nepal requires high-level preparations, coordination among government agencies and a broad national consensus, without which it will not be successful in defending its national interests effectively. Thus, the negotiations should involve strategic and long-term issues related to Nepal's trade and development policies vis-à-vis specific reference to LDC status and regional cooperation. Nepal should, therefore, emphasize the issues as discussed below in its negotiating strategy:

(a) Issue of marginalization and preferential treatment

Nepal has been participating actively in the global trading system by reforming its trade policies. However, the net gain to its economic growth has been below expectations due to the complex multilateral trading system and complicated trade barriers. This has resulted in further marginalization of the country in international trade. To strengthen its negotiating capacity, Nepal should consider the commitments made by the developed countries with regard to preferential market access. It should be noted here that the Doha Ministerial Declaration states: "We commit ourselves to the objective of duty-free, quota-free market access for products originating from

[155] World Trade Organization General Council Meeting, 10 December 2002.

[156] Nepal needs to amend 35 forms of existing national legislation related to various topics and issues, as mentioned by the Chief of the World Trade Organization Division at the Ministry of Industry, Commerce and Supply.

LDCs. In this regard, we welcome the significant market access improvements by WTO members in advance of the Third United Nations Conference on LDCs (LDC-III) at Brussels, in May 2001".[157] The promises made by the developed nations at the G-8 Summit in Genoa and the United Nations Conference on LDCs in Belgium in 2001 can, therefore, play a crucial role in LDC endeavours. The developed countries have endorsed their commitment to duty-free and quota-free market access for all LDC products through the "Everything but Arms" scheme of the European Union and the GSP scheme. With the cooperation of other developing countries, Nepal should take advantage of the developed countries' commitment when conducting negotiations to defend its national interests.

It is true that the majority of Nepalese exports enjoy GSP treatment in the developed countries. However, the export products of interest to Nepal and other LDCs are subject to either higher tariffs or tough border conditions. To ensure a full and effective utilization of the preferences, Nepal should continue to press for flexibility in the "rules of origin" collectively with other LDCs.[158]

(b) Consideration of Zanzibar Summit Declaration

The negotiation strategy should give continuity to the unanimous declaration of the Zanzibar Summit, which stated that "the scope of future multilateral trade negotiations will have to take into account the inability of LDCs to participate effectively in negotiations on a broad agenda and implement new obligations due to the well-known limited capacity of LDCs".[159]

Regarding the implementation aspect of WTO rules, there should be "significant movement" in the commitments made by the rich countries, particularly in agriculture, subsidies, textiles and clothing. Nepal should press for exemption of LDCs from all safeguard actions. LDCs that are implementing safeguard actions should be exempted from undertaking compensatory measures.

(c) Effectiveness of special and differential treatment

The WTO provision grants special and differential (S and D) treatment to the developing countries and LDCs by recognizing their difficulties in accepting all or some of the obligations. S and D has not been effectively implemented. The negotiation strategy should insist that S and D be treated as an integral part of the negotiations regarding matters of concern to developing and LDCs. That will help Nepal to defend its national interests within the multilateral trading system. The negotiation strategy should focus on the Doha Ministerial Declaration that reaffirms S and D treatment as

[157] Doha Ministerial Declaration, paragraph 42.

[158] During the LDC Ministerial Meeting in Preparation for the World Trade Organization Doha Summit, 22-24 July 2001, Bangladesh, supported by Nepal and Bhutan, argued that the rules of origin, including other stringent conditions, should be liberalized for effective utilization of preferences.

[159] Ministerial Meeting of LDCs on the Preparation for the World Trade Organization Doha Summit in Zanzibar, Tanzania, 22-24 July 2001.

an integral part of the WTO Agreement, giving emphasis to the proposal for a "Framework Agreement on Special and Differential Treatment".[160]

In contrast, Nepal is having difficulty in availing itself of the benefits of the S and D provision even during the accession negotiation process. The WTO trading partners actually imposed more demands during the second working party meeting, stretching from a need to lower bound tariff rates to the expansion of the services sector. The transition period as envisaged in the S and D provision is proving difficult to agree upon by trading partners in Nepal's commitment for accession. The WTO trading partners are demanding Nepal's commitment to new issues, including respecting the WTO-plus issues, such as the IT Agreement, chemical harmonization, textile harmonization and government procurement. This has, in fact, been slowing Nepal's accession to the WTO despite the WTO aim of facilitating the LDC accession procedure.

(d) Delaying entry into new issues

There is increasing pressure on LDCs, including Nepal, to abide by the new WTO rules dealing with investment, competition policy and transparency in government procurement as well as trade and environment. These issues are under study by various WTO working groups; some are only at the initial stage of consideration. Therefore, Nepal with the collective initiative of other LDCs, should take a stand by delaying entry into negotiations on such issues. Assumption of the new rules would add an extra burden on the poor countries including Nepal.

(e) Collective response

Nepal is a signatory of SAPTA (South Asian Association for Regional Cooperation Preferential Trading Arrangement), which is aimed at promoting trade within South Asia.[161] However, no collective response has been initiated in WTO by the members of this regional group apart from a few coordinated efforts by India and Pakistan on issues such as textiles and garments. This is partly because of the diversity in their economic interests and development levels. The interests of relatively bigger economies such as Bangladesh, India, Pakistan and Sri Lanka are more or less similar. Nepal's priority, which is similar to that of Bhutan, is different. In this regard, the bargaining strength of the individual countries could be enhanced if "collective positions" were proposed at WTO forums. Moreover, regional pressure can be instrumental in allowing Nepal and Bhutan to accede on a fast-track basis.

The South Asian countries can also propose their interests collectively in "emphasizing expeditious action for the full and fair implementation of existing agreements and commitments, with special reference to the impact on developing

[160] Doha Ministerial Declaration, paragraph 44.

[161] SAPTA is an agreement among the seven South Asian nations (Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka) to reduce tariffs on a product-by-product basis. It is aimed at converting the region into a free trade zone under the South Asian Free Trade Agreement by 2010.

countries and LDCs".[162] The negotiation strategy should also focus on broadening and strengthening S and D clauses in favour of the developing countries and LDCs. Regional cooperation should garner enough clout to block "unlimited modification of rules of origin to the detriment of the developing countries and LDCs, and avoidance of arbitrary anti-dumping, anti-subsidy or safeguard measures by the developed countries".[163]

A collective response is important to the improvement of market access in services as well as the prevention of piracy of traditional knowledge built around biodiversity. Regional coordination can also be useful in blocking demands by developed countries regarding "new issues" such as social clauses, environment, governance, labour standards etc.

(f) Regional approach

In view of the need for a collective response, Nepal should focus on a regional approach to address the capacity-building in WTO issues. One such mechanism would be a network at the regional level, embracing the South Asian Association for Regional Cooperation countries, and among the regional groupings. At both levels of networking, ESCAP can develop modalities for implementing the network programmes in close coordination with the national focal points. The network activities should primarily concentrate on national and regional level capacity-building with a sectoral emphasis.

The network activities should give priority to information dissemination, human resources development and institutional enhancement. In the case of information dissemination, the network programmes should conduct regular information seminars. The basic objective of such seminars would be to create awareness and ownership of the WTO mechanism among small and medium-sized enterprises and rural-based entrepreneurs who are deprived of easier access to information and training on WTO issues. These types of programmes can help rural communities and enterprises to understand and adjust to the impact of strong competition arising from globalization and the cost of binding with the multilateral trading system. At the higher level of information sharing, the idea of technical workshops dealing with more complicated WTO issues (for example TRIPs, SPS, and TBT) could be organized. Another area of regional cooperation, under ESCAP auspices, could be human resources development with WTO specialization through short-term WTO courses, both at the national and regional levels by emphasizing the sharing of experiences on WTO issues. This network activity could be facilitated by developing or strengthening the existing trade-related institutions within the countries and/or at the regional centres. Such institutions can play a crucial role in the development of the WTO sector action plan, such as textiles and clothing, agriculture and service trades, which are of concern to all developing countries and LDC countries, including Nepal.

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[162] Joint Statement by the South Asian Association for Regional Cooperation Commerce Ministers at the Third World Trade Organization Ministerial Conference, Maldives, 9 August 1999.

[163] Ibid.

G. Conclusion

Nepal's membership in WTO is inevitable. One of the most challenging tasks in this regard is to create a sense of national ownership so that Nepal can defend its trade and economic interests within the parameters of the multilateral trading regime. The advantages for Nepal from the rule-based system will depend upon the ability of the Nepalese business community to understand WTO rules and business advocacy. The role of other stakeholders is equally important in creating the sense of national ownership in order to defend the national interest. The business sector should have the ability to identify, and take advantage of, trading opportunities by following strategies within the framework of the WTO obligations.

It is also important that they take the initiative in bringing to the notice of the Government their problems regarding exports, so that the Government can raise the issues at appropriate WTO forums in order to defend their interests. The Government, with private sector support, should consider developing a mechanism for accessing WTO mechanisms in cases of arbitrary actions and threats from trading partners. Many poor nations can barely afford to do this and they would benefit from the world trade rules. Therefore, it is necessary to formulate a private sector-government partnership approach to capacity-building for negotiations and defending national trade interests. This will only be possible through a national network. Achieving all this hinges on capacity-building and national ownership, backed by the availability of financial and human resources.

VANUATU*

A. Introduction

Vanuatu applied to join WTO in 1995 but shelved an agreed package at the Doha Ministerial Conference in 2001. A number of problems with the process led to the current suspension of accession. This study is an attempt to examine these problems and draw lessons from the experience. It is also an effort to determine how much autonomy Vanuatu had during the accession process as well as some of the likely effects of the previously agreed package on the economy and policy environment. Accession is unlikely in the near future. Yet, however uncertain politicians are about the gains from WTO entry, they are mostly aware that Vanuatu must eventually join if it is to keep pace with changes in the world economy. Exclusion from global trading arrangements would likely worsen trade performance and ultimately economic growth.

Section A of this paper provides an outline of the scope and methodology. The main question concerns the extent to which Vanuatu can use WTO to impose a useful policy regime, and to what degree the Government can influence this policy environment. Policy autonomy is crucial for a small, vulnerable economy with LDC status.

In section B, an overview is given of the economy during the past decade with relevance to WTO entry. The accession process was largely a product of, and was integral to, a structural adjustment process initiated in 1997 by the Asian Development Bank (ADB). This report is thus partly an assessment of that structural adjustment. One of the conclusions is that the adjustment took too little account of Vanuatu's unusual characteristics, including its small size, vulnerability, limited range of exports, high costs and the subsistence nature of much of the economy. This insensitivity to local features was the result of a one-size-fits-all approach that employed a policy package more appropriate to larger economies.

Section C examines the accession process and outlines why the move to take up WTO membership was shelved. In part, the reason was too little public and political awareness; however, more importantly, the process was simply too complicated, drawn out and resource-intensive. Vanuatu also suffered because larger WTO members were worried that granting any concessions would set a precedent for more important trading partners. The accession process was flawed in that it tried to intervene in sensitive areas about which those members making demands knew little, with the complicated nature of land ownership being a case in point.

A prime benefit of WTO membership is that it offers Vanuatu the chance to set up a consistent long-term policy regime. Section D argues that entrenching sensible economic policies will reduce political interference, put in place useful economic

* Prepared by Daniel Gay, Overseas Development Institute Fellow, and Roy Mickey Joy, Director, Vanuatu Department of Trade, Industry and Investment, Port Vila, and reviewed by ESCAP.

incentives and ensure that businesses face a predictable policy future. However, Vanuatu must choose this policy regime, and it must be compatible with its export development strategy, which includes the possibility of subsidies and infant-industry protection. The existing accession package and the tariff regime established during structural adjustment led to a sub-optimal tariff structure. Any future accession must accommodate existing policy plans.

1. Theoretical framework

It is important to establish the theoretical perspective underlying the study. As WTO entry affects society and political structure, the report draws on sociology as well as economic theory. In particular, the study is influenced by the concept of "reflexive modernization", a broad-based attempt to illuminate both the positive and negative changes in modern international society. The idea of reflexivity is most commonly associated with the work of sociologist Anthony Giddens.[164] Many analyses suggest that States are swept along by irresistible global forces such as increasing capital and trade flows, whereas Giddens' analysis can be used to suggest that we have partial control over the process of internationalization. We possess this limited control because the institutions and structures within the international economy are of our making, not manufactured by some external phenomenon. Reflexivity consists of reacting to these institutions and structures.

Applying the concept of reflexive modernization to trade would suggest that worldwide trade rules are at the same time created by purposeful human processes but also reflexively, subject to human influence. While emphasis is often placed on the inevitability of globalization and the impossibility of small States influencing their relation within it, Giddens' analysis can be used to show that States are able to influence their relationship within international trade. Repeatedly emphasizing the inexorable nature of the process can even encourage a sense of resignation among small players, in turn undermining their ability to negotiate.

The concept of reflexivity provides a useful point of access to WTO accession. The image can be used as a methodological tool to illuminate the extent of Vanuatu's policy autonomy inside the multilateral trading regime. How far can Vanuatu determine its future economic and trading arrangements? Does Vanuatu's accession simply reflect the demands of existing member countries or is there some space for manoeuvre? To what extent was Vanuatu – as potentially the first LDC to accede since the Uruguay Round – capable of changing the conditions for future entry of other LDCs?

In outlining the lead-up to accession and the outcomes, the study examines how reflexivity operates. In other words, it explains to what extent Vanuatu was able to act autonomously within the WTO accession procedure and by how much future domestic policymakers will be able to decide national strategy. Of course, one of the perceived benefits of WTO entry is precisely that it limits room for manoeuvring by preventing

[164] A. Giddens, 1990, *The Consequences of Modernity*, Stanford, Stanford University Press. The concept of reflexivity has also been applied to economics by theorists such as John Maynard Keynes and George Soros.

special interests from interfering in policy and, hence, removes autonomy from governments. This issue is dealt with in section D.

2. Why policy autonomy matters

According to the ESCAP study on trade and investment (No. 49), entitled *Facilitating the Accession of ESCAP Developing Countries to WTO through Regional Cooperation*, "a critical factor in ensuring a smooth accession process was for each acceding country to direct and maintain ownership of the accession process" (p. 2).

Ownership is particularly important for Vanuatu, since a lack of domestic governmental influence over the accession process led to the deferral of WTO entry at the Doha Ministerial Conference in 2001 for political reasons following the completion of the final accession package. Vanuatu's membership in WTO is likely to be completed only with the consent of civil society. Public awareness and support can only be achieved if the country owns the process, both before and after accession.

Policy autonomy is particularly important for small, exposed economies that need adaptability in times of hardship. Vanuatu has a population of only 200,000 and its remote location in the south-west Pacific means it is geographically distant from its trading partners. The country ranks top of 111 countries on the Commonwealth Secretariat index of economic vulnerability owing to the recurrence of earthquakes and tropical cyclones. It is this vulnerability, rather than simply a low per capita GDP, that gives Vanuatu its United Nations LDC status. Removing important policy advantages – such as the ability to raise subsidies in response to a temporary decline in commodity prices – could have a stultifying effect on the economy.

As the economics literature shows, for some States that are at an early stage of development, with imperfect international competition and the potential for increasing returns to scale, it is rational to permit subsidies or protective tariff rates for a short period. Optimal growth can be achieved only with the option of exercising such autonomy over policy. As will be shown later in this paper, the negotiations over Vanuatu's accession involved demands that would have denied it access to such policy tools.

During Vanuatu's accession process, members of the working party argued that as a non-member the country did not have access to special and differential treatment provisions aimed at developing nations. The original provisions for special and differential treatment can be found in GATT 1947, Articles XVIII, XXXVI, XXXVII and XXXVIII. Further special and differential treatment provisions exist in the so-called 1979 "enabling clause", the 1999 agreement on waivers of Article I of GATT 1994 for developing countries, as well as under the WTO Agreements on agriculture, sanitary and phytosanitary measures (SPS), textiles, technical barriers to trade (TBT), GATS, TRIPs and TRIMs.

Clauses allowing for special treatment were included precisely because less-advanced economies need flexibility in policy-making. WTO is supposed to allow deviation from the "one-size-fits-all" approach. Denying such differential treatment

to the smallest and least-advantaged potential member begs the question of why the provisions are included if they are not used.

B. Economic overview

1. Comprehensive reform programme

In 1997, the Comprehensive Reform Programme (CRP) was introduced with assistance from ADB with the objective of making government more efficient and raising economic growth. Political instability in the mid-1990s created fiscal problems, culminating in riots over the news that the Government had been misallocating resources from the Vanuatu National Provident Fund (VNPF), the State pensions account. CRP was aimed at bringing the country back from political and social disorder. The opportunity was taken to enact structural economic reforms alongside political and civil service reorganization, despite the economic problems being policy-related rather than structural.

As in a number of other developing countries, structural adjustment was linked to trade liberalization and WTO accession. Although the WTO membership process began in 1995, its explicit advocacy under CRP provided the main impetus for accession. The efficacy of CRP was crucial to garnering public support for a new policy regime and providing support for the economy during its transition to WTO membership. CRP can be judged on three criteria:

2. Government performance
Public expenditure and privatisation
Macroeconomic aggregates

Five years after the programme began, the results remain mixed. Without CRP, economic policy would probably have remained highly inconsistent and it is unlikely that the economy would have maintained the performance of the previous decade. A more modern public sector will help Vanuatu's position within the international trading regime. Government performance has improved in some ways, with fewer extended family (*wantok*) appointments to civil service positions and a more meritocratic system of hiring and firing. Policy has become less susceptible to the influence of special interests. The introduction of a free press has rendered ministers and civil servants more open to scrutiny.

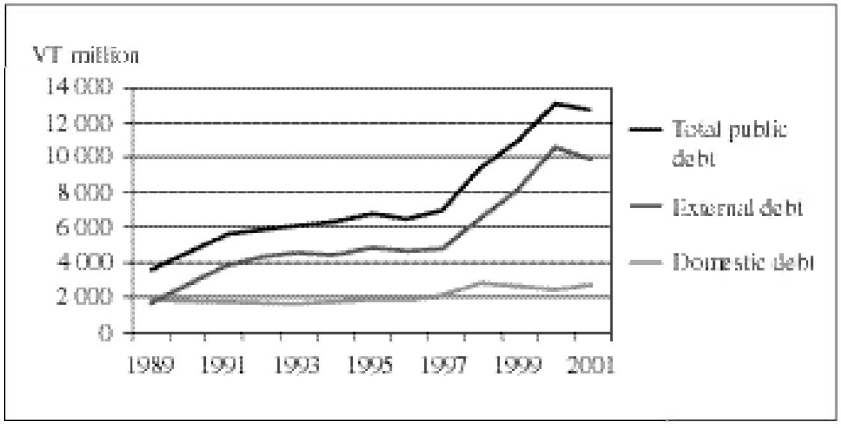
However, many public servants and ministers feel that, after the initial period of encouragement, they have been left under-resourced and with a new set of problems. Government was never big, with public expenditure averaging only 27 per cent of GDP during the 1990s. ADB has pointed out that in 1990 Vanuatu had one of the lowest ratios of government employees per capita among Pacific island economies, at three per 100 inhabitants of the country. This compared very favourably with the Cook Islands at 18.2, Tuvalu at 8 and Fiji with 6 per 100 inhabitants.[165]

[165] *Vanuatu: Economic performance, policy and reform issues,* Asian Development Bank Pacific Studies Series, 1996: 103.

Despite the small size of the Government, CRP ushered in a period of privatization aimed at altering the structure of government revenue and shifting more economic activity to the private sector. However, as recent economic theory has shown, institutions are as important as ownership.[166] Most major privatized government enterprises simply moved from the status of a publicly accountable monopoly to a private unaccountable monopoly. In a small economy such as Vanuatu, the institutional capacity for effective regulation will always be difficult to achieve.

In such a small market, there is little room for competition and government officials often have a vested interest in maintaining supernormal profits among former public firms with which they maintain close relations. Companies operating in areas crucial to overall efficiency (or example, Air Vanuatu, Telecom Vanuatu Limited and UNELCO, the electricity and water utilities company) have little incentive to reduce prices, which are among the highest in the Pacific.

From a situation of relatively low indebtedness in 1996, CRP left Vanuatu with an external borrowing problem. The external stock of debt, mostly ADB foreign currency loans as part of CRP, ballooned in 1997 (figure I) and had reached 31.2 per cent of GDP by 2002, compared with 15.6 per cent of GDP in 1990.[167] A predicted expansion in GDP growth has not materialized, leaving Vanuatu with a substantial debt obligation but little means of generating new revenue for repayment. The Department



Source: Vanuatu 2003 Government budget.

Figure I. Public debt, 1989-2001

[166] For example, see J. Stiglitz, 2002, *Globalisation and its Discontents*.

[167] Vanuatu's small size makes data collection easier and less prone to large errors than is the case with many larger developing countries, but problems remain. Generally, data on the domestic economy are less reliable than international data. Trade statistics are derived from the ASYCUDA customs database, although importers are believed routinely to misclassify some products. Banking and finance statistics are generally seen as among the most reliable, although figures from the Reserve Bank of Vanuatu and the Department of Statistics sometimes conflict.

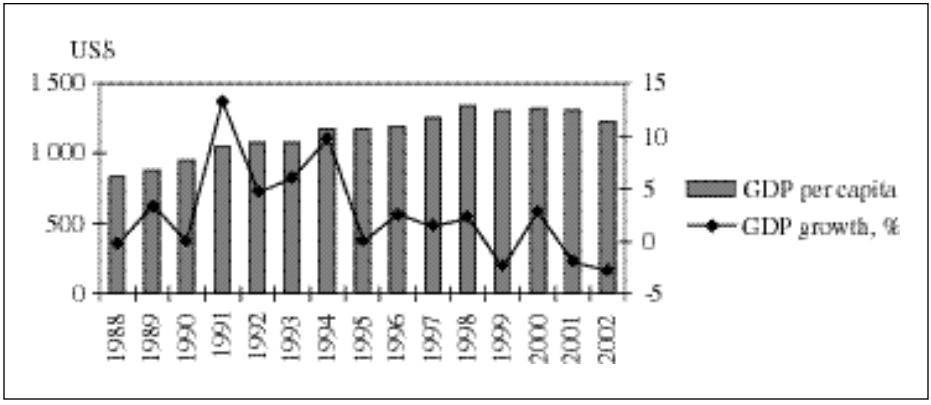
of Finance predicts that total interest payments will have risen to 8 per cent of domestic revenue by 2007 from a projected 7 per cent in 2003. Not only does the debt stock consume a growing amount of vital domestic resources, it also rules out a number of policy choices such as currency devaluation. This limits Vanuatu's policy autonomy.

Measured by macroeconomic aggregates, CRP has also fallen short of its targets. According to a 1996 ADB study: "In the second period (of the reform programme) between 2000 and 2005, the fruits of reform really begin to 'kick in' and GDP growth accelerates to an average rate of 5.8 per cent".[168] GDP growth has declined since CRP began. While the fall in GDP growth was partly due to a fall in exports and internal issues such as the riots in 1998 over the misappropriation of revenue from the National Provident Fund, CRP was aimed partly at equipping Vanuatu for dealing with such potential problems.

3. Gross domestic product

GDP expanded at a modest annual rate in the past two decades. During the 1980s, the annual GDP growth averaged 3.2 per cent, rising to an average of 3.7 per cent in the 1990s despite volatility resulting from fluctuations in tourism, changing demand for agricultural products and serious weather events.

GDP per capita, which currently stands at around US$ 1,200 (figure II), has stagnated since the mid-1990s and has declined in recent years owing to the continuing high birth rate, improved health standards and the recent slowdown in GDP growth. It should be noted, however, that four-fifths of the population are subsistence farmers living on the 81 outlying islands. The cash economy is located mostly in just two towns: (a) the capital Port Vila on the island of Efate and (b) Luganville on the island of Espirito Santo.



Source: Department of Statistics.

Figure II. GDP growth and per capita GDP

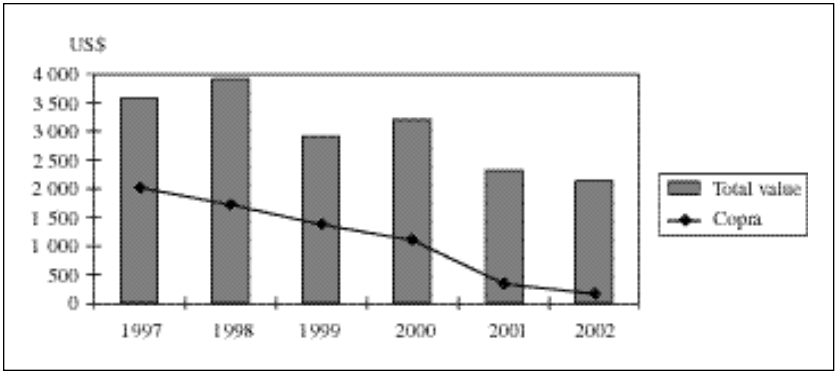
[168] Asian Development Bank, op. cit.: xv.

4. Trade

(a) Exports

Vanuatu has a lower ratio of exports to GDP than any other Melanesian economy and proportionally one of the smallest export sectors of the Pacific island economies. The economy has been able to produce only a limited range of exports. In the latest three-year period for which statistics are available, four products – copra, kava, beef, and timber – made up 73 per cent of export earnings. Copra was the biggest export in terms of value during the past two decades, although dependence on the commodity has fallen as the export sector has diversified. However, a halving of the world price of copra between 1997 and 2001 is still a major explanation for an increase in the trade deficit during the period under review. Recent trends for the main exports are shown in the annex. I.

The latest figures from the Department of Statistics show that Vanuatu's overall domestic exports fell from VT 3.2 billion (US$ 24.7 million) in 2000 to VT 2.3 billion (US$ 17 million) in 2001 (figure III), extending the general decline of recent years. During 2001, exports were worth only 7 per cent of GDP.



Source: Department of Statistics.

Figure III. Overall exports and copra exports, 1997-2001

Exports have shifted away markedly from the European Union to Australia in recent years figure IV. This is largely due to a decline in the value of copra sales to the European Union, but it can also be attributed to the recent ban by some European countries on kava-derived products owing to reports of liver-related illnesses.

Case study: The Kava industry

The prohibition of kava in developed countries has reduced exports by Vanuatu and hurt the country's economic growth; however, the Government has insufficient resources to challenge the ban. WTO entry may better enable Vanuatu to deal with similar future barriers to exports of its products.

Kava is a root used in Pacific societies as a traditional beverage. Infused in water and drunk fresh, it induces relaxation. Its biological home is Vanuatu, although the plant, of which there are over 80 cultivars in the country, is grown by other Pacific island nations. A late 1990s boom in the use of kava as a herbal alternative to manufactured relaxants prompted many Vanuatu farmers to begin planting large quantities of the crop for export. Kava represented 22 per cent of the overall value of domestic exports in 2001, and during the past five years has comprised a yearly average of 14.8 per cent of exports.

The ban resulted from reports from Germany in 2001 that 30 to 40 people had become ill or died after taking kava-derived herbal supplements. Following the German action, other European countries as well as Canada and Singapore restricted or prohibited kava imports. In addition, Australia, New Zealand and the United States either partially banned the product or issued warnings against it. Health agencies argued that products involving extracts from the kava plant had contributed to liver disease.

The impact of the ban on the economy was thus severe, contributing to a decline in GDP growth during 2002. An estimated one-third decline in kava exports during 2002 cut a fifth from Vanuatu's total yearly export earnings. Not only is the export of kava itself important to the economy, but the fall in overseas sales has resulted in domestic oversupply and lower prices as farmers try to sell excess produce.

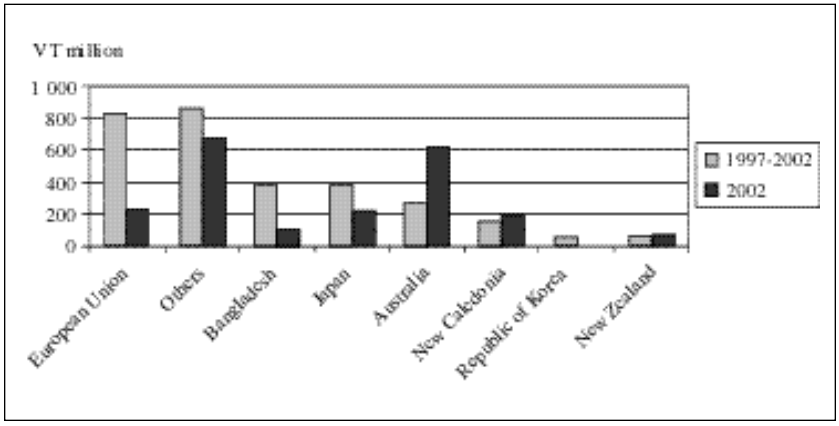
Some commentators have alleged that European and global drug multinationals lobbied for prohibition because the natural sedative was beginning to rival benzodiazepines like Prozac and Valium. Doubts surround the true cause of the casualties in Germany, with reports suggesting that one of the victims was an elderly alcoholic. Other countries banned kava without evidence of similar cases within their own borders.

Kava has been drunk traditionally in Vanuatu for many centuries with no adverse effect on physical well-being. The country has normal levels of liver health. Scientists suggest that poor processing of the product by selected developed country firms is to blame for the few health problems, rather than the raw product itself.

While the ban may or may not be justified, it is possible that it constitutes an illegal trade barrier. The truth is unclear and, in the meantime, exports of a key commodity crop have collapsed with a severe effect on the economy. The Government can do little to challenge the ban as it lacks funds for international legal action or a scientific study.

WTO membership might have allowed Vanuatu, with other Pacific WTO members such as Fiji, the opportunity to challenge the decision using the WTO dispute settlement mechanism. Currently, Fiji is considering a legal challenge but Vanuatu can take no part in the action. The benzodiazepine lobby would probably have been less willing to push for a ban on products exported by a group of WTO members. However, Fiji's influence is weakened because it is acting alone. Vanuatu and other exporters of the crop were considered too small and under-represented to be able to raise a serious challenge.

Vanuatu is likely to remain particularly exposed to overseas challenges to the standards of its agricultural exports because it is small and lacks technical and marketing experience. WTO membership would not only help reduce the chances of succumbing to powerful developed country lobbies, it would also enable Vanuatu to legitimately claim in advance that it was complying with strict international agricultural and food safety standards.



Source: Department of Statistics.

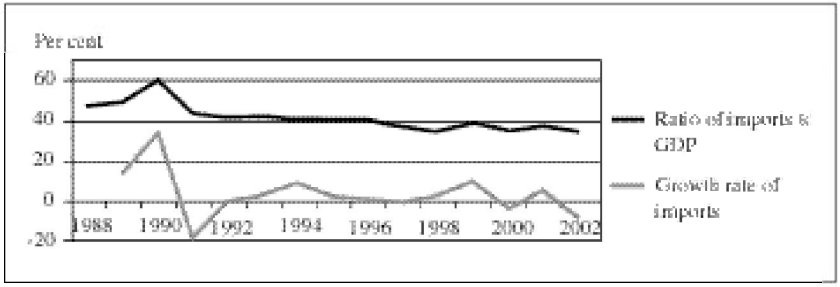
Figure IV. Annual exports

During recent years, Vanuatu had free access to the European Union under the Lomé convention and the 2001 "Everything but Arms" initiative for LDCs. The weak export performance in the region during that period suggests that Vanuatu does not need improved market access to the European Union from WTO entry.

(b) Imports

A limited manufacturing base means the import bill is large. Receipts from exports usually cover around a third of imports, and the economy has run a current account deficit every year since independence in 1980. More than half of the goods usually come from Australia and New Zealand, but in 2001 the proportion of imports coming from those two countries climbed to 72 per cent. The rise in trade with neighbouring Australia and New Zealand lends some support to the view that regional trade may yield bigger gains than ensuring continued market access to the European Union or the United States.

Despite assertions by some international agencies that the import substitution policy of the past two decades has failed, available data provide some evidence to the contrary. Real imports per capita fell 14 per cent between 1995 and 2001. The ratio of imports to GDP fell from 52 per cent in 1983 to 38 per cent in 1998 (although it had climbed slightly by 2000), while imports grew by an average annual inflation-adjusted rate of only 0.3 per cent between 1983 and 2001 (figure V). Coupled with the fact that the economy became more diversified under the hitherto blanket protectionist tariff regime, these data provide support, although not conclusive, for the case that carefully targeted protection of some infant industries may yield further gains. This does not advocate the continued protection of inefficient industries in which Vanuatu has no comparative advantage.



Source: Department of Statistics.

Figure V. Growth rate of imports and ratio of imports to gross domestic product

5. Balance of payments

Within the current account (table 1), the trade deficit is partly offset by a surplus in services, with tourism accounting for around half of the earnings from services. Tourism arrivals have increased steadily during the past decade since the new international air terminal opened in Port Vila. The ethnic disturbances in Fiji during 2000 boosted visitor numbers but there was a concomitant decline in 2001 and 2002 (figure VI). Most visitors come from Australia.

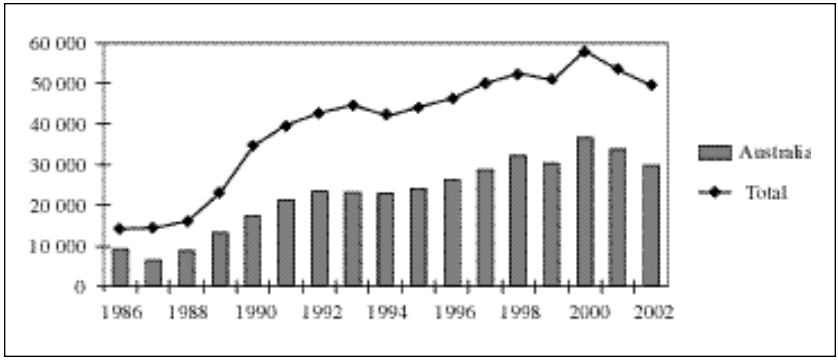
Copra has rivalled tourism as a net foreign-exchange earner as a significant number of tourist operations are foreign-owned and some revenue is sent overseas. Earnings from copra are also the major source of cash in poor rural areas. However, the multiplier effect from tourism earnings is likely to be larger as most funds are spent in the developed urban areas where the circulation of money is higher. Within the capital account, aid flows dominate capital transfers, with roughly half of the aid

Table 1. Balance of payments, 2002

(Unit: VT million)

Category	Revenue
Current account	
Balance on merchandise trade	-7 989
Balance on services trade	3 843
Balance on investment income	-556
Net current transfers	2 814
Capital account	
Capital transfers	
General government	889
Other sectors	435
Financial account	353
Net errors and omissions	-211
Gross official reserves	4 854

Source: Reserve Bank.



Source: Department of Statistics.

Figure VI. Tourist arrivals

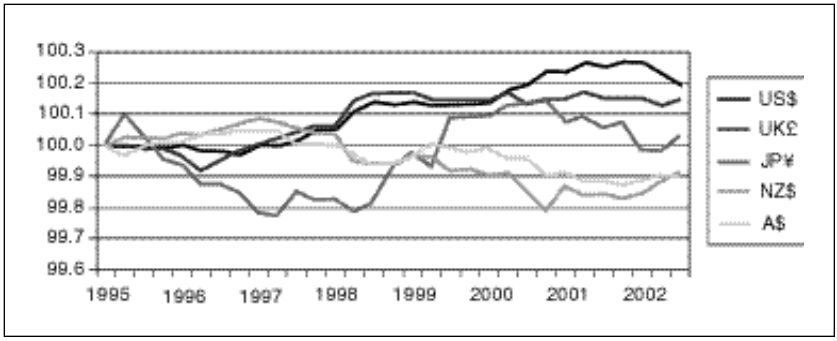
payments going to the Government and half going to other sectors. Australia is the biggest donor, while the European Union, France, United Nations and ADB also contribute. Net private investment flows are strongly negative, and Vanuatu has found it increasingly difficult to attract investment in recent years owing to difficulties with land tenure and overseas fears about political stability. Foreign exchange reserves covered around five months of imports during 2001, and the 2002 budget predicted that this level of cover would remain similar during the next five years.

6. Inflation

Inflation has been lower in recent years than in most neighbouring countries including Fiji, Papua New Guinea and Solomon Islands. Between 1990 and 2001, the average annual rate of increase in Vanuatu's consumer price index was 3.1 per cent. As a small, open economy and an importer of consumer products, Vanuatu is dependent on world prices, in particular those in Australia and New Zealand where inflation has likewise remained low and stable during recent years. The likelihood of currency stability, a continued high proportion of imports to GDP and sound monetary policy mean that inflation is likely to remain steady in the near future. Concerns have been raised, however, about the accuracy of inflation figures. Anecdotal and other evidence suggests that the true figure has been slightly higher in recent years.

7. Currency and financial sector

During the past eight years the nominal rate of the vatu has depreciated slightly against the US dollar and pound sterling and has appreciated marginally against the New Zealand dollar and Australian dollar. The vatu operates in a "crawling peg" system against a weighted basket of currencies, the composition of which the Reserve Bank keeps secret and which is occasionally adjusted. Calculations show that the real effective exchange rate has diverged significantly from the nominal rate in recent years, implying the existence of inflation that is not accounted for in the consumer price index.



Source: Department of Statistics.

Figure VII. Unit of foreign currency per Vatu, indexed to 100 in 1995

Vanuatu is the busiest tax haven in the Pacific, which is arguably one of the few areas where the economy has a true comparative advantage. Significant flows of funds arrive from Asian countries (e.g., Hong Kong, China) which are within a similar time zone. The financial sector employs over 400 people, a substantial proportion of the working population in the capital Port Vila. The two main foreign consumer banks, ANZ and Westpac, are attracted partly by the ability to operate on a tax-free basis. They would be unlikely to provide consumer services at existing prices, or possibly not at all, if significant new taxes were introduced on their operations.

Vanuatu's reluctance until now to comply with international information-sharing agreements has been criticized by the Organization for Economic Cooperation and Development and it would possibly conflict with any WTO multilateral agreement on investment. Concerns have been raised that the financial sector represents an avenue for money laundering. While this is always likely to be a problem with tax havens, the issue has been prominent following a recent scandal involving the proceeds from a global lottery fraud. Changes aimed at improving Vanuatu's international reputation have included making the Reserve Bank the regulator of the banking industry as well as passing tighter laws on the proceeds from crime entering the country. Critics also charge that Vanuatu does not gain enough from the large sums of money that pass through its financial institutions. Apart from employment, the only benefit is the revenue from small annual business licences. One suggestion for raising revenues is a small tax based on the declared balance of institutions registered with the Reserve Bank. This would be easy to administer and would attract much-needed revenue for the Government.

8. Summary

Structural adjustment and economic liberalization were integral to the WTO accession process. However, before the introduction of CRP, Vanuatu had few of the macroeconomic problems often associated with small developing countries. GDP growth had been stable and positive for almost two decades. Public debt was small. The fiscal situation was relatively well managed and inflation was low and predictable.

Unemployment was not a significant problem. Although there was a persistent and large current account deficit the capital account of the balance of payments was boosted by significant aid flows.

Although the economy was in trouble before structural adjustment, CRP has failed in most of its objectives. It was thus a missed opportunity. The standard policy set of privatization, tighter spending and trade liberalization failed to accommodate Vanuatu's unusual situation. The slow pace of development since independence can be attributed to features peculiar to many Pacific island economies such as a restricted export base, high internal and international transport costs, and small geographical size. Vanuatu's vulnerability must also be given special consideration.

Import substitution was not a complete failure. Given the narrow export base and opportunity for improved policy-making, carefully-targeted infant industry protection may yield further gains.

Trade with neighbouring economies has increased markedly over recent years. United States' trade flows have always been negligible while trade with the European Union, traditionally the biggest export partner, has fallen significantly. In addition to access to the European Union and the United States, efforts should be made to improve and diversify regional trade, possibly within the Melanesian Spearhead Group Free Trade Agreement (MSG-FTA) (see annex II), the Pacific Island Countries Trade Agreement (PICTA) and with East Asian countries.

Vanuatu already has free access to the European Union and will negotiate a new economic partnership agreement with the European Union under the Cotonou Agreement as part of the Pacific region. Vanuatu is restricted in the number of products it can export, and because the value of exports is very small – US$ 17 million in 2001 -large demand already exists for many products that it currently offers.

Any new set of policies induced by WTO entry must be designed to minimize further disruption to a now fragile macro economy. Such polices must allow sufficient flexibility to accommodate Vanuatu's vulnerability, small size and high level of costs. Reductions in bound tariff rates from Vanuatu can only be directly reciprocated by concessions in other areas, such as a lengthy transition period in order to adopt new rules. Increasing the volume of market access to developed WTO members such as the United States and the European Union is not a prime attraction for Vanuatu.

As a very small underdeveloped island economy, Vanuatu must retain autonomy over tariff and subsidy policies, at least during the transition period to WTO accession. As section C suggests, the WTO accession process must empower Vanuatu to force through a positive long-term policy environment rather than restrict its policy options.

C. Accession process

Although Vanuatu still holds WTO observer status, its accession is unofficially on hold following the withdrawal of the agreed terms at Doha. WTO officials were particularly keen to complete Vanuatu's accession at Doha, the start of the so-called

"development" round, as countries from three official levels of development would enroll at the same time. The other two were China, as a developing country, and newly industrialized Taiwan Province of China. Vanuatu would have been the first LDC to join since the establishment of WTO following the completion of the Uruguay Round in 1994. Establishing the WTO development credentials was seen as important, following the decline in credibility at Seattle.

Vanuatu politicians suspended WTO accession largely for populist reasons, as a general election was due the following year. The ruling coalition was keen to secure support from influential businesses ahead of the election, particularly as economic growth was weak. There was an explicit appeal to the populist anti-globalization sentiment in order to win votes. Some observers have even suggested that the politicians purposefully waited until WTO entry was almost finalized before withdrawing, in order to achieve the maximum populist electoral benefit. The WTO Accessions Office claimed not to have been notified of the reason for the decision.

Much of the impetus for joining WTO appears to have been that it would enhance Vanuatu's global recognition; the commercial implications of accession were understood only at a late stage. Little study was conducted on the short- and long-term welfare benefits and costs, while the policy effects were never fully appreciated. Government estimates suggested that administrative and travel costs related to accession were an estimated VT 20 million (US$ 150,000). These funds came from the government budget rather than directly from donors.

The annual payments to WTO by observers were also considered unaffordable and had reached CHF 23,070 by 2003. While a donor might be found, the total outstanding amount of CHF 168,420 in unpaid fees – about the same as the entire annual budget of the Department of Trade – represents, at the very least, an unwelcome psychological hurdle. Assuming Vanuatu receives a fixed annual sum of aid, any foreign donor payment for WTO entry would divert funds from other important areas.

The shelving of accession at the final hour despite the existence of a previously agreed upon package raises questions over communication between the delegation and politicians. The head of the Vanuatu delegation admitted that public awareness of WTO was weak and that politicians were not kept fully informed of decisions.[169] It did not help that the public service operates a two-tier system, with departments separate from ministries. One lesson that should be learnt from this situation is that accession must be accompanied by a vocal publicity campaign. Membership cannot be sprung on the public and politicians at the last moment.

The decision to withdraw can also be blamed on the complicated and resource-intensive nature of the information request process. As suggested in the ESCAP *Studies in Trade and Investment* (No. 49): "It is also commonly recognized

[169] Department of Trade research has shown that either most businesses do not know what the World Trade Organization is or they consider it irrelevant. A number of government departments are likewise ignorant of the functions of the World Trade Organization.

that the fact-finding stage of information by the working party is too long, too inquisitorial in nature, frequently repetitive and uncoordinated".[170]

Vanuatu could not, and still cannot, afford a permanent mission in Geneva. The delegation consisted of the Director of Customs, the Director of Trade and two part-time external consultants who were barred from some meetings because they were not Vanuatu citizens. The Minister of Trade was only periodically involved. A lack of manpower meant that the negotiating party had little time to communicate with politicians. Without specialist technical and legal back-up, negotiators themselves found it hard to understand complex jargon. On some issues policy had to be made on the hoof rather than a formal negotiating position agreed beforehand.

If small developing countries are to negotiate favourably, and if WTO is to be considered a truly rules-based system, they need either much better support or a far simpler accessions process. This could be achieved if a team of personnel was made available specifically to assist smaller countries; however, the existing Advisory Centre on WTO Law is a small step in the right direction. Tighter regulations must be established on governing the resources involved in the negotiation process – perhaps including a limit on working party and delegation numbers and a time limit for bilateral and multilateral offers – so that no party is at a disadvantage. LDCs such as Vanuatu cannot afford a full-time comprehensive team of negotiators based in Geneva, and it is evident that rather than simply signing up for a free and fair system, any potential new member must fight for favourable terms.

The process is stacked in the favour of developed incumbents who can baffle applicants with jargon and out-manoeuvre them by virtue of superior resources. Among small countries, the lack of administrative and technical capacity is a major obstacle to successful membership and constitutes an issue quite separate to the economic impact of joining. There should be no pretence that by maintaining a high administrative and technical cost of membership, incumbent members have anything but their own interests at heart.

1. Precedence and most-favoured nation treatment

Part of the explanation for Vanuatu's withdrawal is that politicians considered many conditions too commercially damaging in the short term. Some large countries were reluctant to treat Vanuatu as they should – as basically irrelevant for bilateral trade – because granting concessions would set a precedent for more important trading and investment partners. Of course, most-favoured nation (MFN) treatment and non-discrimination constitute the raison d'être of WTO. It is well established within trade theory that a regime based on rules avoids welfare-reducing trade disputes and reduces incentives to engage in activities such as dumping and subsidies. Entering a binding agreement not to raise tariffs can increase aggregate welfare. The same rules must therefore apply to all members of any arrangement.

[170] M. Duncan and R. Duncan, 2002, in *Facilitating the accession of ESCAP Developing Countries to WTO Through Regional Cooperation*, ESCAP, New York.

However, in many cases, countries went beyond the bounds of the WTO Agreement. For example, the Cairns group of agricultural exporters demanded that no country using agricultural subsidies be allowed to join WTO. This action is not, however, stipulated by the WTO Agreement. In some instances, bigger countries deliberately tried to mislead Vanuatu over the efficacy and legality of agricultural subsidies. It was argued that because the Stabex funds provided under the Lomé IV Convention were aid, they could not be used as agricultural subsidies. As pointed out in a paper by two key delegation members, Roman Grynberg and Roy Mickey Joy, Vanuatu had to argue the contradictory position that it was forced to use the funds to subsidize exports, but at the same time that the Government freely chose to use the Stabex funds as subsidies.[171]

The United States showed particular severity with Vanuatu despite the almost total absence of bilateral trade between the two. In one area, this strictness could have worked to Vanuatu's advantage. Under bilateral negotiations the United States demanded that Telecom Vanuatu Limited (TVL) open up to competition at the end of its contract in 2012. Vanuatu argued that ending the monopoly agreement would have reduced incentives for the company to invest in important infrastructure. However, it is unclear that TVL is undertaking enough investment in infrastructure in any case. Electricity, telecommunications and water costs are among the highest in the Pacific. TVL only completed installation of the mobile phone network (which is limited to three small geographical areas) in May 2002. Renegotiating the monopoly agreements of both TVL and the utilities company, UNELCO, a tthe end of their contracts is thus of paramount importance.

However, the demand by the United States for a reduction in tariffs to around 15-25 per cent, compared with Vanuatu's offer of an average 49 per cent, would have been more damaging, as is shown later in this paper. American negotiators also argued against a two-year transition period to adopt TRIPs legislation and train officers. The United States was especially opposed to the use of special and differential treatment provisions, arguing that because Vanuatu was not a member of WTO it was not eligible.

Wholesale and retail trade was another area in which the United States made unreasonable and unnecessary demands. It was not in Vanuatu's interests to deny greater access to foreign retail firms, but other Pacific island nations had more to lose since small local shops were on the restricted list. A number of countries, including Tonga, urged Vanuatu not to accept this request in case it was again used during their own accession.

Vanuatu's only town – with a population of 36,000 – is unlikely to ever become a market or labour pool big enough to be of interest to attract serious investment from the United States. Bilateral trade fluctuates from year to year and is never worth more than about US$ 1 million. It has been suggested that the United States was being so

[171] R. Grynberg, and R. M. Joy, 2000, "The accession of Vanuatu to the WTO – lessons for the multilateral trading system", *Journal of World Trade, Vol.* 34, No. 6, December 2000, pp. 159-73. NB: Vanuatu does not use funds from its recurrent budget as subsidies.

firm in its demands because it was negotiating with China at the same time and did not want any concessions made to Vanuatu used against it.

WTO has taken a number of measures to avoid similarly intrusive demands in future. Most notably, document WT/L/508, recording a decision made on 10 December 2002, outlines a number of ways in which the LDC accession process can be streamlined. These measures will undoubtedly help other countries to avoid some of the problems encountered by Vanuatu. They are mostly too late to be of immediate use in Vanuatu, first because the package has already been agreed and any renegotiation would be limited. Second, many members of the Vanuatu Government are likely to remain suspicious of WTO despite such changes.

One area in which document WT/L/508 may help is in technical assistance. WTO members and the Secretariat itself have become much more willing to extend help in this area following the difficulties faced by acceding LDCs. Given the technical nature of much of the accession process, such assistance is vital. However, the type of technical assistance given is crucial. Pledges must cater to the demands of individual countries rather than simply follow a generic pattern. Technical assistance must meet several criteria for it to be effective. It must be requested, rather than foisted upon the country by an international agency. It must be practical, not simply a written report by a short-term consultant. In addition, it should involve training so that the activities can continue after the programme ends. Consultants must be based in the country concerned for the duration of the assistance and should, if possible, be nationals of the country concerned.

2. Trade and tax regime

Before CRP, reform import duties were as high as 207 per cent while nearly two-thirds of tax revenue came from trade taxes. There has never been any income tax. A range of other compulsory flat-rate business taxes has generated much of the remainder of government revenue. Policy makers built in this dependence on trade and business taxes for a reason; the cash economy in Vanuatu is very small and the cost of administering and collecting taxes high. Customs compliance is notoriously difficult, while the fragmented nature of the country has left much policing and law enforcement to traditional rule.

The dependence on tariffs, however, produced several inefficiencies. The discretionary system of exemptions that accompanied it was open to abuse, and rendered the business and policy environment unpredictable. Reliance on import duties also made it harder for policy makers to usefully protect infant industries; tariffs were high on most goods, whether consumer, intermediate or capital. For example, Vanuatu has protected its alcohol and ice cream producers for 20 years despite having no obvious potential comparative advantage in these areas. Lastly, dependence on tariffs made consumer goods more expensive and raised overall costs.

The existing tariff schedule is designed mostly around collecting revenues rather than on economic incentives. The tariff reductions under WTO accession took little account of volumes of goods traded, or effective protection rates, which had never

been calculated.[172] It is likely that a uniform reduction in a number of nominal rates would distort the rate of effective protection. Tariffs on consumer goods had fallen from 47 per cent in 1990 to an average of 15 per cent by 2003. Falls in tariffs on intermediate and capital goods were less. By mid-2003, average tariffs were 20 per cent, although wide-ranging exemptions probably lowered this figure to between 10 and 15 per cent.

Value-added tax (VAT) was introduced in 1998 as part of the ADB reform process, which also abolished export taxes and simplified the business licensing scheme. Without the reforms a goods offer would have been impossible under WTO. VAT and tariffs now constitute the two main sources of recurrent government revenue, with administrative fees and charges holding a distant third place.[173] As table 2 shows, tax revenue from goods and services increased during the WTO accession phase while revenues from import duties declined.

Table 2. Domestic revenue as a percentage of total tax revenue

(Unit: Percentage)

Revenue source	1997	2001
Import duties	53	34
Goods and services taxes	36	51
Administrative fees and charges	–	8

Source: Government budget, 2003.

The thinning of the tax base restricted Vanuatu's ability to make lower bound tariff offers during WTO accession. While CRP had attempted to reduce dependence on import tariffs, paradoxically by abolishing a range of other taxes and licences it actually made tariffs more important as a source of revenue and, hence, as a bargaining point. Vanuatu had less to offer during WTO accession than it might have had before the introduction of CRP. In addition, by binding tariffs at arbitrary rates that did not reflect the economic fundamentals, the process restricted the future ability of the Government to set optimal policy. In yet another sense, Vanuatu's ability to act. autonomously during and after the accession process was reduced.

3. Investment regime

Vanuatu was forced to overhaul its investment regime during WTO accession despite there being few trade-related reasons for doing so. Article XVI of the GATS stipulates that:

[172] The difference between the value added in sector X at domestic prices and the value added in sector X at international prices, that is:

ERP = $V_D - V_I / V_I$ where V_D = domestic value-added and V_I = international value-added.

[173] Vanuatu's budget is divided into recurrent and development expenditure. Overseas grants comprised 9 per cent of total government revenue in 2001.

> "If a member undertakes a market access commitment in relation to the mode of supply referred to in subparagraph 2(a) of Article I, and if the cross-border movement of capital is an essential part of that service itself, that member is thereby committed to allowing such movement of capital...".[174]

Although a specific interpretation of the "movement of capital" was absent at that time, Vanuatu was still obliged to liberalize further and change the way it dealt with incoming investment. This had a number of advantages. Before CRP and WTO accession, investment rules were opaque, often arbitrary and subject to discretionary judgment by politicians. There was no explicit policy on incoming foreign investment. One particular barrier to overseas investment was the so-called "green letter", which allowed the Minister of Immigration to revoke residence permits without the need to provide a reason. The victim had no right of appeal.

Following the CRP reforms, and as part of the WTO process, the investment environment became more rules-based and decisions less subjective. The 1998 Foreign Investment Act, No. 15, which was a consequence of the CRP process, was further revised in 2001 with the result that the Vanuatu Foreign Investment Board was replaced by the Vanuatu Investment Promotion Agency (VIPA), whose focus was now intended to be on promoting investment rather than vetting and regulating.

Land represented a particularly controversial area in which WTO members requested changes to the investment system. Vanuatu's strong traditions mean that land is attached to large extended families who consider it a source of security and stability. Freehold land ownership was abolished with independence in 1980, and the usual arrangement for an investor is a 75-year leasehold agreement. It would be politically impossible for a government to force through any Bill aimed at making land ownership freehold.

A succession of foreign advisers and multilateral institutions has argued that the absence of freehold constitutes an unwelcome barrier to investment. However, this argument is undermined by the fact that substantial real estate investment occurred during the two decades after independence. Also, as any Hong Kong or central London resident knows, as long as returns are sufficiently high in the medium term, investors do not require a lease that is held in perpetuity.

Disagreements over land rights, however, do present a problem to investors. These disputes are partly a result of the absence of historically firm boundaries between plots. To that end, the Government has set up a number of land arbitration panels aimed at resolving the often long-standing quarrels over ownership. The answer is not to make firm rulings on the freehold foreign ownership of land. Resolving these arguments will take time and sensitivity, and local ni-Vanuatu must be seen to own the process rather than it being forced on the country by outsiders.

[174] R. Grynberg and R. M. Joy, 2000, p. 164.

The WTO process can be seen to have resulted in a "one-size-fits-all" investment policy that had little relevance to Vanuatu. It was in neither the interests of WTO members nor Vanuatu to force through a ruling on land. Members of the working party knew little about the intricacies of property ownership in Melanesia, while most WTO members are unlikely ever to buy land in Vanuatu. It would have been politically suicidal and socially unsustainable for the Government to have enacted a major reform of the land laws. Yet, Vanuatu was still unable to persuade members of the merits of its case. An intrusive and generic accession process meant that the only option for the Vanuatu delegation was to directly refuse to concede any ground on this issue.

4. Summary

WTO members were keen for Vanuatu to accede since the country would have been the first LDC to join WTO proper. Yet, the onerous nature of the accession process and lack of leeway ultimately led to Vanuatu's withdrawal. The Government can take part of the blame, but it would not have been able to exploit popular opposition to WTO-inspired policy adjustment had the process been handled more sensitively and with greater public involvement.

Many policies were inappropriate, while the public and politicians were allowed scant ownership. The inflexibility of membership precluded local influence. Accession was also simply too difficult to understand. The haste to accede meant that many of the consequences of accession were overlooked until the final hour.

The problem of precedence represented a further obstacle to Vanuatu's accession. Although too small to be of much consequence to most members, some members felt that they had to force Vanuatu to comply with strict demands because they did not want to yield concessions to bigger economies.

Reforms to the tax and trade regimes for WTO membership removed a number of distortions. However, these reforms narrowed the tax base and made government revenue more volatile. The reforms also made it harder for Vanuatu to negotiate.

WTO-inspired investment reforms made the approvals process less arbitrary and prompted the investment promotion authority to become more focused on marketing. However, a number of requests from WTO members showed them to be ill informed and politically impracticable. In fact, it is questionable whether WTO should interfere with land ownership, an issue central to the social fabric of Vanuatu.

D. Economic impact

1. Regional trade agreements

Vanuatu's performance in regional trade arrangements provides lessons for WTO accession. First, the arrangements indicate what could happen when trade is further liberalized. Second, the experiences show that regional trade arrangements are only a precursor to multilateral liberalized trade.

The proposed Pacific Island Countries Trade Agreement (PICTA) had not been ratified by Vanuatu by April 2003, while the South Pacific Area Regional Trade and Economic Co-operation Agreement (SPARTECA) has been of little significance and is due to end in 2005.

The main bloc with implications for Vanuatu is the Melanesian Spearhead Group (MSG), formed in 1988 to foster cultural and political cooperation between Papua New Guinea, Solomon Islands and Vanuatu. The MSG Free Trade Area (FTA), created in 1993, allows 150 tariff lines to be traded duty-free between the four members. Fiji joined MSG-FTA in 1998, while New Caledonia is an observer. By 2005, the Agreement is intended to cover all goods although some will be protected using negative lists.

The immediate benefit of MSG-FTA to Vanuatu was mainly through beef exports, which are sent mainly to Papua New Guinea and Solomon islands. Kava has been exported to Fiji since 1997. The existence of MSG-FTA resulted in an increase in CIF exports from US$ 20,000 in 1993 to a peak of US$ 2,326,000 in 1997. Exports to MSG as a proportion of total exports are higher than exports by other MSG countries. Available data show that trade creation outweighed trade diversion in the years following the formation of MSG-FTA.

As the table 3 shows, during the four years following the inception of MSG, frozen beef exports to MSG members rose from 4 mt to 133 mt while exports to the rest of the world fell from 33 mt to 9 mt. Frozen beef exports to MSG increased from about 10 per cent in 1994 to 94 per cent of total frozen beef exports in 1997. Thus, trade was diverted from other countries to within the MSG. However, the overall effect of MSG was to create trade, and frozen beef exports increased from 37 mt in 1994 to 142 mt in 1997. This is above the rate of increase for total exports during the same period.

Table 3. Exports of frozen beef to the Melanesian Spearhead Group and rest of the world

(Unit: metric tons)

Year	Papua New Guinea	Solomon Islands	Fiji	Melanesian Spearhead Group	ROW[a]	World[b]
1994	0	4	0	4	33	37
1995	0	22	0	22	17	39
1996	52	21	0	73	0	73
1997	42	91	0	133	9	142

Source: Pacific Islands Forum Secretariat MSG Trade Review 1999.

[a] ROW = rest of world excluding MSG.

[b] Includes MSG.

Vanuatu suffered from MSG after an increase in cheap imports threatened to seriously damage the revenue of a number of local companies. Amid Fijian protests, Vanuatu and Solomon Islands negotiated emergency protective tariffs on six MSG products (canned corned beef, fruit juice, ice cream, wood and timber products, toilet paper and furniture) in October 2002 with the aim of protecting local industries for three years. One problem with MSG is that its member economies have similar compositions, rendering potential gains from trade small. WTO entry, in theory, should enable Vanuatu to realize the benefits of trading with several more differentiated partners, particularly in East Asia, where Vanuatu currently conducts little trade. WTO entry must ensure that gains from MSG are not undone; Vanuatu is the only active member of the group that is not a WTO member. However, there is little reason to belief that the trade creation effect experienced under MSG-FTA would unravel, given the quality of Vanuatu beef and the proximity to MSG economies.

It is important to emphasize just how small the industrial sector is in Vanuatu (table 4). Most industrial subsectors comprise only one or two companies, and the emergency MSG protective tariff rates negotiated during 2002 each corresponded specifically to the demands of one company. While the short-term impact of opening up to international competition is a common complaint from businesses in countries acceding to WTO, in Vanuatu the closure of even one major company would constitute a major blow to employment and aggregate economic growth. WTO entry could be expected to raise unemployment over the short term in manufacturing, construction, retail and wholesale, hotels and restaurants, and finance and insurance. Together, these sectors comprise 47 per cent of employment. To a greater extent than in many larger economies, the Government must ameliorate the near-term employment effects of trade liberalization.

Table 4. Formal sector employment

Industry	Number of employed
Agriculture, forestry and fishing	748
Manufacturing	1 273
Electricity and water	156
Construction	838
Retail and wholesale trade	2 466
Hotels and restaurants	1 631
Transport and communication	1 027
Finance and insurance	455
Other business services	532
Government	4 475
Other services	671
Total	**14 272**

Source: Vanuatu 2000 labour market survey.

2. Policy consistency

WTO entry represents an opportunity for Vanuatu to entrench useful economic policy for the long term. In the past, policy has been unstable owing to frequent changes of government and a high turnover of staff in the public sector. Enacting laws based on WTO rules that are internationally enforced can put in place a consistent set of policies that will help economic growth. A coherent strategy has a number of advantages. By providing protection for a specified period for those industries that enjoy the potential for higher returns to scale, companies can achieve a firm comparative advantage. A consistent strategy helps avoid unnecessary changes of direction by preventing the interference of special interests. Setting a credible deadline for the ending of infant industry protection, for example, forces companies to aim toward increased efficiency. WTO membership can be used to enforce this credible deadline. Establishing a guiding principle for export development also makes it easier for departments to formulate policy and coordinate actions with other departments.

Vanuatu is too small to compete on the world market in high-end manufacturing or large agribusiness operations, although it can export a number of potentially lucrative niche products such as organic coffee, organic root crops and high-quality beef. Focusing policy on establishing Vanuatu's true comparative advantages over the long term means that inefficient or low value-adding companies are encouraged to reinvest in more useful areas.

Any policy regime, however, must be of Vanuatu's choosing. As explained in section C above, many of the policies that would have resulted from proposals put forward during the initial accession period were inappropriate. It is crucial that Vanuatu has the autonomy under the accession process to decide policies that fit its specific circumstances. This is not an escape from hard-but-necessary liberalization, but the recognition of Vanuatu's peculiar situation.

During 2002, the Department of Trade, Industry and Investment launched its export development strategy, a set of objectives aimed at arresting the decline in exports during recent years. If Vanuatu accedes to WTO, any accession package must accommodate this existing strategy. It involves establishing actual and potential areas of specialization relative to trading partners, helping industries in these areas to grow, and increasing global and regional integration where it helps Vanuatu. This will involve a period of targeted protection and assistance for selected infant industries. The bound tariff rates agreed under the previous accession package would probably need to be renegotiated under any new accession package.

3. Special and differential treatment

Successful implementation of the export development strategy as a WTO member would require leeway in economic policy-making – specifically, recourse to several special and differential treatment provisions. WTO document WT/L/508 allows, for the first time, special and differential treatment for LDCs.

It is a fallacy that the best strategy for every developing country is rapid and total liberalization. In the ESCAP *Studies in Trade and Investment* (No. 49), two of the authors argued that, in effect, developing countries usually undermine their own economic welfare during negotiations by seeking recourse to special and differential treatment.[175] The authors suggested that what were seen by potential members as economic costs – such as tariff reductions and lower subsidies – were in fact benefits, while recourse to special and differential provisions undermined economic growth over the long term. According to the authors, sensibility was positively correlated with liberalization. Incumbent WTO members know what is in the best interests of applicants.

The authors proposed that: "In their role as economic managers, Governments can be broadly depicted as sensible, super-sensible and non-sensible... Super-sensible governments... actively promote unilateral trade and economic liberalization at home by resisting protectionist pressures and implementing ongoing trade reforms that substantially exceed their WTO commitments".[176] As Vanuatu balked at the final hurdle it is presumably considered non-sensible.

If it were true, however, that rapid and total liberalization is always the best policy, then there would be little to negotiate. Incumbent WTO members could just order acceding members to abolish tariffs and subsidies, lower non-tariff barriers, privatize all government-run enterprises and open up capital accounts. The result would be an increase in welfare.

Of course, liberalization is not a byword for common sense. Like most developed country governments, LDCs such as Vanuatu are not entirely liberal in economic policy. Governments rightly deviate from the "cookie-cutter" method. Developing countries do not join WTO because they want another entity to make policy for them. They join for the perceived benefits such as market access, a fixed policy regime and other related gains.

A further reason why wholesale immediate liberalization is inappropriate is that infant industry protection and subsidies have been proven to raise domestic welfare under certain circumstances. Both empirically, as seen in many East Asian countries, and theoretically, as suggested by the New Trade Theory, strategic trade works under imperfect competition and the possibility for increasing returns to scale.[177] Small, highly-underdeveloped economies such as Vanuatu must be permitted to learn from the development success stories.

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[175] Duncan and Bosworth, op cit.: 13.

[176] Ibid.: 13.

[177] The classic papers include: J. Brander and B. Spencer, 1985, "Export subsidies and international market share rivalry" in *Journal of International Economics*, No. 18, pp. 83-100; and P. Krugman, 1984, "Import protection as export promotion: international competition in the presence of oligopoly and economies of scale" in Kierzowski (ed.). *Monopolistic Competition and International Trade*, Oxford, Oxford University Press.

Vanuatu simply could not accept many of the changes demanded by many WTO members. An immediate reduction in tariffs to 15-25 per cent would have thrown Vanuatu's tiny private sector into competition with globally competitive neighbouring economies and probably would have made many businesses bankrupt. The fall in tariff revenue would have forced high taxes on an already weak private sector. As shown in section B above, the tax regime is already struggling with changes to the revenue structure. It is likely that the swift abolition of price supports to the majority of farmers who live in outlying islands would have left them without any income.

Reducing tariffs has the ultimate aim of increasing competition, which carries a number of benefits including the more efficient allocation of scarce resources. However, in small economies such as Vanuatu's, trade liberalization can actually reduce competition because there is little incentive for new companies to enter the market. Entry costs are high and potential revenues are low. The most likely outcome is a single incumbent monopoly or oligopoly. This is the case in the Vanuatu wholesale market, where two large companies dominate the import of consumer goods.

Therefore, simultaneously with current account liberalization, there must be some domestic impetus toward competition. The problem is that the protection necessary to encourage domestic competition is often hostile to external liberalization. The answer is to sequence reforms correctly, which means first instituting measures such as cutting start-up costs, introducing antitrust legislation and diversifying the economy. External trade liberalization can then take place. In summary, there is a counter-intuitive result; increased protection and a delay in trade liberalization can actually increase competition.

Case study: Vanuatu Commodities Marketing Board

WTO entry would hasten reform of the Vanuatu Commodities Marketing board (VCMB). Reform could reduce political interference and enhance competition, but a transition period would be necessary to help farmers move into new areas.

VCMB is a statutory body whose remit is to set domestic prices for copra and cocoa, approve licences for production and market Vanuatu commodities abroad. It is responsible for buying all copra from Vanuatu's coconut farmers, who form a significant proportion of the 80 per cent of the population living in outlying islands.

Prior to the 2001 general election, the Union of Moderate Parties (UMP) promised farmers that, under an UMP Government, VCMB would purchase copra at around US$ 185 per metric ton (mt). For this to be viable, VCMB claimed the world price would have to be at least US$ 350 for it to break even. Following an UMP victory, however, the international price of copra kept falling, hitting a low of around US$ 175/mt.

The continuation of effective price supports to farmers with only sporadic funding from government resulted in near-bankruptcy by early 2003. Insufficient funds existed for the board to purchase all farmers' produce. The fall in incomes caused popular discontent.

As with marketing boards in many other developing countries, the political nature of VCMB has undermined its performance. It has little incentive to market Vanuatu products

abroad because it possesses a domestic monopoly. During the 1990s, when VCMB won a steady stream of revenue, it ceased attempts to find new markets and often squandered the proceeds of high prices instead of building reserves for when prices fell.

Dependence on copra has made it harder for farmers to diversify into new areas. They see little reason to grow root crops when a guaranteed price is provided for copra. This has undermined exports and reduced internal trade, resulting in lower economic growth.

Political influence and the low international price combined during 2002 to halt all exports of copra. A local coconut-oil processing company, COPV, stepped in to buy copra from VCMB, which claimed this created jobs for indigenous ni-Vanuatu. However, there were equivalent lay-offs at the stevedoring company, Niscol. Selling locally is claimed to result in less shrinkage during shipment and thus a higher price. COPV, however, has insufficient capacity to process the 600 mt a week of copra that VCMB has to offer.

VCMB cannot be abolished overnight. Political opposition would be too strong and many farmers depend solely on family-owned copra plantations. Most ni-Vanuatu are subsistence smallholders who occasionally sell produce when they need cash. They do not possess the commercial experience for speedy changes in output.

However, WTO entry, with a suitable transition period, would help spur useful reform of VCMB, while government could position itself outside the process. The board could then take on a purely administrative role, leaving more prices to the market and marketing to private institutions. Government could use some of the resources it previously used propping up prices to help farmers move into other areas.

As is well known, Australia and the Cairns group of agricultural exporters insist that no country can join the WTO if it maintains export subsidies. During accession, Australia required Vanuatu to leave its ES1 schedule blank. This would have meant that VCMB could not have maintained copra export subsidies using government revenue or external grants.

WTO entry would make it harder for VCMB to exclude foreign ownership of domestic industry, as it currently does through tight control of licences. New investment in the production of agricultural commodities would spur competition and improve efficiency. Levels of equipment and expertise in the industry are low, and technology transfer borne out of new foreign investment would enhance productivity.

A transition period of several years to WTO membership is vital. During this period and afterwards the government must have the autonomy to impose subsidies when necessary to support rural livelihoods. However, the impact of WTO membership on VCMB could be worthwhile. Gradually exposing some commodity production to market prices and diversifying agricultural exports should support rural incomes and help enhance Vanuatu's export performance.

4. Summary

Judging by the regional trade agreements of which Vanuatu is a member, further trade liberalization must by managed carefully. The challenge is to retain the gains made through the MSG-FTA in the form of enhanced exports, while the domestic economy must be strengthened to allow companies to compete effectively on the international marketplace.

Industry is so small that the fortunes of individual companies have a major impact on the overall economy. About half of employment is in sectors that would be affected by WTO entry.

One major benefit of WTO entry is the embedding of useful economic policy for the long term. Infant industry protection only works if it has a credible deadline and if protection is gradually reduced. WTO entry could be used to enforce such an environment.

This long-term policy must be chosen by Vanuatu rather than forced upon it by incumbent members. Any new accession package must be compatible with the existing export development strategy.

It is likely that Vanuatu would need recourse to special and differential treatment provisions. It has been argued, in particular by the United States, that these provisions cannot be used. However, speedy liberalization throughout the economy is unrealistic and misguided. Government must decide its own policies, and commit to these policies for the long term under a framework enforced by the WTO. These policies are likely to include non-liberal measures such as protection and subsidies.

WTO entry would likely help reform of the Vanuatu Commodities Marketing Board, an entity responsible for buying and marketing copra output. But this reform must still permit the occasional use of subsidies, or overseas aid, to support poor farmers.

E. Conclusions

Vanuatu was a victim of the cookie-cutter approach to structural adjustment and trade liberalization that afflicted a number of other underdeveloped economies in the 1990s. From macroeconomic stability and a manageable debt situation, the economy is now growing more slowly than during the last two decades, while foreign debt is a growing problem. The comprehensive reform programme has restricted policy options and further increased resentment toward international agencies including WTO.

The possibility must be entertained that Vanuatu will never experience an East Asian-style boom. It is too small, isolated and geographically fragmented while it is unlikely to attract significant investment in high-value-added areas. An improvement in the rate of development is possible and the country can learn from the economic success stories, but policies spurred by WTO accession must accommodate Vanuatu's special circumstances.

One of the main lessons of Vanuatu's WTO experience is that acceding small economies must enjoy greater influence over accession. This would ensure that their special circumstances are taken into account. Membership failed to a large extent because there was insufficient political and public ownership, while the process was so complicated and drawn-out that it was beyond the capability of a team of just a handful of full-time officials. Had Vanuatu been allowed greater ability to decide the terms under which it joined, membership might have been successful. The irony is that accession failed not because any WTO economy stood directly to lose, but because bigger countries feared that concessions granted to Vanuatu could be used elsewhere. A tiny, poor country became sidelined from a key institution of the world economy for no tangible economic reason.

This negative experience has had subsequent repercussions for policy. Politicians, having realized the potential populist gains from insularity, are now less amenable toward regional trade agreements and economic partnerships. For example the Melanesian Spearhead Group Free Trade Area faces problems following Vanuatu's negotiation of emergency protective rates on several local products, while Vanuatu delayed ratification of the Pacific Island Countries Trade Agreement.

Ensuring that Vanuatu maintains control over policy may not lead to perfection, but the experience of structural adjustment suggests that too much outside influence may be worse. Rapid and total liberalization are inappropriate. There must be some capacity for periodic subsidies to support small farmers. Cutting tariffs significantly in a short space of time would be politically impossible and most businesses would be unlikely to survive the shock. If duties cannot fall to zero straight away, then it makes sense to establish useful protection for infant industries over a specific period. Land, a particularly sensitive area throughout Melanesia, cannot be made subject to private ownership overnight on a freehold basis. Leasehold does not represent the main barrier to investment.

It seems unnecessary for WTO members not to have granted access to special and differential treatment. This is aimed precisely at LDCs like Vanuatu, and if it is argued that only members can use it, then its utility is diminished. The United States refusal to grant a transition period for membership was also a key reason for the failure of accession. The economic transformation would be so great that flexibility is essential to allow companies and the government to adjust to the new environment.

At the beginning it was asked: To what extent was Vanuatu able to demonstrate a reflexive relationship within the international trading regime? Were Vanuatu WTO negotiators able to act autonomously and how much, if the country had joined, would future policymakers have been able to decide national strategy?

The answer to the first question is that Vanuatu enjoyed little sovereignty during the accession process. Any capacity for reflexive action proved limited. A small and weak country was steamrollered by bigger opponents. And neither would Vanuatu have enjoyed sufficient policy choice after membership. It was denied the opportunity to subsidize copra farmers, while some bound tariff rates were too low for flexibility in the face of any sudden decline in government revenue.

Nevertheless there were small areas in which Vanuatu could exercise some autonomy and reflexive influence. It was able to achieve an average bound tariff rate well above the 15-20 per cent demanded by the United States. Subsequently the government has lowered tariffs as it has seen fit, demonstrating that it is committed to trade liberalization on an appropriate timescale.

Vanuatu, despite its tiny size, may also have been able to influence the future accessions of underdeveloped countries. WTO officials and members of working parties on the accession of LDCs are likely to be more careful about their future demands, both on an administrative and substantive level. Vanuatu's withdrawal of accession at the last minute, at Doha, may have embarrassed the WTO. Members that

bear in mind the legitimacy of the WTO will be keen to avoid a repeat of that experience.

Some parts of the accession package would have worked to Vanuatu's advantage. As was suggested above, one of the most crucial benefits was the establishment of a long-term policy environment with which politicians found it difficult to interfere. However inappropriate were some of the conditions agreed under the final package, at least economic policy would be difficult to change at short notice.

Global presence on trade disputes is particularly important for small economies. The case of kava shows that access to the dispute settlement mechanism might prove useful. Even if bringing an action were too expensive and time-consuming, lobbying groups may prove more wary about challenging the export standards of a group of WTO members. Concordance with global sanitary and phyto-sanitary standards would further help the export of agricultural and food products.

As in a number of other countries, Vanuatu's commodities marketing board, the VCMB, has suffered from political intervention and its monopoly status has distorted prices for key commodities. The board is unsustainable in its present state. WTO membership, given a transition period, could be used to enact useful reform with minimal political fallout. Exposing copra and other commodities to market prices would improve efficiency, while opening up the market to foreign ownership would help technology transfer, competition and overseas marketing.

Vanuatu is burdened with some of the highest utility prices in the Pacific region. These costs are one of the biggest barriers to development. Under the GATS, Vanuatu was urged to end the monopoly agreements on telecoms, water and electricity. This would have boosted competition and reduced prices, improving efficiency in many areas. The argument that ending the monopoly agreement would have reduced incentives to make new investments is questionable since it is unclear that UNELCO and TVL have been investing much anyway. The monopoly agreements are in effect a licence to gain supernormal profits.

Vanuatu can benefit from WTO entry, and the country must keep open the option of membership if it is to stay in step with changes in the world economy. If it does not, it will be left behind. In any case the several trade agreements with which the country is involved must be WTO compatible. However the delay in accession lies not primarily with poor negotiating by Vanuatu, but with a restrictive and over-demanding membership process. Perhaps the inability of Vanuatu to join on appropriate terms has been a drawback for all parties. If WTO members do not cater more to the specific needs of small underdeveloped economies, Vanuatu will not be the last to withdraw.

Annexes

I. RECENT EXPORT TRENDS

Copra

In recent years Vanuatu has enjoyed a prolonged period without serious cyclone damage. Coconut yields have generally improved, resulting in a general increase in production. However, according to 2001 annual statistics, copra export in this period recorded a low of 14,258 mt, compared with 29,634 mt exported in 2000. The fall was mainly due to the reduction in world export prices and limited shipping services to the main producing areas. Despite efforts to diversify exports, copra remains the principal export revenue earner for the country. Bangladesh was the main export market in 2001.

Cocoa

Cocoa earnings fell 56.4 per cent to VT64 million in 2001 from VT147 million in 2000. This was mainly due to a drop in production of 48.8 per cent between 2000 and 2001, attributable partly to the limited nature of shipping services to the main provinces.

Beef

Beef exports fell to VT239 million in 2001 from VT380 million in 2000. First quarter figures for 2002 show a decrease in exports compared to the previous quarter because of market difficulties in neighbouring pacific islands. Smallholders welcomed a rise in exports of live cattle to Indonesia in 2001. Beef exports have been hampered by quota restrictions on exports to the European Union.

Kava

Kava exports increased to VT503 million in 2001 from VT478 million in 2000. Despite healthy demand from Fiji, New Caledonia and other Pacific Islands, demand from Vanuatu's larger markets, the United States and European Union, looks likely to decline further due to reports of liver-related diseases from the processed derivatives of the kava plant.

Timber

Timber exports recorded a steady decrease from 1998 to 2000, reflecting a general decline from all overseas markets including Australia, Japan, New Caledonia and Taiwan. The main explanation was the fall in market prices in 1999 and the lower production level in 2000.

Cowhides

Cowhide exports declined to VT39 million in 2001 from VT47 million the year before. Exports to the traditional markets, Australia and Japan, dropped to nil from 1998-2000.

II. PREFERENTIAL AND REGIONAL TRADE ARRANGEMENTS

Vanuatu had not yet ratified by April 2003 the Pacific Island Countries Trade Agreement (PICTA), a regional free-trade area due to be phased in over the next decade. Vanuatu can also potentially join the Pacific Agreement on Closer Economic Relations (PACER), a treaty aimed at expanding economic cooperation.

Under the 2000 Cotonou Agreement, Vanuatu as part of ACP is committed to the negotiation of new WTO-compatible trade arrangements with the European Union that will come into force in 2008. New reciprocal Economic Partnership Agreements between ACP and the European Union will replace existing non-preferential trade arrangements. Cotonou must comply with article 24 of the GATT on territorial application, frontier traffic, customs unions and free-trade areas.

The SPARTECA agreement between the Pacific islands, Australia and New Zealand provides duty-free access for Vanuatu agricultural products into the Australian and new Zealand markets. Vanuatu, however, faces difficulty in complying with the strict standards required.

The Melanesian Spearhead Group involves bilateral trade agreements within the region. An MSG Free Trade Area is due to take effect by 2003 for Fiji and Papua New Guinea and 2005 for Solomon Islands and Vanuatu.

VIET NAM*

Introduction

1. State directions and general progress of international integration

As part of the reformation process (*Doi moi*), Viet Nam set out directives for multilateralism and the diversification of external relations, marking the beginning of the international economic integration process of the country.

The Report on Socio-economic Development Strategy for 2001-2010 states "Viet Nam will continue to expand its external economic relations in a more multilateral and diversified manner. It will actively participate in the process of international economic integration in a way that is relevant to its current level of development while ensuring the fulfillment of its bilateral and multilateral commitments under the ASEAN Free Trade Area (AFTA), Asia-Pacific Economic Forum (APEC) and Viet Nam-United States Bilateral Trade Agreement as well as the promotion of its accession to the WTO".

More recently, Resolution No. 07/NQ/TW on international integration reaffirmed that: "Viet Nam will actively participate in international economic integration by attracting foreign capital, technology and managerial skills to promote the process of industrialization and modernization, and realize the general objectives of a rich people, a strong country, and an equitable, democratic and civilized society".[178]

So far, Viet Nam has achieved considerable progress along its integration path. The country resumed relations with the International Monetary Fund and the World Bank in 1992. It became a member of the Association of South East Asia Nations (ASEAN) on 25 July 1995, and began fulfilling its obligations as an AFTA member from 1 January 1996. Viet Nam has also been a member of the Asia-Europe Meeting (ASEM) since March 1996, and has participated in APEC since November 1998. On 13 July 2000, the Viet Nam-United States Bilateral Trade Agreement was officially signed. Viet Nam has diplomatic relations with 168 countries and economic relations with 150 countries. It has signed over 80 bilateral trade agreements, 40 bilateral investment agreements and 40 agreements on avoidance of double taxation.

2. Process of accession to the World Trade Organization

Currently, Viet Nam is actively engaging in accession negotiations to WTO. In January 1995, Viet Nam officially applied for membership and became an observer at

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* Prepared by Nguyen Ngoc Son, Multilateral Trade Policy Department, Ministry of Trade, Hanoi, and reviewed by ESCAP. This report does not necessarily reflect the official views of the Ministry of Trade.

[178] Resolution No. 07/NQ/TW, 27 November 2001, Politburo on International Economic Integration, Hanoi.

WTO. The Working Party on Viet Nam's accession to WTO has organized six sessions, with the main objective of making its economic and trade policy transparent to WTO members. Viet Nam has concluded the transparency stage and is in the early stage of negotiations on market access commitments. To date, Viet Nam has responded to over 1,700 questions from the Working Party members.

In addition, during the accession process, a number of official documents have been completed to make domestic regulations transparent and emphasize the determination of Viet Nam to join WTO. The documents include action plans to implement WTO Agreements, notifications on domestic policies and offers on goods and services.

3. Organizational mechanism involved in the accession work

Economic integration has been recognized as one of the major tasks facing the whole country in the *Doi* moi process. As a result, the Government has carefully built and structured a systematic mechanism to assist in achieving this goal as explained below.

(a) National Committee on International Economic Cooperation

The National Committee on International Economic Cooperation (NCIEC) assists the Government in formulating strategies for external economic relation and cooperation, and maintains overall management of economic integration matters. It is also responsible for assisting the Government in guiding ministries and other relevant State bodies in adjusting existing regulations so that they conform to the principles and requirements of international treaties or organizations. Another function of NCIEC is to communicate with different social groups on integration-related issues.

NCIEC comprises representatives from several ministries, the most important of which is the Ministry of Trade (MOT). The NCIEC office is maintained at MOT.

(b) Ministry of Trade

MOT is the principal authorized agency involved in WTO accession negotiations. It is responsible for drafting and submitting all accession strategies and plans to the government. The Multilateral Trade Policy Department, among other MOT departments, was especially set up to assist the Minister of Trade with integration policies and WTO accession negotiations.

(c) Government negotiating delegation

The government negotiating delegation comprises representatives at the departmental level from the ministries and agencies concerned.

(d) Line ministries

Each ministry concerned has a specific group of personnel to deal with accession matters. Their function is to contribute ideas and arguments from their professional points of view either to MOT or to the government negotiating delegation.

A. Process of policy reform for World Trade Organization membership

1. Changes in the ownership system

Viet Nam has been changing from a centrally planned economy to a market-based economy. National Assembly Resolution No. 51/2001/QH10 of 25 December 2001 on the amendment of, and supplement to the 1992 Constitution recognized six economic components (or types of economic ownership) as equal before the law. These are the State sector, collective sector, private individuals and household sector, private capitalist sector, State capitalist sector and foreign investment sector. All enterprises operating legally on the territory of Viet Nam and under the laws of Viet Nam were recognized and protected by la[179] (including protection against nationalization).

Including in the stimulating progress made regarding the ownership system was the successful change of control and ownership in the State-owned sector, which was aimed at improving competitiveness and creating more favourable market economy conditions. Encouraging measures have also been applied to increasing ownership in the foreign investment sector and developing a new type of ownership in the form of cooperatives.

Since 1991, the State sector has been undergoing restructuring and reorganization on a market orientation basis. As of August 2002, Viet Nam had equitably transformed the ownership of 985 enterprises. In addition, the Government issued Decree No. 103/ 1999/ND-CP on 10 September 1999 on the assignment, sale, contracting out and leasing State-owned enterprises. The Law on Enterprises, promulgated on 12 June 1999, governs limited liability companies, joint-stock companies, partnerships and private companies. As for private companies alone, about 62,300 companies have been established under this law.

Foreign investors are allowed to participate in the equitability process by purchasing shares in State-owned enterprises in sectors identified in the Prime Minister's Decision No. 145/1999/QD-TTg of 28 June 1999. Recently, the Ministry of Planning and Investment promulgated Decision 260/2002/QD-BKH promulgating a list of sectors in which foreign investors can purchase shares in non-state-owned enterprises in accordance with the law on the promotion of domestic investment. The total value of shares sold to foreigners may not exceed 30 per cent of a company's registered capital.

With the increasing number of market participants, this process is highly relevant to WTO accession in the sense that it offers more opportunities for the development of a competitive environment and a market-based economy.

[179] Vietnamese laws do not recognize private ownership of land, forests and water resources, but they do recognize the right to use these resources. Long-term land-use rights of farmers, including the transfer of land-use rights, have been recognized by the State since 1988. Viet Nam recognizes the ownership to fixed assets (except land) of foreigners during their residency in the country.

2. Trade policies

(a) Improved mechanism for trading rights

Previously, only enterprises that held licences issued by MOT were allowed to engage in direct import or export activities.[180] The licensing requirement was then abolished by virtue of Government Decree No. 57/1998/ND-CP, 31 July 1998, and the working capital requirement for trading enterprises was no longer effective. Since 1 September 1998, all wholly Vietnamese-owned enterprises – irrespective of the ownership structure, nature (trading or manufacturing) and size of capital – have been allowed to import and export goods.[181] Except in the case of those on the prohibited lists, the Government does not limit or intervene in the scope of business chosen by enterprises.

Decree No. 24/2000/ND-CP of 31 July 2000 allowed foreign investment enterprises and business cooperation parties not only to export directly or authorize their agents to export their products, but also to make purchases directly in the Vietnamese market for export or export processing (except for prohibited exports or certain exports specified by MOT for specified periods).

(b) Other improvements in trade policies

The Government has also taken the following steps towards an improved legal framework and WTO-consistent trade policies:

(a) Technical barriers to trade. Viet Nam is currently completing the legal framework covering this area in an effort to further facilitate trade and comply with the WTO Agreement on Technical Barriers to Trade;[182]

(b) Customs valuation. Viet Nam is drafting legislation based on the principles of the Agreement as well as introducing measures to combat commercial fraud and transfer pricing. In addition, a Working Group has been established to promote implementation of the Agreement. Currently, Viet Nam is implementing the Agreement on a pilot basis for goods imported from ASEAN countries under the ASEAN Common Effective Preferential Tariff (CEPT) Programme;

(c) TRIPs measures. As far as intellectual property rights are concerned, Viet Nam's legal framework is reasonably adequate. An action plan for the implementation of the TRIPs Agreement has already been prepared

[180] Decree No. 64/HDBT, 10 June 1989.

[181] Decree No. 44/2001/ND-CP, 2 August 2001 on amending some Articles of Decree No. 57/1998/ ND-CP.

[182] The legal framework for standardization, metrology and quality control comprised the Ordinance on Metrology No. 16/1999/PL-UBTVQH10, 6 October 1999 and the Ordinance on Goods Quality No. 18/1999/PL-UBTVQH10, 24 December 1999, and their implementing legal documents.

for review by WTO members and it has been a party to many international Conventions;[183]

(d) Trade defence measures. Recognizing the importance of trade defence measures (especially anti-dumping, countervailing and safeguard measures) in international trade, Viet Nam is in the process of building the legal framework for introducing such measures.

3. Investment policies

Viet Nam applies a wide range of incentives to attract foreign investment. These incentive policies include (a) giving priority to projects in agriculture and consumer goods production, (b) encouraging export-oriented production, (c) special incentives for investment in disadvantaged regions and (d) encouraging investment in labour-intensive sectors.

According to the Law on Amendments and Supplements to some Articles in the Law on Foreign Investment of 9 June 2000 as well as its guiding legal documents, the following additional incentives are being offered to attract greater foreign investment:

(a) Flexible regulations of establishment. Enterprises with foreign investment are permitted to change the form of investment, and divide, consolidate or merge with other enterprises. Existing joint ventures are allowed to transform into wholly-owned foreign capital enterprises under certain conditions. In addition, there is no obligation to form a joint venture with a local partner. Foreign investors are entitled to make their own choice from three forms of investment set forth by the Law on Foreign Investment in Viet Nam;

(b) Reducing the administrative burden. The duration for investment licensing was cut from 60 working days to 45 working days for projects under the category of appraisal and issuance of investment licences, and to 30 working days for projects under the category of registration for investment licences;

(c) Expanded control over the use of foreign exchange. The ratio of revenue in foreign currency to be surrendered by enterprises with foreign investment has been reduced from 70 to 30 per cent. Such enterprises, particularly large-scale businesses, are allowed to open an account at an overseas bank if approved by the State Bank of Viet Nam;

(d) Movement of business people. Viet Nam has greatly simplified procedures related to granting visas (i.e., a reduction of the waiting period and the simplification of application procedures). Viet Nam is also planning to participate in the APEC Business Travel Card scheme that allows free movement of business people in the APEC community;

[183] These include the Paris Convention for the Protection of Industrial Property (the Paris Convention) and the Madrid Agreement on International Registration of Marks (the Madrid Agreement), the Convention establishing WIPO in 1976 and the Patent Cooperation Treaty (PCT) of March 1993.

(e) Other preferential conditions. Viet Nam protects industrial property rights and guarantees the lawful interests of foreign investors in technology transfer activities. Enterprises with foreign investment are permitted to mortgage assets associated with land and the value of land-use rights in order to secure loans at a credit institution permitted to operate in Viet Nam.

4. Economic reform in other related sectors

(a) Monetary and foreign exchange policies

The State Bank of Viet Nam regulates the money supply to control inflation and facilitate economic growth using various flexible policy instruments such as refinancing, reserve requirements, interest rates, foreign exchange rates, open market operations and other supplementary instruments. Since 1997, the bank has applied a uniform rediscount rate for all commercial banks since 1997. Credit policy focuses on increased lending to the private sector, especially farm households, and expanding the portion of mid- to long-term lending. In the State sector, lending is only extended to profit-making enterprises.

In 1989, Viet Nam replaced a fixed exchange rate system with a flexible exchange rate mechanism. Foreign exchange transaction centres have been operating since the end of 1991, and an inter-bank currency market for commercial banks was established in 1993. The State Bank of Viet Nam monitors the balance-of-payments and foreign exchange reserves position of the country and only intervenes in the market when necessary. The State Bank of Viet Nam also sets the average transaction exchange rate of the Vietnamese dong against the US dollar on a daily basis in the inter-bank foreign currency market.

(b) Tax policy

With regard to tax policy, recent tax reform focused on streamlining the tax rate structure, non-discrimination, broadening the tax base, improved tax administration and the introduction of value-added tax (VAT) to replace a turnover tax.

The major remaining taxes levied in Viet Nam are corporate income tax, agricultural land-use tax, a tax on the transfer of land-use rights, a natural resources tax (royalties), a land and housing tax, (personal) income tax, VAT, a special consumption tax (excise tax), and import and export duties. In addition, the Government levies some fiscal charges such as land rent, usage fee for government-owned capital, a business licensing tax, a property registration fee and a transportation fee.

B. Prospects and challenges posed by the accession process

1. Potential impact of WTO membership on national economic performance

(a) Prospects

Viet Nam's decision to integrate with the regional and international economies is aimed at achieving rapid and sustainable development. As a result, the expectations with regard to the potential benefits to be gained from joining WTO are quite high and include:

(i) Expanded markets and increased exports

Throughout its history, GATT/WTO has completed eight rounds of negotiations with considerably liberalized terms and conditions for trade in both goods and services. Commitments made by each WTO member are to be applied on an MFN basis to all other members. These commitments include the removal of non-tariff measures, tariff binding at low levels, tariff reductions and other commitments to make each country's trade policies more transparent and liberalized.

Given its natural endowments and cheap labour costs, Viet Nam can take advantage of all of these commitments once it becomes a member of WTO. In particular, it can expect to benefit in those areas of comparative advantage such as agricultural products and textiles. In this particular regard, WTO is pursuing the removal of trade barriers in these areas in order to protect the interests of many exporting countries. Under the Agreement on Textiles and Clothing (ATC), members are required to completely remove quantitative restrictions to the trading of these products by the end of 2004. Thus, if Viet Nam is already a member, at that time all quotas currently applied to Viet Nam's exported textiles and garments will be removed. In agriculture, WTO members have made commitments to reduce trade barriers and subsidies even further. This is also expected to be of great benefit to an agricultural exporting country such as Viet Nam.

Another prospect is that the concessions made are more equitable than those made under bilateral trade agreements, which may be associated with conditions unrelated to trade, such as human rights, labour standards and environmental requirements etc. This can occur when an agreement is concluded between a developing or less developed country with a developed country that is dominant in international trade. Therefore, if concessions are already made under WTO terms and conditions, Viet Nam may avoid any likely disadvantaged positions that might result from bilateral trade agreements.

Given the above points, membership in WTO may allow Viet Nam to take advantage of market access concessions. This would create favourable conditions for Vietnamese products to penetrate international markets, thus enhancing the country's production and exports, expanding its markets and increasing its export earnings (see annex tables 1 and 2).

(ii) Improving domestic competitiveness and accelerating the restructuring process

Previously, domestic enterprises had a competitive edge over foreign producers mostly because they were protected. Even among domestic enterprises, competition was limited because state-owned enterprises had more privileges than those in the non-state sectors as the former had easier access to production inputs (such as land and capital) and were even supported throughout the production process.

With a lower level of protection by tariff and non-tariff measures, competition will increase in the domestic market. Higher competition will also lead to restructuring and self-improvement of domestic enterprises (both state-owned and others) in achieving higher productivity and competitiveness. At the same time, greater access to modern technology and more reasonable input sources will provide domestic manufacturers with more opportunities to improve efficiency. However, this prospect can only be realized on the condition that solutions are found and considerable resources are spent on restructuring the national economy. This is discussed in more detail in subsection 1 (b) below.

(iii) More favourable legal system for trading activities, and protecting enterprises with equitable tools for solving international trade disputes

In the process of joining WTO, Viet Nam has to make all its trade-related policies transparent and submit plans for gradually making them consistent with WTO principles. Throughout this process, the legislative framework of Viet Nam will become more apparent and consistent with international practices, thus creating a favourable business environment and healthy competition as well as encouraging trade, investment and other forms of cooperation with the international community.

Viet Nam will, as a WTO member, be in a better position to defend its interests on the international scene. Currently, importing countries tend to reinforce the use of sanitary standards or allegations of price dumping in order to protect the interests of domestic producers. Exports of shrimp and gas lighters to the European Union, frozen fish fillets to the United States and garlic and waterproof footwear to Canada have already suffered from trade barriers of this type. If Viet Nam were already a member of WTO, it could have taken advantage of the available dispute settlement mechanism to protect the legitimate interests of its domestic enterprises.

(b) Challenges

The implementation of international trade commitments during the process of international economic integration, while offering many important advantages, will expose domestic enterprises and the national economy to considerable challenges.

This fierce competition comes as the result of tariff binding[184] and tariff cuts.[185] At the same time, acceding countries have to commit to removing non-tariff barriers and realigning export subsidies. In addition, there is a tendency for most recent acceding countries to enter sectoral arrangements, that is, to cut their tariffs down to zero for the whole sector. Actually, all participated in the Information Technology Agreement (ITA).

As a developing country at a low level of development, Viet Nam is facing many difficulties and challenges, which include legislative framework and human resources. These challenges could be perceived during the accession process.

(i) Combined pressures from domestic industries a major challenge in the accession process

The country is in transition from a centrally planned to a market-based economy and, therefore, the competitiveness of many domestic industries as well as the national economy as a whole is still limited. However, integration requires the country to make tough commitments. During this process, many domestic industries may find that under the pressure of competition they are unable to adjust by the time these commitments become effective. This could happen if the relationship between integration and the present level of national economic development is not properly settled. Consequently, the result may be very costly, both in economic and social terms, and a certain level of protection may be necessary.

Opening the domestic market to competition requires not only the restructuring and improvement of each industry involved but also the restructuring of the national economy. In other words, this process requires a new economic structure with a view to making the best use of the comparative advantages. In the long term, when natural advantages play decreasing roles in the global production chain, the value created by industries based on these advantages will also decrease. Therefore, the long-term challenge is whether the country can identify potential areas where it can maintain and enhance its competitiveness.

The challenge of competition has already affected the negotiation process. More liberalized policies and further commitments have not received support from the domestic industries of Viet Nam. The Government is in the difficult position of having to decide which sectors to engage, and when and how, in the process. As a result, the decision to move forward faster in the negotiations in WTO depends very much on

[184] It is evident from the Protocols of Accession that past entries have seen almost no unbound tariff lines. The number of individually bound tariff items for non-agricultural products are (the figures in parenthesis are the total number of tariff items): Albania, 8,459 (of 8,459); Croatia, 6,469 (of 6,469); Estonia, 5,328 (of 5,328); Georgia, 5,206 (of 5,206); Jordan, 5,896 (of 5,896); Kyrgyzstan, 6,068 (of 6,068); Latvia, 4,564 (of 4,564); and Oman, (4,858 (of 4,858). The situation concerning agricultural products is analogous.

[185] The key demand by current WTO members has been that acceding economies bind their tariffs for industrial goods at roughly double the average rate for Organization for Economic Co-operation and Development countries, which would imply an import-weighted average of bound rates of no more than 10 per cent.

internal considerations and negotiations, which, in turn, will require much time and expertise to analyse the situation and explore appropriate solutions.

(ii) Existing economic legislative framework needs to be more efficient and consistent with international regulations

Despite positive efforts to complete the existing trade and economic legislative framework, many steps remain to be taken. Corresponding to any steps taken towards more liberalized trade and investment policies, many laws and regulations need to be adjusted in order to meet international standards. One example is the time span between promulgating legal documents and when they come into effect; this needs to be long enough (depending on the type of legal documents) to ensure transparency for all parties concerned. Another example is that the Government has to make reasonable adjustments to related policies in order to support the removal of non-tariff measures.

The economic and trade legal framework is still not comprehensive enough to cover new issues arising as part of the process of renovation and economic integration. Such issues include competition policy, trade and environment, e-commerce, intellectual property rights and trade defence tool. As mentioned above, some positive progress has been made but the way ahead is very long. Implementing the new policies and measures once they are in place will not only require practical knowledge but also a great deal of resources.

(iii) Limited human resources proven to be a long-term challenge

Human resources are an important factor and containing great challenges for the process of integration. Vietnamese personnel are generally limited in international experience, economic knowledge, foreign languages and especially negotiation skills. This will create considerable difficulties for Viet Nam as it enters the stage of substantial negotiations.

As a factor of cross-cutting importance, human resources are required for ensuring that all stages and areas involved in WTO accession contribute to the general objective. During the accession stage, human resources will be required for analysing, recommending an approach to making commitments or formulating certain action plans, or participating in direct negotiations. After acceding, human resources will remain an important factor in the implementation of the country's commitments as well as in helping the domestic business community to adapt to international markets.

In view of the crucial role that human resources will play, the challenge that is facing Viet Nam is enormous. Therefore, human resources should be given priority on the national strategic agenda.

(iv) Impact on the national balance of payments

After accession to WTO, trade will become more liberal. While imports may increase at a very high rate, it may take more time for exports to reach the same level. This situation will lead to deficits in the national balance of payments after accession and will require the country to adopt flexible monetary and fiscal policies in order to

cope with such a situation. This is a common concern of all developing countries and Viet Nam is no exception. Although not directly affected by the region's 1997 economic crisis, Viet Nam has experienced a trade deficit for many years.

2. Particular implications for foreign direct investment

Traditionally, foreign investors have come to Viet Nam mainly for its cheap labour or natural resources. However, it is recognized that these two traditional factors are now losing their positions in the consideration of foreign investors. This is one reason why foreign investors in Viet Nam are now paying more attention to service industries where they can be more competitive in the domestic market, rather than to production and manufacturing where the traditional advantages are declining. Another interesting aspect is that previous traditional foreign investors in Viet Nam were mainly from the same region, with the leading role being played by countries/ areas such as Malaysia, Singapore and Taiwan Province of China. However, more developed countries such as Japan, the Republic of Korea and the United States as well as the European Union are playing an increasingly active investment role, and services are becoming more important in the eyes of these newcomers.

Recognizing the importance of foreign investment to the development of the national economy (see annex figure), Viet Nam has taken considerable steps towards ensuring a favourable environment. However, the implications of WTO accession for FDI should be looked at from a more subjective perspective, with the above features and trends in mind.

First, the opening of the market in goods has combined implications. On the one hand, it means that foreign investors have more market opportunities. Those investors based in Viet Nam will benefit from freer and more secure access to other markets while taking the traditional advantage of labour, land, and other natural resources in Viet Nam. These are practical considerations in the case of foreign investors who locate their plants in Viet Nam to produce textiles, footwear or other labour-intensive products. On the other hand, competition will increase in the domestic market with the easier entry of imported goods. In this regard, investors will have to consider not only the traditional advantages, but also many other factors related to the domestic market, in order to ensure that they have a certain competitive edge over imported goods. In this difficult situation, the Government will have to create additional favorable conditions to attract and assist foreign investors.

In addition, the opening of service markets will attract more foreign investors. During the negotiations, Viet Nam will gradually have to open its service markets by removing restrictive regulations related to market access and national treatment. This process will eventually lead to the increasing presence of foreign service providers in many potential markets such as banking, insurance, security and tourism.

Another prospect is that WTO accession will direct foreign investment objectives in one way or another. In the context of a protected economy, investors often enter for the benefits of the domestic market as they are protected. However, after accession to WTO, they will certainly turn to investing in areas with high export potential. This

will have a positive implication for FDI in the sense that investors will have to rely on their own competitiveness, as well as on the national conditions that are increasingly required to be more conducive to investment.

Finally, the accession process is expected to bring about a transparent and legal environment, removing any measures that are unnecessarily hindering trade and investment. This will contribute to creating a promising overall climate for foreign investment. Generally, investment is expected to increase in the long term as a result of trade openness and policy reforms. However, this situation will no come about naturally; instead, it will require concerted actions from the government side.

3. Costs and benefits to the business community

From the above analysis of the impact of WTO accession on trade and investment, the general benefits likely to be enjoyed by the business community can be summarized as:

(a) Increasing market opportunities. As trade barriers are removed, domestic enterprises will either be able to export at more competitive prices or choose more cost-saving inputs for their production;

(b) Equal opportunities and a fair environment for development. This is especially important for private or small and medium-sized enterprises that have not received equal treatment with big market players such as state-owned or foreign invested enterprises;

(c) Pressure both on state-owned and non-state enterprises to restructure and make improvements, which should be deemed as a benefit from the development perspective;

(d) An expected increase, or greater efficiency, in foreign investment, which will at the same time bring in the technology and skills needed to develop domestic counterparts.

However, it is important not be too optimistic and overlook the related costs and challenges, which mostly arise from the fierce competition that the domestic business community will have to face, both inside and outside the country, such as:

(a) The threat to many enterprises of being forced out of business due to weak competitiveness. Restructuring to become more competitive requires a great deal of investment in terms of capital, technology and human resources;

(b) Difficulties for domestic enterprises in developing their market niches abroad due to limited capacity and understanding about markets. Most private enterprises had paid little or no attention to foreign markets until recently. Those enterprises that have gained a footing in international markets usually export through intermediary partners. One of the difficulties is that their foreign clients find them to be insufficiently reliable. In addition, with limited capital, they are unable to provide favourable terms

of payment or carry out detailed market research. When most of the visible barriers are gradually removed, the above difficulties may create invisible barriers to accessing foreign markets;

(c) On entering international trade, Vietnamese enterprises are prone to many trade disputes in which they are usually in a weaker position. There might be two possible causes. First, they may not be professional enough to avoid violating rules and practices commonly applied in international trade, or to protect themselves from being challenged by their trading partners. Second, their foreign competitors might be receiving government support (for example, subsidies), thus adversely affecting exports by Vietnamese businesses. This situation requires enterprises to be familiar with any rules or practices applied in international trade, and for the Government to develop a specific mechanism to protect them.

4. Social impacts of WTO accession

Trade liberalization in the WTO accession process tends to ensure higher efficiency and more sustained economic growth. This will, in turn, have an impact on the wider community – the development and prosperity of which are the key objectives of accession. The direct effects may arise from reduced tariff revenue, competition and economic restructure. Consequently, these will give rise to indirect effects on many other social aspects. The general impact may eventually be optimistic but, in the short term, challenges often prevail.

(a) Higher benefits to consumers

Liberalized trade opens the door to production at low cost (as the result of improvement against competition) and cheaper imports. Consumers (both enterprises and consumers) are the direct beneficiaries of this process. They can spend their money on a wider range of goods and services at lower prices. On the other hand, consumers also gain access to products and services of higher quality and safety levels. Together with overall economic growth, better consumer benefits will contribute to higher living standards and the development of the country as a whole.

(b) Impact on employment

Trade liberalization may have a combined effect on the employment issues. Employment may rise due to increased investment and production. However, it may also decrease as a result of administrative reform, restructuring in many industries, the closure of loss-making enterprises or an increasing abundance of unskilled workers. In the case of Viet Nam, with roughly 67.3 per cent[186] of the population working directly in the agricultural sector, the immediate effect could be more on the negative side.

[186] MOLISA and General Statistical Office, Statistical Yearbook 2000.

In addition, there remains the challenge of finding a solution for workers made redundant during the restructuring of domestic industries in the move towards higher growth. The workforce structure will be altered, particularly with regard to the movement of labour to industries that are more competitive. It will also be necessary to prepare for deeper divisions of labour whereby each worker is required to take up a specialized position and achieve higher productivity.

(c) Impact on various social groups

The definition of different social groups may be referred to as the combination of all groups having vested interests in the progress of trade liberalization and economic development. These groups include farmers, industrial workers, small children and the elderly, the poor, people in rural and mountainous areas, disadvantaged people etc. The channel of impact is felt mainly through possible reductions in budget income (as the result of tariff cuts), which may lead to lower spending on certain social welfare programmes (such as education, healthcare, charity work and other activities of a public service nature). The resulting pressure is often higher for those groups that have traditionally been protected by the State.

The impact on different social groups may also result from economic restructuring and the reallocation of production. This will affect their jobs, assets and lives in general, and will eventually lead to one group gaining a more advantaged position or vice versa.

(d) Impact on poverty reduction

Trade liberalization is likely to be associated with reduced poverty in the long term because of its link to economic growth, and through that to poverty reduction. In the short to medium term, trade liberalization will reduce the cost of the consumption basket of the poor, thus having a positive impact on poverty. It may also lead to increased wages and employment for the poor who work in those sectors that develop as a result of liberalization.

The prospect of investment is also positive aspect for poverty reduction in the sense that it may lead to many new investment areas[187] and complexes, thus creating more jobs and changing the living conditions of the poor in many difficult areas.

C. Recommendation

In view of the prospects and challenges of trade liberalization as well as its various impacts on different groups in the national economy, some key recommendations on pushing ahead with the current process of negotiations and maintaining long-term development objectives are given below.

[187] The Government, through land-use and other incentive policies, encourages investors to locate in rural, mountainous or other remote areas.

- Always ensure a logical, sound basis for making a decision. In the context of the current negotiations, further commitments should be supported by a cost-benefit analysis and careful research on the competitiveness of different industries. Priorities should be identified for the various industries and measures to be taken, so that a clear-cut approach can be prepared for the upcoming negotiations. To this end, cooperation with independent research institutions will be necessary. This recommendation is relevant to move faster forward in negotiations.

- The restructuring of domestic industries is of particular importance to the efforts to adapt to competition pressure resulting from trade liberalization. There are two perspectives in this regard. In the short to medium term, a shift is required from inefficient to more efficient industries (which can utilize the country's advantages of cheap labour and natural resources) in order to become more competitive. In the long term, the value-added from these available inputs will decrease and give way to highly skilled labour or high-tech input. As a result, it will be necessary to identify and develop certain areas of comparative advantages.

- Human resources are of a crosscutting nature, meaning that they are vital to all stages of negotiations and subsequent development. Therefore, importance should be attached to the human resources aspect. Many elements are required from human resources, including a good knowledge of multilateral trade, smart negotiating skills, professional expertise in different areas, fluency in foreign languages and familiarity with international law.

- The Government should put in place some supporting policies for domestic enterprises that are challenged by trade liberalization. These policies could include:

  (a) Implementation of new trade tools such as anti-dumping, countervailing and safeguard measures in order to protect domestic enterprises from unfair practices;

  (b) Encouraging trade promotion activities to help enterprises gain easier access to foreign markets;

  (c) The provision of equal access to resources (such as information, capital and land) by small and medium-sized enterprises.

- Communicating with the business community and different social groups is very important in two ways. First, it ensures people are well aware of the costs and benefits of WTO accession and prepares them for its future impact. The business sector needs to understand how the process will affect them in order to make appropriate improvements. Individuals need to know in what ways their lives will be affected and how they can readjust to the situation (i.e., undergo training or move to another sector that is safer in terms of employment opportunities). Another aspect is that

good communication offers an opportunity for all parties concerned to contribute their ideas and expertise to the process.

- One point that should be noted is that non-governmental organizations such as the Viet Nam Chamber of Commerce and Industry, consumer associations and many professional associations can play important roles in communicating with society. This is because their opinions are more objective and relevant, and therefore, more easily accepted by the target audience. For this reason, non-governmental organizations should, to the extent necessary, be engaged in the process.
- More effort should be made to complete the restructuring of the legal system in a more WTO-consistent manner. This major task includes the adjustment of existing legal documents and the introduction of new ones. This will require not only considerable resources and a master action plan for the present, but also relevant implementation capacity in the future.
- Due to limited available resources, especially financial and human resources, international assistance is of great importance to Viet Nam in carrying out the process of economic development, particularly WTO negotiations. Therefore, the following recommendations are made with regard to regional cooperation.
- Regional cooperation should focus on exploring ways to help countries in their accession process, especially less-developed countries and countries in transition, so that they can make commitments that are relevant to their particular social and economic conditions.
- Human resources should be developed, with the focus on capacity-building for government officials directly involved in accession negotiations as well as those engaged in the formulation and implementation of policies and international commitments.
- Domestic policies should be adapted to become more WTO-consistent. This issue is more country-specific and a substantial survey should be made of each country's situation.
- Support should be provided to countries in accession in exploring solutions to employment issues, the reduction of social gaps and the minimization of the negative impacts of international integration.
- The interests of the business community should be protected by maintaining regional forums/dialogue between governments and enterprises. This will allow governments to remain aware of the challenges faced by enterprises as well as find suitable solutions.
- The understanding and capacity of the business community needs to be improved through, for example, communications/outreach activities on integration and market access. These types of activities will assist enterprises to better adapt to the new competition environment.

Annex

COUNTRY STATISTICS

Annex table 1. Engines of growth

Sector	Growth rate (percentage)				
	1998	1999	2000	2001	2002[a]
Total industrial output	12.5	11.6	17.5	14.2	14.4
State	7.7	5.4	13.2	12.7	11.9
Private	7.5	10.9	19.2	20.3	19.3
Foreign investment	24.4	21.0	21.8	12.1	14.7
Total agricultural output	4.9	7.4	7.5	4.7	5.0
Agriculture	5.7	7.3	5.4	2.6	4.5
Forestry	-3.5	7.0	7.9	-0.9	0.2
Fisheries	3.5	7.9	19.3	17.4	8.1
Services[b]	5.1	2.3	5.3	6.1	6.2

Source: General Statistical Office.

[a] Estimated.

[b] The figures for services are based on value-added.

Annex table 2. Contribution to export earnings

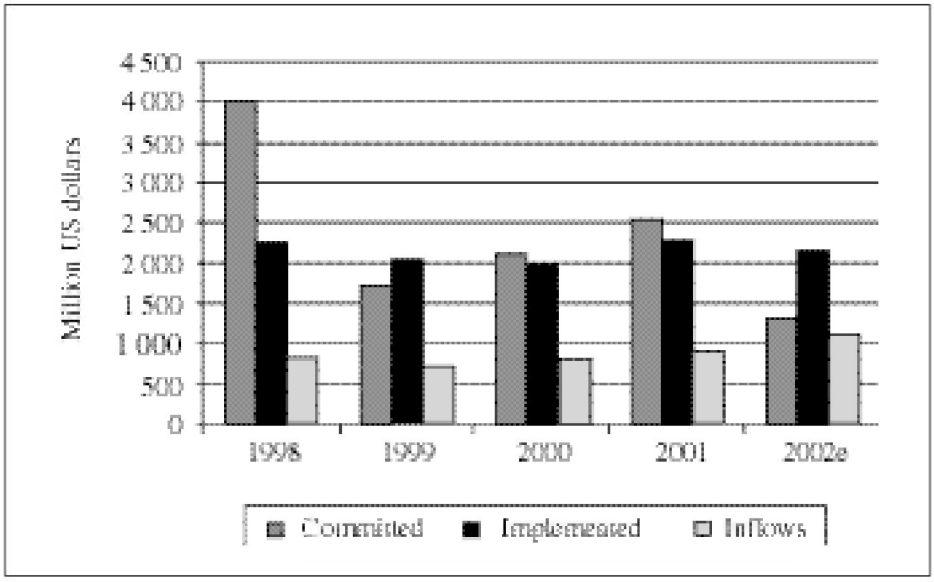
Category	Growth rate (percentage)					Value[a] (US$ million)
	1998	1999	2000	2001	2002[a]	2002[a]
Crude oil	-12.8	69.7	67.5	-10.8	-0.5	3 110
Non-oil	4.8	16.3	16.1	8.7	9.2	12 990
Agricultural products	8.4	5.6	-9.8	-5.1	7.1	2 009
Seafood	4.8	16.3	55.5	20.2	15.3	2 050
Mining products	-8.3	-5.2	2.7	3.1	14.7	130
Garments	0.2	29.3	8.3	4.4	31.6	2 600
Footwear	3.7	39.1	5.2	6.5	11.6	1 740
Electronics	n.a.	23.5	33.8	-23.9	-16.1	500
Handicrafts and fine arts	-8.4	51.3	40.8	-0.7	34.0	315
Other	2.8	5.8	31.3	25.5	-3.2	3 647
Total exports	2.1	23.4	25.4	4.0	7.0	16 100

Sources: General Statistical Office, and Ministry of Trade estimates.

[a] Estimated.

n.a. Not available.

Annex figure: Foreign investment



Sources: Ministry of Planning and Investment, and World Bank estimates.

[a] Estimated.

Note: "Committed" refers to registration of projects by foreigner investors; "Implemented" is estimated according to the aggregate disbursement schedules of the projects, including equity and loan components; and "Inflows" are estimated based on average shares of foreign and domestic equity investors and lenders as well as on information about major project disbursements General Meeting.

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