task force

Trade

Trade for development

Achieving the Millennium Development Goals

MillenniumProject

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TASK FORCE ON TRADE

Trade for development

EARTHSCAN

The UN Millennium Project is an independent advisory body commissioned by the UN Secretary-General to propose the best strategies for meeting the Millennium Development Goals (MDGs). The MDGs are the world's targets for dramatically reducing extreme poverty in its many dimensions by 2015—income poverty, hunger, disease, exclusion, lack of infrastructure and shelter—while promoting gender equality, education, health, and environmental sustainability.

The UN Millennium Project is directed by Professor Jeffrey D. Sachs, Special Advisor to the Secretary-General on the Millennium Development Goals. The bulk of its analytical work has been carried out by 10 thematic task forces comprising more than 250 experts from around the world, including scientists, development practitioners, parliamentarians, policymakers, and representatives from civil society, UN agencies, the World Bank, the International Monetary Fund, and the private sector. The UN Millennium Project reports directly to UN Secretary-General Kofi Annan and United Nations Development Programme Administrator Mark Malloch Brown, in his capacity as Chair of the UN Development Group.

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Trade for development

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Foreword

The world has an unprecedented opportunity to improve the lives of billions of people by adopting practical approaches to meeting the Millennium Development Goals. At the request of UN Secretary-General Kofi Annan, the UN Millennium Project has identified practical strategies to eradicate poverty by scaling up investments in infrastructure and human capital while promoting gender equality and environmental sustainability. These strategies are described in the UN Millennium Project's report *Investing in Development: A Practical Plan to Achieve the Millennium Development Goals*, which was coauthored by the coordinators of the UN Millennium Project task forces.

The task forces have identified the interventions and policy measures needed to achieve each of the Goals. In *Trade for Development*, the Task Force on Trade makes a strong case for a multilateral trading system that is more supportive of economic growth and poverty alleviation in developing countries. To this end, it puts forward a set of goals to be accomplished by the ongoing Doha Round as well as longer term objectives for the trading system to achieve by 2015 and 2025. It suggests that the High-Level Millennium Review of September 2005 be used to advance the trade for development agenda.

This report emphasizes high-income countries' responsibility to lead by example in pursuing more open markets and in supporting the Least Developed Countries to raise their export competitiveness. It proposes concrete and practical steps that governments and international agencies can undertake to bring trade to bear on development.

The report has been prepared by a group of leading experts who contributed in their personal capacity and volunteered their time to this important task. I am very grateful for their thorough and skilled efforts, and I am sure

that the practical options for action in this report will make an important contribution to achieving the Millennium Development Goals. I strongly recommend it to anyone who is interested in how to mobilize trade for development.

Jeffrey D. Sachs
New York
January 17, 2005

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This report has benefited greatly from the contributions of the members of the task force. Task force members are in solid agreement on many points contained in the report; however, some task force members are in disagreement with some of the ideas included in the report, its conclusions, and its recommendations. Only the task force coordinators take full responsibility for all of the report's contents.

The task force coordinators wish to extend special thanks to Julia Nielson for her superb performance as technical coordinator. They also wish to thank Haynie Wheeler for her support as task force associate.

Preface

This report reflects the work and dedication of members of the UN Millennium Project Task Force on Trade, an expert international advisory group whose members responded to the mandate of the Secretary-General of the United Nations. Task force members provided input in their individual capacity as experts; moreover, they brought to the table expertise from a variety of sectors reflecting their professional backgrounds, including academia, business, government, and civil society. Senior staff and sectoral experts from the International Monetary Fund, the World Bank, the World Trade Organization, the United Nations Conference on Trade and Development, and the Food and Agriculture Organization also were included in the group.

The task force and technical support personnel reviewed an enormous amount of background material, representing the latest research and country-level experiences on trade. It also commissioned new work to explore specific topics. Task force subgroups met with academic, government, and research organization representatives to present findings and further refine ideas.

The task force's mandate was to develop an operational framework of action for developing further an open, rule-based, predictable, nondiscriminatory trading and financial system. The report concludes that trade openness can be a powerful driver of economic growth, which is in turn indispensable to reducing poverty and fostering development. Consequently, this report addresses the topics that should be solved in the WTO Doha Round to make it really an undertaking supportive of development. The report argues how important it is for this endeavor not only to complete the present Round successfully but, beyond that, to build a multilateral trading system that in the long run delivers the total removal of barriers to all merchandise trade and a substantial and extensive liberalization in services, including the temporary movement of people.

The report suggests ideal trade liberalization targets for both 2015 and 2025, which heads of state could adopt in the context of the "2000 plus 5" high-level review of the Millennium Summit. The report emphasizes the importance of complementing the trade agenda with sufficient support to poor countries for generating the sources of revenue needed to compensate for losses incurred as a result of lowering import duties, for building the human and physical infrastructure they need to benefit from increased market opportunities, and for adjusting to erosions of existing trade preferences stemming from multilateral negotiations.

Acknowledgments

The UN Millennium Project Task Force on Trade gratefully acknowledges the many individuals, institutions, and organizations that assisted it over the course of the project. We wish to express our thanks to Jeffrey Sachs for his leadership, guidance, and unflagging energy. We also wish to acknowledge the support, encouragement, and patience of project manager John McArthur and the Millennium Project Secretariat—and to thank them all.

This report was prepared under the guidance of coordinators Ernesto Zedillo of the Yale Center for the Study of Globalization and Patrick Messerlin of the Groupe d'Economie Mondiale de Sciences Po. The effort was advised by an international task force whose individual and professional expertise contributed in numerous ways to the final product. In addition to helping to develop the report's overall framework, the task force members provided background information, offered comments and analysis throughout the process, and contributed expertise that reflected noteworthy breadth and scope. This group included Mark Allen, Kym Anderson, Drusilla Brown, Eugenio Diaz-Bonilla, Wendy Dobson, Niall FitzGerald, Bernard Hoekman, Veena Jha, Patrick Low, Ricardo Meléndez-Ortiz, Mari Pangestu, Lakshmi Puri, and Harmon Thomas.

The report benefited immeasurably from the skills and expertise of Julia Nielson who graciously took a partial leave from the Organization for Economic Cooperation and Development to serve as a superb content and editing director. The task force thanks Mr. Donald Johnston, OECD Secretary-General, for facilitating Julia's collaboration in this project. We also thank Haynie Wheeler, Associate Director of the Yale Center for the Study of Globalization, the Task Force on Trade project manager, for having carried out her responsibilities with singular efficiency and kindliness.

The task force drew from the research and expertise of many individuals and institutions actively engaged in trade-related issues. We extend our thanks to those who prepared background papers during the initial stages of the report's development. These individuals include Simon Evenett, Christopher Findlay, J. Michael Finger, Douglas Irwin, Timothy Josling, Keith Maskus, Petros Mavroidis, Çaglar Özden, Sherman Robinson, Pierre Sauve, Maurice Schiff, and Alan Winters. Among the meetings and workshops organized by the task force were a series of discussions focusing on some of the more complex and contentious trade-related issues. The task force wishes to thank those who attended these workshops, contributed to the discussion, and provided valuable comments: Jagdish Bhagwati, Daniel Esty, Robert Evenson, Susan Feinberg, Carsten Fink, Penny Golberg, Galina Hale, Koichi Hamada, Michael Keane, Kenneth Kelly, Philip Levy, Will Martin, Walter G. Park, Sherman Robinson, Kamal Saggi, Peter Schott, and T.N. Srinivasan.

Several members of the task force wrote background papers and attended the trade sessions in addition to their other contributions to the project, and these included Kym Anderson, Drusilla Brown, Eugenio Diaz-Bonilla, Bernard Hoekman, and Veena Jha. The task force also wishes to thank Bernard Hoekman for organizing country-level case studies to assess the impact on poverty reduction of potential trade reforms in a small sample of low-income countries and wishes to thank the John D. and Catherine T. MacArthur Foundation for its support in this endeavor.

Abbreviations

ACP	African, Caribbean, and Pacific countries
AGOA	African Growth and Opportunity Act
AMS	aggregate measure of support
APEC	Asia-Pacific Economic Cooperation
ATC	Uruguay Round Agreement on Textiles and Clothing
CAP	Common Agricultural Policy
CARICOM	Caribbean Community (and Common Market)
CCP	countercyclical payment
DDA	Doha Development Agenda
DTI	Department of Trade and Industry
DWP	Doha Work Programme
EBA	Everything But Arms
FAIR	Federal Agriculture Improvement and Reform Act
FDI	foreign direct investment
FSRIA	U.S. Farm Security and Rural Investment Act
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GI	geographical indication
GSP	Generalized System of Preferences
ICT	information and communication technology
IF	Integrated Framework for Trade-Related Technical Assistance to LDCs
IPR	intellectual property right
LDC	Least Developed Country
MDG	Millennium Development Goal
MEA	multilateral environmental agreement

MFA	Multi-Fibre Arrangement
MFN	most favored nation
NAFTA	North American Free Trade Agreement
NAMA	nonagricultural market access
NGO	nongovernmental organization
ODA	official development assistance
ODS	overall trade-distorting domestic support
OECD	Organisation for Economic Co-operation and Development
OIE	International Office of Epizootics
PPM	process and production methods
PRSP	Poverty Reduction Strategy Paper
RTA	regional trade agreement
SDT	special and differential treatment
SPS	Sanitary and Phytosanitary Measures
STE	state trading enterprise
TBT	Technical Barriers to Trade
TIM	Trade Integration Mechanism
TRIMS	trade-related investment measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights
UAA	Uruguay Agreement on Agriculture
UNIDO	United Nations Industrial Development Organization
WCO	World Customs Organization
WTO	World Trade Organization

goals

Millennium Development Goals

Goal 1

Eradicate extreme poverty and hunger

Target 1.
Halve, between 1990 and 2015, the proportion of people whose income is less than $1 a day

Target 2.
Halve, between 1990 and 2015, the proportion of people who suffer from hunger

Goal 2

Achieve universal primary education

Target 3.
Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling

Goal 3

Promote gender equality and empower women

Target 4.
Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015

Goal 4

Reduce child mortality

Target 5.
Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate

Goal 5

Improve maternal health

Target 6.
Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio

Goal 6

Combat HIV/AIDS, malaria, and other diseases

Target 7.
Have halted by 2015 and begun to reverse the spread of HIV/AIDS

Target 8.
Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases

Goal 7

Ensure environmental sustainability

Target 9.
Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources

Target 10.
Halve, by 2015, the proportion of people without sustainable access to safe drinking water and basic sanitation

Target 11.
Have achieved by 2020 a significant improvement in the lives of at least 100 million slum dwellers

Goal 8

Develop a global partnership for development

Target 12.
Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system (includes a commitment to good governance, development, and poverty reduction—both nationally and internationally)

Target 13.
Address the special needs of the Least Developed Countries (includes tariff- and quota-free access for Least Developed Countries' exports, enhanced program of debt relief for heavily indebted poor countries [HIPCs] and cancellation of official bilateral debt, and more generous official development assistance for countries committed to poverty reduction)

Target 14.
Address the special needs of landlocked developing countries and small island developing states (through the Program of Action for the Sustainable Development of Small Island Developing States and 22nd General Assembly provisions)

Target 15.
Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term

Target 16.
In cooperation with developing countries, develop and implement strategies for decent and productive work for youth

Target 17.
In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries

Target 18.
In cooperation with the private sector, make available the benefits of new technologies, especially information and communications technologies

Overview

In September 2000 the UN Millennium Declaration was adopted by all the presidents and prime ministers present at the Millennium Summit, and it was endorsed unanimously by the members of the United Nations General Assembly. It grew out of a set of "international development goals" of 1996 and reaffirmed the commitment of UN members to achieving significant, measurable improvements in people's lives (see the list of Millennium Development Goals on pages xviii–xix).

Millennium Development Goal 8 is the topic for this task force. Fundamental to this Goal is contributing to and upholding an open, equitable, rules-based, predictable, and nondiscriminatory multilateral trading system. Upholding such a system is also important for achieving other Goals. The mandate of this task force is to explore how the trading system can be improved to support developing countries, with special attention to the needs of the poorest of them.

This overview presents our main conclusions and recommendations.

Main conclusions

Trade openness can be a powerful driver of economic growth, which is indispensable to reduce poverty and foster development. Trade, however, is not a silver bullet for achieving development. There is no way around the other institutional, macroeconomic, and microeconomic conditions that, along with well designed social policies, must also be met to attain development. Yet it is very likely that if developed countries open their markets significantly more to developing countries and developing countries also become more open, poverty would fall faster worldwide, including in most of the poorest countries, if the needed complementary policies are in place.

Achieving more open and fair markets for the promotion of development is the mission of the multilateral trading system. This system has evolved

progressively since the end of the Second World War and has delivered impressive results for many countries, particularly those now fully industrialized.

Throughout most of its existence, however, the trading system has mainly served the interests of developed countries. Sometimes by their own decision and other times by explicit exclusion dictated by richer countries, developing countries have not been influential in the design of the multilateral trading system. Moreover, most of the existing multilateral rules, through respective rounds, emulate to a great extent the policies, the practices, and most important, the laws and regulations of a few developed countries.

The system is thus unbalanced against the interests of developing countries. Balancing the system will give developing countries greater economic growth potential, a major stake in developing multilateral trade rules and disciplines and in pursuing trade liberalization, and a more effective capacity to expand trade and defeat poverty.

That balancing goal was the raison d'être of the Doha Development Agenda (DDA) Round of trade negotiations launched in November 2001, at least according to the rhetoric.

But this sense of purpose was short-lived. With key deadlines missed and progress practically nil on every issue contained in the DDA, the WTO Ministerial Conference of September 2003 collapsed amid acrimony. There is no single reason to explain this; however the failure of the US, the EU, and Japan to lead by example is a major one.

WTO Members have since made a courageous effort to revive the Doha Round, but a lot more will be required. The 2004 Doha Work Programme framework, while necessary to prevent the collapse of the Round, is far from sufficient to sustain it.

The real work remains to be done, and a sense of urgency is required if the Round is to be completed by the end of 2006 or very early 2007 at the latest. If this narrow window of opportunity is missed, it is hard to see how the Round can be completed in time to contribute to achieving the Millennium Development Goals by 2015.

All WTO Members must identify the core priorities of a real "Development Round" and make concrete political and financial commitment to achieving them. What must be done in the Doha Round and beyond?

Agriculture—the biggest and costliest aberration

The biggest and most costly aberration of the trading system is to be found in agriculture. Farm producers in rich countries receive support in excess of $250 billion, thanks to which their farmgate prices are almost one-third higher than world prices. Consumers in those countries pay for that protection through higher taxes and higher food prices. It's their choice, but it must be stressed that by doing so they also impose a heavy burden on other agricultural producers, particularly in developing countries. Agricultural protection in both

developed and developing countries is most assuredly a cause of poverty in poor countries.

That rich countries should lead farm liberalization is beyond question. They should deliver substantial liberalization under all three pillars of the agricultural negotiations. They should shift their farm policies to income support—helping the poor and small farmers in rich countries adjust to more open farm markets. Export subsidies should be totally and definitively eliminated, as agreed in the DDA framework of August 2004. This will send a powerful signal to developing countries, which will follow suit with their own deeper market opening without the danger of trade and competition being greatly distorted by export subsidies. Negotiations on farm trade liberalization should also broaden their focus beyond elimination of export subsidies to stress reductions in tariffs—themselves a powerful discipline on export subsidies—and reduction in domestic support. Market access negotiations must address both the unacceptably high peaks (often called tariff peaks) that remain in agriculture and tariff escalation, which continues to frustrate developing country efforts to move up the value chain.

The growth of the poorest countries depends crucially on a more dynamic farm sector—coming from increased domestic production for import substitution and/or exports. The fragility of these countries, however, suggests that, as a result of the Doha Round, they should reduce only their bound tariffs—since most of their applied tariffs are moderate—and also their applied tariff peaks, which cost their poor consumers dearly without bringing public revenue. Additional complications for the few poor countries that may be hurt by this modest liberalization could be dealt with by a substantial increase in international aid—to provide the necessary means for a new wave of Green Revolutions and to ensure adequate food security.

Nonagricultural market access—developing countries should also liberalize

Although not as severe as in farm products, trade barriers in nonagricultural products continue to be significant and particularly detrimental to developing countries. For example, developing countries' exports to developed countries face tariffs that are, on average, four times higher than those faced by the exports of other developed countries. Developing countries' exports suffer from tariff peaks, tariff escalation, and quotas imposed by rich countries on goods of great export potential. Although over the last few decades developing countries have undertaken an unprecedented level of trade liberalization, both on an autonomous basis and in the context of multilateral and regional negotiations, they still suffer, of course, from their own protection, which not only reduces their competitiveness in world markets, but also cancels enormous opportunities of increased trade among themselves.

While developed countries bear a special responsibility to liberalize in this Round, developing countries should also do so—in their own interests

and because they are important markets for each other and for the poorest countries. While still achieving less than full reciprocity, the poorest countries should nonetheless bind their tariffs at uniform and moderate rates in their own development interests. Adjustment costs should be economically and socially sustainable in developing countries, for example, by phasing in tariff reductions and providing international technical and financial assistance.

The Uruguay Round Agreement on Textiles and Clothing (ATC) mandated the progressive phasing out of quotas by January 1, 2005. But phase-outs were heavily backloaded, with more than 50 percent of quotas—covering the most commercially valuable products—left to be removed by January 1, 2005. Backloading robbed developing countries of one of the major expected gains from the Uruguay Round and gave rise to legitimate doubts about the willingness of the major importers to honor the agreement. It also undermined any chance of gradual and orderly adjustment in the sector; the abrupt removal of the remaining quotas on January 1, 2005, may create adjustment problems for importers and exporters alike, and is likely to unleash powerful protectionist forces. These must be effectively contained—for example, by restraining the proliferation of contingency protection measures. The correct answer lies not in pursuing protectionism by other means, but in providing adjustment support to the poorest countries and small suppliers highly dependent on this sector through trade and development measures.

This has led some to call for an extension of quotas, but this would be a mistake. "Temporary" textile and clothing protection has been around for 40 years; continued protection is likely only to prolong and further distort the adjustment process. Addicts always promise that they will quit tomorrow—the difficult process of adjustment must be started now. Given the role that developed countries have played in creating the scale (if not the fact) of the adjustment challenge, they must now be prepared to contribute to covering its costs. Assistance could help developing countries move into niche markets or up the value chain and strengthen their networks of suppliers and clients to meet just-in-time production deadlines. Removal of trade barriers and domestic distortions by developing countries themselves would also help increase competitiveness. Tariff preferences may ease adjustment for some countries in the short term, though restrictive rules of origin will need to be addressed. More helpful and less distortionary temporary breathing space could be provided by all developed countries extending duty-free and quota-free access to all products from the poorest developing countries no later than January 1, 2006.

Services—a major source of gains for developing countries

Liberalization of trade in services, especially of mode 4 (the temporary movement of people to supply services), has been recognized as a major source of gains for developing countries, capable of bringing more benefits to them than perhaps any other part of the Doha Agenda. Services liberalization promises

real development gains—in terms of the efficiency and growth potential of the economy as a whole, the export of goods and other services, and access to basic services to improve the lives of the poor. Done right, services negotiations offer developing countries an opportunity to act in their own economic interest and get paid for it.

But services gains are not automatic, and producing an outcome that supports development can be a challenge, given the need for regulation to address complex issues of market structure, market failures, and noneconomic objectives. Ensuring that services liberalization results in competition and increases access to services by the poor are key regulatory challenges—and will require increased assistance and regulatory creativity. But with appropriate care to the nature, pace, and sequencing of reform, adjustment—including that related to increased imports of labor-intensive services—can be managed.

A serious "Development Round" must make progress on mode 4. Developing countries should seek to expand access for groups of interest to them (such as contractual service suppliers, and intracorporate transferees) and improve the transparency and usability of existing access. Bilateral or plurilateral agreements could also be considered as an interim step. These cover a broader range of workers than mode 4 and provide scope to develop trust and complementary policies, (such as on brain drain, remittance transfer, return, and recognition). Over time, recruitment of workers under these schemes could be opened on a most favored nation (MFN) basis to any country that can implement the requirements. Agreements would be notified to the WTO, and interested WTO Members would have the opportunity to indicate their interest in joining or negotiating similar agreements. An MFN waiver would likely be necessary. Although a potentially useful interim step, bilateral or regional agreements are no substitute over the longer term for bound multilateral commitments under the WTO. WTO commitments remain the best and most effective way to deliver gains to developing countries, and commercially meaningful market access commitments on mode 4 are essential to fulfill the development dimension of the services, and Doha, negotiations.

Keeping markets open—not adding costs and uncertainties with new barriers

Hard-won gains in market access in agricultural and nonagricultural products are increasingly eroded by other policies that recreate trade barriers and/or create transaction costs and uncertainty.

Antidumping is used disproportionately against the exports of developing countries, with a severe chilling effect on their actual and potential trade—though some developing countries are now also becoming major users of antidumping measures. The Doha Round could help in several ways. The *de minimis* threshold below which developing country exports are immune from antidumping could be raised—currently, as soon as imports from developing

countries emerge from being insignificant, they can be restricted by high antidumping barriers. Additionally, national antidumping laws could be required to treat all affected domestic interests—import-competing industries, consumers, and users—equally.

Many developing countries are being denied effective market access by their inability to meet ever more—and ever higher—OECD standards or similar market-entry conditions. Exemptions are unlikely to help, serving only to brand developing country exports as inferior or unsafe, and providing no incentive to raise national standards for the benefit of domestic consumers. Where standards are imposed by private buyers, there is even less scope for—or point in—seeking exemptions. Two things are essential if developing countries are not to be left behind: assistance to make effective use of the Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) disciplines to ensure that standards are not abused for protectionist purposes; and significant assistance to construct the institutional frameworks and infrastructure required to meet legitimate standards. Further, developing countries must be assisted to become more substantively involved in standard-setting processes and those standard-setting activities themselves need to be oriented toward issues of greater interest to developing countries.

Preferences—to be replaced with equivalent development assistance

Rich countries have used preferences to divide developing countries and promote their narrower regional, sectoral, and political objectives, often establishing complicated regulations that exclude exports from otherwise eligible countries. The poorest countries have often received limited benefits from preference schemes, including because preferences do nothing to address their multiple supply-side constraints. Benefits are also often at the expense of other developing countries, and they are smaller than would be the case with either direct transfers or multilateral liberalization. But the price of preferences is continuing protection in rich countries. MFN liberalization—plus appropriate compensation for countries that may suffer adjustment problems—is likely to be a better path.

Although preference erosion is generally less than often thought, some countries may confront possible large losses and will require concrete assistance. Given the history of preference programs, developed countries as a group should pay. They should replace preferences with equivalent development assistance, which could be used by the recipient governments to fund adjustment costs. Operationalizing this deal should be an explicit part of the Doha Round. Any such assistance should be seen as part of a broader effort that is needed to help poor countries build and strengthen their ability to use trade beneficially. However, specifically in the context of a Doha deal, there is a need to accompany global commitments to implement far-reaching trade reforms on an MFN basis with a temporary program to transfer additional

resources to developing countries, especially those that will experience preference erosion losses.

Free trade agreements—imposing high transaction costs

Likewise, free trade agreements have a mixed record in achieving real liberalization, especially on the hardest nuts (such as agricultural subsidies or sensitive products). Benefits may be limited (or achieved at the expense of others) but costs can be high. Unlike at the WTO where developing countries can form effective coalitions, in free trade agreements (FTAs) they are at a disadvantage in resisting the inclusion of nontrade issues or erosion of their WTO rights (such as TRIPS+ on patents, especially pharmaceutical patents, and other WTO+ provisions). Multiple FTAs with differing rules of origin impose high transaction costs, particularly on small traders, and divert the limited negotiating resources of poor countries from the pursuit of multilateral liberalization.

Singapore issues—trade facilitation promises gains

Three out of the four so-called Singapore issues (competition, investment, transparency in government procurement) have rightly been left off the Doha Round. None meets the essential tests of whether rules on regulatory issues should be included in the WTO: Are they trade related? Are they in line with broader development priorities? And what is the specific value of a WTO agreement? These issues are not priorities for poor countries and could divert scarce resources from other issues with higher development payoffs. Even where there are development benefits, they may not be best pursued through a WTO agreement.

Trade facilitation promises trade and development gains, but a WTO agreement cannot be business as usual. It should not impose heavy obligations on developing countries and make light promises of assistance. The main value of a WTO agreement on trade facilitation would be as a mechanism for attracting and channeling international assistance. From a development perspective, the best model is one where implementation deadlines could be customized in negotiations with individual countries (along the lines of GATS precommitments), with technical and financial assistance negotiated and customized as part of a package. A review process, involving expert organizations and other developing countries with similar experiences, could identify problems early, and negotiated extensions would be possible. Flexibility on dispute settlement could be provided by a "peace clause."

Trade-related intellectual property rights—some areas of interest to developing countries

Should intellectual property rights have been included in the WTO? From an economic point of view, probably not, because they require a very delicate

balance of market forces and public action—a balance unlikely to be the same for all countries. TRIPS obligations also tend to be "one size fits all," taking no account of levels of development and varying interests and priorities. While the agreement tries to mitigate this to some extent by providing for differing implementation periods, countries acceding to the WTO may not even have access to these normal flexibilities.

That said, the TRIPS Agreement is not without areas of actual or potential interest for developing countries (although the balance of costs and benefits will vary among developing countries and according to the issue), nor is it without some flexibility in its provisions. However, the flexibility provided for implementation of TRIPS seems yet insufficient on paper, and even more so in practice, and the assistance provided is clearly inadequate. There is a clear case for revisiting more of the rules to determine their impact on developing countries and any additional flexibility required. In other cases, the agreement provides for flexibility, but certain WTO Members—the US on drugs, the EU on geographical indications—are trying to narrow unacceptably the scope of that flexibility.

Special and differential treatment—making it more effective and operational

While it is clear that developing countries benefit from freer trade, it is equally clear that their capacity to do so is different from that of developed countries. Developing countries generally have a more limited ability to take advantage of new opportunities and to bear adjustment costs. Special and differential treatment makes sense and should be made more effective and operational.

There is no compelling case for exemption for rules on traditional trade policies. Additional freedom to use bad policies promises few development gains and risks harming other developing countries (such as subsidy wars). For rules on domestic regulations requiring actual investment of resources, a cost-benefit analysis based on four factors should guide what special and differential treatment to grant and to whom: the extent to which the rules are related to trade (market access), the extent to which they are in line with broader development priorities, the costs of implementation, and the relative costs to others of nonimplementation. Assessments of costs and benefits will vary by issue and the level of development of the country concerned.

Where the costs are high and the trade and development benefits minimal, the issue should not be included in the WTO. Where the costs are high and development benefits only a longer term priority, there is a strong case for extensive—but not eternal—flexibility. Where development benefits are greater or more immediate, a model that calibrates commitments with assistance and gives greater flexibility to countries to determine appropriate implementation periods is appropriate. Where WTO rules promise real and short-term trade and development benefits, concrete technical and financial assistance should be

assured—say, through mandatory commitments subject to review and linked to implementation requirements of developing countries.

Coherence—adopting sound complementary policies and ramping up aid for trade

If trade liberalization is to contribute to economic growth, expanded trade, and poverty reduction, it must be coordinated with other policies at both the national and international levels. At the national level, policy coherence means the adoption of sound complementary policies by national governments to manage liberalization, as well as ensuring that trade policymaking is appropriately informed by expertise across a range of policy areas. At the international level, coherence calls for a significant ramping up of "aid for trade" by the development community (to negotiate, assess, and implement WTO agreements and to design and implement adjustment policies) and for a clear and realistic view of the WTO's role in technical assistance. This assistance for increasingly deeper capacity building must be additional to, and not at the expense of, development aid. Trade liberalization requires international negotiations and international assistance, but its benefits and challenges remain fundamentally a question of domestic economic and policy reform.

Main recommendations

A real development round is achievable but will require some enlightened, albeit self-interested, leadership on the part of the major players in both developed and developing countries. Providing this leadership is not within the realm of trade negotiators' capacities. Political leadership must be generated at a higher level, perhaps not even at the ministerial level but at the head of government level as part of a coherent policy approach—economic, political, and social—to meeting the development challenge.

The year 2005 offers a rare opportunity to harness the broader momentum of the "2000 plus 5" high-level review of the Millennium Summit to seek a major political consensus among the heads of government of a group of 20 or so countries on the Doha Development Round and other topics crucial for achieving the Goals.

Heads of state can agree on the major strategic criteria to shape the multilateral trading system for the future. This grand vision would keep the eyes of negotiators preparing for the Sixth WTO Ministerial Conference, in Hong Kong (China) in December 2005, on the prize of a real development round and the contribution it could make to achieving the Goals.

In this context it is recommended that leaders agree on the following ideals for the future path of the trading system:

- In a conveniently distant long term (2025) the multilateral trading system must deliver the total removal of barriers to all merchandise trade, a substantial and extensive liberalization of trade in services, and the

universal enforcement of the principles of reciprocity and nondiscrimination in a way that supports attainment of the Millennium Development Goals. This target is ambitious but not impossible, with political will and appropriate support for adjustment. And there is a base to build on: Asia-Pacific Economic Cooperation (APEC) economies have already committed to free trade by 2010 for developed Members and 2020 for developing Members.

- The most useful WTO would be one focused solely on trade and relieved of other global economic governance tasks, which could be better accomplished by other international instruments or entities.

Consistent with these criteria, more medium-term targets could be adopted. Greatly increased international technical and financial support for reform and adjustment by developing countries will be needed to ensure the achievement of those targets; in the absence of such assistance, more flexibility would be required. But given the potential benefits, it is in all countries' interests for substantial assistance to be forthcoming to underpin the following targets:

- By 2015, no bound farm tariff should exceed 5 percent for OECD countries, 10 percent for developing countries, and 15 percent for the poorest countries. All nontariff barriers, including tariff-rate quotas, should be removed by 2010.
- As soon as possible and no later than 2010, all export subsidies should be abolished, with comparable disciplines on similar instruments.
- Domestic support (such as price support, direct production subsidies) must be made both less trade-distorting (decoupled from production) and subject to an overall, significantly lower limit. All countries should decouple all support payments to farmers by 2010 and cap all domestic support measures at 10 percent of the value of agricultural production (on a by-product basis) by 2010 and at 5 percent by 2015. The Green Box (of minimally trade-distorting subsidies) should be maintained for the poorest countries—with clarifications or marginal additions such as support for diversification, transportation subsidies for farm products, consumption subsidies for domestic food aid, public assistance for establishing farm cooperatives, or institutions promoting marketing and quality control.
- Developed countries should bind all tariffs on nonagricultural merchandise at zero by 2015, the target date for achieving the Millennium Development Goals. A mid-term target could be for no tariff higher than 5 percent by 2010. Ideally, developing countries should all be at zero tariffs by 2025. As soon as possible, these countries should bind all their tariffs in coherence with their applied rates. The poorest countries should also aim to bind all tariffs at a uniform and moderate rate.
- Duty-free and quota-free access for all exports from the poorest countries should be extended by all developed countries no later than January 1, 2006.

- The liberalization of mode 4 of the GATS (temporary movement of labor to provide services) should be adopted as a high-priority item on the international agenda, considering its potential benefits for both developing and developed countries as well as the need to manage in a more orderly fashion the mounting migration pressures in the world. Developing countries' liberalization to foreign direct investment must be matched by developed country liberalization to foreign labor.
- The traditional approach to special and differential treatment must be revised away from the present, for the most part counterproductive, system of exemptions from obligations and complex webs of discriminatory preferences. A trading system limited only to agreements that are in the trade and development interests of all Members to implement under the framework of binding multilateral trade rules should be accompanied by special and differential treatment that affords appropriately long and flexible conditions to adjust to trade liberalization and real and substantial aid for trade. Poor countries must be supported in generating the sources of revenue needed to compensate for losses incurred as a result of lowering import duties, in building the human and physical infrastructure they need to benefit from increased market opportunities, and in adjusting to erosions of existing trade preferences stemming from multilateral negotiations.
- A temporary "aid for trade fund" commensurate with the size of the task, or significantly ramped-up contributions through such existing channels such as the Integrated Framework, is needed to support countries in addressing adjustment costs associated with the implementation of a Doha reform agenda. Such funding must be additional to current aid flows (and could be financed out of the tariff revenue that is presently collected by OECD and higher income developing countries on imports that will be subject to Doha reduction commitments). A priority task for the development and trade communities could be the identification of new and existing channels through which this additional funding could most efficiently be made available for relevant, targeted projects in developing countries.

Chapter 1

Introduction

In September 2000 the UN Millennium Declaration was adopted by 190 presidents and prime ministers and passed unanimously by the members of the United Nations General Assembly. It grew out of a set of "international development goals" in 1996 and reaffirmed the commitment of UN members to achieving significant, measurable improvements in people's lives (see the list of Millennium Development Goals on pages xviii–xix).

Millennium Development Goal 8 is the topic for this task force. Fundamental to this Goal is contributing to and upholding an open, equitable, rules-based, predictable, and nondiscriminatory multilateral trading system. It is also an important instrument for achieving other Goals. The mandate of this task force is thus to explore how the trading system can be improved to support the development of developing countries, with special attention to the needs of the poorest developing countries.

Why is trade expansion critical for the Goals?

Openness to trade is associated with higher incomes and better economic performance. While there are differences of view about the magnitude and strength of this relationship, the general direction of effect is not in doubt: no closed or isolated economy has performed better than those integrated into the world economy (Irwin 2003) (box 1.1). Openness to trade gives firms and households access to world markets for goods, services, and knowledge—lowering prices, increasing the quality and variety of consumption goods, and fostering specialization of economic activity in areas where countries have a comparative advantage. Trade generates more investment and fosters higher productivity of domestic industries as a result of competition and access to knowledge. Trade is important for generating the positive externalities that are associated with learning through the diffusion and absorption of technology.

Box 1.1

Why openness to trade matters

Source: Irwin 2003.

The share of investment in GDP is positively correlated with growth in per capita income, and trade is positively correlated with investment. Over the period from 1950 to 1998, within-country capital investment as a percent of GDP was 1.9 percentage points higher in a liberalized regime than in a nonliberalized regime. Tariffs and other trade barriers that raise the domestic price of capital goods mean that each investment dollar buys less capital, reducing the efficiency of investment spending. This is harmful to investment and therefore to growth as well: empirical evidence tends to suggest that the free importation of intermediate and capital goods is an effective way of promoting investments that increase growth.

In addition, trade contributes to productivity growth in at least two ways: it serves as a conduit for the transfer of foreign technologies (knowledge and know-how) that enhance productivity, and it increases competition in a way that stimulates industries to become more efficient and improve productivity.

The first channel, where trade serves as a conduit for the transfer of foreign technologies, operates in several ways. One is through the importation of capital goods and equipment. Imported capital goods that embody technological advances can greatly enhance an economy's productivity. To the extent that trade barriers raise the price of imported capital goods, countries are hindering their ability to benefit from technologies that could raise productivity. The second channel by which trade contributes to productivity is by forcing domestic industries to become more efficient. Trade increases competition in the domestic market, diminishing the market power of firms and stimulating them to improve their efficiency; otherwise, they risk going out of business.

Over the past decade, study after study has documented this phenomenon. Detailed analyses of India's trade liberalization in 1991 and the Republic of Korea's trade liberalization in the 1980s reached essentially the same conclusion: trade not only disciplines domestic firms and forces them to behave more like a competitive industry, it also helps increase their productivity. And the higher an economy's productivity, the higher that country's standard of living.

Aggregate economic growth differences have been largely responsible for the differences in poverty alleviation across regions. While the relationship between growth and poverty alleviation is affected by the distribution of income, initiatives that boost economic growth are likely to be helpful in the fight against absolute poverty. Trade liberalization is one such an initiative to boost economic growth.

For all countries, trade is an important source of wealth generation, and can lead to more rapid economic growth. It can generate the foreign exchange that countries need to import essential technologies (such as farming equipment or spare parts for manufacturing). It makes access to these technologies possible, and the absence of trade barriers lowers their cost. These technologies in turn boost the productivity and competitiveness of domestic producers, who also gain from access to larger, wealthier markets abroad. For companies in developing countries, access to other markets can be essential to generate the level of demand necessary to enable them to exploit economies of scale and generate sustained growth. The greater efficiency of local firms also benefits consumers, through significantly lower prices and greater availability of imported goods and services through imports (McCulloch, Winters, and Cirera 2001; Oxfam 2002).

Policies that shelter the economy from the world market impede these spillover benefits and dynamic gains (see box 1.1). Of course, such gains are not automatic and depend upon appropriate complementary policies. Also important are "fundamentals" that determine the incentives for firms to invest in a specific country. The business environment, the quality of infrastructure, education and training, and the labor force, among other factors, will play an important role in determining the relative costs of production and the competitiveness of firms.

Domestic policy settings are key determinants of the conditions for markets to develop. In many developing countries, private sector growth faces a range of impediments. Complex or poorly enforced regulations affecting the entry of new firms (for example, registering a firm in Angola takes 146 days and costs more than 8 times the average per capita income) and their operation (such as complex tax codes that discriminate against smaller firms) and barriers (high costs) to exit of firms inhibit private sector growth and entrench the informal economy. Trade liberalization may do little to stimulate growth in economies with limited competition or distorted capital and labor markets—increased openness to trade is positively correlated with income in all countries, but is associated with a lower standard of living in economies that heavily regulate new entry or impose high costs on restructuring (Bolaky and Freund 2004).

The absence of laws—for instance, of bankruptcy laws to facilitate orderly exit—can also stifle entrepreneurship and deter investment. The creation of an enabling environment for markets to develop requires the rule of law (both an appropriate set of laws, in particular for protecting property rights and resolving contractual disputes, and the fair and effective enforcement of those laws), as well as investment in the basic infrastructure that underpins the whole economy (energy, roads, water, and telecommunications, as well as health and education) (UNDP 2004b). Inserting developing countries into global production and supply chains also requires improving the quality of products, upgrading the technological and skill content of export activity, expanding the base of domestic firms able to compete internationally, and developing links with global production and distribution networks (UNCTAD 2003c).

Increased trade is an important instrument—not a goal in itself. More trade will not necessarily result in expanded national income or poverty reduction—this is a function of the whole set of the economic, social, and political conditions that influence development. In moving toward a more open trade regime, adjustment costs also need to be taken into account. While more trade and specialization will help increase aggregate real income over time, some groups in society will lose in the short run, and others may confront a permanent reduction in expected income. Measures to safeguard the interests of poor households are particularly important in the design of policy reform.

Furthermore, trade performance and the gains from trade enjoyed by a country also depend on what trading partners do. Foreign market access restrictions

may lower (raise) the prices of exports (imports) and have negative effects on the terms of trade, the incentives to investment, and the growth potential of developing countries. That is, international policy settings also matter. For developing countries to benefit from their comparative advantage (low labor costs, resource endowments) and expand their trade, the restrictions and barriers to their exports of goods and services must be removed—along with anticompetitive practices and distortions in key sectors such as agriculture and services.

Developing countries and trade

During the past 50 years growth in world trade has outpaced growth in world GDP—in the last 20 years by a factor of two—and exports now represent almost one-fifth of global GDP (Oxfam 2002). Exports have grown faster than GDP in most developing regions, with the share of trade in GDP increasing between 1992 and 2002 by 7 percent for developing countries and 10 percent for low-income countries. Exports now account for more than one-quarter of GDP in developing countries, and the developing country share of global trade has increased from one-fifth to one-quarter over the last decade. Part of this rise has been in manufactured goods, exports of which from developing countries rose at 12 percent a year between the mid-1980s and 2000, with exports of high-technology goods increasing at more than 20 percent a year over the same period (Oxfam 2002).

A similar picture emerges for foreign direct investment (FDI) over the same period, with very large increases in the ratio of stocks of FDI to GDP in

Table 1.1

Inward and outward stocks of foreign direct investment as a percentage of GDP, selected years

Source: Adapted from UNCTAD 2003e, table B.6.

Region/economy	1980	1985	1990	1995	2000	2001	2002
Least Developed Countries							
Inward	3.1	4.1	4.9	9.9	19.6	21.8	23.4
Outward	0.6	2.6	1.1	1.9	2.6	2.5	2.5
Developing countries							
Inward	12.6	16.4	14.8	16.6	31.1	33.4	36.0
Outward	3.8	3.8	3.9	5.8	12.9	12.8	13.5
Developing countries, minus China							
Inward	13.5	18.3	15.6	16.1	30.9	33.4	36.0
Outward	..	4.4	4.3	6.3	15.1	15.1	16.1
Developed countries							
Inward	4.9	6.2	8.2	8.9	16.5	17.9	18.7
Outward	6.2	7.3	9.6	11.3	21.4	23.0	24.4
World							
Inward	6.7	8.4	9.3	10.3	19.6	21.2	22.3
Outward	5.8	6.6	8.6	10.0	19.3	20.4	21.6

both developing and Least Developed Countries (LDCs) (table 1.1). Increases have occurred in all developing regions (Africa, Latin America and the Caribbean, Asia and the Pacific), and are significant even without China. Between 1980 and 2002 inward stocks of FDI for developing countries increased from approximately $307 billion to some $2.3 trillion, and for LDCs from approximately $3.4 billion to $46 billion (UNCTAD 2003f). Developing countries are also a growing source of investment. Outward stocks more than tripled as a percentage of GDP between 1980 and 2002. For LDCs, the percentage, while much smaller, quadrupled over the same period.

Underpinning this growth in trade and FDI has been significant liberalization in recent decades by both developed and developing countries. However, barriers in many countries remain high, especially for goods and services in which developing countries have a comparative advantage, such as agriculture and labor-intensive manufactures and services. The gains from removing these barriers would be substantial.

Estimates of the gains from liberalization vary according to the assumptions used.[1] For instance, the World Bank (2003a) has estimated gains from deep liberalization of goods trade (services are not included) as $520 billion for the world in 2015 in 1997 dollars and $350 billion for low- and middle-income countries. It estimates that this should reduce the number of people living on $1 a day by 61 million and those living on less than $2 a day by 144 million.[2] Factoring in dynamic gains, this reform would boost GDP growth rates for developing countries by one-third—from 4.6 percent to 6.1 percent in 2015 (Anderson 2004). Other estimates suggest that the dynamic gains from trade liberalization will increase developing countries' income by approximately 3 percent to 5 percent of their GDP by 2010–15, allowing for a period of adjustment (the static gains are smaller, ranging from 1 percent to 2.5 percent) (Cline 2004).

It should be stressed that these are potential gains. As noted above, their realization is conditional on an environment that allows the associated movements of labor and capital across sectors to occur, that encourages the needed investment in new sectors of activity, and that provides the vulnerable with some assurance that they will be assisted if necessary. Insofar as these conditions are not met, complementary domestic reforms need to be implemented prior to and in conjunction with the global trade reforms. Analysis of the prospective impacts of global reforms at the national level is therefore important. As illustrated in the LDC case studies that were undertaken for this report, global reforms, while potentially helping many of the poorest in society, may also impact negatively on poor households, depending on their circumstances and initial conditions. Policy needs to be designed to offset to the extent possible any major negative impacts a global reform may have on a substantial part of the more vulnerable in society. Some governments will have the capacity to redistribute some of the local gains from global reforms, while others may confront much greater constraints. The industrial countries have an important

role to play in designing a set of global reforms that will maximize the positive impact on poverty reduction—both in terms of their own reforms and the "policy space" that may be required for poor trading partners—and putting into place a parallel effort to provide poor countries with financial assistance to address adjustment costs.

The country case studies, as well as recent research assessing the likely global impacts of alternative Doha Round outcomes, also reveal that that the above-cited potential beneficial effects of a round on poverty are very much conditional on an ambitious outcome. Less ambitious scenarios are unlikely to generate a significant impact. While this means that adjustment costs will be small, most likely negligible for poor countries, the same is true of benefits (box 1.2).

Box 1.2

Impacts of a "limited" Doha Round

Source: Hoekman, Nicita, and Olarreaga 2004.

What would be a Doha Round outcome that seems plausible today? The July 2004 World Trade Organization (WTO) negotiations suggest that eliminating export subsidies on farm products could be agreed. Concerning tariffs, past rounds have varied in terms of reductions in protection, but often have aimed for average cuts of one-third or less in the average level of protection. However, it must be underlined that WTO negotiations focus on the level of tariffs commitments, not on applied rates of protection. This is crucial in the Doha Round context because bound tariffs on farm products are often very high—hence, cuts may affect bound tariffs while leaving applied tariffs largely unchanged.

As a result, a plausible Doha Round outcome could be as follows: all agricultural support and bound tariffs in agriculture and manufacturing would be cut by 40 percent, farm export subsidies would be eliminated, and trade facilitation would be improved (it is assumed that it would bring developing countries halfway toward an average index of facilitation [see chapter 9] developed by Wilson, Mann, and Otsuki 2003). It must be underlined that this outcome is very limited. A 40 percent cut in bound tariffs will lower the average applied most favored nation (MFN) tariff rate in the world only from 10.8 percent to 9.5 percent; it will have no implications for average tariffs in many low-income countries, and, as a result, it will have small effects on world prices of the products that are of greatest importance from a poverty perspective (the goods that poor households either consume or derive income from) such as food products or garments. Moreover, the focus of the current negotiations on farm export subsidies is misplaced because the key instrument for seriously improving market access remains tariff cuts (chapter 3).

Global welfare gains from such a limited Doha Round outcome may be in the range of $50 billion, of which 40 percent would accrue to developing countries. Low-income countries would obtain $2.3 billion, and the poorest countries $0.8 billion—or 1.7 percent of the potential global gains.

This result suggests two observations. First, it underlines the necessity, if one wants to get a development-friendly Doha Round, to obtain a much better outcome from the WTO negotiations than the one described here. As a matter of comparison, if all barriers were removed, estimated gains would be 10 times larger for the world as a whole. Second, developing countries could still get substantial benefits from a limited Doha Round if they enforce domestic complementary policies (box 3.6). In other words, the more limited the outcome of the Doha Round, the more developing countries will have to rely on their own domestic policies. However, even a limited Doha Round offers a useful focal point to pursue domestic reforms and to mobilize the additional resources that are needed to implement them.

The World Trade Organization

Given that multilateral trade negotiations under the auspices of the World Trade Organization (WTO) are currently under way, it seemed appropriate for this report to focus primarily on the WTO and the role that the trading system can and should play in supporting development. Given the positive association between trade openness, growth, and poverty reduction, the focus of the WTO on reducing barriers to trade makes it a useful instrument from a development perspective.

The WTO was born in 1995, as part of the outcome of the Uruguay Round of trade negotiations. The Uruguay Round was the eighth round of negotiations held under the auspices of the WTO's predecessor, the General Agreement on Tariffs and Trade (GATT). The GATT emerged as part of the post–World War II international architecture to provide a framework for countries to manage their trade relations, including to help prevent a repeat of the disastrous experience of the Great Depression, and the discriminatory system of managed trade and "beggar thy neighbor" exchange rate devaluations that helped to create it. The establishment of the WTO almost 50 years later reflected the increasing complexity of the trade agenda and the desire to create a permanent forum for the negotiation of trade and the effective settlement of trade disputes—and a set of trade policy-related disciplines that are firmly based on the principle of nondiscrimination.

The creation of the rules-based trading system reflected the post–World War II consensus that trade relations should be based on rules agreed by countries, and reinforced by institutions for cooperation, rather than on the exercise of raw power. Good rules constrain the powerful and protect the weak; they make both better off. However, there are clearly some limits to the ability of sound rules and institutions to compensate for the inequalities between nations. In this sense, the WTO shares both the strengths and weaknesses of other parts of the postwar global architecture, including the United Nations. To remain effective and appropriate, rules must also evolve to reflect the changing global economy—and the changing membership of the trading system.

Unlike its predecessor, the GATT, which was formally a provisional agreement and functioned essentially as a contract between countries, the WTO is a full-fledged international organization with 148 Members. A key feature of the WTO, perhaps inherited from the contractual nature of the GATT, is the extent to which it is member-driven. All trade rules and agreements are initiated and negotiated by the Members; the WTO Secretariat has no right of initiative or power to interpret WTO agreements. All decisions in the WTO are taken by consensus—although the WTO Agreement technically provides for voting where consensus cannot be reached, on the basis of one Member, one vote, in practice only consensus is observed.

The substantive rules of the WTO are listed in 23 multilateral trade agreements, all of which are mandatory for all WTO Members. Most of these

agreements relate to trade in goods. Three framework agreements dealing with trade in goods, services, and intellectual property rights (respectively, the General Agreement on Tariffs and Trade—GATT; the General Agreement on Trade in Services—GATS; and the Agreement on Trade-Related Aspects of Intellectual Property Rights—TRIPS) provide an overall structure. All the agreements are enforced through transparency, consultation, and dispute settlement mechanisms.

The GATT covers trade in all goods, with the exception of agriculture and textiles, currently the subject of separate agreements. The exclusion of two key sectors of developing country export interest from the general rules for trade in goods has been the source of much bitterness. The exclusion matters—for instance, while the GATT in principle forbids the use of both quantitative restrictions (numerical limits or quotas) on imports and export subsidies, quotas are still permitted in textiles trade, and export subsidies remain in use in agriculture. This anomaly has ended for textiles, which were due to be brought under GATT rules by January 1, 2005. However, whether agriculture should continue to be treated differently from trade in other goods remains a hotly contested issue among WTO Members.

Other agreements affecting trade in goods (and which take precedence over the GATT) include those on sanitary and phytosanitary measures, technical barriers to trade, industrial subsidies, contingent protection (antidumping, safeguard, and antisubsidy actions), import licensing, trade-related investment measures, and a range of customs issues (such as preshipment inspection, customs valuation, and rules of origin).

The GATS is a framework agreement for trade in services covering all services, barring certain types of air-traffic rights and services supplied under the exercise of government authority. While there are some general disciplines, such as transparency and most favored nation (MFN) status, under the GATS, WTO Members can negotiate which service sectors they open to foreign suppliers and the conditions under which they do so. This is in contrast to the GATT and other rulemaking multilateral trade agreements where market opening and other rules cover trade in all goods (bar agriculture and, until the end of 2004, textiles).

The TRIPS Agreement requires WTO Members to protect six types of intellectual property, including patents, copyrights, and trademarks. Whereas the GATT and GATS mostly consist of general principles that constrain Members, such as MFN status, TRIPS establishes specific standards. For instance, patent protection is to be provided for almost all inventions and is to be at least 20 years in duration from the date of filing. TRIPS also requires Members to ensure that enforcement procedures are available under their national laws, permitting effective action against any act of infringement of rights.

Two plurilateral trade agreements, on government procurement and trade in civil aircraft, apply only to Members that have joined these agreements.

Broadly speaking, three basic principles underlie the trading system: transparency, nondiscrimination, and reciprocity (although reservations apply to this last principle with regard to developing countries, as is discussed further below). These three principles are central to the benefits countries hope to gain in becoming Members of the WTO (box 1.3).

Transparency

Transparency is a basic principle found in all WTO agreements. Generally, Members are required to make a wide range of information on their trade-related policies available to the public at large, through publication or similar means at the national level. In many instances, Members are also required to inform other WTO Members of their policies—in particular new or changed policies—through notification to the WTO. WTO Members may also seek information from each other regarding matters covered by WTO agreements at any time.

Box 1.3

Benefits of the multilateral trading system for developing countries

- Economically sound and legally fair multilateral rules protect the weaker players from the protectionism of the strong and help to create a more level playing field for trade—say, for example, by banning export subsidies in industrial sectors (more easily or massively used by rich countries) or "voluntary" export restraints (more easily imposed on others by large economies).
- The most favored nation (MFN) principle protects smaller players by preventing larger players from carving up world markets among them. MFN spreads the benefits of deals made between major players to all members of the trading system. It also prevents countries from using trade to punish or reward individual countries for political reasons.
- Sound rules give predictability to world trade, enabling necessary investments to be made by traders and investors.
- Sound multilateral rules reinforce domestic reform efforts and provide a means of locking in reforms and undermining pressures for policy reversal by powerful vested interests. As certain interests have more influence in politics than value in economics, the domestic political process will sometimes choose import protection even when it does not serve the national economic interest—hence the value of international obligations in the making of national trade policy.
- The trading system can facilitate the process of liberalization by providing a forum for mutual exchange of "concessions." While many economic gains come from unilateral liberalization, exchanges of concessions can help to overcome political obstacles to reform by providing counterbalancing gains to losses suffered by particular groups.
- The transparency requirements of the trading system not only facilitate trade but help to promote good governance of trade policy by requiring countries to make information on trade-related policies publicly available—and hence contribute to global good governance.
- The trading system provides for the settlement of trade disputes in an orderly process of negotiation and adjudication, rather than by sheer weight of economic or trade power alone.

Nondiscrimination

The basic requirement of the GATT is that trade policies be nondiscriminatory. Nondiscrimination is reflected in two core rules. First, the MFN rule requires that Members not discriminate between like products originating in different trading partners. Rough shorthand for "treat all nations as well as you treat your most favored nation," the rule requires that treatment granted to products from one country be granted to like products from all WTO Members. Second, the national treatment rule requires that once a good has entered into the territory of a country it is subject to the same treatment as like products produced domestically (it is entitled to the same treatment as like national products).

Nondiscrimination principles also extend to measures affecting trade in services under the GATS. MFN—in this case the requirement to treat like services and service suppliers from all other WTO Members as well as you treat those from your most favored country—is a general obligation, although countries had a one-off opportunity to claim exemptions from MFN at the time they joined the GATS. However, national treatment obligations (the requirement that a WTO Member extend to like services and service suppliers from other WTO Members treatment no less favorable than that accorded to its own national services and service suppliers) are qualified; WTO Members may maintain discriminatory measures provided they indicate those they are maintaining in their market-opening commitments. That is, each GATS member decides (negotiates) which service sectors will be subject to national treatment, and what measures that violate national treatment will be kept in place for that sector.

Reciprocity

Reciprocity is the engine of the WTO, reflecting a desire to limit the scope for free-riding that may arise because of the MFN rule and the desire to obtain "payment" for trade liberalization in the form of better access to foreign markets. Reciprocity is not an economic necessity—a country gains overall from unilateral liberalization. But it is a political necessity: as different groups within the society win and lose, the existence of a forum for bargaining facilitates the political management of liberalization by enabling gains to national exporters to be used to offset losses to other groups. Reciprocity can thus help to overcome the power of vested interests resisting liberalization and domestic reform.

Reciprocity is also at the heart of the notion that trade agreements must reflect a balance of rights and obligations, a package under which all parties gain. However, in view of their different capacities to implement and benefit from trade agreements, concepts of nonreciprocity or special and differential treatment for developing countries have also become increasingly important principles of the system.[3] The extent to which reciprocity or nonreciprocity—and the ensuing balanced package—has operated in practice is discussed in the following section.

Developing countries in the WTO

Developing countries in the GATT/WTO have sought to limit the reach of reciprocity by seeking special provisions in their favor known as "differential and more favorable treatment." Such special and differential treatment, as it has come to be known, applies to all developing countries. As a general rule, developing countries in the WTO self-select—that is, they nominate their own status as developing. Within developing countries, LDCs generally benefit from additional favorable treatment. LDC status is determined by the United Nations (appendix 1).

Special and differential treatment (SDT) provisions in the WTO span three main areas: market access, exemptions, and technical assistance. For market access, two kinds of provisions apply. First, developed countries can grant trade preferences to developing countries (that is, apply lower tariffs on goods exported from developing countries), which would otherwise be forbidden by the MFN rule. Second, other SDT provisions related to market access provide freedom for developing countries to make fewer or lesser market opening commitments than developed countries in trade negotiations (nonreciprocity). Other SDT provisions take the form of exemptions or deferrals from some WTO rules. For example, developing countries may have additional time to implement WTO Agreements (such as transition periods for implementation of the TRIPS Agreement), or may not be subject to certain provisions (for example, developing countries with a GNP of less than $1,000 per capita are exempt from the GATT prohibition on export subsidies, and thus are free to subsidize their merchandise exports if they wish). Finally, a number of SDT provisions relate to the provision of technical assistance by WTO Members to assist developing countries with the implementation of WTO agreements.

These three types of SDT are not equal, however. Only some—such as exemptions from certain provisions of WTO Agreements or extended time periods for implementation, and the scope to undertake fewer market opening commitments—are legally enforceable. Provisions relating to technical assistance are "best endeavors"—that is, WTO Members are not legally obliged to provide such assistance, they are simply encouraged to make their best endeavors to do so. Similarly, the granting of trade preferences to developing countries is permitted by the trading system but is not obligatory, and these preferences can be subject to additional conditions or can be unilaterally withdrawn by the granting country at any time. In sum, only exemptions and more limited market opening can really be thought of in WTO terms as a right; preferences and technical assistance are essentially conditional upon the goodwill of other WTO Members.

Even this limited special and differential treatment came at a price. First, exemption from WTO rules and market opening requirements meant that the trading system did not provide any impetus for developing countries to carry out their own liberalization, or any support for the development of sound trade

policies. Second, their lack of obligations under the system (nonreciprocity) undermined developing countries' ability to influence the process and to make demands of others. The fact that, in terms of both their number and activism, most developing countries are latecomers to the multilateral trading system helps in part to explain why many present WTO rules predominantly reflect the interests of rich countries. The special treatment for agriculture and textiles is the clearest example of this—the permissive approach to subsidies in agriculture compared with other goods reflects the use of these subsidies by many developed countries. The same is true for import quotas in textiles (it is also a good example of how carve-outs from the rules do not help the development of sound trade policies in the developed countries concerned). More recently, the inclusion of far-reaching rules on the protection of intellectual property rights has strengthened perceptions that the WTO contract is unbalanced.

If an important benefit of the trading system is the governance of trade relations by the rule of law rather than the law of the jungle, then it is critical that those rules not be antithetical to the interests of developing countries. However, developing countries are increasingly questioning the extent to which the trade rules embodied in the WTO serve their development interests or take account of the particular challenges and constraints they face in integrating into the global economy and pursuing their development strategies.

Although the Uruguay Round saw the active participation of developing countries in the system for the first time, many are now expressing disappointment with the outcome of that round, arguing that the expected benefits have not materialized, while the obligations of implementation have exceeded both expectations and available resources. At the turn of the millennium, developing countries were vocal in their criticisms of their treatment in the WTO (box 1.4).

The Doha Development Agenda

Against this background, it is not surprising that many developing countries did not initially support the launch of a further round of negotiations. Implementation of the Uruguay Round was costly and unfinished, expected market access benefits had not materialized, and there was a strong feeling that the rules were unbalanced. But much as these problems made developing countries wary of new negotiations, they also proved intractable in the absence of negotiations.

Backdrop to the new round

As mandated under the Uruguay Round "built-in agenda," negotiations on agriculture and services commenced on January 1, 2000.[4] These negotiations held some interest for developing countries, in particular to correct the imbalances of the Uruguay Round: in agriculture, to try again to reduce developed country agricultural protection, and in services, to improve access for temporary

Box 1.4

Major shortcomings of the multilateral trading system for developing countries

- Market access gains from the Uruguay Round—especially in areas of real interest to developing countries (such as agriculture and textiles)—never materialized. Where limited access was achieved, it was undermined by subsidies and contingency protection actions such as antidumping measures and safeguards.
- While market-opening commitments are binding and enforceable, special and differential treatment provisions aimed at assisting developing countries (technical assistance, preferential access) tend to be "best endeavors," or subject to unilateral and discretionary implementation.
- Rules reflect the priorities and needs of developed countries more than developing countries (for example, export subsidies are permitted for agriculture, but not industrial products). Further, rules—such as trade-related aspects of intellectual property rights (TRIPS) and trade-related investment measures (TRIMS)—can constrain the policy flexibility of developing countries to use instruments arguably used by developed countries at comparable stages of their development. As the WTO agenda goes deeper into regulatory issues, the fear of imposing one-size-fits-all rules on developing countries at pivotal stages of their development increases.
- Insufficient attention has been paid to the enormous demands on developing countries in implementing the outcome from the Uruguay Round. Agreements related to intellectual property, customs valuation, technical barriers to trade, and agricultural food safety have been particular targets of criticism in this regard.
- The use of retaliation as the final sanction for noncompliance in the dispute settlement system is unfair to smaller developing countries whose capacity to inflict painful retaliation upon a noncomplying trading partner is extremely limited.
- Developing countries are at a disadvantage in representing their interests and participating effectively in the negotiations due to resource constraints. Many developing countries have small delegations; some are not represented in Geneva at all. The depth of technical expertise in capital might also be limited, with a few overstretched staff covering an increasing array of ever more complex negotiations, including at the regional level.

movement of people as service suppliers. However, it rapidly became apparent that these negotiations would make little progress in the absence of broader tradeoffs.

Developing countries had also raised a long list of issues related to the implementation of Uruguay Round agreements. These related to both the need for greater assistance to implement the agreements and to dissatisfaction with the substance of the agreements themselves, which were argued to be both insufficiently supportive of development and overly restrictive in limiting the policy space available to developing countries (see box 1.4). This list included calls for changes to, or interpretations of, existing agreements to "rebalance" the Uruguay Round outcome. However, developed countries argued that many of these proposals were tantamount to renegotiation of the agreements—something which could only take place in the context of a broader round of negotiations.

Developing country agreement to a new round thus emerged from the growing realization that a new round of negotiations was the only realistic route

for rebalancing the Uruguay Round outcome—agricultural market access and subsidy reform, changes to existing rules, making SDT more effective, and improved market access for temporary movement of natural persons to supply services could not be achieved outside of a new round. While eventually supporting the launch of a new round, developing countries were determined to see their interests placed at the heart of the agenda.

This determination, and the growing activism and engagement of developing countries in the trading system since the Uruguay Round (with their "positive agenda"), led to the Doha Round of trade talks being termed the Doha Development Agenda. While the Doha Declaration signaled recognition of a problem by the broader WTO membership, there were no shared perceptions on how to solve that problem, or on what the precise "development" dimension of the Doha Development Agenda would be.

The original Doha mandate

The Doha Agenda agreed at the Ministerial Conference in 2001 spans market access, existing rules and proposals for new disciplines, enforcement, and SDT for developing countries, including technical assistance and capacity building. The market access–related policy agenda goes beyond tariffs and tariff quotas and spans trade-distorting subsidies in agriculture, so-called "contingent protection" (antidumping and safeguards), and the reduction of restrictions on trade in services. The Doha Agenda includes negotiating mandates on some issues and, for others, mandates continuing study with progress reports or recommendations to future ministerial conferences (box 1.5).

The wealth of references to developing country concerns in the Declaration masked a lack of agreement on the real development priorities of the Doha Agenda. Developing countries had a range of specific priorities under the heading "development," varying according to their trade and development needs and interests. For some, the emphasis was on achieving real and significant gains in market access—first and foremost in agriculture, but also in textiles and temporary movement of natural persons to supply services. For others, the focus was on securing broad exemptions from any new commitments, as well as significantly improved assistance to build their capacity to participate in both trade and trade negotiations. Most developing countries remained skeptical about the development benefits of the Singapore issues and, following the experience of the Uruguay Round, wary of launching negotiations in areas where the future scope of an agreement was unclear and the implementation costs potentially high.

These differences were mirrored in developed countries, some of which also saw the development dimension as resting chiefly with market access gains—but often with a greater emphasis on liberalization by developing countries than on a reduction of their own protection in sectors of developing country export interest. Others viewed the development dimension as being largely

Box 1.5

What's in the original mandate of the Doha Agenda?

Source: WTO 2001b, 2001c, 2001d.

Implementation-related issues and concerns—50 measures clarifying WTO Members' obligations in a range of agreements (agriculture, subsidies, textiles and clothing, technical barriers to trade, trade-related investment measures, and rules of origin) were adopted in the Decision on Implementation-Related Issues and Concerns. Other outstanding implementation issues are an integral part of the Doha Work Programme, dealt with either under relevant specific negotiating mandates or as a matter of priority by the relevant WTO bodies, which must report to the Trade Negotiations Committee by the end of 2002 on appropriate action.

Agriculture—without prejudging the outcome, mandates comprehensive negotiations aimed at substantial improvement in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support. Special and differential treatment is to be an integral part of all elements of the negotiations and nontrade concerns are to be taken into account. Negotiating modalities are to be agreed by March 31, 2003.

Services—confirms the negotiating guidelines already agreed by the Council for Trade in Services. Deadlines set for initial requests (June 30, 2002) and initial offers (March 31, 2003).

Nonagricultural market access—negotiations shall aim to reduce or as appropriate eliminate tariffs, including tariff peaks, high tariffs, and tariff escalation, as well as nontariff barriers, in particular on products of export interest to developing countries. Product coverage shall be comprehensive and without a priori exclusions. Negotiations shall take full account of the special needs and interests of developing country and Least Developed Country participants, including through less-than-full reciprocity in reduction commitments.

TRIPS—negotiations for the establishment of a multilateral system of notification and registration of geographical indications for wines and spirits. Under the implementation agenda, the TRIPS Council will address the extension of higher geographical indication protection to other products, as well as the relationship between TRIPS and the Convention on Biological Diversity and the protection of traditional knowledge and folklore. A separate decision mandates the TRIPS Council to find a solution to the difficulties faced by WTO Members with no or insufficient pharmaceutical manufacturing capacity in using the compulsory licensing provisions of the agreement.

Singapore issues—named after the venue of the First WTO Ministerial Conference in 1996, they are trade and investment, trade and competition, transparency in government procurement, and trade facilitation. Negotiations are to take place after the Fifth Ministerial Conference on the basis of a decision to be taken, by explicit consensus, on modalities of negotiations.

WTO rules—negotiations to clarify and improve disciplines on antidumping subsidies and countervailing measures (preserving the basic concepts, principles, and effectiveness of these agreements, their instruments, and objectives, taking into account the needs of developing and least developed participants); fisheries subsidies, taking into account the importance of this sector to developing countries; and regional trade agreements, taking account of the developmental aspects of these agreements.

Dispute settlement understanding—improvements and clarifications to be agreed by May 2003.

Box 1.5

What's in the original mandate of the Doha Agenda?
(continued)

Trade and environment—negotiations, without prejudging their outcome, on the relationship between existing WTO rules and specific trade obligations in Multilateral Environmental Agreements (MEAs); procedures for information exchange between MEA secretariats and relevant WTO committees, and criteria for observership; and the reduction or, as appropriate, elimination of tariff and nontariff barriers to environmental goods and services. Work programs to explore the effect of environmental measures on market access (especially for developing countries and LDCs); TRIPS; and environmental labeling, with recommendations to the Fifth Ministerial Conference on future action, including the desirability of negotiations.

Electronic commerce—maintain the current practice of not imposing customs duties on electronically delivered products until the Fifth Ministerial Conference. This refers to products that are both ordered and delivered online; products ordered online but delivered in physical form through regular channels attract the normal tariff.

Examination of issues relating to trade of small economies (recommendations for action to the Fifth Ministerial Conference)—trade, debt, and finance; and trade and technology transfer (both reporting on progress to the Fifth Ministerial Conference).

Technical assistance and capacity building—core elements of the development dimension of the trading system. Support for mainstreaming of trade in national economic development plans and poverty reduction strategies. Priority for technical assistance to small, vulnerable, and transition economies and those not represented in Geneva. Need for coordination among bilateral donors. Director-General to consult with relevant agencies, donors, and beneficiaries on ways of enhancing and rationalizing the Integrated Framework for Trade-Related Technical Assistance to LDCs (IF) and the Joint Integrated Technical Assistance Program. Mandates development of a plan to ensure longer term funding of WTO technical assistance at an overall level no lower than that of the current year and commensurate with the activities outlined in the Doha Agenda. Reaffirms specific commitments to provide technical assistance in various parts of the Doha Agenda and instructs the Director-General to report on the implementation and adequacy of these commitments at the Fifth Ministerial Conference.

Least Developed Countries—commit to the objective of duty-free, quota-free market access for products originating from LDCs and to considering additional measures for progressive improvements in market access for LDCs. Work to facilitate and accelerate negotiations with acceding LDCs. Urged to significantly increase contributions to the IF Trust Fund and WTO extrabudgetary trusts funds for LDCs. Explore enhancement of the IF. Director-General, in coordination with heads of other agencies, to report to the Fifth Ministerial Conference on all issues affecting LDCs.

Special and differential treatment—review all provisions with a view to strengthening them and making them more precise, effective, and operational.

confined to preferential market access for the poorest developing countries and increased technical assistance and capacity building for the implementation of WTO obligations. Expectations on all sides were high, but differing—on the extent of market access that would be offered and by whom, and on the level and purpose of trade-related technical assistance.

Throughout 2002–03, the story of the Doha Agenda was one of missed deadlines and mounting frustration. The March 31, 2003, deadline for the agreement on the modalities for the agriculture negotiations passed without agreement.[5] No progress was possible until the European Union agreed internally on the latest reform of its Common Agricultural Policy (CAP), which did not occur until June 2003. However, this reform proved underwhelming and provided little impetus for the talks (chapter 3). In July 2003, in an effort to break the stalemate, members requested the EU and U.S. to come up with a joint proposal on agriculture. As in the Uruguay Round, many members expected that the U.S. would push the EU in the direction of liberalization. However, this did not happen. Instead, the U.S. moved toward the EU position. When their joint proposal emerged in August 2003, it surprised and dismayed many as a minimalist text that largely served to preserve the existing protection in both parties. The EU–U.S. deal not only failed to move the negotiations forward, but contributed to a growing climate of mistrust in the negotiations.

The absence of progress on agriculture, widely viewed as the key promise of the "development" round, obstructed progress on other issues. The deadline for agreement on negotiating modalities for nonagricultural products (the same date as for those for agriculture) was similarly missed. For many countries, the difference between the level of ambition in the U.S. and EU proposals for reductions in protection on agricultural and nonagricultural products was all too stark. Discussions on the review of special and differential treatment provisions and a range of outstanding implementation concerns also remained near a stalemate, with agreement looking possible on less than a third of the approximately 120 proposals tabled. Views on the Singapore issues likewise remained far apart. The web of deliberately interlinked deadlines established in the Doha Agenda was rapidly degenerating into gridlock.

Another critical deadline, December 2002 for TRIPS and access to medicines, also passed without agreement. This issue—allowing developing countries with little or no manufacturing capacity in pharmaceuticals to make use of special procedures under TRIPS to import patented medicines under compulsory licenses—captured public attention and became one of the tests of whether the Doha Agenda was fulfilling its development promise. Agreement was eventually reached on August 30, 2003, when the U.S. dropped its objection to a compromise text first agreed by all other WTO Members nine months earlier, but by then it was too late to generate much goodwill or to lighten an atmosphere soured by months of increasingly acrimonious discussions (chapter 10).

In the first half of 2003 another issue also captured public attention and became viewed as a further development test for the trading system. In May a number of West African cotton-exporting countries—Benin, Burkina Faso, Chad, and Mali—drew attention to the impact on their cotton farmers of high

cotton subsidies in the U.S., and to a lesser extent, the EU and China. They proposed the abolition of these subsidies over three years and the payment of compensation to their farmers in the interim. This proposal attracted considerable support, from both developing countries and the donor community in developed countries, although differences of view existed over whether cotton should be addressed separately or as part of the agriculture negotiations.

By the time of the Fifth Ministerial Conference, in September 2003 in Cancún, WTO Members had made little progress on the key elements of the Doha Agenda. Although the Fifth Ministerial was originally intended as a mid-term review, or stock-taking, of the state of play in the round, ministers were confronted with a series of fundamental decisions on the nature and scope of the negotiations.

The Cancún Ministerial

The Cancún Ministerial ended in failure at 6 PM on Sunday, September 15, 2003, when the Chair of the Conference (Mexican Trade Minister Derbez) concluded that no agreement on the agenda was possible among WTO Members and brought the proceedings to an end.[6]

At the heart of the collapse of the talks lay the failure to make substantial progress on agriculture. The EU–U.S. joint proposal, which was largely incorporated into the negotiating text for the meeting, was not viewed as a basis for negotiations by many developing countries, a group of which tabled their own alternative draft text as a basis for negotiation.

This group, the G-20, had been formed prior to Cancún, in response to deep frustration at the EU–U.S. proposal and the general lack of progress on agriculture.[7] Under the leadership of Brazil, South Africa, India, and China, the G-20 galvanized a range of developing countries around the need for reform of the agricultural policies of major developed countries. The G-20 negotiated strongly and effectively as a group on agriculture at Cancún, despite attempts by both the U.S. and the EU to exploit their internal differences on agriculture (such as differences over subsidies—India seeking to retain its own subsidies and Brazil opposing all subsidies—and market access) and other issues (such as the Singapore issues).

The emergence of the G-20 as a powerful negotiating force changed the dynamics of the agriculture negotiations and drew unprecedented public attention to the unequal treatment of agriculture in the trading system. The G-20—and the Cairns Group of agricultural exporters with whom it shared many common members—pressed hard for greater movement on market access and subsidies from the EU, U.S., and Japan.[8] However, these members gave little ground and countered that the G-20 countries were not prepared to open their own markets to agricultural imports. Intensive negotiations did not—and could not—bridge the considerable gap between the two sides, given the lack of willingness to put concessions of real value on the table.

Two other groups were also active on agriculture. The G-33, a group of 33 developing countries, demanded the right to designate a number of agricultural "special products" to be exempted from any new tariff reduction commitments.[9] The G-33 also called for the establishment of a special safeguard mechanism on agriculture for all developing countries. The G-10, which represents mostly importers (and a few exporters), and includes Bulgaria, Iceland, Israel, Japan, Liechtenstein, Mauritius, Norway, the Republic of Korea, Switzerland, and Taiwan (China), was interested in the status quo or in a very slow evolution of reform.

As in the lead-up to the Ministerial Conference, failure of movement in agriculture stymied progress in nonagricultural market access (NAMA), where no agreement proved possible on the modalities for tariff-cutting negotiations. In addition to disagreements between developed and developing countries over the degree to which formulas should target high tariffs and the extent of flexibility to be granted to developing countries to make fewer and smaller reductions, another issue emerged to block progress. A large group of the poorest developing countries opposed any further tariff reductions on the grounds that this would undermine the value of their trade preferences in developed country markets.[10]

Many of these same poorest developing countries also united to form a stronger negotiating voice on issues beyond the erosion of preferences. The G-90 brought together the African, Caribbean, and Pacific (ACP) group of countries, the LDCs, and the African Union.[11] Along with a few more advanced developing countries such as Malaysia, the G-90 was instrumental in blocking negotiations on the Singapore issues.

Cotton also proved to be a major issue at the Cancún Ministerial, with the Director-General taking personal charge of consultations (representatives of WTO Members chaired the five formal negotiating groups on agriculture, NAMA, development, Singapore issues, and other issues). While the U.S. remained intransigent on the question of its cotton subsidies, many other WTO Members, in particular other developing (and some developed) country agricultural exporters, were sympathetic to the injustice, but argued that cotton should be dealt with as part of the agriculture negotiations and not subject to a special deal. Expectations had been raised on cotton, but were bitterly disappointed: the Chair's text on Saturday night (September 14) proposed neither the removal of the harmful subsidies nor payment of compensation, but instead encouraged assistance to help these countries diversify their economies away from cotton production. This enraged the African Group and, in what was felt to be its sheer insensitivity to the concerns of some very poor countries, further dismayed many other developing countries that were already deeply frustrated by the lack of progress in the negotiating group on development.

By Saturday night, the atmosphere had deteriorated significantly. Members increasingly reiterated well known and hard-line positions, escalating

the rhetoric and diminishing the scope for flexibility, and with it the prospect of agreement. It was against this backdrop that consultations began on the Singapore issues on Sunday morning. The EU delivered a belated offer to remove investment and competition policy from the table, but the African Group refused to countenance negotiations on any of the four issues, while the Republic of Korea and Japan insisted that negotiations be launched on all four. The Chair concluded that there was no basis for consensus among the members and the conference ended among bitter recriminations.

The 2004 Doha Work Programme framework

In closing the Cancún meeting, ministers tasked their officials to continue working on outstanding issues with a renewed sense of urgency and purpose and taking fully into account all the views expressed in this conference. The General Council Chairman and the WTO Director-General were asked to convene a meeting of the General Council at senior officials' level no later than December 15, 2003, to take necessary action.

While consultations on agriculture, NAMA, the Singapore issues, and cotton continued throughout October and November 2003, little progress was made. On December 15, WTO Members were able to agree only to allow the negotiating groups to reconvene in the new year, following the appointment of new chairs.

However, in January 2004 the U.S. launched a new initiative to relaunch the round and ensure that 2004 was not a wasted year. In a letter to all WTO Members, U.S. Trade Representative Robert Zoellick proposed that WTO Members agree by mid-2004 on a framework for continuing the Doha Round. The letter signaled some U.S. flexibility on agriculture, moving away from some of the elements of the EU–U.S. deal and proposed that, of the Singapore issues, only trade facilitation be included in the agenda (and perhaps transparency in government procurement if there was sufficient support). Investment and competition, it suggested, should be taken off the table in the interests of encouraging African and other developing countries to agree to a framework for negotiations by mid-2004. This framework would establish a basis for the negotiations to continue, but would not include specific figures for negotiating modalities. That is, it would not include the actual percentages by which subsidies or tariffs on agricultural or nonagricultural products would be cut as a result of the negotiations.

Other members generally welcomed the U.S. initiative. Intensive consultations took place in Geneva and Member capitals throughout the first half of 2004 with a view to agreeing on a framework package to keep the Doha Round alive. Key areas for consultation were the future of the Singapore issues—and in particular whether the G-90 would agree to the launch of negotiations on trade facilitation, NAMA, development issues, and, of course, agriculture.

On May 9, 2004, the European Commission, in a letter from Trade Commissioner Pascal Lamy and Agriculture Commissioner Franz Fischler, made its own proposal aimed at helping to reengage the negotiations. The two commissioners signaled that the EU was prepared to move on export subsidies in agriculture, subject to a satisfactory outcome on market access and domestic support. They acknowledged that, of the Singapore issues, only trade facilitation and perhaps transparency in government procurement would remain inside the Doha Development Agenda. A key element was the proposal that LDCs and other weak or vulnerable developing countries in a similar situation (essentially the G-90) be given the round "for free"—that is, that they should not have to open their markets beyond their existing commitments on agriculture and NAMA. As with the U.S. proposal, while views differed on the specific proposals, the initiative was generally welcomed by WTO Members as a contribution toward a mid-year agreement.

After long and arduous negotiations, a negotiating framework package was agreed by WTO Members in the early hours of August 1, 2004.[12] The 2004 Doha Work Programme (DWP) essentially puts the Doha Round back on a more focused footing, the key elements being the core market access agenda—agriculture, services, and NAMA—plus trade facilitation (the only surviving Singapore issue) and development issues. The text also affirms existing Doha Agenda negotiating mandates on intellectual property, dispute settlement, rules, and trade and the environment (see box 1.5).

The agriculture text is widely viewed as the linchpin. While only laying down the basic pillars in the form of a "framework" for future talks, it nonetheless represents a significant advance from the U.S.–EU text prior to Cancún and the months of deadlock that followed. The text was based on the results of intensive consultations, including at the ministerial level, of a grouping known as the Five Interested Parties (FIPs)—comprising the U.S., EU, Brazil, India, and Australia—a process that attracted sharp criticism from others (notably the G-10 and G-33) who were not represented in the grouping.

Cotton will be dealt with "ambitiously, expeditiously, and specifically" as an integral part of the agriculture negotiations rather than on a separate track. A special subcommittee will be established to "ensure appropriate prioritization of the cotton issue" and the Director-General will work with relevant international organizations, including the Bretton Woods institutions, on the development aspects.

The outcome on NAMA—"initial elements for future work on modalities"—consists of the Chair's text from Cancún with an additional opening paragraph indicating areas where further negotiations are required. These areas include the treatment of developing countries, the issue of preference erosion, and the formula for the negotiations. While the aims are kept ambitious, the specifics of key elements are left to be negotiated later.

The 2004 DWP reiterates calls for the strengthening of WTO provisions on special and differential treatment (SDT) in favor of developing countries and implementation issues. The Committee on Trade and Development in Special Session is instructed to complete its review of all outstanding proposals and report to the General Council with clear recommendations for a decision, by July 2005. On implementation issues, the General Council should review progress and take any appropriate action no later than July 2005, on the basis of a report by the WTO Director-General to be submitted no later than May 2005.

Negotiations on SDT proved difficult, largely due to differences among developing countries. Some more advanced developing countries (mostly Latin American and East Asian) objected to language that was seen as accepting the creation of a *de facto* new class of developing country WTO Member, covering small and vulnerable countries that are not LDCs, primarily in relation to market access. It was finally agreed that the trade-related issues identified for the fuller integration of small, vulnerable economies into the multilateral trading system should also be addressed, without creating a subcategory of members, as part of a work program, as mandated in paragraph 35 of the Doha Ministerial Declaration (which refers to a work program under the auspices of the General Council to examine issues relating to the trade of small economies).

Services remained relatively low-profile throughout and the main outcome is a new deadline for revised offers of May 2005.

Finally, negotiations on trade facilitation (improving the movement, release, and clearance of goods, including goods in transit) were officially launched, with reassurance for developing countries that commitments will be linked to capacity to implement and that support and assistance in implementing future commitments will be provided. Of particular importance was the recognition of the principle that the extent and timing of entering into commitments would be related to the implementation capacities of developing countries and Least Developed Countries. Where the implementation of commitments would require infrastructure development, support and assistance should be provided; where it is not, and the developing country or Least Developed Country lacks the necessary capacity, implementation will not be required. The other Singapore issues—trade and investment, trade and competition policy, and transparency in government procurement—are completely dropped from the negotiating agenda, allowing developing countries to focus on core development-oriented areas without devoting scarce resources to new and complex subjects.

Acknowledging that the original January 1, 2005, deadline for the end of the Doha Round will not be met, a Sixth WTO Ministerial Conference is scheduled for December 2005 in Hong Kong (China). No new deadline was set for completing the round.

Perhaps the most significant feature of the agreement is one not listed under any particular heading. That is, more than any previous round, the

Doha Round is being shaped by the actions and positions of developing countries. If developing countries have been a powerful force in shaping the agenda on issues of interest to them—witness the G-20's unambiguous message that no deal is possible without a meaningful outcome on agriculture or the West African cotton producers success in placing their concerns on the agenda—they have also been equally effective in using their power to refuse to negotiate on issues in which they felt they had little interest—the G-90 and the Singapore issues.

Who's gaining little—or even losing

While the Doha Round is making visible the substantive trade interests of some developing countries and the legitimate aspirations of those countries to rebalance the WTO agreements to better reflect their interests, it is also revealing another reality—that the WTO has many Members who see themselves as gaining little from liberalization, or even as losing from liberalization due to preference erosion.

The poorest WTO Members have not made the development gains experienced by some other developing countries over the last 20-odd years. They have lower growth, face much more serious deficits in economic infrastructure, and on the whole suffer more severe political and governance problems. They face a wide range of domestic constraints to participation in the global economy and are not major participants in trade. These countries generally also have very limited and highly product-specific market access interests, have seen their foreign currency earnings eroded by steadily declining commodity prices, and are often dependent on preferential access for their products in major developed country markets. They have few means to pursue their interests at the multilateral level in terms of either leverage or resources. Their capacity to participate in both negotiating and implementing WTO agreements is severely limited by real resource and governance constraints. The major benefit these countries are likely to receive from WTO membership in the short term is limited to support for domestic economic reform efforts.

From the perspective of these poorest developing countries—which include but are not limited to the LDCs—the Doha Round offers relatively few immediate benefits, but carries the risk of additional, potentially burdensome obligations. This is a particular problem for countries that, while very poor, do not qualify as LDCs under the UN definition and therefore do not qualify for the most extensive special and differential treatment (which largely exempts LDCs from WTO obligations and offers them duty-free and quota-free access to major markets). These countries fall instead under the self-selected "developing country" category of the WTO, under which very different countries are subject to identical rules—Pakistan and Singapore, Botswana and Hong Kong (China) are all subject to the same WTO rights and obligations. The breadth of the developing country classification in the WTO has resulted in a situation

in which more than a quarter of the countries with developing country status have higher annual gross national income than the poorest OECD country (Turkey). That this situation gave rise to difficult discussions in the lead-up to the August 1 framework agreement is not surprising.

The concerns of the poorest developing countries are not restricted to the market opening or obligations they might be asked to undertake. Many of these countries currently benefit from trade preferences in developed country markets, which has led them not only to oppose any further liberalization or assumption of WTO obligations on their part, but also to oppose liberalization by other WTO Members on the grounds that it would erode the value of their preferential access. Many of the poorest developing countries are now in the paradoxical position of arguing against reductions in rich country protection, in particular very high tariffs on products of major interest to developing country exporters, in order to preserve the value of their preferential access.

It is clear that if progress is to be made in the Doha Round, ways need to be found to address the concerns of the poorest developing countries—about the kinds of obligations they might be asked to assume, and about their ability to benefit from the rules and access negotiated.

But it is also clear that, however configured, developing countries are now a major force for change in the WTO. There has been a shift in the tectonic plates and the trading system is confronting a complex new reality, opening the way for the achievement of a genuine development round.

Where next: the road to Hong Kong (China)—and beyond

WTO Members have now agreed on the framework to guide the next phase of the negotiations. But there is a long way to go to translate this into a development round. The 2004 DWP framework agreed on August 1 may have been necessary to prevent the collapse of the Doha Round, but it will not be sufficient to keep it going without a considerable ramping-up of effort on the part of all Members.

The real work is yet to be done. While the changeover of the European Commission and the U.S. election may mean that only limited progress is possible in the coming months, Members should position themselves to be ready to continue working in earnest early in 2005. This sense of urgency is necessary: the deadline for the achievement of the Millennium Development Goals is 2015 and, if the global trading system is going to make a meaningful contribution, there is a limited window of opportunity to conclude the Doha Round. For a variety of reasons—including expiry of U.S. fast track negotiating authority, timing of elections in major WTO Members (France in April 2007, the U.S. in 2008)—the Doha Round will need to be concluded by the end of 2006 or very early 2007 at the latest if it is to contribute to the achievement of the Goals.[13] To do that, concrete agreement on negotiating modalities on agriculture and NAMA, and real progress in negotiations on services, trade

facilitation, and development issues will be needed at the Hong Kong (China) Ministerial Conference in December 2005.

To do that, Members will have to both identify the core priorities of a real development round and commit real political and financial resources to achieving them. This report aims to assist in that process.

Structure of this report

This report has four parts.

Part 1 covers the market access agenda, focusing on each of the core Doha Round issues in this regard: agriculture (chapter 3), services (chapter 4), and nonagricultural market access (chapter 5). Each of these chapters assesses what needs to be done, and by whom, for liberalization to serve development, including in the adjustment costs. Each chapter concludes with recommendations on how and where we should be on these issues in order to achieve the Millennium Development Goals by 2015 and how we might get there from here.

Chapter 6 looks at how hard-won market access gains can be undermined by the use of contingency protection and offers some possible solutions. It also considers the role that ever-increasing and ever-higher product and production standards are playing in diminishing the expected market access gains of developing countries and what sorts of actions might help. Part 1 ends with a look at preferential market access, given the concerns that have been raised about the potential impact of MFN liberalization on preference-receiving countries (chapter 7). It asks whether preferential access has conferred the expected benefits and balances them against the associated costs, including the cost of preference erosion.

Part 2 considers a range of rules-related issues, focusing on two questions. What issues should, from a development perspective, be the subject of trade rules? And what sorts of trade rules on those issues make sense from a development perspective? Chapter 8 sets out three tests for whether an issue should be included on the WTO agenda. Is the issue related to trade, specifically to market access? Is it in line with broader development priorities? And what is the specific value added of a WTO agreement? On the basis of these three tests, chapter 9 assesses both the exclusion of trade and investment, trade and competition, and transparency in government procurement from the Doha Round and the inclusion of negotiations on trade facilitation. It then posits some ideas on the circumstances under which an agreement on trade facilitation might serve development. Chapter 10 applies the same logic to TRIPS, on two issues that have dominated the TRIPS negotiating agenda: access to medicines and geographical indications.

Chapter 11 addresses the broader question of the case for special and differential treatment in relation to WTO rules. It explores whether there is a development case for different treatment for traditional trade policy instruments

and "regulatory" type rules. It concludes with some general thoughts on the way forward on special and differential treatment in the WTO.

Part 3 takes up other systemic issues. Chapter 12 follows on from chapter 11 on special and differential treatment by noting that, while the trading system can contribute to development, it alone cannot deliver development. It focuses on the need for policy coherence at the national level, including complementary policies to ensure that trade liberalization supports development, and at the international level, in the form of significantly increased aid for trade. The chapter concludes with a practical example of policy coherence between trade and other policies in the form of trade and environment. Chapter 13 argues that the preferential free trade agreements have a mixed record in terms of the extent of real liberalization achieved, and that any benefits conferred are often at the expense of other, excluded countries. It also considers whether the arguments are any different for agreements between developing countries. Chapter 14 looks at the evidence of developing country participation in the dispute settlement system and discusses some of the structural constraints they face in prosecuting their rights.

Part 4 concludes, drawing on the preceding analysis to offer some thoughts on the way ahead for the Doha Agenda as a concrete contribution toward achieving the Millennium Development Goals (chapter 15). It restates the main conclusions and presents a set of key recommendations.

Box 1.6
Postscript—use of terms

Throughout this report, several different groups of countries are referred to: OECD countries, developed countries, developing countries, the poorest developing countries, and Least Developed Countries.

Developed countries refers to those high-income countries that are considered to be developed countries in the WTO. This largely—but not entirely—corresponds with membership of the Organization for Economic Cooperation and Development (OECD). Two OECD countries are considered to be developing countries in the WTO—Mexico and the Republic of Korea. The category of OECD countries is used in the section on agriculture because much of the research on agricultural protection has been conducted by the OECD. A list of OECD members is in appendix 3.

Developing countries refers to those countries that have self-elected developing country status in the WTO.

Least Developed Countries (LDCs) refers to the United Nations List of LDCs (appendix 1).

The *poorest countries* include the LDCs, but also a number of low-income WTO developing countries. They include countries with a GDP per capita of less than $1,000 (the criterion used in the WTO Agreement on Subsidies and Countervailing Measures), as well as those falling under the World Bank category of low-income countries. However, no attempt is made to define these countries in a comprehensive manner (appendix 4).

1

Market access agenda

Chapter 2

Why another Round?

In the euphoria following the completion of the Uruguay Round and the creation, after 50 years, of a global trade organization, projections were made of the enormous benefits to follow. Implementing the Uruguay Round agreements, it was claimed, would result in worldwide welfare gains of $274.1 billion annually, of which $86 billion would accrue to developing countries and $188 billion to developed countries (OECD 1993). Nine long and exhausting years of negotiations were about to result in unprecedented gains for the global economy.

Reality, however, has been on a smaller scale. Although the Uruguay Round put agriculture and textiles back on the table and created a framework for negotiating services, market opening—and the associated large projected gains—have not materialized.

Nowhere is this more evident than in agriculture. The long-awaited Agreement on Agriculture has failed to result in a major market opening, with total support to agriculture remaining at $318 billion in 2002 (OECD 2003c). Tariffs for a range of commodities remain at well over 100 percent, with particularly high tariffs often concentrated in products of export interest to developing countries.

Benefits have also failed to materialize in textiles. The majority of quotas were phased out only on January 1, 2005, and the anticipated freeing up of trade has been further limited by high tariffs, as well as safeguards and antidumping actions. Equally, while tariffs on merchandise trade have declined overall, very high tariffs remain in some sectors, particularly in those of interest to developing countries. The result: the average OECD most favored nation tariff on imports from developing countries is four times higher than on imports originating in the OECD (Laird 2002). Barriers in other developing countries are also a significant impediment, possibly accounting for up to 70 percent of the total tariffs levied on developing countries' industrial exports (Hertel and Martin 2000).

Another area of developing country comparative advantage—labor-intensive services—also saw little liberalization in the Uruguay Round. Even by the relatively low standards of liberalization achieved under the GATS, the temporary movement of service suppliers (mode 4) stands out, with the fewest and most restrictive commitments.

There is clearly much real work to be done in the Doha Round on market access. In services and industrial products, unilateral liberalization provides a strong foundation for the current multilateral negotiations; in sharp contrast, with a few notable exceptions such as New Zealand, no such unilateral liberalization has been undertaken in agriculture. There are real gains to be made, and not just in terms of large figures for global welfare. The benefits of liberalization accrue at the national level and, first and foremost, to those who currently pay for protection: consumers and other sectors of the domestic economy.

Who pays for protection?

The costs associated with protection are borne by the domestic economy. Protection raises costs of the protected goods and services above the world market price. The burden of this additional cost falls on two main groups—domestic consumers and other sectors of the economy for which the protected goods and services are key inputs.

Consumers—and often the poorest consumers—pay for protection

While tariffs impose costs on foreign exporters, in terms of lost opportunities, and are paid directly by domestic importers, the real burden ultimately falls on the domestic consumers—be they enterprises or individuals. The cost of tariffs is generally passed on to the consumers, and the artificially high price of imported goods also allows domestic manufacturers of competing goods to maintain higher prices. Higher prices for basic goods reduce their availability to poor consumers—protection is often a regressive policy.

Poor people in rich countries can pay more than their share of the costs of protection. Tariffs are a tax, but unlike a sales tax are not transparent (tariffs, unlike sales taxes, do not appear on receipts); and unlike an income tax, they can sometimes be regressive, with a disproportionate impact on low-income consumers (box 2.1).

In the U.S., it is also estimated that poor consumers, who tend to spend a higher proportion of their income on food, also bear a heavier burden in terms of the higher food prices generated by protection. A single-parent family's average annual budget for home meals is 60 percent of a two-parent family's budget, although the latter's average earnings are around two and a half times greater (Gresser 2002). Although agricultural tariffs are often viewed as revenues paid by foreigners and collected by governments, in reality they are closer to a sales tax imposed on food, with most of the benefits redistributed to larger farmers (Diaz-Bonilla and others 2003).

Box 2.1

Tariffs hit poor consumers hardest

Source: Gresser 2002.

In the U.S., tariffs—unlike the income tax—can fall most heavily on low-income earners because they can be highest on goods important to the poor (table 1). Remaining high tariffs tend to be on essential items—such as shoes and clothing, which make up only one-fifteenth of U.S. merchandise imports, but bring in around half of the annual tariff revenue. In comparison with other expenses (education, transport, entertainment), these goods are relatively small expenses for middle-class or wealthy families but very large expenses for poor families with children (table 2). (The same could be said for high EU tariffs on farm products.)

Single-parent families spend around 55–60 percent less than two-parent families on transport, healthcare, education, insurance, and household furnishings—and 80 percent less on telephones, computers, clocks, luggage, and jewelry. But their spending on necessities—food and clothing—is much closer to the average for all families. The single-parent family's clothing budget is two-thirds the two-parent family's. In shoes alone the figures are $411 a year for a single parent family, and $480 for a two-parent family.

Tariffs are also usually lowest on luxuries and highest on the cheap goods poor families are most likely to buy. For instance, women's silk underwear has a 2.4 percent tariff but polyester underwear a 16.2 percent tariff. A silk suit has a 1.9 percent tariff and a wool suit a 12 percent tariff, but a polyester suit has a 29 percent tariff. Snakeskin handbags have a 5.3 percent tariff but plastic-sided handbags an 18 percent tariff. Silver-handled forks have no tariff but cheap stainless steel forks a 15 percent tariff.

These high tariffs may not be effective in protecting jobs. Sneakers (trainers) costing $3 or less, those mostly bought by the poor, are subject to a 48 percent tariff (adding $1.06 to a standard $2.20 sneaker). Yet domestic employment in the sneaker sector in the U.S. is 3,000 persons (for all sneakers; it is unknown what proportion are making cheap sneakers). Most sneakers under $3 come from Indonesia or China.

Table 1 Comparison between tariff tax rates and income tax rates

Family type	Average income	Income tax rate	Expenses on high tariff goods	Estimated costs of tariffs	Tariff tax rate
High-income	$110,000	19.7%	$7,916	$660	0.6%
Two-parent	$66,913	6%	$5,752	$470	0.7%
Single-parent	$25,095	No liability	$2,158	$307	1.2%
Working welfare leaver (expenses estimated)	$14,872	No liability	$1,900	$279	1.9%

Source: Adapted from Gresser 2002. Figures for the two-parent family and single-parent family come from the U.S. Bureau of Labor Statistics (2002), table 1500. For the high-income family, figures are from table 1201 in the same publication. Figures for the working welfare leaver are taken from LoPrest (2001).

Table 2 Main tariff expenses of a single parent family, 1999
(average earnings $25,095)

	Expenses ($)	Tariff rates (percent)	Cost of tariffs ($)
Food (at home)	1,005	1–13	14
Clothes	1,440	5–30	212
Shoes	411	10–30	68
Linen	60	10	5
Other goods	67	0–11	8

Source: U.S. Bureau of Labor Statistics 2002; United States International Trade Commission; Gresser 2002.

To the extent this story is repeated in other developed countries, it presents a powerful equity argument for reform. Developed countries bear a special responsibility to deliver real market access for development in the Doha Round, and such evidence of the inequities of their protection not only at the global level for poor countries, but also at the domestic level for the poorer members of their own societies, may be important in combating pressure for extended protection from well organized producer lobbies.

These arguments may also be important within developing countries, where there is some evidence that some of the same patterns may hold. In Viet Nam, for instance, bicycles are essential purchases for the poor, used for taking children to school and goods to market. But a 50 percent tariff renders the cost of bicycles prohibitive for many poor people; the cheapest bicycle is around twice the monthly income of people in rural communities (Thanh 2001). Equally, 25 percent or more tariffs on mosquito nets in Zambia and Senegal harm the ability of the poor to prevent malaria, which kills almost 1 million people a year in Sub-Saharan Africa (Bannister and Thugge 2001).

That said, there can be important differences between countries in terms of tariff structure and how the poor are affected by liberalization. This last point is important—where the poor are producers of the liberalized goods, as well as consumers, gains from liberalization can be adversely affected by adjustment. For developing countries these factors are especially important as they have both larger numbers of poor (and very poor) people, and a more limited capacity to absorb adjustment costs. Tariffs may also be an important source of government revenue. In view of these differences, the adjustment impact of tariff liberalization on agricultural and nonagricultural goods in developing countries is specifically addressed in the following chapters.

Other sectors can also pay for protection

The cost of protection in one sector is also borne by other sectors for which the protected products, be they goods or services, are inputs. Protection is often cast as a choice between domestic and foreign jobs, but in reality it can be more a choice between one set of domestic jobs and another (box 2.2).

While the following chapters look at the market access agenda for agriculture, services, and nonagricultural products separately, there are clearly strong linkages among them. (For example, agricultural and nonagricultural producers and exporters are hurt by poor-quality services.) Equally, the size and nature of the adjustment challenge from liberalization in any one sector will be affected by the kinds of offsetting benefits that might emerge in other sectors. (For example, poor urban laborers who may experience food price rises from agricultural liberalization could see the demand for their labor rise if labor-intensive manufactures were similarly liberalized in export markets.) These linkages are discussed in more detail in the following chapters.

Box 2.2

Who pays for protection?

Source: Cato Institute 2003; Washington Post Writers Group 2003; Barfield 2003; Hufbauer and Goodrich 2003; Francois and Baughman 2003; OECD 2003e; UNCTAD 2003c.

Support for the U.S. sugar industry means that the cost of sugar within the U.S. is up to three times the world price. In 1998 U.S. sweetener users paid an estimated extra $1.9 billion for sugar due to protection, and protection is now being blamed for job losses in the U.S. confectionary industry. With sugar accounting for 92 percent of the raw materials for hard candy, the price of sugar can be a determining factor in location decisions—some firms have moved to Canada, where labor costs are comparable to the U.S. but sugar costs can be up to $10 million less a year. The mayor of Chicago, which has lost 11 percent of its confectionary jobs since 1991, cited sugar protection as a key reason for companies relocating outside the U.S.

A safeguard on U.S. steel, in the form of tariffs ranging from 8 percent to 30 percent, was imposed in March 2002—similar measures were imposed by the EU, a few days later. The Consuming Industries Trade Action Coalition, a group including manufacturers of vehicles and vehicle parts, construction equipment, tools, and dye works and appliances, estimated that 200,000 jobs were lost to higher steel prices during 2002, more than the number employed by the U.S. steel industry (187,500). Of these jobs 50,000 were lost in the manufacturing, machinery and equipment, and transportation equipment and parts sectors. While data were insufficient to measure the exact number of job losses attributable to the safeguard (as opposed to other factors such as increased demand and lower production), it was evident that, in the absence of tariffs, damage would have been significantly less. Others estimated the losses attributable to the safeguard at (conservatively) around 26,000 jobs over 12 months, contrasted with little pickup in employment in the steel-producing sector. Small businesses were hardest hit due to their limited ability to pass increased costs onto their clients.

In services the costs are arguably magnified due to the role of some services in underpinning many economic activities. Infrastructure services—such as telecommunications, transport, financial services—directly affect the ability of other sectors to participate in trade. A recent OECD survey of developing country services exports highlighted lack of access to reliable and inexpensive infrastructure as a key impediment facing developing country exporters. Poor quality and expensive telecommunications services undermined export potential in business services or back-office processing. Small- and medium-size enterprises exporting professional services over the Internet were particularly penalized by unreliable telecommunications, which prevented timely service delivery, resulting in lost clients. Access to efficient and reliable logistics services, transport, and communication infrastructure is essential for insertion into global supply chains.

Chapter 3

Agriculture

Agriculture is crucial for developing countries, particularly for the poorest ones. On average, it represents 40 percent of GDP, 35 percent of exports, and 50–70 percent of total employment in the poorest developing countries; the proportions in the middle-income developing countries being 12 percent, 15 percent, and 15–40 percent, respectively. Further, agriculture is particularly important for the poorest people in all developing countries: roughly 70 percent of the world's poorest people live in rural areas, with the proportion in the poorest countries being as high as 90 percent. Undoubtedly, reducing poverty and attaining the other Millennium Development Goals necessitates, as an absolute priority, improving the economic situation of the farm sector and rural areas in developing countries.

If domestic action by developing country governments—including removal of anti-agriculture domestic biases, such as manufacturing protection and overvalued exchange rates—is important, action on the part of high-income countries is absolutely critical. Current farm policies that support prices and subsidize agricultural production in OECD countries distort trade and investment incentives by depressing world prices and preventing developing countries from exploiting their comparative advantage. They create huge distortions, which can be captured by the following simple comparison: in 2002 the total amount of support to OECD farmers ($318 billion) was 5.5 times the total OECD official development assistance to developing countries ($58 billion) and about 100 times the share of OECD official development assistance granted to agricultural production in developing countries.

The current protection in OECD countries

In 1994 the Uruguay Agreement on Agriculture (UAA) brought agriculture into the legal framework of the multilateral trading system. But it did not

liberalize farm trade. The commitments that were made—the ban on quantitative restrictions, the tariffication of border protection, the minimum market access based on tariff-rate quotas, the reduction of export and production subsidies—did not noticeably lower the effective level of OECD farm protection since 1995 (although one could argue that, without the UAA, OECD protection would have risen rather than followed a flat trend) (box 3.1).

This is not surprising. The tariffication process in 1993–94 was consciously handled by most WTO Members in such a way that it amplified the initial level

Box 3.1

OECD agricultural protection

Sources: OECD 2003b, 2003c, 2003f, 2004a.

- Total net transfers from consumers and taxpayers to farmers in OECD countries constituted 51 percent of the value of farm production in 1986–88. In 2003, after implementation of all the Uruguay Agreement on Agriculture commitments, they still amounted to 48 percent of the value of farm production. In sum, half of the value of production at the farmgate—or roughly three-quarters of the value added—is still derived from transfers.
- The range of average support across OECD countries remains as wide now as it was 15 years ago: less than 5 percent of gross farm receipts in Australasia, 20 percent in North America, 35 percent in the EU, and more than 60 percent in Japan, Norway, the Republic of Korea, and Switzerland. There has been a noticeable increase in support in recent OECD members (Mexico, Turkey, and the Central European countries). Over half the entire budget for the European Community is still absorbed by farm subsidies.
- As the number of active farmers continued to decline sharply during the 1990s, support per farmer has risen in many OECD countries—by 30 percent in the U.S. and 60 percent in the EU, sending the wrong signal in terms of resource allocation.
- OECD farmers get only a small portion of all the money poured into agriculture—only 25–30 cents of every dollar or euro of support go to OECD farmers' incomes. The remaining 70–75 cents end up in the pockets of landowners (whose fields are rented by farmers) and suppliers of other farm inputs or is wasted through inappropriate (subsidy-based) choices of crops. This enormous waste provides a strong rationale for reform from the perspective of OECD farmers themselves.
- This rationale is even stronger for small farmers. The smallest 25 percent of European farms receive less than 4 percent of total European support (the same as in the U.S.), whereas the largest 25 percent of European farms receive 70 percent (80 percent in the U.S.) of the total. The fact that existing farm support mostly benefits large farmers provides a strong rationale for reform from the perspective of OECD public opinion, which supports farm policies out of a desire to assist small family farms.
- OECD farmers often have above-average OECD incomes: Netherlands (250 percent), Denmark (175 percent), Belgium (127 percent), Japan (120 percent), U.S. (110 percent), and Poland (105 percent). In sum, resources are transferred from poorer OECD households to richer ones. This is a powerful equity argument for policy reform from the OECD countries' own perspective.
- Lastly, current OECD farm policies have in practice largely failed to protect the rural environment because they result in intensive use of fertilizers and encourage polluting production methods. Policies targeting well defined environmental goals would be much more efficient and effective.

of protection to which the tariff cuts decided in the Uruguay Round would be applied so that these cuts had a very limited impact—so-called "dirty" tariffication. Moreover, OECD WTO Members often limited the real value of their commitments by adopting "specific" tariffs (tariffs denominated as a fixed sum per unit of product, such as €300 per ton of rice) rather than *ad valorem* tariffs (which are expressed as a percentage of the import price). For instance, the U.S. and the EU have imposed specific tariffs for one-third of their farm products, and these specific tariffs are devastatingly protectionist because they automatically increase the level of protection when world prices are low, that is, when protection is very much sought after by domestic farmers. Developing countries used another way to limit the real value of their commitments: they set their "bound" tariffs (which cannot be raised without compensating the affected trading partners) at a much higher level than their actually applied tariffs so that, if necessary, they could rapidly and massively increase their applied tariffs without any risk of having to offer compensation. Lastly, tariff-rate quotas (restrictions combining a lower (in-quota) tariff rate for a specified volume of imports and a higher (over-quota) tariff rate for imports above this volume) have been used as a way to maintain existing preferences, not to open domestic markets more widely, or in a less discriminatory manner. These weak disciplines on tariffs, coupled with very limited restraints on export subsidies and domestic price support, prevented any real reform of farm trade.

OECD farm protection hurts developing countries, including those with "preferential" agreements

OECD farm policies severely limit access to major OECD farm markets. They generate large price volatility in world markets: while OECD farmers are sheltered from almost all possible risks because of price support and other subsidies, developing country markets bear the burden of amplified price volatility. They force farmers from developing countries to match OECD subsidized prices for the products concerned. They induce developing countries' farmers to over-invest in OECD least-subsidized products, such as coffee and cocoa, leading to excessive supply and depressed prices for these crops. Absent protection in developed countries, greater diversification in developing countries would be feasible. Last, OECD policies have a perverse mimicking effect. Many governments of developing countries use OECD policies as a rationale for sheltering their own farmers from the depressed prices and amplified market volatility caused by trade-distorting OECD policies. While politically understandable, these policies impose additional costs on poor countries.

Contrary to widespread belief, closed OECD markets are not solely a problem for major agricultural exporting countries such as Argentina, Brazil, or Thailand. They also affect the poorest developing countries, which are often dependent on a very small set of commodities, many of them subsidized and protected by OECD countries, such as sugar, cotton, and rice (box 3.2).

Box 3.2

OECD farm protection and developing countries—a tale of three products

Source: OECD 2004a.

Sugar is one of the most policy-distorted of all commodities. Among the large OECD countries, the European Union is the worst offender with protection rates above 100 percent, meaning that producers receive more than double the world market price. EU support to sugar producers totaled €3.3 billion in 2003—that is, more than half the total OECD support for sugar, and 1.4 times the value of sugar exported by the eight developing countries for which sugar exports represent more than 20 percent of their total exports.

U.S. subsidies to cotton growers totaled $3 billion in 2001–02, meaning a protection rate of 95 percent. This represents half of the world subsidies to cotton, with China, the EU, and India being the other key offenders (their subsidies amount to 21 percent, 17 percent, and 9 percent, respectively). U.S. subsidies are equivalent to four times the value of cotton produced by the four African countries (Benin, Burkina Faso, Mali, and Chad) that argued the cotton issue at the Cancún Ministerial Conference because cotton is a critical cash crop for their many small-scale and near-subsistence farmers.

Rice support in Japan amounts to a staggering 700 percent of production at world prices. It amounted to almost $13 billion in 2003—roughly two-thirds of the OECD producer support for this product, the bulk of the rest of OECD support being provided by the Republic of Korea ($6 billion)—denying huge export opportunities to poor countries in South Asia (Bangladesh, India, Viet Nam, and so on) or to the poorest regions (Thailand).

Both the U.S. and the EU have adopted farm reforms since the 2001 Doha Ministerial. What follows shows that, unfortunately, these reforms are either going in the wrong direction (the U.S.) or are largely virtual (the EU). Both reforms are due to be revisited in 2006–07, as part of the normal legislative process in the U.S. and as a step in the enlargement process in the EU. These reexaminations will offer the last chance for these two large WTO Members not to block the Doha Round. But it is clear that, to be credible, signals of change need to be made quickly.

The 2002 U.S. Farm Bill: turning into Europeans?

Following its adoption by Congress, the U.S. Farm Security and Rural Investment Act (FSRIA) was signed in May 2002 by the president (who chose not to fight the bill). It will last until 2006. Its main feature is to reinforce the link between subsidies and production decisions. This is a significant backward step compared with the previous Farm Bill, the 1996 Federal Agriculture Improvement and Reform Act (FAIR Act) which, in conformity with the UAA, eliminated all mechanisms linking subsidies to production decisions ("decoupling" of subsidies), except for a specific type of deficiency payments (loan deficiency payments). Despite this important exception (in 2002 loan deficiency payments represented almost 40 percent of total U.S. producer support as estimated by the OECD) the evolution of the FAIR Act toward economically sound and WTO-consistent decoupled subsidies was important because it signaled a serious commitment to a profound reform of U.S. farm policy. By moving backward, the FSRIA has raised serious doubts about this commitment.

The FSRIA reinforces the link between subsidies and production decisions by reintroducing support ("target") prices for calculating newly created countercyclical payments (CCPs). Target prices are defined for the years 2002–07 and for a much wider set of crops (cereals, cotton, milk, peanuts, rice, soybeans, and other oilseeds) than those covered by the FAIR Act. Although they are marginally lower than those prevailing before 1996, these target prices provide higher support levels because world prices have declined since 1996. Based on these target prices, CCPs insulate U.S. farmers from world prices, providing higher support when world prices drop and smaller support when world prices increase.

What follows illustrates the concrete functioning of the FSRIA in a hypothetical case for wheat in 2004–07 (prices are in rounded figures). For this period, the wheat target price is $144 a ton. If the world market price for wheat is, say, $100 a ton, any U.S. wheat producer is eligible for three layers of support: a loan deficiency payment defined as the difference between the loan deficiency payment rate for wheat (fixed at $101 a ton by the FSRIA) and the world price; a direct payment fixed at $19 a ton for wheat by the FSRIA; and a CCP of $24 a ton, the CCP being calculated as the difference between the target price and the market price, less the loan deficiency payment and the direct payment.

These arcane calculations reflect differences between the bases for paying the three supports that are crucial in the WTO context. Loan deficiency payments are paid on the basis of production during the period in question. As they are clearly not decoupled subsidies, they pertain to the WTO Amber Box of trade-distorting subsidies. Direct payments are paid on the basis of historical production, that is, production having occurred during the reference period defined by the FSRIA. They are considered to be decoupled subsidies—hence, they pertain to the WTO Green Box (the box of permitted subsidies). By contrast, the legal status of the CCPs was initially ambiguous. To the extent that they are paid on the basis of historical production, they are decoupled from current production. But, because they rely on target prices, they contain a link between production decisions and the size of the subsidy. This link is reinforced by the possibility, under the FSRIA, to "update" historical production by taking into account more recent production levels than those of the reference period. Updating opens the door to "strategic" behavior by U.S. farmers, that is, expanding acreage and yield-increasing inputs for further updating in the case of expected severe price declines in the future. Lastly, links with production decisions are reinforced by the specific dairy provisions contained in the FSRIA, namely, a guaranteed intervention price for a specified milk quota. The ambiguity as to their legal status was dissipated by one of the provisions of the 2004 Doha Work Programme (DWP) framework.

In terms of policy instruments, the FSRIA is an important regression compared with the FAIR Act. That its projected economic impact may be only marginally worse has two main explanations. The first is that, when farm prices declined between 1998 and 2002, U.S. farmers lobbied for, and got, ad hoc

subsidies on top of those allowed under the FAIR Act. Adding this ad hoc assistance to the "regular" FAIR Act subsidies gives roughly the same amount of support as the total level of subsidies available under the FSRIA. In other words, the effective level of protection does not change much because the FSRIA locks in the actual level of support provided since 1998. Second, as the FAIR Act removed most of the supply controls, U.S. farmers have already expanded crop areas to their maximum profitable limits under current prices, limiting the risk of an increased base for payments for the time being. Finally, because of the way CCPs are designed, the effective impact of the FSRIA depends on the level of world farm prices. As these prices have increased in 2003–04, actual U.S. subsidies are substantially smaller than FSRIA appropriations.

However, the conclusion of a limited additional economic impact of the FSRIA over the FAIR Act requires an important caveat. It ignores the stronger systemic impact of the Act over the longer term. Undoubtedly, the FSRIA has refueled hopes for ongoing farm protection in the U.S., further eroding the pro-liberalization U.S. export farm lobbies. This systemic effect is best illustrated by the shift of the largest U.S. farm association (the American Farm Bureau), which recently voted (by a narrow margin of 204 to 202) to support only future trade agreements "that prevent economic damage to import-sensitive commodities...while advancing U.S. agricultural trade and food security interests," causing the chairman of the Indiana branch of the Farm Bureau to say that "we are turning into Europeans" (*Financial Times,* January 15, 2004). As a result, the FSRIA is fueling, all over the world, fears of increased price volatility and uncertainty in the future, leading to reinforced pressures for more protectionist farm policies in other WTO Members.

The 2003 Luxembourg reform of the Common Agricultural Policy: "Matrix Reloaded"

In June 2003 the European Council adopted the Luxembourg reform of the Common Agricultural Policy (CAP). Adopted in the 1960s, the CAP was relentlessly expanded until the mid-1980s. Initially based on support for very high domestic prices, it transformed the EU from a net importer into a large net exporter of farm products. That is, it not only closed European markets to foreign competition, but it also dumped European farm products into foreign markets, through export subsidies, endangering the farm sectors of many developing countries. The unsustainably large costs of the CAP imposed the first CAP reform (the 1992 McSharry reform). The UAA was used as an excuse for introducing this reform, a short-term political expediency that proved to be costly in the long run because it induced European farmers to believe that, since then, all their pains were due to "farm trade liberalization" (which, as shown above, has not yet occurred) rather than to the systemic flaws of the CAP. Coping with the EU enlargement to Central European countries again revealed these systemic flaws and entailed a second reform (the 1999 Berlin reform).

The 2003 Luxembourg reform is still incomplete. It needs additional regulations at the European level, in particular for reforming the sugar market, which is one of the most protected in the EU yet is crucial for many developing countries (the July 2004 Commission proposal to reform the sugar market will be examined by the European Parliament and the Council of Ministers in the months to come) (see box 3.2). Moreover, EU member states have some freedom in implementing key aspects of the 2003 reform, notably the exact dose of decoupling. While several large farm producers (Britain, Germany, Ireland) have decided to adopt maximum decoupling, other EU member states did not make such a clear choice, increasing the risks of perverse impacts of the reform, which will be described below.

However, despite the missing elements, enough information is available to suggest strongly that the 2003 CAP reform is very modest and may even generate new problems without having the capacity to solve the existing ones.

The 2003 reform introduces a new instrument—single farm payments—which, as early as 2005 but no later than 2007, will replace a subset of the existing support measures, namely the subsidies based on the area planted (cereals, oilseeds) and on the herd size (beef, cows, sheep). As they are based on the average production in 2000–02 and do not require actual production of farm products, these single payments are considered as "decoupled" from production decisions.

This decoupling has been the main reason for the hype about the 2003 reform.[1] It was presented as a decisive shift of the CAP toward a WTO-consistent approach based on decoupled support, in sharp contrast with what happened with the U.S. FSRIA.

However, this hype is not justified. First, as underlined above, only area-based and head-based subsidies will be decoupled. These subsidies account for a very limited share of producer support to EU farmers—between 21 percent and 27 percent in 2002—depending on the actual dose of decoupling adopted by the EU member states (in what follows, all figures refer to the EU-15).

Second, for all but one (milk, see below) of the main EU crops and herds, the 2003 CAP reform maintains the current price support, which is by far the main source of EU producer support (58 percent in 2002).[2] Given that for many products it is price support that determines the actual level of protection, the 2003 reform leaves the EU current level of protection unchanged. As a result, the 2003 reform can have only a modest impact on the markets of the current 15 EU member states. EU farm prices are estimated to change by 1 percent or less for wheat and other cereals, oilseeds, poultry, and pork, and by 2 percent or less for milk (FAPRI 2003; OECD 2004b).[3] Such modest price changes can in turn bring only small changes in the quantities produced (less than 1 percent) and consumed in Europe, hence in EU imports from, and exports to, the rest of the world, and ultimately in world prices (FAPRI 2003; OECD 2004b).

The 2003 reform substantially reduces support prices for only three products: butter, rice, and rye. Butter is by far the most important. The butter intervention price will be reduced by an additional 10 percent on top of the 15 percent reduction agreed in the 1999 Berlin reform.[4] As a result, the EU butter market price is projected to decrease by around 7 percent by 2008, with the world butter price increasing by less than 4 percent and EU exports of butter declining by 16 percent (OECD 2004b). However, the estimated changes of EU prices of other major dairy products (milk, cheese, skimmed milk powder) are modest (2 percent), as are changes in the corresponding world prices (less than 1 percent) (OECD 2004). These globally modest changes in the dairy sector are achieved at a very high price for EU taxpayers: the payments granted to EU dairy farmers to compensate them for the decrease in price support are estimated to amount to €4.2 billion—22 percent of the current producer support to milk producers in 2002.

The two other products (rye and rice) are marginal—0.3 percent of EU farm production (in fact, the German rye producers anticipated a decline in rye support due to the huge EU stocks). The cut in the rice price support is interesting for two reasons: it is driven by trade policy (it is necessary to honor the EU commitment under the Everything But Arms (EBA) initiative to provide access to the EU rice market to EBA beneficiaries); and it is a test case for sugar and bananas, the two other products in the same situation under the EBA initiative. The rice support price will be reduced by 50 percent in 2004—but, once again, these changes will be very costly for EU taxpayers since the single payments for rice will amount to the whole producer support in the sector. The EU market price is projected to decline by between 13 percent and 33 percent, and EU production by 12 percent, but the change in the world rice price is estimated to be very small (less than 2 percent) (FAPRI 2003; OECD 2004b). Imposed by the EBA initiative, the 2003 reform has a boomerang effect on the EU trade policy because the current EU protection for rice is mostly determined by price support. Lowering this support automatically reduces the level of protection on rice imports from countries that are not EBA beneficiaries. In order to eliminate this possibility, the EU has already announced its intention to negotiate import quotas with non-EBA rice exporters—and these are likely to be bitter and difficult negotiations.

As noted above, the Commission's July 2004 proposal for reforming the sugar market (another key product for developing countries) is not yet adopted—it is said that the final decision is expected to be taken "within 12 months" (that is, before July 2005). The core aspects of the Commission's proposal are a cut by one-third of the support price over three years, a reduction of the EU production quota by 16 percent over four years, and new decoupled support for sugar beet farmers to compensate income losses. The post-reform support price will basically align the EU price to the U.S. support price, and it will still be much higher than the current (and forecast) world price (€421

a ton compared with €160–€200 a ton), suggesting a very limited impact on foreign farmers. The production-quota reduction will be too small to change world prices (Brazilian producers could easily fill the gap).

At this stage, the 2003 CAP reform thus suggests two main conclusions. First, it has almost no impact on the level of producer support (in percentage terms) to EU farmers, which (all other things being constant) is projected to decrease from 57 percent to 56 percent (OECD 2004b). By contrast, it allows a substantial shift of EU support from the Blue Box (subsidies exempted from reduction under the Uruguay Round because they are under production-limiting programs) to the Green Box (subsidies not deemed to be trade-distorting, hence acceptable) if they stay as currently defined (a big if). For instance, the projected level of the remaining EU support in the Blue Box would be smaller than the 5 percent threshold suggested in the August DWP framework. Similarly, the sum of the domestic subsidies deemed trade-distorting (calculated as the aggregate measure of support, or AMS) and Blue Box subsidies in 2008 would be half (in case of maximal decoupling) to two-thirds (in case of minimal decoupling) of the corresponding sum in 2003. In other words, the 2003 reform allows the EU to "play boxes" in WTO negotiations, by shifting some of them to the legally safest Green Box subsidies. But it has no effect on import barriers and export subsidies—the core issue for the EU trading partners.

Second, the 2003 reform's estimated economic impact is modest, with the bulk of the net welfare gains flowing almost entirely from the shift of the CAP burden from consumers to taxpayers and farmers in the dairy sector; dairy consumers will benefit from lower butter prices, but taxpayers will pay more (the very expensive compensation program for dairy more than offsets the savings from lower dairy export subsidies), whereas dairy farmers will lose some rents associated with the existing milk quotas (assuming that they are effectively the current beneficiaries of the rents, a debatable proposition). The fact that the net gains of the 2003 reform are so dominated by reform in the dairy sector can only be a source of serious concern because this sector is well known for its strong lobbying capacity (once again, as of September 2004, nothing definitive has been decided for the EU sugar regime).

The partial decoupling approach adopted by the 2003 reform not only fails to solve the existing CAP problem, but it may well generate additional problems. First, the single payments to be introduced are subject to "cross-compliance" criteria based on respect for statutory environmental, food safety, animal welfare, and animal and plant health standards (a nonexhaustive "priority" list of 18 such statutory standards has already been adopted). Farm land must also be kept in "good productive" condition, and there should be no significant decrease in total permanent pasture area. Such cross-compliance clearly has the capacity to limit the new freedom of European farmers about production choices.

Second, the 2003 reform relies on systematic "overcompensation"—that is, it is paying farmers more than the value of the lost subsidies, as did the 1992

McSharry reform. This flows from the wide difference in terms of transfer efficiency between area-based or head-based subsidies and single payments. Only 25–30 cents of every euro of area-based or head-based support goes to EU farmers' incomes, as opposed to 50 cents in the case of single payments (OECD 2001b). In other words, matching the pre-2003 subsidies would actually have required single payments amounting to only half the current area-based or head-based subsidies—and not the 95–110 percent granted in the 2003 reform on rice and butter.[5]

Third, the large EU farmers will be, once again, the main beneficiaries of the 2003 reform because they got most of the area-based and head-based subsidies during the reference period. And the poorest EU farmers will not get enough income support to leave production because they will get very limited single payments (see box 3.1). Further, by giving crop-free and herd-free money to large farmers, the 2003 reform has triggered fears among European farmers, in particular the smaller farmers, that large farmers will use this money to invest in the areas where they currently produce. They have thus been able to impose limits on using single payments for investing in farm sectors such as fruits, vegetables, and potatoes. In sum, the 2003 reform has had the perverse impact of generating intra-EU production quotas—far from bringing simplification, as argued by its supporters.

Intra-EU production quotas, combined with more quotas on EU imports (rice), make the 2003 reform more likely to open the door to a protectionist regime akin to the Multi-Fibre Agreement in clothing than to open EU farm markets to freer trade.[6] That the DWP framework opens so many possibilities to "liberalize" through tariff-rate quotas can only magnify these worries.

This evolution is all the more plausible because it echoes similar EU initiatives, such as the new restrictions on grains imposed by the EU in 2002. It is also made more likely by the 10 new EU member states that have not been able—or keen—to use their accession negotiations as an opportunity to introduce deep CAP reforms. Instead of trying to gain as much of the pre-2003 CAP as possible, they could have fought for amplifying "modulation"—shifting more subsidies from the current wealthiest farmers (all of them being in the EU 15) to all the small farmers (being in the current or new EU member states) and to the large (but restructuring) farmers in the new EU member states. As a result, the new EU member states have lost an opportunity to build a bridge between the EU farmers and those from developing countries.[7]

Reasons for hope: first cracks in the tectonic plates of OECD farm protection?

Given the dismal picture of the failure of the EU and U.S. to provide true farm reforms, are there any grounds for optimism with regard to the WTO negotiations? Indeed, the stability of OECD agricultural protection during the 1990s reflects the political clout of OECD farmers. But things are changing

(Messerlin 2003). First, farmers nowadays represent only 2 percent to 4 percent of the active population in all the large OECD countries, and they constitute a relatively old, rapidly declining labor force. However, the remaining farm labor force has to date been in favor of protection, suggesting that OECD governments may adopt a freer trade farm policy only when the farm sector is miniscule. Moreover, while public awareness of the costs of OECD farm policies is growing, it remains low. For instance, in 2000 a Eurobarometer survey revealed that fewer than half of Europeans were aware of the existence of the CAP, despite the fact that it accounts for half of the OECD budget.

Second, farmers also have increasingly diverging interests. A growing share of farmers—in particular, small farmers—realize that they will lose little (see box 3.1), and might even gain, from a shift from the current farm policies to farm trade liberalization accompanied by sound domestic policies. The interests of small farmers in OECD countries and farmers in developing countries are increasingly converging: both groups will gain from a shift from the current OECD farm policies to truly decoupled (income-support) schemes. Such schemes will shift the policy focus from large farmers (by far the main beneficiaries of the current subsidies) to poor (most of them being small) farmers, be they located in rich or poor countries. In sum, focusing on decoupling has the political advantage of being friendlier to small OECD farmers and is promising in terms of building the coalitions necessary for taking on the extraordinary political forces that hold back agrifood liberalization in OECD countries, particularly in Europe. This coalition-building process will help tackle the current situation in which consumers and taxpayers are no longer motivated to fight for more liberalization in agrifood as they believe that it has already been liberalized under the UAA.

Moreover, the increasing demand for processed food products is creating large consumers—the small and large agrifood firms—that can organize and unite the interests of all OECD consumers, providing for the first time a powerful counterpoint to farm lobbies and rebalancing the political forces on farm protection. The technological evolution behind the shift to processed food is a challenge for OECD farmers as it tends to reduce their share of food revenue.

The political forces on farm reform are already undergoing a shift due to two major factors. First, public support for current OECD farm policies has been eroded by the critical campaigns of nongovernmental organizations (NGOs), which have become key agents in raising the media profile of, and creating new constituencies for, farm reform in OECD countries. Several European consumers' associations have also become more aggressive in demanding liberalization, particularly those that care about poor consumers, the main victims of the current agrifood protection (McKechnie 2003). NGOs such as Oxfam (2002) and World Vision have done much to move the debate out of trade policy circles and to raise broader public awareness of the costs of OECD

farm policies for developing countries. These campaigns have also done much to highlight the failure of existing protection to deliver environmental benefits or to help small family farms.

Second, sanitary crises in OECD countries (such as mad cow and other instances of food contamination) have undermined public support for their own domestic farmers. While relatively few, these outbreaks have been traumatic for the populations involved, and they have contributed to increase public questioning of what this large expenditure of tax revenue on agriculture is for—if it cannot guarantee safe, reliable food. These changes are yet precarious and should not be overstated. Despite the fact that sanitary crises have emerged from distinctly homegrown regulatory failures, they have also fed calls for the localization of food production and consumption, restricting world food trade to a few exotic commodities. Similarly, consumers' and environmentalists' concerns can lead to import restrictions, as best illustrated by the genetically modified organisms issue.

Finally, in the EU and the U.S., budget pressures may be helpful in the coming years, although history shows that one should not count too much on budgetary disciplines. In the U.S., pressure to reduce the record budget deficit will force scrutiny of a range of domestic programs, from which farm spending may not be immune, as early as 2005, although increasing world prices are softening the impact of this constraint. In the EU case the 1999 and 2003 CAP reforms have put a cap on the EU farm budget, with financial rules ensuring the systematic respect of the cap; although here again, increasing world prices are introducing temporary relief (particularly on EU export subsidies). However, the 10 new EU member states may trade some of their votes on other issues for changing these disciplines and getting more production-related support. Moreover, the 15 pre-enlargement EU member states may want to lobby for more subsidies for rural development and other multifunctionality items—there is no cap on such subsidies. Lastly, EU member states could decide to increase subsidies at the national level: under the 2003 reform, they can make additional payments up to a maximum of 10 percent of the total single payments to encourage specific sectors important for the environment, quality production, and marketing.

Driving forward the agrifood liberalization agenda will be easier if certain farmers decide to cooperate. An important first step in this direction will be reached if OECD farmers get rid of their erroneous belief that their current problems are caused by liberalization when, in fact, they are generated by persistent protection (as shown at the beginning of this chapter). Another illustration of such misconceptions is the idea that, as it is the largest food importer in the world, the EU must necessarily be an open market. This argument holds little weight because it reflects a host of factors that have little to do with the level of protection, such as the fact that Europe's climate excludes production of the tropical products Europeans consume in large quantities.

A second step will be reached if OECD farmers are convinced that there can be a "life after subsidies," that is, that many will survive trade liberalization (Johnson 2000). For instance, what could be expected to happen in France—a key European member state when it comes to agrifood liberalization—following a 50 percent cut in European protection? There are three very distinct effects (Francois, van Meijl, and van Tongeren 2003): French farm output would decline by 15 percent in the long term in cereals and cattle (roughly 12 percent of the total agrifood production); it would remain stable in milk and sugar (roughly 15 percent of the total agrifood production), though with eroded rents; and it would increase in pork and poultry by 6 percent, in horticulture by 8 percent, and, above all, in processed food by 18 percent (roughly 63 percent of the total agrifood production). These estimates fly in the face of public opinion. They are far from being cataclysmic. The changes would mostly require that a limited number of farmers redefine their product mix toward products in which they are competitive, including shifting away from farm products toward processed food.

The last step consists of adjustment schemes to ease the transition to liberalization. In fact, by recognizing the need for reform now, OECD farmers are in a position to negotiate appropriate adjustment schemes. These schemes are not new (box 3.3). OECD countries have two advantages for designing adjustment policies: they have a broader tax base and their farmers are older (in their mid-fifties)—meaning that, since only the farmers currently in operation should be compensated for the existing situation, the average transition period to be considered is roughly 15 years, at most.

Yet all these powerful trends still raise a key question. Will the OECD farmers realize that, in this context, it is better for them to negotiate now—when they still have some power for shaping the instruments and speed of liberalization—than in a decade or two—when their political weight will be even smaller, maybe to the point to be too small to influence future WTO negotiations?

Benefits from farm liberalization

For developing countries, farm reform is the main source of welfare gains from liberalizing trade in goods. The common outcomes of the available calculations of the gains from trade liberalization suggest two main observations, outlined below: that the biggest gains come from countries' own liberalization, and that the poorest countries will tend to gain proportionally more than the other developing countries.

The biggest gains come from countries' own liberalization

The enormity of OECD protection should not obscure a crucial relation between the sources of the welfare gains and the beneficiaries. Developing countries' welfare gains from farm liberalization will mostly come from their

Box 3.3

Adjustment schemes in OECD countries

Source: Beard and Swinbank 2001; Colman 2002; Drake-Brockman and Anderson 2003; Edwards 2003; Orden, Paarlberg, and Roe 1999; Orden 2003; Swinbank and Tangermann 2001.

Until recently, OECD countries paid little attention to adjustment programs in agriculture. In the immediate postwar period, the focus was on industrialization, and rural depopulation was seen as the main source of much-needed workers for industry. Adjustment programs such as the progressive reduction of producers of alcohol, known as *bouilleurs de cru* in France, were rare. After the 1960s, no attention was paid to the farmers who left the farm sector. It was assumed that the current OECD farm policies were slowing down rural depopulation as much as possible (although some argue that, indeed, they may have accelerated it).

As a result, the interest in substantial adjustment programs in agriculture among OECD countries has been short-lived (Sweden, 1989–92) or is too recent to provide interesting lessons (Australian dairy in 2000 and sugar in 2000 and 2002, U.S. peanuts under the 2002 FSRIA). Paradoxically, the most determined shift away from a regulated farm policy (New Zealand, 1986) was not accompanied by a large-scale adjustment program. In the EU only plans for such programs exist (for instance, in the dairy sector).

Ideally, such programs should rely on four principles: decoupling payments from current production decisions so that future payments are based on past entitlements; decoupling payments from land (farms) and coupling them to individuals (farmers); fixing definitively the future level of payments; and limiting the duration of payments (10 to 20 years at most) and reducing them over time.

own liberalization, reflecting the basic point that protection hurts the consumers of the protecting country. Similarly, most of the OECD gains from farm liberalization will come from their own liberalization.

The exact balance between the two sources of liberalization gains (those from own liberalization and those from trading partners' liberalization) depends on the detailed hypotheses of the calculations. Higher estimates suggest that 90 percent of the gains are coming from the own-group liberalization (IMF 2003) while lower estimates are within the 50 percent to 60 percent range (Diao, Diaz-Bonilla, and Robinson 2003). But note that even the lower results suggest that a majority of gains come from liberalization of the country's own group. In particular, some key developing countries in the post-Cancún negotiations (for instance, Brazil and India) would gain much more from the liberalization of intra-developing country trade than from the opening of OECD markets (though this partly mirrors the elimination of OECD export subsidies). The consequences of such a situation for the coming WTO negotiations are immense.

That said, available calculations also show that developing countries would make significant gains from OECD farm liberalization. Similarly, OECD countries get noticeable welfare gains from developing countries' farm liberalization. In other words, developing countries have a strong interest in liberalizing OECD farm policies (and vice-versa).

These estimates underline the crucial responsibility of the OECD countries in leading farm trade liberalization. They also suggest two lessons for developing countries: first, developing countries are right to keep the pressure

on OECD countries to liberalize their agriculture; and second, they would be wrong to renounce their own liberalization. They also suggest that the only context in which it is possible to benefit from such systemic effects is multilateral negotiations—not unilateral or bilateral ones. Indeed, in stark contrast to services (and even, to a lesser extent, industrial goods), experience in agriculture has been that very limited liberalization of market access and of subsidy regimes has been undertaken unilaterally, with the exception of New Zealand and Australia (leaving aside the short-lived cases of Sweden and Estonia). And the experience of the bilateral negotiations between the U.S. and Australia or the Central American countries or between the EU and Mercosur underlines how limited progress on agriculture outside of WTO negotiations is, and how difficult implementation is in the rare cases of bilateral liberalization (NAFTA). One can hardly expect changes in this respect.

These estimates are also consistent with the fact that, during the last decade, intra–developing country trade has been more dynamic than developed-developing country trade in agricultural products. This is because tariffs have been reduced by developing countries (often in the context of World Bank or IMF programs) and despite the fact that average levels of overall protection in developing countries are still substantial—with average tariffs higher in poor developing countries (19.3 percent) than in middle-income developing countries (16.3 percent), and with developing countries' ability to increase their applied tariffs very rapidly and massively because their bound tariffs are still very high (box 3.4). In other words, the growth in intra-developing country trade in agriculture despite the high level of actual and potential protection reflects the large growth in demand for a number of commodities in developing countries.

Box 3.4

Freer trade and market volatility

Source: Goletti 1994; Dorosh and Shahabuddin 2002; Hoda and Gulati 2002.

Following the poor harvests in 1997 and 1998 in Bangladesh, hundreds of private traders imported several million tons of rice from India. This competitive trade stabilized rice prices in Bangladesh at import parity levels. This trade not only addressed the issue of food security for the poor, it also allowed the Bangladeshi government not to focus on rice price stabilization, a policy that has a weak economic case and that, in particular, has little effect on the poorest farmers. Private sector trade was the most efficient stabilization policy.

In sharp contrast, farm policies can rapidly destabilize prices. In 1999 and 2000 Bangladesh experienced excellent rice harvests. India, which was enjoying continual good harvests, introduced export subsidies in early 2001. To protect its farmers from Indian subsidized rice, Bangladesh raised import tariffs on rice from 5 percent to 43 percent in August 2001—stopping rice imports, and keeping rice prices at a relatively high level.

Such illustrations about international trade can be extended to countries' own domestic trade. Many developing countries suffer from fragmented internal food markets for a host of reasons. Among them are official or hidden restrictions to trade between various regions or states, which prevent interregional trade flows in a timely and efficient manner, particularly in the case of large developing countries.

Are the poorest countries among the beneficiaries?

Developing countries as a whole gain from liberalization, but is this also the case for the poorest countries? Would not most of the gains accrue to large middle-income countries, such as Brazil, Argentina, and Thailand, that have strong comparative advantages in agriculture and are already major players in world farm markets? The answer is no. The best information currently available strongly suggests that, in general, the poorest developing countries stand to gain too, and even that they will tend to gain proportionally more than the other developing countries.

A first piece of evidence to support this answer is the relative importance of the poorest countries' exports of products facing subsidies in at least one WTO Member. Contrary to widespread perception, preferential (duty-free) access to the European or U.S. markets, be it through the Generalized System of Preferences, EBA initiative, or African Growth and Opportunity Act, is not really helpful. The absence of restrictions at the borders does not prevent behind-the-border measures—price support and other domestic production subsidies—that keep OECD farmers producing and selling in their own OECD markets. The presence of heavily subsidized OECD producers in the market makes it very hard for exporters from the poorest countries to compete in those markets, despite their preferential tariffs.

Keeping this key point in mind, basic statistics tell a shocking story. The poorest countries (excluding China and India) are much more affected by farm protection than other countries: 29.3 percent of their farm exports are products that are subsidized by one or more WTO Members, compared with 6.4 percent for middle-income developing countries, and 4 percent for the OECD countries, with China and India's exposure rate being much lower at around 5 percent (Hoekman, Ng, and Olarreaga 2004) (appendix 4, table A4.3). For countries such as Benin, Burkina Faso, Burundi, Chad, Malawi, Mali, Rwanda, Sudan, Tanzania, Uganda, and Zimbabwe, 60 percent to 80 percent of their total exports are farm goods subsidized by OECD countries.

This regressive nature of existing OECD protection (it hurts the poorest countries more than other developing countries) is reinforced by the fact that, if protection varies greatly by product, those farm products that are most heavily protected by OECD countries are often key exports of developing countries. Contrary to popular opinion, the poorest countries are potential exporters of farm goods similar to highly protected OECD products, such as fruits, vegetables, rice, sugar, and meat. The average rate of support (tariffs and domestic support) of these farm products ranges from 5 percent to 150 percent in the U.S., and from 30 percent to 330 percent in the EU (OECD 2004a).

All these points are crucial because what counts is the overall protection (taking into account everything from tariffs to domestic subsidies), not just the protection granted by one instrument (tariffs). Preferential agreements

cannot deliver the elimination of behind-the-border measures; it is impossible to eliminate domestic subsidies paid to OECD farmers only for products coming from a given region. The only forum where behind-the-border measures can be addressed is the WTO. With a WTO agreement, developing countries with preferential agreements will lose their tariff preferences (though, for many countries, the magnitude of such erosion of preferential access is likely to be relatively small, as discussed below) but many will gain from the removal of behind-the-border protection.

Because they face such high overall protection, it is not surprising that some of the largest beneficiaries of world farm liberalization would be regions dominated by the poorest countries. Indeed, the most detailed calculations currently available based on 28 individual developing countries (12 poorest and 16 middle-income developing countries) suggest a low probability of net losers among the poorest countries in the context of multilateral negotiations on farm liberalization: 3 if no liberalization occurs among developing countries, none if it occurs (Diao, Diaz-Bonilla, and Robinson 2003) (table 3.1). The probability is even lower for middle-income developing countries. Looking at changes in farm value added (an important criterion for farm-intensive countries) provides an even more optimistic view. These calculations provide three other lessons. First, the archetypal poorest countries (Sub-Saharan Africa, except South Africa) show welfare gains from liberalization by every OECD country. Their gains are highest when the EU liberalizes—a feature highlighting the illusion of preferential agreements and their incapacity to address the problem of behind-the-border protection. Second, the four poorest countries showing welfare losses when only OECD countries liberalize (Bangladesh, China, Indonesia, and Sri Lanka) face gains when every country liberalizes. Third, developing countries' welfare gains are larger when the EU liberalizes than when the U.S. does. This is because EU protection is relatively higher, with a wider set of trade restrictions and spread over a larger number of farm products than is U.S. protection. Developing country targeting of the EU in the Doha negotiations echoes these broad features.

The possibility that some individual poorest countries could lose from farm reform needs to be considered for two economic reasons. First, their gains

Table 3.1

Estimated number of individual countries possibly facing net losses from farm liberalization

Source: Diao, Diaz-Bonilla, and Robinson 2003.

	Liberalization occurs in				
	U.S. alone	EU alone	Japan alone	All developed countries	All countries
Estimated number based on losses from changes in welfare					
Poorest countries (12)	4	2	0	3	0
Middle-income countries (16)	4	0	0	1	0
Estimated number based on losses from changes in farm value added					
Poorest countries (12)	0	0	0	0	0
Middle-income countries (16)	0	0	0	0	0

from a more efficient allocation of domestic resources could be offset by a deterioration of their terms of trade (a decline of the prices of the products they export caused by the fact that many other countries simultaneously increase their exports of these products). Second, they may be net food importers and be sensitive to higher world prices for staples (this point is examined in detail in the next section).

However, the strength of these economic reasons is debatable. Under full employment, expansion of developing countries' agriculture (following world price increases because of liberalization in rich countries) requires labor to move away from urban production, hence reducing the domestic gains that could have compensated for deteriorating terms of trade. This evolution is much less likely if one assumes (as seems more realistic) unemployment in rural and urban areas of the developing countries: in such a case, an increase in world farm prices would (if transmitted to domestic prices) lead to more production and employment in rural areas, which, in turn, would help to increase production and employment in nonfarm sectors (there being no constraint on the available labor force), thus generating successive waves of income multipliers. Similarly, the fact that world prices of many food products have been depressed for decades (because of OECD agricultural protectionism) has contributed to some developing countries becoming net food importers (and artificially specializing in certain products).

That said, the possibility of losses being incurred by the poorest countries is politically important enough for policymakers to take into account, both when designing negotiating modalities and when defining the domestic policies aimed at enhancing developing countries' capabilities to increase their farm supply and to benefit from new market access. This is the focus of the following section. But it should be underlined that the developing countries facing such losses would not be better off were they to make no commitments themselves in the Doha Round. Assuming that a country is too small for its own policy choices to alter its export and import prices significantly (a reasonable hypothesis in the case of the poorest developing countries), it would still suffer the terms of trade loss from the trade reforms of the other countries—but without getting the economic efficiency gains from reforming its own policies in agriculture and in industry (where presumably it has most of its comparative advantages).

Addressing concerns about liberalization

Two main concerns are often voiced about farm liberalization. First, it could affect food security—that is, the capacity of a country to ensure that its whole population will have enough food on a stable basis, whether domestically produced or imported (this problem becomes an income issue for households whenever a country is open to trade). Second, it could have a particularly negative impact on the poor within countries—that is, on whether individuals will lack income to buy enough food to live decently.[8]

This section separately addresses both these issues—food security and the impact on the poor. However, the appropriate answers to these problems are similar: they consist in combining liberalization with appropriate domestic action—not in closing domestic markets to foreign exports. The crucial role of domestic policies is not surprising. Much of the impact of liberalization depends on the supply response in developing countries' agriculture. This supply response in turn depends on a host of factors, most of which are determined by national conditions and policies, such as infrastructure investments, well functioning credit and other input markets, and the existence or absence of anti-agriculture and anti-export biases in the country in question.

Farm liberalization and food security

A first concern is that farm liberalization is seen by many as bringing with it the risk of generating food price increases high enough to hurt developing countries. But the currently available estimates of world price increases of commodities after liberalization do not exceed 5 percent to 10 percent. Full and instantaneous liberalization of OECD farm policies would boost the volume of global agricultural trade by more than 50 percent, but would cause real international food prices to rise by only 5 percent on average. Given that any farm trade liberalization is likely to require a decade for implementation (as for the commitments adopted during the previous GATT Rounds), the effects of such food import price increases would be indiscernible from other possible changes influencing trade, such as those related to demand changes and technical progress (both factors that can be strong enough to reverse the expected trade-related price rises) or exchange rate movements.

A second concern is that farm liberalization would also increase the price volatility of food products. But contrary to popular belief, trade is a powerful insurance policy against climate shocks and other sudden differences between countries. What did European cattle farmers do when confronted with a serious heat wave in the summer of 2003? They increased the trade of forage (to the point of closing some roads in order to facilitate convoys) between the European regions most and least hurt, allowing farmers in all the regions to get the necessary forage for their cattle. Similar illustrations can be found for trade between developing countries (see box 3.4). Eliminating existing farm policy distortions would reduce the variance of farm prices by stimulating production in the least protected countries, hence "thickening" the markets.

Finally, food security concerns require a focus on a subset of developing countries that currently have a structurally precarious level of food security. A preliminary but essential step is to have a sense of the number of developing countries which could be concerned. The UAA established a list of net-food-importing developing countries (NFIDCs) and granted them some special rights. As this list was the outcome of (last-minute) negotiations, it is important to check whether it fits a rigorous definition of food security risks

and does not simply reflect negotiating leverage. Such a rigorous definition shows that food security risks affect a large number of the poorest countries: 54 of 68, with 39 of them running serious risks, while they affect only 12 middle-income developing countries (Diaz-Bonilla, Thomas, and Robinson 2002; see appendix 4, table A4.3). The average level of food security risk (1 being the highest level of security risk, 12 the lowest) is 2.5 for the poorest countries, whereas it is 4.5 for China and India, 6.4 for the middle-income developing countries, and 10.6 for the OECD countries.[9]

This result is important: it means that the issue of food security merges into the broader question of the situation of the poorest countries. It reinforces the suggestion made below that, while the poorest countries should be asked (and be willing) to bind their tariffs at a (much) lower level than their current bound tariffs, they should be required to reduce only their current applied high tariffs—such high tariffs are often called tariff "peaks."

The special safeguard debate. Food security concerns have also led to an impassioned debate on the necessity for a special safeguard for developing countries.

This debate was initially launched by some developing countries that asked for access to the UAA special safeguard (Article 5). The UAA made this provision available only to countries that tariffied their border measures—that is, all the OECD countries, but only 20 developing countries (and only one of the poorest countries).[10] The UAA special safeguard offers importing countries the possibility to limit a sudden surge in low-priced imports more easily than the usual GATT safeguard (GATT Article XIX).[11] It is thus aimed at the security of domestic farmers; it has little to do with the food security risks outlined above, which focus on consumers in developing countries not having enough food—in fact, surges in low-priced imports benefit consumers.

Indeed, farm liberalization is seen by many as a situation where rich, heavily equipped, and well trained OECD farmers will wipe out poor farmers in developing countries. Far from this, OECD farm liberalization is estimated to increase the food output of all the 40 individual developing countries or groups of countries (Diao, Diaz-Bonilla, and Sherman 2003). Calculated as a percentage of the value added, the impact of world farm liberalization would be (again) greatest for the poorest countries—ranging between 3.1–3.4 percent for the Sub-Saharan countries, compared with 2.2–2.9 percent for the Latin American countries and less than 2 percent for the Asian countries. The value of agricultural exports of developing countries would be boosted by more than their agricultural imports would be dampened. All of the 40 developing countries or groups of developing countries would improve their trade balances, indicating that food self-sufficiency in the poorest countries would rise.

In sum, the wiping out of developing countries' farmers by foreign farmers, though technically possible, does not look very likely—and even less likely

if one includes the strong local dimension of food, which implies that most farmers produce for local markets, a dimension hard to fully integrate in the calculations.

Even so, would a special safeguard for developing countries be the best instrument to address these fears? The answer is no, for two reasons. First, in the context of WTO negotiations, granting a special safeguard to developing countries is likely to be "paid for" by keeping the special safeguard currently enjoyed by the OECD countries. Second, there is already a normal GATT safeguard (based on Article XIX), offering ample opportunities to react to strong import pressures.

Safeguards have also proven to be difficult to control. The last 30 years of trade policy in developed and developing countries alike—including the last decade of using the Uruguay Round special safeguard—abundantly demonstrate that safeguards are seldom used to protect the people for whom they were intended. More often, they fall into the hands of unrelated but powerful vested interests—large farmers instead of small farmers, traders instead of farmers, and so on. In this context, large countries have huge advantages. They will not hesitate to impose safeguards, which will create the very price turbulences that developing countries fear. By contrast, small economies will often hesitate to displease their powerful trading partners by taking safeguards against them. They will generally end up imposing safeguards on the imports from their fellow developing countries, spreading turbulence and magnifying the initial problem.

As explained below, the balance of the 2004 Doha Work Programme framework underscores these concerns. It provides developing countries with a special safeguard, paid for by keeping the Uruguay Round special safeguard, which is mostly enjoyed by the rich countries. The combination of the existing Uruguay Round special safeguard and a possible Doha special safeguard for developing countries is likely to seriously undermine the value of any farm reform, and thus greatly diminish the overall gains expected from more liberal farm trade.

Alternatives to safeguards. There would have been—there still is, since the 2004 DWP framework is a "work program"—a better way to address the fears just expressed, which may still be possible to explore in the coming negotiations. It would be for the Doha Agreement on Agriculture to allow the poorest countries that currently have low bound tariffs on certain farm goods to increase these tariffs during the Doha negotiations. These countries would receive the desired flexibility to reposition themselves in the context of a liberalization process, while still keeping tariff reshuffling under the control of multilateral negotiations. (Such an approach is equivalent to the use of GATT Article XXVIII without its costly compensatory mechanism.) Negotiators could decide to limit this one-off option to the poorest countries running food security risks (as defined by rigorous criteria, such as those mentioned above) or to the few food products that are key in the country's diet.

This approach should suffice in the Doha Round context. As described below, the Doha negotiations should rely on a formula for tariff cuts based on progressivity (deeper cuts in high tariffs) with a possible cap on bound tariffs—that is, a maximum bound tariff. This maximum tariff is likely to be substantially higher than the tariff rates currently applied on farm imports by most developing countries. So, the foregoing alternative to a special safeguard for developing countries offers flexibility to anxious developing countries.

Meanwhile, it has many important benefits for the multilateral trading system that a special safeguard will not provide. It ensures that the measures taken will consist of tariffs, not quotas. It sets *ex ante* the maximum possible tariff increases (the difference between the applied rate and the maximum bound tariff). It sets such increases on a tariff line basis (safeguards tend to cover many tariff lines). It helps the poorest countries start the crucial process of binding tariffs. It avoids the redundancy of making a special safeguard available to countries with very high bound tariffs. Last but not least, it will provide a key argument for developing countries to ask for the elimination of the Uruguay Round special safeguard currently enjoyed by the OECD countries.

A new special safeguard available to developing countries is thus not a desirable option for dealing with concerns about the potential for domestic producers to be wiped out by foreign competition. Nor is it the best option for dealing with food security concerns. First, it is difficult to understand why such an instrument would need to be made available to middle-income countries, with most of them running no serious food security risks (see above), or to the poorest countries, which are not required to modify their current applied tariffs (other than the tariff peaks).

Second, and above all, there is a much more efficient alternative for dealing with these risks: emergency food stocks. From an economic perspective, such stocks differ from stocks used for stabilizing prices in that they should be bought and sold at market prices. Annex 2 (paragraph 3) of the UAA already includes emergency food stocks as a component of the Green Box, but developing countries running food risks should fight for clarification of the UAA language (in addition to getting a more rigorous definition of when developing countries are running food security risks).

The most important clarification concerns the possibility of treating public emergency purchases of food from existing domestic and foreign traders as equivalent to emergency public stockholding. This possibility is only briefly evoked in the UAA's Annex 2, but it could help to solve several problems (Lind 2001). First, it would limit the huge maintenance costs entailed in keeping public stockholding (estimated to be within the range of 15 percent of the grain price in both India and the EU). Second, public foodstocks are hard to run efficiently, as best illustrated by India where the mammoth foodstocks (estimated at about 60 million tons) held by the Food Corporation of India (responsible for stocking and supplying the Public Distribution System) coexist

with several hundred million people lacking easy access to food (Hoda and Gulati 2002).

More systematic public purchases from traders should also be encouraged. If done at the world level (the necessary capital is estimated at $400 million), their costs could be spread over many countries. Public purchases offer a transparent alternative to international food aid, limiting the risk of using such aid as disguised export subsidies. They can be done at the right time, that is, when food is necessary, not when it is available in excess in developed countries (a key problem of food aid). Public purchases also allow a much more flexible approach in terms of the food products to be stocked. All these advantages would be particularly beneficial to the poorest countries, and are consistent with the Millennium Development Goals.

In sum, improving food security should be dealt with not through restrictive trade policy (under the banner of a special safeguard) but through an open trade policy coupled with the possibilities of *ex ante* adjustment of bound tariffs and of *ex post* emergency food stocks, and with the elimination of the special safeguard provision already enjoyed by OECD countries.

Farm liberalization and the poor

Analyzing the impact of multilateral and domestic farm reforms on individual incomes requires a distinction between four main types of households within each developing country: net sellers of food (mostly farmers owning their land), landless rural workers, urban unskilled workers (often underemployed laborers), and urban skilled workers.

Net sellers of food would benefit, undoubtedly and directly, from domestic food price increases following international food price rises. Farm households of this group represent a large share of the poor people in most developing countries, particularly in the poorest countries. For instance, they represent 60 percent to 80 percent of total rural employment in South Asia (Rosegrant and Hazell 2000).

The three other groups of households are net food buyers—hence they are hurt by higher food prices. But whether they become ultimately poorer depends on what happens to their earnings—that is, to the demand for their specific labor.

Most of the urban skilled workers are unlikely to see a rapid offsetting rise in the demand for their services following farm reforms. That would probably be the case for doctors, lawyers, or bureaucrats, but not for engineers who could benefit from a boom in demand for rural infrastructure. However, one can reasonably assume that these net losers from farm reforms are also the more affluent people in developing countries and that they will find it relatively easy to pay a little extra for food.

Poor landless rural workers (20 percent to 40 percent of total rural employment in South Asia) would likely enjoy a rise in the demand for their unskilled

labor—be it demand for farm labor or for labor in rural enterprises that grow as farmers spend their enhanced income on manufactures and services. This, coupled with the fact that wage raises would more than offset the rise in food prices in rural areas, means that this group would benefit indirectly from farm reforms.

That leaves the last of the four main types of households, underemployed urban poor, as the major vulnerable group. A proportion of these urban poor would not be worse off—those for whom trade reform generates a more-than-offsetting increase in the demand for the (often informal) services that are relatively intensive in that group's labor. For the rest of these households, which would lose from farm reforms, there are also some opportunities. Their losses may be offset if barriers to imports of semiskilled labor-intensive manufactures are reduced by their trading partners (chapter 5) and if semiskilled labor-intensive services from developing countries are becoming more tradable because of technical progress or reduced restrictions on movement of workers (chapter 4).

Taking these many economic forces into account suggests that losers among the poor would be far less numerous than is often believed. But this does not mean that there will be no losers from international and domestic farm reforms—adjustment policies to complement trade reforms will remain a necessary part of the package. Yet the design and financing of appropriate complementary policies can present real challenges for poor countries (box 3.5).

The need for domestic complementary policies: freer trade does not mean laissez-faire

Farm liberalization will require domestic adjustment in most developing (and developed) countries, hence the need for active domestic complementary policies. Foremost among the rural poor who may lose from trade reforms are those who are employed in or produce crops that are initially highly protected and who are unable to shift quickly from these crops to other agricultural or industrial activities. Examples include farmers producing maize in Mexico, wheat in Morocco, and bananas in several Caribbean countries.

If the mobility of the rural poor is limited, a reduction in farm protection alone is likely to hurt them as prices for their output fall. The costs for the rural poor may be particularly high in the short term. Over time, losses may be reduced and even eliminated, as farmers change their output mix and produce more of the crops whose prices do not fall. But this scenario is not necessarily a sufficient answer: it does not solve the problem of how farmers could survive during the transition period.

These adjustment problems could be addressed in two ways. The first is through progressive liberalization, that is, gradually phasing down tariffs in the vulnerable crops according to a pre-announced schedule. However, experience shows that this solution has limits. Unless a pre-announced schedule of

Box 3.5

Mismanaging adjustment to trade reform—Zambia in the early 1990s

Source: McCulloch, Baulch, and Cherel-Robson 2000; Dinh, Adunga, and Myers 2002; Winters, McCulloch, and McKay, 2004.

The Zambian case of the early 1990s illustrates the importance of the careful design of trade reforms and appropriate complementary reforms. Until 1990 reliance on copper exports and high protection had led Zambia—a country that had a per capita income similar to that of the Republic of Korea in the mid-1960s—to a long-term decline.

Starting in 1991 import licenses, quantitative restrictions, and most subsidies were abolished, and marketing boards were demonopolized. However the supply response was much more limited than had been hoped for. Following the abolition of the official monopsony in maize, two private firms dominated the activity and abandoned purchasing from farmers in remote areas—confining many of the benefits of greater availability of new and cheaper imported goods to urban and periurban areas. The official marketing boards had provided small farmers with inputs secured against future output, whereas the post-liberalization private agents did not. Thus, small farmers in remote areas lost out, despite the rise in prices for commodities they produced.

Safety nets in Zambia were underfunded and unable to offer serious mitigation to the losers from trade liberalization. This reflects the general fact that developing country governments have much less capacity to assist the losers of trade reforms, given their limited fiscal resources. In the Zambian case, it also reflected the adoption of a cash budget that restricted spending to domestic revenue performance. This led to great difficulties for ministries and agencies in planning and delivering programs, as resource availability became much more uncertain and volatile. Moreover, resources were redirected away from the poor, with a pernicious effect on the quality of public service delivery to them.

Finally, a significant expansion in nontraditional exports, mostly horticulture and floriculture, occurred in the mid-1990s. But only from 1996 onward did rural economic growth begin to have a significant impact in reducing poverty and the employment losses caused by the privatization of parastatals offset by private sector employment expansion.

Targeting and sustainability are two challenges for general safety nets. Experience suggests that workfare programs can be most effective, provided they are well designed and administered, complemented by programs to provide food to those who cannot work and to children. Examples of the latter that have been successful in a number of countries are food-for-education schemes.

tariff reductions is actually implemented from the start, reforms with initial implementation lags and long transition periods (typically over five years) lack credibility and provide lobbyists with too much time to defeat them.

Second, liberalization must be combined with complementary policies aimed at easing the costs of adjustment for affected groups. Trade policy is not the best instrument for addressing issues raised by individual incomes. Better targeted policies are needed, focusing on the specific problems at hand. The necessary complementary policies will vary across countries but are likely to include a wide range of domestic structural policies (investments in land reform, education, technology, infrastructure) and income-transfer policies. Development of these policies requires analysis of the prevailing situation before reforms are pursued, and identification of the sources of rigidity and of the balance between rural net sellers (including the importance of subsistence farming), rural net buyers, and the urban poor.

If the problem is the relative immobility of farmers, complementary policies should directly target the farm sector. Shifting crops may require restructured land arrangements, adequate capital, education for the farmers and their families, and research and development. Limits on all these inputs may make farmers unable to take advantage of the opportunities created by farm reforms.

But if farmers are relatively mobile (able to undertake crop changes), their efforts to adjust may be held back by rigidities in the nonfarm sectors, be they industry or services. Complementary policies should then target these nonfarm sectors.

Services are particularly important. Inefficient or costly services may prevent poor farmers from being able to take advantage of new export opportunities. For example, a crucial, though often neglected, sector in the context of trade farm reform is distribution. In many of the poorest countries, farm exports constitute a major share of total exports, but transportation and logistics services in these countries are often limited and costly, placing a heavy burden on poor farmers attempting to access export markets. Rough handling of fruits and vegetables (including at airports and seaports), lack of storage, and inadequate packing and transport facilities result in considerable post-harvest losses, often estimated at 30–40 percent of the product sale value. Barriers to entry into distribution enable middlemen to artificially reduce the prices paid to poor farmers and increase those paid by consumers—that is, they can pocket much of what used to be collected as tariff revenue and do not pass on the savings from tariff cuts to consumers. The relative market power of farmers, food processors, and distributors is an issue for both developed and developing economies because distributors and food processors tend to concentrate more—and faster—than farmers. Rather than the levels of concentration, it is the imbalance between the different levels of concentration at the various stages of production that can be a source of problems. This situation can be addressed much more successfully by facilitating some kind of cooperation between farmers (for instance, through well designed regulations on cooperatives) rather than by imposing trade barriers (generally captured by the most powerful actors, that is, the largest ones).

In the same vein, parastatal "marketing boards" often strongly restrict competition for the products of poor farmers—curbing their incomes. Eliminating these boards and paying attention to the continuous supply during the transition period of the key ancillary services (transportation and credit) that these boards may have provided is crucial, particularly for the poorest farmers (see box 3.5). More generally, ensuring effective competition among private firms is very important. Granting exclusive state licenses to private firms (through import monopolies or exclusive distribution arrangements) should be avoided so that farmers do not have to pay excessive prices for their inputs or receive artificially depressed prices for their outputs.

Some of these complementary policies require the removal of restrictions—say, on barriers to entry of additional suppliers in key service sectors—or

exclusive licenses, to promote gains from competition. Others require the commitment of government resources—such as to undertake land reform, to pass regulations on cooperatives, or to fund increased education and appropriate technology, particularly in the regions that have not benefited from the Green Revolutions of the 1970s (Hazell 2002).

Many of the poorest countries may face real difficulties in finding the financial resources for developing and adopting these appropriate complementary policies (see box 3.5). In such cases, the international community has a key role to play in financing the adjustment policies. Institutions such as the World Bank can play a major role in supporting liberalization by providing the resources for adjustment and reform programs (the role of the international community in supporting complementary policies and safety nets is discussed further in chapter 12). Well organized international food aid will also continue to be important for the poorest countries.

In summary, the best approach for developing countries is to combine liberalization with complementary policies—supported and, where necessary, financed by the international community—to ensure that the benefits of liberalization are reaped and its costs, particularly for the most vulnerable groups, minimized. Case studies of Madagascar, Ethiopia, Zambia, and Cambodia suggest that appropriate complementary policies can greatly increase the gains to poor countries, even from a limited Doha Round (box 3.6).

Negotiating issues—strategic view and tactical choices

If multilateral and domestic farm liberalization is both beneficial and manageable for all developing countries, then what needs to be done in terms of trade negotiations, and how should it be done? In other words, what strategic view should be adopted, and what tactical choices in line with this view should be made during the Doha Round?

This section sketches the main strategic aspects (box 3.7), then identifies the key tactics for the Doha negotiations under the three pillars of the 2004 DWP framework: market access, export subsidies, and domestic support. While each is discussed separately, the linkages between them are crucial. For developing countries, it is crucial that the Doha negotiations should go beyond export subsidies and achieve a significant reduction in tariffs—not only to provide market access opportunities, but to end the protection granted by rich countries' domestic subsidies behind high tariff walls. Reducing border protection is the necessary pressure that will force rich countries to discipline domestic subsidies, since it is becoming politically impossible to increase them. Were only export subsidies eliminated, the Doha Round would have simply put the world farm trade in the situation known by the trade in industrial goods in 1947, before the birth of the GATT—high import barriers everywhere. Such a move could hardly be qualified as progress in farm trade liberalization, and it could be costly to many countries.

Box 3.6

Trade and complementary reforms in two of the poorest countries

Source: Nicita 2004a, b; Balat, Brambilla, and Porto 2004; Soloaga 2004.

A very limited Doha Round outcome (as defined in box 1.2) would increase prices of goods that are important to households in the poorest countries only by a small amount—1 percent or less for Madagascar, 1 percent to 4 percent for Ethiopia. Only a proportion of this international price change would be passed through into domestic prices, reflecting internal transportation and distribution costs, among other factors (especially in economies lacking internal integration, such as Ethiopia). Given these small world and domestic price changes, the impact on exports of a limited Doha Round outcome would also be relatively small. So would be the overall effects on poverty—real incomes would increase by less than 0.5 percent in Madagascar and by 0.1 percent in Ethiopia. Such a small impact should not come as a surprise: it reflects the fact that the assumed Doha Round outcome is very limited, illustrating the crucial need for a more ambitious outcome. It also illustrates the importance of complementary actions by governments of low-income countries to increase the gains from trade.

For Madagascar, a poor country with a liberal trade policy (the average tariff is less than 5 percent, the highest tariff band is 20 percent), complementary actions should revolve around improving productivity and enhancing the supply response to price changes. Such actions would amplify the benefits of the very limited Doha Round outcome for poor households by a factor of 5—from 0.5 percent of real income to 2.5 percent.

For Ethiopia, a poor country with relatively high trade barriers (the average weighted tariff is 15 percent), actions aiming to increase the supply response, productivity, and linkages to markets would triple the positive trade effects of a limited Doha Round outcome. Much more important from a poverty perspective is the potential economic impact of domestic reforms that result in a decrease in subsistence and consequent increase in labor market participation. Such actions could have a significant impact on poverty—increasing real incomes of the poorest households by up to 6 percent.

The Doha Round would offer a potentially useful focal point to pursue such complementary reforms and to mobilize the additional resources that are needed to implement them. Moreover, because Ethiopia is a relatively protected economy, its own liberalization could have a significant positive effect on the average real incomes, although the poorest in society might benefit the least, with an increase of 3 percent, compared with 10 percent for households in the top third of the income distribution.

Similar conclusions can be drawn for Zambia and Cambodia.

Market access

The priority of the Doha negotiations should be a substantial reduction in existing bound tariffs, with a focus on the elimination of tariff peaks. Provisions on market access in the 2004 DWP framework lack clarity and robustness (box 3.8). Too many elements are yet to be defined or negotiated, and some will be counterproductive—untying what others try to tie. What follows makes a case for a substantial reinforcement of some key provisions during the coming negotiations.

The first key provision of the 2004 DWP framework is the choice of a tariff-cut formula. Relying on a formula is a wise decision, but there are many competing formulas (box 3.9). Unfortunately, the 2004 DWP framework has chosen the tiered formula, which is not the best choice. In this context, it is important to reaffirm the advantages of the Swiss formula which can be

Box 3.7

A strategic view—the "grand vision"

Adopting a strategic view about the world situation in farm reform by 2015–20 is a critical first step. It should include:

- A commitment by all countries to reduce MFN bound tariffs dramatically. By 2015 no bound farm tariff should exceed 5 percent for OECD countries, 10 percent for developing countries, and 15 percent for the poorest countries, and the dispersion in rates across tariff lines should be reduced.
- A binding commitment by all countries to fully decouple all support payments to farmers by 2015, and to cap all domestic support measures to 5 percent of the value of agricultural production (on a specific product basis).
- A binding commitment by all countries to abolish export subsidies by 2010, and to impose the same disciplines on export-subsidy substitutes, such as export credits, two-tier price schemes (as in the EU sugar regime, where high consumer prices in the EU market indirectly cross-subsidize EU exports to world markets), food aid, and exporting state trading enterprises.
- International institutions (the International Monetary Fund, World Bank, the Food and Agriculture Organization, and so on) should stand ready to provide adjustment assistance to developing countries for food security reasons (emergency food stocks) and for financing complementary policies (investments in domestic law, land reform, infrastructure, education, technology, and so on). The level of intervention should be consistent with the Millennium Development Goals. Emergency stocks could take the form of an international financial fund.

This strategic view does not imply the elimination of all subsidies. Complementary policies include genuine farm policies, and there is a valid rationale for nontrade-distorting subsidies in many contexts. What should characterize them is that they should address well defined problems and be decoupled as much as possible from production

characterized as a "continuous" tiered formula (with a built-in maximum post-liberalization tariff). This feature allows the Swiss formula to avoid all the problems raised by the discontinuities that are necessarily associated with the thresholds to be defined in a tiered formula. Indeed, it would not be very surprising if WTO negotiators face such huge difficulties in defining the tariff bands, with the corresponding thresholds and the specific reduction coefficients, that they ultimately turn again to the Swiss formula.

The first advantage of the Swiss formula is to offer immediate and costless information on the post-liberalization tariff rates (and particularly on the maximum possible tariff) as soon as the reduction factor is agreed (see box 3.9). In comparison, the tiered formula would require the negotiators to take at least six decisions to reach this point—two tariff bands and four specific reduction coefficients. And it would also require considerable work in each capital city on how to implement these four reduction coefficients, tariff line by tariff line. The capacity of the Swiss formula to deliver such complete information with so few decisions also exerts powerful constraints on rent-seeking interest groups. Moreover, the reduction factor does not need to be the same for all the countries. For instance, it could be lower for OECD countries than for developing countries, and it could be higher for the poorest countries than for the

Box 3.8

The 2004 Doha Work Programme framework on market access

Source: WTO 2004d.

Tariff cuts

- Reduction of bound tariffs on the basis of a "tiered" formula (to be defined) (see box 3.9).
- Progressivity: deeper cuts in higher tariffs.
- Possibility of a tariff cap.

Sensitive products

- Flexibility (to be defined) for "sensitive" products through combining tariff-rate quotas and tariff reductions.
- Some MFN expansion of the tariff-rate quotas will be required for all sensitive products.

Other elements

- Tariff escalation to be addressed through a formula to be agreed on.
- The Uruguay Round special safeguard remains under negotiation.

Special and differential treatment for developing countries

- LDCs are not required to undertake tariff reduction commitments.
- SDT for developing countries (other than LDCs) justified on the basis of food security, livelihood security, and rural development needs (all undefined).
- SDT provided through lesser tariff reductions and lesser expansion of tariff-rate quotas.
- Longer implementation period.
- Additional flexibility for "special" products (all terms to be defined).
- Flexibility (to be defined) for newly acceded countries.
- Establishment of a "special safeguard mechanism" for the developing countries.
- Accelerated market access for tropical products and alternatives to narcotic products.
- Expeditious results for cotton.

two other country groups (generating proportionally greater cuts for OECD than for developing or the poorest countries).

Its second advantage is that it cuts tariff peaks by more than the smaller tariffs—hence maximizing the economic benefits from trade liberalization. The Swiss formula is a powerful instrument to move protection automatically toward greater neutrality across goods at the lowest political domestic cost since the ranking of the domestic products in their level of protection remains unchanged, though the protection differentials between these products are narrowed.

The Swiss formula requires specific tariffs to be transformed into *ad valorem* tariffs. This greatly improves transparency. Interestingly, this transformation is explicitly included in the 2004 DWP framework on industrial goods (chapter 5), but not in Annex A for agriculture—a surprising difference, because specific tariffs are primarily used for farm products. The conversion from specific to *ad valorem* tariffs is a crucial benefit for developing countries because it removes the implicit but strong bias of specific tariffs against developing countries' exports: as products originating in developing countries often

Box 3.9

The war of the formulas

Source: Francois and Martin 2002, 2003.

First is the "linear" formula, a simple proportional cut, with all tariffs reduced by the same proportion: $T = ct$. T is the post-liberalization tariff and t is the pre-liberalization tariff, and c is the constant proportion by which tariffs are to be reduced. The aim of the negotiations is to agree on c. From a negotiating point of view, this formula hardly offers an acceptable balance of concessions between countries with very different tariffs, particularly tariff peaks. From an economic point of view, this formula has the disadvantage of not cutting tariff peaks by more than small tariffs, whereas such tariff peaks impose most of the welfare costs of protection.

Under the Uruguay Round formula, countries choose the extent of their tariff cuts for individual products (tariff line by tariff line) but they have to reach an agreed average cut for all the tariffs involved (36 percent in the Uruguay Round) and a minimum cut on each tariff (15 percent in the Uruguay Round). From a negotiating point of view, this formula gives maximum flexibility to countries. From an economic view, it minimizes liberalization since countries tend to adopt high tariff cuts on goods not domestically produced, but minimum tariff cuts on those domestically produced. Hence, domestic producers remain protected by minimum cuts—hence the absence of actual liberalization in the Uruguay Round, where minimum cuts were imposed on tariff peaks. In sum, the Uruguay Round formula minimizes the economic gains to be expected from liberalization.

The "tiered" formula, introduced in the WTO Harbinson text (February 2003), was suggested as a compromise between the Uruguay formula (favored by the EU) and the Swiss formula (favored by the Cairns Group). It splits the whole range of tariff rates imposed by all the WTO Members into "bands," with each band subject to specific reductions. For instance, the Harbinson text suggested three tariff bands (lower than 20 percent, from 20 percent to 120 percent, greater than 120 percent) with specific average and minimal reduction rates for each band. The tiered formula, essentially the Uruguay Round formula with built-in progressivity, faces the same basic problems, though they are softened by the progressivity afforded by the bands. But it has two major problems: the definition of the thresholds is crucial (hence the source of tense negotiations that can lead to complicated and perverse outcomes), and it defines no "maximum" tariff, a key point in such a highly protected sector.

The "Swiss" formula comes from the negotiations on industrial goods in the Tokyo Round. It cuts the highest tariffs by more than the lowest tariffs according to the formula: $T = (rt)/(r + t)$ where r is the "reduction factor." By agreeing on r, negotiators define the highest post-liberalization tariff because, when t (pre-liberalization tariff) is very high, $t/(r + t)$ approaches 1 so that T (post-liberalization tariff) equals r (in other words, pre-liberalization megatariffs will be reduced to the lower, preestablished maximum level post-liberalization). When t is very small, $r/(r + t)$ approaches 1 so that T equals t (in other words, post-liberalization tariffs will be about the same as the low pre-liberalization tariff). Technically, the Swiss formula is generally considered as the best available. As a result, its benefits are explained in the main text.

Last is the "blended" formula, which is a cocktail of the foregoing formulas. Countries could use the Uruguay Round formula for some tariff lines, the Swiss formula for other lines, and so on.

tend to have lower unit value exports (reflecting lower quality, less processing, and the like), on a per unit basis, the effective rate of protection implied by a given specific tariff is systematically higher on their products.

All these features make the Swiss formula especially valuable for the poorest countries. The pivotal role of the reduction factor (which is the only parameter considered by negotiators) allows countries with minimal individual bargaining power to make large coalitions on this central issue, instead of being dragged into detailed negotiations that they cannot follow closely enough. Its transparency makes countries deprived of large negotiating teams capable of assessing the concessions made by the trading partners.

The Swiss formula happens to be friendlier to developing countries than to OECD countries for a more circumstantial reason: the farm tariffs currently applied by developing countries are often lower than those imposed by OECD countries (when one takes into account specific tariffs and seasonal tariffs). Table 3.2 illustrates the case where the maximum tariff (the reduction factor) is assumed to be equal to 35 percent for all the WTO Members (once again, negotiations could agree on different reduction factors for the OECD, middle-income, and poorest developing countries, reinforcing the results of table 3.2). It shows that OECD countries would have to liberalize substantially under the Swiss formula, whereas countries such as Brazil or Malawi would simply have to reduce their average bound tariff, without changing their applied average tariff—though tariff peaks are likely to be reduced. Tariff negotiations could be futile when based on other formulas. These formula reductions leave very high tariffs for the OECD countries, even on average—such high tariffs will exert little pressure for eliminating or reducing OECD export and production subsidies.

The second key provision of the 2004 DWP framework on agriculture is the treatment of the tariff-rate quotas. Tariff-rate quotas are border restrictions that combine a lower (in-quota) tariff rate for a specified volume of imports and a higher (over-quota) tariff rate for imports above this volume. Eliminating them is preferable to expanding them because they have many negative features: they generate quota rents that convert would-be free traders into supporters of the protective regime, they introduce scope for discriminating between countries, and they can reduce national welfare by much more than similarly protective import tariffs. Tariff-rate quotas were introduced by the UAA because it was clear that the then ongoing tariffication process would often lead to prohibitive tariffs. However, the adoption of a Swiss formula with a reasonable maximum tariff eliminates this rationale.

The last key provision of the 2004 DWP framework is special and differential treatment for developing countries. As argued above, even the poorest countries have strong interests in nondiscriminatory (MFN) tariff cuts by OECD countries. At a first glance, this seems paradoxical because most poor countries enjoy preferential (though often limited) tariffs in OECD markets. But MFN tariff cuts have much more powerful effects than preferential tariff reductions on the two other OECD instruments of protection—export and production subsidies. MFN tariff cuts will almost automatically generate equivalent cuts in export subsidies. This is because reducing MFN tariffs

Table 3.2

Comparisons of the impact of the various formulas for tariff reductions on selected farm sectors

Percent

Initial tariff[a]	Countries	Uruguay formula[b]		Swiss formula[c]		Harbinson formula[b]			
						OECD[e]		Developing countries[f]	
		Minimum	Average	Average[d]	Global[b]	Minimum	Average	Minimum	Average
473.7	Japan: bound	402.6	303.2	16.7	28.2	307.9	189.5	331.6	284.2
91.9	Japan: applied	78.1	58.8	14.9	22.6	59.7	36.8	70.8	58.8
55.3	EU: bound[g]	47.0	35.4	16.9	19.4	35.9	27.7	42.6	35.4
35.0	U.S.: bound	29.8	22.4	10.2	16.2	22.8	17.5	27.0	22.4
22.8	U.S.: applied	19.4	14.6	8.1	13.0	14.8	11.4	16.6	16.6
43.5	Brazil: bound	37.0	27.8	17.5	17.8	28.3	21.8	33.5	27.8
16.4	Brazil: applied	13.9	10.5	15.4	10.6	12.3	9.8	12.0	12.0
125.0	Malawi: bound	106.3	80.0	24.2	24.2	81.3	50.0	87.5	75.0
13.8	Malawi: applied	11.7	8.8	13.8	9.5	10.4	8.3	10.1	10.1

a. Average tariff on 13 product groups (see text).
b. Tariff cut on the average initial tariff.
c. Factor 30.
d. Average of the tariff cuts by product.
e. Assuming that the country would be an OECD country.
f. Assuming that the country would be a developing country.
g. Bound and applied tariffs for the products in question are very close for the EU.
Source: For the formulas, proposals tabled in the WTO Special Session on Agriculture. For the initial tariffs, DRIFE 2003 (see text).

leads to a reduction in domestic prices (an impact that preferential tariffs on generally very limited imports do not have), and this in turn causes production costs to fall and removes the need for export subsidies (most of which are paid for in order to compensate for differences between high domestic costs and low world prices). Similarly, MFN tariff cuts will erode the protectionist impact of the production subsidies mostly granted by the OECD countries to their farmers. The higher the tariff rates, the smaller the domestic subsidies need to be to provide a given level of protection.

But what about tariff cuts by developing countries? The 2004 DWP framework clearly imposes looser commitments on developing countries, in almost all possible dimensions (tariff reductions, tariff-rate quota expansions, product coverage, longer implementation period, and so on). This approach introduces too many escape possibilities for developing countries and is counterproductive. Because tariffs are the main instrument of protection used by developing countries on imports from other developing countries, tariff cuts are the most straightforward tool for unleashing the gains to be expected from farm trade between developing countries. While OECD countries should bear the deepest cuts, it is not in developing countries' own interests to maintain high agricultural protection.

But what about the poorest countries? The 2004 DWP framework states without ambiguity that LDCs are not required to undertake commitments on bound tariffs. This approach is also counterproductive. First, because the negotiations are on bound, not applied, tariffs, and as the applied farm tariffs of the poorest countries are often moderate, commitments to reduce bound

tariffs will have a limited impact on applied tariffs (except in the case of applied tariff peaks). Reducing bound tariffs to a more moderate level would have then cost little to the poorest countries, while it would have put future liberalization on a firmer ground. Second, it is often argued that allowing the poorest countries to make no commitments is justified because they do not have the fiscal capacity to support agriculture through less trade-distorting direct income supports. This argument ignores the fact that (applied) tariff peaks are usually so high that they provide no tariff revenue, so that more moderate tariffs are likely to increase tariff revenues. A much more sensible approach would have been to ask the poorest countries to adopt a uniform and moderate structure of bound tariffs—that is, leaving unchanged most of their current applied tariffs and reducing only their tariff peaks.

Export subsidies

Doha negotiators have inherited from the past 20 years a difficult legacy of bitter disputes on export subsidies between countries convinced of their comparative advantages in farm exports (such as the U.S. during the Uruguay Round or Brazil today) and the EU. These disputes have been so intense that they have overshadowed the other aspects of farm negotiations—particularly tariff reductions. However, the elimination of export subsidies alone does not constitute a real trade liberalization—as said above, it would be similar to the pre-1947 situation in trade of industrial goods.

It is well known that eliminating export subsidies without reducing tariffs and domestic support will be costly to countries that are net importers of farm products (because export subsidies depress world prices). These costs have been calculated: removing only OECD export subsidies would harm all the subgroups of developing countries, except Brazil and the rest of Latin America (IMF 2003). But, and this is crucial, the same calculations have also shown that these costs are transformed into net gains as soon as tariffs and domestic support are reduced or eliminated. There is thus a serious need to recast the export subsidies issue—and more broadly the export competition issue—which has been too much captured by negotiating rhetoric (box 3.10).[12]

First, export competition is very much country specific—in sharp contrast to the widely used tariffs. Export subsidies are almost exclusively a Western European phenomenon: five-sixths of all export subsidies in the mid-1990s were granted by the EU, and all but 2 percent of the rest were accounted for by Norway, Switzerland, and the U.S. (eight non-OECD countries can provide export subsidies under the UAA provisions). Like-instruments (export credits and food aid) are mostly used by the U.S., with the notable exception of widespread two-tier price schemes (such as the EU sugar regime, where high consumer prices on the EU market indirectly cross-subsidize EU exports to world markets). Finally, there are only a few important cases of state trading enterprises (mostly in Canada).

Box 3.10

The 2004 Doha Work Programme framework on export competition

Source: WTO 2004b.

Basic principles

- Parallel elimination of all forms of exports competition (export subsidies, subsidy elements of export credits and guarantees, trade-distorting practices by exporting state trading enterprises, food aid generating commercial displacement).
- Implementation modalities to be agreed.
- End date to be specified.

Special and differential treatment for developing countries

- Maintaining the UAA exemption for subsidies on certain inputs and downstream activities (such as marketing) (Article 9.4) for a reasonable period.
- Appropriate provisions for LDCs and net-food importing developing countries.
- Special consideration for state trading enterprises in developing countries aiming to preserve price stability.
- Higher *de minimis* threshold on export subsidies.
- Longer implementation period.

Second, eliminating farm export subsidies is, of course, essential for all the developing countries that have comparative advantages and export capacities in farm products—hence their strong advocacy in this part of the negotiations. But export subsidies should be a concern for all developing countries. Because they have helped convert traditional net importers of commodities (such as the EU) into net exporters, they have reduced incentives in all developing countries for investing in farm production. In particular, they have also led developing countries' governments to neglect their domestic farm sector, and not to pursue the often successful Green Revolution efforts (FAO 2003).

That said, the 2004 DWP framework provisions on export competition warrant four remarks. First, because the elimination of export subsidies could induce rich countries' governments to use the like-instruments instead, it is important to discipline such substitutes as well, as specified by the framework. However, ideally, these disciplines should be nondiscriminatory, that is, not defined by type of beneficiaries (for example, no less stringent provisions if export credits or food aid are granted to the poorest countries or net-food-importing countries). This is because subsidies are by nature fungible, so privileged beneficiaries could do business from their special status (for instance, resell food they received under special export credits or through food aid programs). Even with a nondiscriminatory regime, monitoring the subsidy component of export credits and food aid would be a difficult task, as illustrated by the OECD consensus on export subsidies in manufacturing (which mostly covered well defined and easily traceable products).

Second, it is important to renew the exemption for developing countries (Article 9.4) regarding marketing costs, internal transport, and freight charges, as the 2004 DWP framework provides. These are not to be regarded as export subsidies and thus should not subject to reduction commitments.

Third, a higher *de minimis* threshold for export subsidies for developing countries makes some sense (although ideally it should have been limited to the poorest countries). This provision will protect the first inroads of developing countries' exporters from being immediately crushed by antisubsidy procedures by developed and other developing countries. By contrast, it is difficult to understand with some precision what is meant by the special consideration for state trading enterprises in developing countries aiming to preserve price stability. At a first glance, it does not seem a good idea, given the experience with state trading enterprises and the existence of superior instruments to address food security concerns.

Fourth, it is worth noting that the 2004 DWP framework did not make any clear reference to Article 13 of the Uruguay Agreement on Agriculture (the so-called "Peace Clause"). This temporary ban on the right to impose countervailing duties on imports of goods that have benefited from domestic support and export subsidies in agriculture lapsed on December 31, 2003. The silence of the DWP framework is important. Developing countries with a stake in further liberalization in farm and food products should not agree to an extension of the Peace Clause under the Doha Round unless they have achieved their negotiating objective of enlarging market access for their exporters. The end of the Peace Clause is an essential instrument of pressure in this regard, and developing countries should not give up the possibility of being able to use disputes to raise public awareness of the need for reform of agricultural subsidies and to create pressure for reform (as has successfully been pursued recently with regard to sugar and cotton).

Domestic support

Domestic support (price support, direct production subsidies, and so on) is a domain where OECD countries have been able to get de facto "reverse special and differential treatment" under the UAA: domestic support measures deemed to be trade-distorting were listed in an Amber Box, but their aggregate monetary value (called the "Aggregate Measure of Support" or AMS) was merely subject to reduction commitments—not to outright prohibition as for industrial products.

This reverse special and differential treatment was reinforced by the fact that the Amber Box has three main exceptions: the Blue Box (payments under production-limiting programs), the threshold of *de minimis* levels of domestic support (subsidies considered too small to be trade-distorting), and certain measures to encourage agricultural and rural development in developing countries (measures under Article 6.2 of the UAA). At a first glance, these three limits to the Amber Box disciplines seem to establish a fair balance between exceptions for OECD and those for developing countries. But in reality this is not the case. Some OECD countries have been able to allocate a large portion of their huge farm subsidies to the Blue Box, and they have been by far the

main beneficiaries of the definition of the AMS in terms of the whole farm sector, rather than in terms of specific products. These lavish exceptions explain why most OECD countries have been able to maintain a very high level of domestic support—rendered less visibly expensive by high tariff walls. In sharp contrast, developing countries have only very marginally utilized Amber Box exceptions.

The 2004 DWP framework has provisions dealing with all these elements. One of them is relatively precise—the minimum cut of 20 percent (in the first implementation year) of the overall domestic support (the sum of the Amber and Blue Boxes, plus the *de minimis* threshold) (box 3.11). What follows examines three key issues left by the trade negotiators.

First, the Boxes approach raises a fundamental question. Can "decoupling" be perfect, that is, eliminate all the links between subsidies granted for legitimate objectives and production decisions? The answer is no, and the 2004 DWP framework tends to turn a blind eye to this problem. Every public or collective action may have some impact on production decisions, and governments looking to circumvent rules can use a plethora of potential instruments. For instance, subsidies for achieving noneconomic objectives, such as rural development or environmental protection, may still support farm production to some extent, and hence hurt trading partners' producers. Making such subsidies as minimally conditional upon production decisions as possible is a step in the right direction. But the near impossibility of fully decoupling subsidies from production decisions is what makes the discipline of increased competition from imports by cutting tariffs so essential.

Second, some developing countries' farmers are indirectly benefiting from OECD domestic support. This is best illustrated by the EU sugar and banana regimes, with countries such as Mauritius (sugar) and the Caribbean states (bananas) enjoying quotas that allow them to sell their products on the EU market at the much higher European prices. Such a situation creates incentives for an "unholy alliance" between the farm interests of some OECD and developing countries (chapter 7). A fair and economically sound alternative to maintaining preference margins would be to turn to the Green Box, on which the 2004 DWP framework remains very vague. For instance, the Green Box could include the adjustment measures that OECD countries should take in order to compensate developing country farmers who indirectly benefit from OECD domestic support. These measures could take the form of international flows of direct income support, extending to developing countries' farmers the adjustment support granted to OECD farmers growing the same crops or livestock (see box 3.3 for the core principles for such adjustment support). Any such assistance should be transitional and motivated explicitly by the need to facilitate the adjustments that are required to realize the gains from global policy reforms.

Last but not least, should developing countries seek to expand the coverage of permitted support instruments to allow them more freedom to subsidize?

Box 3.11

The 2004 Doha Work Programme framework on domestic support

Source: WTO 2004d.

Overall reduction

- Definition of overall trade-distorting domestic support (ODS) as the final bound total aggregate measure of support (FBTAMS) plus permitted *de minimis* level and plus the level of Blue Box payments.
- Reduction of the ODS on the basis of a "tiered" formula (to be defined).
- Progressivity of the reductions: deeper cuts in higher levels of ODS.
- In the first implementation year, a minimum cut of 20 percent in ODS.
- Special and differential treatment with longer implementation period and lower reduction coefficients.
- No end target specified.

Final bound total aggregate measure of support (Amber Box)

- Reduction of the FBTAMS on the basis of a "tiered" formula (to be defined).
- Progressivity of the reductions: deeper cuts in higher levels of FBTAMS.
- Product-specific AMS to be capped at their respective average levels according to a methodology to be agreed.
- FBTAMS reduction will result in reductions of some product-specific support.

***De minimis* level**

- Subject to special and differential treatment.
- Exemption for developing countries allocating their *de minimis* support for subsistence and resource-poor farmers.

Blue Box

- Renewal of Article 6.5, which would allow for direct payments under production-limiting programs or for those not requiring production if these payments are based on fixed and unchanging bases and yields (or heads) and if they are made on 85 percent (or less) of a fixed and unchanging base level of production.
- The above criteria, along with additional criteria, to be negotiated.
- All criteria should ensure that Blue Box payments are less trade-distorting than AMS measures.
- Blue Box support will not exceed 5 percent of a Member average total value of farm production during an (undefined) historical period.

Green Box

- Green Box criteria to be reviewed and clarified in order to ensure that Green Box measures have no, or almost minimal, trade-distorting effects or effects on production.
- Improved obligations for monitoring and surveillance of new disciplines.

Indeed, many—including some of the poorest countries in the discussions on special and differential treatment—have argued that developing countries should counterbalance the current reverse special and differential treatment enjoyed by the OECD countries by demanding their own additional rights to subsidize.

This approach has flaws. The UAA already gives developing countries a wide degree of freedom for subsidizing the development of their farm sector provided that these measures are "an integral part of development programs" (investment subsidies) or that "they are targeted at low-income or resource-

Box 3.12

Key tactical choices for the Doha Agreement on Agriculture

Market access

- Reduction of bound tariffs on the basis of a Swiss formula, introducing three maximum tariffs (one for OECD countries, one for the developing countries, one for the poorest countries).
- Removal of all the nontariff barriers, including tariff-rate quotas, by 2010.
- A commitment by all countries to reduce the dispersion in tariff rates as much as possible, that is, substantially reduce tariff escalation.

Domestic support

- A commitment by all countries to decouple all support payments to farmers by 2010 and to cap all the domestic support measures to 10 percent of the value of agricultural production (product by product).
- Maintain the existing Green Box with clarifications or marginal additions (support for diversification, transportation subsidies for farm products, consumption subsidies for domestic food aid, public assistance for establishing farm cooperatives, or institutions promoting marketing and quality control of food products) for the poorest countries.
- OECD countries should compensate developing countries' farmers for loss of preferences under the Green Box.
- Reduce the scope and strengthen the disciplines of the Amber and Blue Boxes with a view to the progressive elimination of the Blue Box and further cuts in the AMS.

Export subsidies

- Elimination of all export subsidies by 2010. The smaller the tariff reduction commitments by countries that use export subsidies, the stricter their commitments in terms of reduction of export subsidies should be.
- Comparable disciplines on similar instruments, such as export credits, two-tier price schemes, state trading enterprises, and food aid.
- No reintroduction of the "Peace Clause"; it provides leverage for developing countries seeking greater market access.

poor producers" (input subsidies). There is thus no need for much wider freedom. But clarification of certain existing provisions might be considered—for instance, how to define low-income or resource-poor producers, poor remote areas, and poor people? These clarifications would aim to minimize the uncertainty about whether such subsidies could be caught by antisubsidy procedures from trading partners (chapter 6 suggests an additional way to improve legal certainty through the *de minimis* threshold). Other provisions could be marginally expanded. For instance, support for diversification, transportation subsidies for farm products, consumption subsidies for domestic food aid, public assistance for establishing farm cooperatives, or institutions promoting the marketing and quality control of food products could be made easier.[13]

All these expansions will require careful handling. "Targeting at the poor" has a mixed record, even when done with the best intentions. There is definitely a tradeoff between more meaningful concessions and a tighter definition of the recipients. Ideally, all these provisions should thus not only meet the basic

principle of the UAA Green Box (be minimally trade distorting), but they should be made specific to programs targeting poor consumers or farmers, and some of them should be made available only to the poorest countries.

Few of the poorest countries have the funds to finance additional subsidies. Fighting for unusable rights has heavy costs in trade negotiations. It wastes negotiating capital, leading to diminished ability to fight for more urgent goals, such as tariff cuts. Indeed, the cautious approach taken here reflects a broader concern about whether subsidy rights are worth having in the context of limited government revenue, rather than a specific desire to limit public intervention.

The extra rights that the poorest countries could get to subsidize would probably come at the expense of ceding greater rights (for example, subsidies for animal welfare could easily become subsidies to livestock producers) to OECD countries, which are rich enough to use them—thus perpetuating or even amplifying the asymmetries that currently plague the system.

Once again, the cautious approach advocated here has one ultimate advantage. It is the best approach for dealing with the "reverse special and differential treatment" currently enjoyed by OECD countries (and the few developing countries with reserved rights in these matters); that is, for reducing the scope of acceptable subsidies for OECD countries by narrowing the scope of the Blue Box (ultimately by abolishing it) and by reducing the AMS.

Chapter 4

Services

While trade in goods—and particularly agriculture—commands most attention on the Doha Agenda, the potential gains from successful services liberalization may be much larger—by up to a factor of five under some estimates (Robinson, Wang, and Martin 1999). Beyond the numbers, services are fundamental for development, in terms of both the efficiency and growth potential of the economy as a whole, and access to basic services to improve the lives of the poor. Smooth transport, logistics, and distribution services are needed to reap the gains of increased exports and imports. Health, water distribution, and electricity are essential services that are still not available to many of the poorest. Services are central to the achievement of the Millennium Development Goals.

The service sector is wide and diverse, encompassing activities as disparate as accountancy, telecommunications, all kinds of transport, health, and tourism.[1] In most developed countries, services account for around 70 percent of GDP; in other countries, the figure is still above 50 percent. Long considered nontradable, trade in services grew by about 6 percent a year on average between 1990 and 2003, keeping pace with the growth of merchandise trade over the same period. In 2003 global services exports increased significantly, up by 12 percent to reach $1.8 trillion. Developing country services exports were valued at $377 billion in 2003, a 6 percent increase over the previous year, while Least Developed Country (LDC) exports were $7 billion, a 9 percent increase over the previous year (WTO 2004c).[2] The majority of "trade" in services takes place through foreign direct investment (FDI) (box 4.1), and services may account for a substantial proportion of total FDI.

The service sector is undergoing a profound transformation. Technological developments, budgetary pressures, and regulatory changes have greatly expanded the range and scope of trade in services. They have introduced

Box 4.1
Ways of trading services

Trade in services, unlike trade in goods, is not limited to flows across a border. The intangible nature of services and the need for proximity between producer and consumer means that services trade can take a variety of forms. The GATS refers to four "modes" by which services can be supplied:

- Mode 1 (cross-border trade): the service crosses the border (for example, an architect in Malaysia faxes a plan to a client in Thailand).
- Mode 2 (consumption abroad): the consumer moves to the territory of the service supplier, for example, to purchase tourism, education, or health services (a Thai goes to Malaysia for a holiday).
- Mode 3 (commercial presence): foreign direct investment (FDI), where a service supplier establishes a branch or subsidiary in another country (for example, a Malaysian architecture firm establishes a subsidiary in Thailand).
- Mode 4 (temporary movement of people as service suppliers): an individual service supplier or company employee moves temporarily to another country to supply services (for example, a Malaysian architect goes to Thailand for six months to supervise the construction of the building she designed).

competition into sectors formerly considered to be natural monopolies (telecommunications, energy); created additional possibilities for cross-border trade (business and computer services); and increased private sector participation in services where, in many countries, the public sector had traditionally played a major role (health, education, environmental services). The growth in services trade is also underpinned by the widespread liberalization of FDI regimes over the past decade, a trend that accelerated in 2002 in the face of diminishing FDI inflows (UNCTAD 2003f).

In sharp contrast to agriculture, services negotiations in the Doha Round take place against a backdrop of widespread unilateral liberalization of services trade and investment regimes by WTO Members. The two sectors thus face very different negotiating environments. While for agriculture, negotiations are crucial in driving even minimal reform, services negotiations tend to play a complementary role, locking in reforms already undertaken. While this means that services negotiations can generate significant gains simply by harvesting existing liberalization (which perhaps explains the relative inattention to services in the Doha Agenda), it also poses a real challenge—in a nutshell, why push strongly for commitments on market access when market opening is being undertaken unilaterally? In other words, if countries are liberalizing because they view it as being in their own economic interest, what are the incentives to translate this liberalization into GATS commitments (that is, to guarantee treatment at least this liberal on a permanent basis)?[3]

A Doha Agenda in services is attractive for three reasons. First, unilateral liberalization has not been spread equally across all services and modes of supply. Significant barriers remain, particularly in areas of great interest to developing countries, such as the movement of natural persons to supply services under mode 4. Second, given that domestic politics and vested interests can

make reforms difficult to sustain, GATS negotiations offer scope to lock in policy reforms by offsetting pressures for protection with pressure from those who gain from increased exports. Third, in the mercantilist world of trade negotiations, preparedness by developing countries to lock in services reforms in GATS commitments can generate leverage to push for the necessary technical and financial assistance to implement regulatory reform or for commitments from trading partners across other parts of the WTO agenda. Done right, services negotiations offer developing countries an opportunity to act in their own economic interest and get paid for it.

Existing levels of protection in services trade and investment

Trade in services differs from trade in goods in two key respects. First, in general, barriers to international trade in services are higher than those to trade in goods. They often take the form of regulatory measures, varying between and within sectors, some preventing market entry, others restricting the scope of operations within the market. For instance, in many countries, provision of professional services is restricted to nationals. But not all regulations on services are necessarily barriers to trade—services tend to be regulated to achieve a range of public policy objectives.

Second, and potentially more important, market access barriers in services can also limit the entry of new domestic suppliers into the market, restricting both domestic and foreign competition. For instance, in many countries, provision of key services remains the province of monopolies (telecommunications, insurance, environmental services). And major services sectors, such as retailing, transport, and banking, can be regulated in such a way that they remain dominated by a few local providers.

Data on barriers in services are notoriously poor. However, available evidence suggests that, on average, developing countries have more restrictive barriers than developed countries, in particular in key infrastructure services—ones that form the backbone of the economy—such as telecommunications and financial services. The pattern is less clear in a number of other sectors, such as education, maritime, professional, and distribution services (OECD 2003e).

Unfortunately, GATS commitments provide limited insight into services barriers. This is because of the flexibility in the GATS to commit to less than the status quo[4] and the extent of unilateral liberalization undertaken since the Uruguay Round—in stark contrast to agriculture. In fact, many WTO Members have significantly more open services markets than their GATS commitments would suggest.

However, in terms of the GATS, the sectors where the highest number of WTO Members have made some form of commitment include tourism (126 Members), financial services (106 Members), business services (101 Members), communications (98 Members), transport (82 Members), construction (72 Members), recreation (59 Members), environmental services (52 Members),

and distribution services (50 Members), with the fewest commitments made in health (45 Members) and education (44 Members). In general, developing countries have made commitments in fewer sectors than developed countries. Of the 99 WTO Members who have made commitments in 80 sectors or fewer from the more than 160 in the Services Sectoral Classification List, 98 are developing countries (WTO 1999).[5] The number of commitments for each sector does not tell the whole story since commitments can still be subject to restrictive conditions (for example, in telecommunications and financial services, especially in relation to market entry) (WTO 1999).

Commitments for each sector are undertaken by mode of supply. Most commitments have been made for mode 3 (foreign establishment, also known as commercial presence)—the dominant mode of supply in all service sectors except transport and, to a lesser extent, telecommunications (World Bank 2002). But these commitments do not necessarily grant open markets—they include many limitations preserving the privileged status of traditional incumbents, particularly where the total number of suppliers in the market is restricted (WTO 1999).

Mode 1 (cross-border) commitments are generally much narrower and more limited than those for mode 3. During the Uruguay Round, many mode 1 entries were left "unbound (meaning that no commitment has been taken by the country in question) due to lack of technical feasibility" for services that are now tradable. While in practice it can be hard to prevent supply by this mode, WTO Members place a range of restrictions on it, including nationality and residency requirements, authorization, and local authentication requirements (OECD 1999).

GATS mode 2 (consumption abroad) commitments show the fewest restrictions, probably because countries have limited interest in, or ability to, control the consumption of services abroad by their nationals.

Commitments on mode 4 (temporary movement of people to supply services) are the fewest of any of the modes and the most restrictive. They tend to be horizontal (covering all sectors listed in the schedule, rather than being sector-specific—see appendix 5) and limited to the highly skilled (executives, managers, and specialists). Only 17 percent cover lower skilled personnel and only 10 countries have allowed some form of restricted entry to "other level" personnel (Chanda 1999). Around half of all mode 4 commitments relate explicitly to people being transferred within companies (intracorporate transferees)—that is, they are linked to foreign investment through mode 3. There are 38 exemptions to most favored nation (MFN) treatment relevant to mode 4 (of which 32 are preferential agreements).[6] Barriers to mode 4 are discussed further below.

Benefits of liberalization

Given the central role that services play as inputs into production, an efficient and diversified services sector is critical for development. Be it efficient

transport links, or business services to enable countries to participate in trade, or health and education to build human capital, services have a major influence upon economic development. Low quality, costly, or inefficient services act as a brake on the entire economy: inefficiencies in roads, railways, power, and water alone cost an estimated $55 billion a year in losses in the early 1990s—an amount equal to 1 percent of the GDP of developing countries or twice the annual budget for financing infrastructure in the developing world (UNDP 2004b). Losses from inefficient services have spillover effects and are not one-time—they hamper economic growth on an ongoing basis by lowering the profitability of existing investment and discouraging further investment (Hodge 2002).

Service liberalization and economic performance

Reduction of barriers—in particular to foreign-owned firms or movements of labor—enhances competition, expands the scale and diversity of activity, lowers prices, and increases quality, all of which generate scope for further growth. For instance, a reduction in services trade barriers that increased cross-border trade and reduced inefficiencies from monopolies by 10 percent and price mark-ups from imperfect competition by a similar percentage could increase the income of developing countries by $900 billion (9.4 percent) by 2015 from 1997 levels (World Bank 2002).

Openness in services can also influence long-run growth performance (figure 4.1). After controlling for other determinants of growth, countries that fully reformed the financial services sector grew, on average, about 1 percentage point faster than other countries. An even greater impetus to growth comes from fully reforming (liberalization plus regulatory reform) both the telecommunications and financial services sectors; countries that fully liberalized both sectors grew, on average, about 1.5 percentage points faster than other countries.

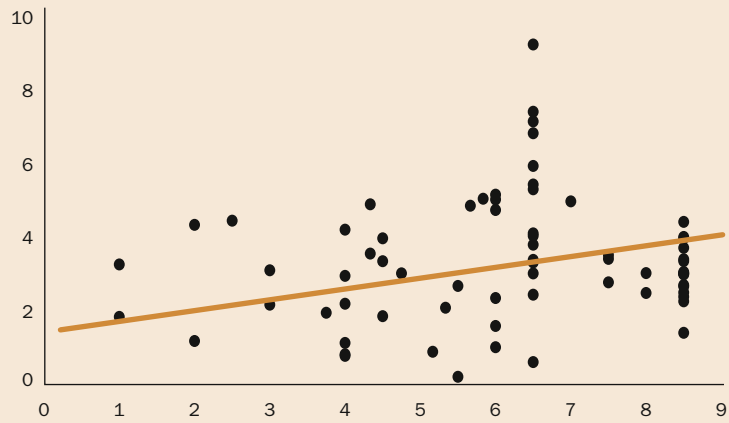
Services liberalization provides three main sources of gains (box 4.2): it removes the bottlenecks in infrastructure services, it lowers prices in liberalized

Figure 4.1

Greater liberalization in services is associated with faster growth

Growth rate, controlling for other variables

Source: Mattoo, Rathindran, and Subramanian 2001.



services; and it improves the range and quality of services provided. Because much of services liberalization is through FDI, services imports bring in flows of capital, know-how, and technology—all severely constraining factors in the development of poor countries. Moreover, the presence of foreign services firms often creates additional demand, including that for other services, in the domestic economy. For instance, unit increases in the output of electricity, transport, public administration, and health in Bangladesh were found to create additional demand for other sectors ranging from 30 percent to 43 percent, while unit increases in housing, construction, and banking and insurance spurred increases in demand of up to 15–10 percent (Azad 1999). Gains from services liberalization also accrue from the fact that the removal of barriers allows entry by new domestic, as well as foreign, firms into the market. In telecommunications services, barriers to market entry by both domestic and foreign suppliers were found to raise prices by up to 70 percent (Warren 2000).

Efficient services are vital to the export of goods and other services

Services are used intensively in the production of all goods and services, making up around 10–20 percent of production costs in both industry and agriculture,

Box 4.2

The three main sources from gains from services liberalization

Source: Luo and Findlay 2002; Boylaud and Nicoletti 2000; OECD 2000, 2001, 2002b; Markusen and Rutherford 2002; Kalirajan and others 2000; Claessens, Demirgüc-Kunt, and Huizinga 2001; Mann 2000.

- *Foreign competitors add to domestic production capacity and enhance efficiency.* Foreign competitors in the logistics sector add to capacity and provide access to the soft technology associated with new ways of organizing businesses, for both manufacturers and retailers. Prospective and effective liberalization of telecommunications has a positive impact on sector efficiency (and on quality of services and prices) in OECD countries. The density of mobile phones grows more rapidly (and prices fall more rapidly) in liberalized markets. In mode 4, exposure to foreign expertise—say, through the presence of engineers or management consultants—can provide important knowledge transmission and productivity gains with flow-on benefits for the development of domestic entrepreneurship and growth.
- *Foreign competition contributes to reducing the price of services.* In Chile, competition in telecommunications resulted in rapid price reductions (thanks to the modernization of infrastructure): between 1989 and 1994, prices for local telephone calls dropped by 36 percent, for long-distance calls by 38 percent, and for international calls by 50 percent. By contrast, nonprudential restrictions on 294 foreign banks in 27 economies in the Asia-Pacific, European, and American regions raised the price of different banking services by between 5 and 60 percent.
- *Foreign providers improve the range and quality of services.* In financial services, foreign participation strengthens the banking systems by introducing new risk management technology. After controlling for all the standard financial and macroeconomic factors, the entry of foreign banks was associated with greater efficiency of the banking system for 7,900 banks in 80 countries. In El Salvador, the sale of a majority stake in the country's public telecommunications operator and the auction of a second cellular license in conjunction with the introduction of competition reduced the delay for connection of a fixed line from up to six years to a couple of days.

and in some cases more—they are 20–25 percent of the readymade garments industry in Bangladesh (Azad 1999). The price and quality of services are critical in determining the cost of all other products and services in the economy. As tariffs come down and production chains go global, services are becoming an ever greater determinant of the competitiveness of goods and services producers (Hodge 2002).

Much of what is required to trade—telecommunications, transport, banking, insurance, and distribution—is services. For agricultural exporters, integration of the agriculture sector within and between economies depends upon access to transportation services (Limão and Venables 2001). Inadequate transport and distribution links result in considerable post-harvest losses, wastage, and overcharging by middlemen—all problems particularly acute in relatively remote areas. Inefficiencies in internal transport systems have also contributed to the concentration of China's development in coastal areas: trucking rates to move a container 550 kilometers inland are estimated to be about three times more than in Europe or the U.S., and railway charges are punitive (World Bank 2002).

Efficient and cost-effective international maritime transport is also vital for many countries' participation in world trade. Restrictions on the provision of port services can significantly raise prices for maritime transport (Fink, Mattoo, and Neagu 2001) and reduce port efficiency—high levels of mandatory port services for incoming ships are estimated to reduce port efficiency by 5 percent (Clark, Dollar, and Micco 2002).

Low-quality services that delay production or delivery effectively also exclude producers from time-sensitive global supply chains. A survey of developing country services exporters found that lack of access to cheap and reliable infrastructure services was a serious problem—for example, when exporters of business and professional services lost clients because unreliable telecommunications prevented timely delivery (OECD 2003e). Transport and financial services underpin the tourism sector, while data processing, customer service centers, and diagnostic health services all rely upon high quality telecommunications. Services are also the key to small- and medium-size businesses being able to take advantage of the new trade opportunities made possible by the Internet. For instance, exporters of handicrafts or professional services might be able to access international markets through the Internet, but without telecommunications and energy services they cannot access the Internet.

The quality and efficiency of all the basic services necessary for trade can be improved by trade itself: that is, by importing high quality and modern services—for example, traded business services provide the quality control and packaging services needed by Vietnamese exporters entering world textile markets (Kyvik Nordås 2004). Services imports can also build capacity in more direct ways: Malaysia formed twinning programs with universities from Australia, the UK, and the U.S. to provide its own population with increased access to higher education, but now markets itself as a destination for foreign

students seeking to take degrees accredited by those countries in a lower cost environment. In 2000 Malaysia attracted more than 26,000 foreign students from nearly 100 countries including Indonesia, China, and India. Similarly, developing country subsidiaries of major financial services firms export to both the home country of the parent firm and third-country markets (OECD 2003e) and the international outsourcing of services, a major growth area for developing country services exports, often takes place through local subsidiaries of developed country companies (that is, outsourcing of exports can be built upon mode 3 imports) (OECD forthcoming).

Developing countries have real export interests

The Doha Agenda is often presented as a tradeoff of developing country agriculture exports in exchange for developed country services exports. This is a mistake.

The gap between developed and developing countries in the share of services in total trade is rapidly closing. Developing countries have increased their exports of services nearly fourfold in the last decade (faster than goods exports), increasing their share of the global marketplace from 14 percent in 1985–89 to 18 percent in 1995–98 (World Bank 2002). As a result, while the share of services in trade in developed countries has stayed reasonably constant at around 20 percent of total trade for 1980–2000, the share in developing countries grew from under 10 percent to just under 20 percent over the same period (OECD 2002c).

Many developing countries are highly specialized in services and have concrete—and growing—export interests to pursue in the Doha Round. While developed countries still dominate trade in services, 21 developing countries feature in the list of top 40 services exporters for 2003 (excluding intra-EU trade), with five (China, Hong Kong (China), the Republic of Korea, Singapore, and India) ranked in the top 10. Their percentage shares of world services trade remain relatively low, reflecting the concentration of services exports from a few developed countries.[7] However, growth rates for nine developing countries—China, the Republic of Korea, Egypt, South Africa, Macao (China), Morocco, Chile, Argentina, and the Dominican Republic—were in double digits (table 4.1).

Even for the poorest countries, services exports are not insignificant. In the 49 LDCs, the average contribution of services exports to GDP was around 6.5 percent in 2001, with some countries reaching peaks of more than 50 percent (Vanuatu and the Maldives). Services were the main export for nine of the poorest developing countries in 2001 (table 4.2).

For these poorest countries, services exports are mostly tourism, while developing countries are exporting a broad range of services. Lower costs of skilled labor, along with cheaper and improved telecommunications, have made electronic supply a major factor in the growth of services exports from developing countries. As in goods, trade between developing countries is also expanding (box 4.3).

Table 4.1

Developing countries in the top 40 services exporters, 2003

Excluding intra-EU trade

Rank	Exporter	Value (billions of dollars)	Share (percentage)	Annual percentage change
4	China	46.4	3.5	18
5	Hong Kong (China)	44.6	3.3	4
8	Republic of Korea	31.3	2.3	16
9	Singapore	30.4	2.3	3
10	India	25.0	1.9	7
11	Taiwan (China)	23.0	1.7	7
16	Thailand	15.7	1.2	2
17	Malaysia	13.5	1.0	–9
18	Mexico	12.6	0.9	1
21	Egypt	10.8	0.8	19
22	Brazil	9.6	0.7	9
26	Indonesia[a]	6.4	0.5	—
27	South Africa	6.4	0.5	40
29	Saudi Arabia	5.3	0.4	3
31	Macao (China)	5.2	0.4	17
32	Morocco	5.1	0.4	24
34	Chile	4.7	0.4	11
35	Argentina	3.8	0.3	32
36	Dominican Republic	3.4	0.3	13
38	Vietnam	3.2	0.2	—
40	Philippines	3.0	0.2	–2

— Not available.

a. WTO Secretariat estimate.

Source: Adapted from WTO 2004b.

Table 4.2

Ratio of exports of goods and commercial services to GDP for selected poorest countries, 1995 and 2001

Percentage

Country	Goods		Services	
	1995	2001	1995	2001
Cape Verde	3	6	12	20
Comoros	5	8	12	13
Eritrea	15	3	16	19
Ethiopia	7	7	5	6
Maldives	21	19	57	60
Samoa	5	—	27	—
São Tomé and Principe	10	7	13	28
Solomon Islands	54	20	11	18
Tanzania	13	8	11	7
Vanuatu	12	9	33	53

— Not available.

Source: Adapted from WTO data.

Labor-intensive services: an opportunity for developing countries

Developing countries enjoy a clear comparative advantage in labor-intensive services, including—in a growing number of areas—at the higher skilled end of the chain. Service supply through temporary movement of natural persons (mode 4) is thus a key priority for the GATS negotiations. But increasingly, so is the supply of labor-intensive services by modes 1 and/or 2, in the form

Box 4.3

Developing country services exports

Source: OECD 2003e.

In port and shipping services, four of the top five global container terminals in terms of throughput are in developing countries; the Philippines accounts for 20 percent of seagoing staff.

In audiovisual services, India exports films to 95 countries and sales grew from Rs 2 billion in 1998 to Rs 5.25 billion in 2001. Hong Kong (China) remains the world's third largest film producer, and Thailand is an emerging player, producing film and television and undertaking postproduction, including computer animation and effects, for other films. Egypt and Brazil are major suppliers of audiovisual services, especially for television, within their regions.

Of the top 150 construction companies in 2002 measured by revenue generated outside the home market, 51 were from developing countries, with China dominating.

In health services, Cuba, India, and South Africa are all destinations for foreign patients. China and India are establishing hospital and specialty clinics in a variety of foreign markets. Asian and Latin American retailers are also expanding in their regions, including into developed countries (Australia and the U.S.).

Barbados is becoming prominent in data processing; the Philippines, India, and China are actively exporting computer software services; and South Africa exports a full range of business and financial services to the southern African region. Indian software and information and communication technology (ICT) companies have established subsidiaries in both developed (U.S.) and developing country (Latin American) markets.

In telecommunications, South African companies are major players in the African market, exporting to Cameroon, Swaziland, Nigeria, Uganda, and Rwanda. Egyptian companies manage GSM networks in more than 20 countries in the Middle East and Africa. Telekom Malaysia exports to Bangladesh, Cambodia, and Sri Lanka.

of the international outsourcing of computer and business process services.[8] New telecommunications technologies have enabled companies in developed countries to take advantage of lower cost skilled labor by outsourcing a range of their business functions (customer help lines, data processing) to companies or subsidiaries based in developing countries.

Both mode 4 and outsourcing promise real export gains for developing countries. In both cases, trade is already under way, and the challenge will be to translate this reality into GATS commitments and to use the negotiations to head off actual, or potential, obstacles to future growth.

Mode 4 (temporary movement of people to supply services). One of the key gains from increased mode 4 trade for developing countries is the remittances (money) sent home by their nationals working abroad. While remittances are sent by a much larger group of migrants, of whom mode 4 is only one part, they are an important and growing source of development finance.[9] The total value worldwide of remittances more than doubled between 1988 and 1999, with officially recorded workers remittances amounting to $72.3 billion in 2001 (World Bank 2003a)—although the total amount is likely higher as many remittances are sent through informal channels. Remittances are larger for low-income countries as a share of GDP and imports than for middle-income countries:

in the poorest countries, remittances are on average about 1.9 percent of GDP, but can be as much as 26.5 percent (Lesotho), and are two to three times larger than total FDI (Ratha 2003). Remittances are also more evenly spread than FDI flows and more stable (unlike FDI, they are countercyclical, tending to increase in times of economic downturn). In most developing countries, remittances are also a larger source of income than aid (Ratha 2003).

The gains from further mode 4 liberalization are potentially great. Opening of developed country labor markets to temporary entry by foreign workers equal to 3 percent of the current workforce would generate welfare (real income) gains exceeding those that could be attained from full merchandise trade liberalization—an aggregate gain of $150 billion a year or 0.6 percent of initial world income (Winters 2003). For both developed and developing countries, the gains would come principally from the movement of low-skilled workers (Winters 2003).

At present, however, mode 4 is subject to a range of restrictions. Wage parity requirements are common: mode 4 workers are generally required to be paid the prevailing wage in the host country, and—under the same rationale of avoiding a competitive cost advantage to foreign workers—also to contribute to social security systems. The latter requirement can be particularly unfair where the foreign worker will never be eligible to receive the benefits of the schemes to which they contribute. As a result of these requirements, the competitive cost advantage of developing countries from lower labor costs shows up less in trade through the temporary movement of people (mode 4) than through outsourcing (modes 1/2). This is because where services are outsourced offshore, the prevailing local wages are paid and the cost advantages of developing country labor remain intact.

Equally, while many schemes facilitate the mobility of the highly skilled, relatively few cover the moderately or lower skilled workers of interest to developing countries. While intracorporate transferees enjoy relatively easier conditions for mobility, groups that are more important to developing countries—such as contractual or independent service suppliers (those who are not attached to a foreign company established in the host country but have a contract to provide a specific service to a host country client)—tend to be subject to quotas and limited to certain sectors and relatively short durations of stay.

Most countries also subject entry of foreign workers to economic needs or labor market tests (under which foreign suppliers are admitted only if it is assessed that there is a "need" for their services in the domestic market). Such tests are often not transparent (few WTO Members have complied with the requirement to provide their criteria) and can be subject to arbitrary or unpredictable application (UNCTAD 2003b). Other difficulties arise from nontransparent, time-consuming, or burdensome visa or work permit requirements and procedures. Lack of recognition of qualifications, including the limited participation of developing countries in mutual recognition agreements, is a further constraint on mode 4 trade.

While the barriers are multiple, there may be scope for progress on mode 4 in the Doha Round, in part because of changing pressures in developed countries. Of course, GATS mode 4 remains a sensitive issue of negotiations. But the reality is that temporary labor movement—in particular, but not only, related to services—is widespread and growing (box 4.4). While there are no reliable, systematic figures for mode 4, in certain sectors considerable mobility is already taking place.[10] Two main factors can be identified.

First, OECD countries experiencing increasingly tight skills shortages see temporary mobility as one solution. For instance, in response to shortages in developed countries, large numbers of nurses move every year, with the majority coming from developing countries (Martineau, Decker, and Bundred 2002).[11] For some, this is part of a strategy of promoting labor exports; for others, it has given rise to concerns about "brain drain" (see "Addressing concerns about liberalization" below). Developing countries have also been an important source of ICT (information and communication technology) workers, although the recent downturn in the sector has led to revision of projected shortages.[12]

Further, as their populations age and their average levels of training and education rise, developed countries will face an increasing scarcity of less skilled labor. Given the fact that, at least in some occupations, there is no substitute for human labor, the demand for and benefits of allowing labor mobility will

Box 4.4

Trends in the temporary movement of workers

Source: OECD 2004a.

In the U.S., more than 201,000 new H1B visas were granted during fiscal year 2001, in addition to 130,000 renewals. Following the ICT bust, only 103,600 new visas were granted in 2002. The quota is likely to revert to 65,000 for 2004. Temporary unskilled labor in the nonagricultural sector (H2B visas) increased by 50 percent over 2000, doubling since 1999 to reach 72,400 in 2001.

In the UK recruitment conditions for the highly skilled were relaxed and work permits increased, in particular in new technologies, health, and education. In 2002, 85,600 new work permits were issued, continuing an upward trend. Switzerland increased its quota for skilled workers temporarily by nearly 30 percent in May 2001 to meet labor shortages (it had previously remained unchanged for 10 years). In Germany foreign employment grew strongly in the health sector in 2001. In France temporary work permits rose by 28 percent between 2000 and 2001 and have more than doubled since 1998. These were mostly skilled workers in the services sector—computer specialists, teachers, and health personnel. Nearly 1,400 foreign engineers and computer managers received temporary work permits in 2001 (up 40 percent on 2000) and an additional 2,640 specialists received a work permit for more than one year (up 63 percent on 2000).

In Australia temporary foreign skilled workers increased; around 43,000 work permits were issued in 2001 (up by more than 10 percent over 2000). In Japan the number of foreigners obtaining residence for employment reasons in 2001 was 142,000, up 9.3 percent over 2000 and 39 percent over 1998. These are mostly entertainers, with highly skilled workers experiencing a slight decline. In Korea more than 28,200 skilled workers entered in 2001, a 60 percent increase over the previous year. Both Japan and Korea granted increasing entry to trainees in 2001—59,100 for Japan and 100,000 in Korea.

increase over time (Winters 2003). The underlying demographics are compelling: over the next decade, while developed countries face aging populations, around 700 million young people will join the labor market in developing countries.

Second, as business goes global and product cycles shorten, companies need to be able to move more people, and more types of people, to more countries but for shorter periods and at shorter notice. The numbers of people moving around the world within their companies are growing (table 4.3). Global project teams, teleworking, and dual-career couples are all contributing to changing the nature of overseas company assignments, with shorter, more frequent visits expanding faster than longer term assignments (PricewaterhouseCoopers 2001). For multinational companies, recruitment of the highly skilled is also increasingly a global affair, fed by increasing student mobility and burgeoning FDI.

Against this background, the share of temporary labor migration (short-term permits, intracorporate transferees, internships, working holidays, seasonal jobs) in total migration flows is increasing. A number of developed countries are adapting labor migration laws to meet the needs of the labor market for highly skilled, skilled, and less skilled workers (the last in construction, elderly care, other business and household services, and agriculture) (see box 4.4).[13]

In addition to these unilateral programs, labor mobility provisions are included in some regional trade agreements (RTAs). These range from free movement for all kinds of workers in deep integration agreements (such as the EU and that between Australia and New Zealand), to near-free movement for the highly skilled (CARICOM), to provision of certain forms of mobility for some categories of persons related to trade and investment (NAFTA). Some, like the Asia-Pacific Economic Cooperation (APEC), do not grant any right of mobility but facilitate the entry of business visitors. Most RTAs focus on highly skilled workers. Some countries also maintain bilateral labor agreements, particularly covering lower skilled or seasonal workers (box 4.5).

Offshore outsourcing (modes 1 and 2)

New opportunities for skilled or semiskilled workers in developing countries are also being created by the international outsourcing of business process and

Table 4.3

Intracompany transferees in selected countries, 1996–2001

Thousands

	1996	1997	1998	1999	2000	2001
Canada[a]	—	2.1	2.8	2.5	3.0	3.3
France	0.8	1.0	1.1	1.8	2.2	2.3
Japan	2.8	3.4	3.5	3.8	3.9	3.5
United Kingdom	13.0	18.0	22.0	15.0	16.0	17.0
United States (L1 visa)	140.5	—	203.3	234.4	294.7	328.5

— Not available.
a. Includes NAFTA entry.

Source: OECD 2004a.

ICT services.[14] These are fast becoming major exports for a growing number of developing countries—shifting modes 1 and 2 from a secondary role until a few years ago to center stage in the Doha negotiations. Developments in ICT have enabled a growing range of services to be outsourced to other countries. What started out as data processing and low-end business support services has now moved into mid-range ICT jobs, medical care, and specialist analyst positions. ICT-enabled exports also tend to be associated with high levels of FDI, human capital formation, demonstration effects, and knowledge spillovers. Regulatory changes have also contributed to this phenomenon. For instance, companies required by new laws to separate research and analysis from consultancy activities also turn to offshore provision for some activities.

Savings from outsourcing can be significant—wages for software developers and data entry agents in India can be a tenth of those in the U.S. The attraction for companies is clear. For instance, General Electric saves about $350 million a year through outsourcing to India; GlaxoSmithKline expects to save around 35 percent a year on its ICT budget; and the U.S. banking industry has saved $2 billion per year in the last four years. Service quality does not suffer, and productivity can rise by 15–25 percent, as these jobs attract skilled, motivated workers in developing countries. Lower labor costs also

Box 4.5

Regional and bilateral agreements to facilitate movements of workers

The APEC Business Travel Card is one of the few regional facilitation schemes including both developed and developing countries. Currently 14 APEC economies participate in the scheme.[a] While more countries are expected to join in the future, neither the U.S. nor Canada is planning to join. The Card is valid for three years and provides multiple short-term business entries, with stays of two or three months on each arrival. Cardholders receive expedited airport processing and are not required to submit separate applications for business visitor visas. There is no limit on the number of cards, and almost 4,000 have been issued to date. Fees vary among the participating economies. The scheme is open to citizens of participating economies who are bona fide businesspeople.[b] Participating economies commit to implement the scheme on a best endeavors basis and are free to maintain existing visa requirements for business visitors. All economies retain the right to refuse an individual without providing reasons or to refuse entry to APEC Business Travel Card holders at the border.

Some countries, mostly in Europe, have bilateral labor agreements. These tend to cover lower skilled or seasonal workers (in construction, tourism, or agriculture), with some covering nurses. Agreements usually include provisions related to return and worker protection. For instance, a scheme between Germany and some countries of Central and Eastern Europe allows employees of foreign companies to work in Germany providing services to German companies. The foreign company acts as a subcontractor to a German firm, with the workers remaining under contract to their foreign employer. Duration is limited to two to three years. The foreign firm must ensure the exit of the workers, and part of the contract payment is withheld until the workers return home. Some enforcement responsibility is also placed on the local German company. Country-specific quotas are included that can be adapted to the labor market situation in Germany.

a. Australia, Brunei Darussalam, Chile, China, Hong Kong (China), Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, Peru, the Philippines, Taiwan (China), and Thailand.
b. It does not include spouses and children; persons who wish to engage in paid employment or working holidays; and professional athletes, news correspondents, entertainers, musicians, artists, and persons engaged in similar occupations.

Source: Nielson 2003; OECD, IOM, World Bank 2004.

enable companies to offer new services or to undertake tasks (such as pursuing overdue accounts) that were previously uneconomical. Considerable benefits also accrue to the importing country as a whole (see box 4.8).

The benefits for exporting developing countries are substantial. While most exports of business services still originate in OECD countries, developing countries are experiencing high growth rates (figure 4.2).[15] India is the leader—its business process outsourcing sector grew by almost 60 percent a year after 2000, and the software development sector grew at 30 percent a year. But other developing countries are also seizing the outsourcing opportunity. While those with large pools of educated English speakers (the Philippines, South Africa) enjoy an advantage in certain markets, others (Costa Rica) provide services targeted at Spanish-speaking consumers in Europe and the U.S. Language is less important where services such as product development are outsourced—China is a favored location for hardware design and embedded software. Tunisia hosts three data processing companies, while both Barbados and Jamaica have developed flourishing back-office industries, and smaller eastern Caribbean countries are collaborating to promote their back-office capabilities (OECD 2003e).

Linkages between modes of supply

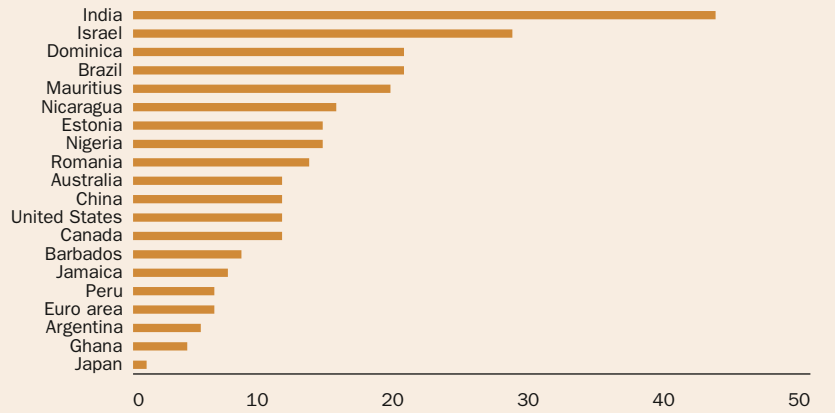
The patterns and growth of developing country exports in labor-intensive services highlight the linkages between modes of supply, where trade through one mode of supply creates new opportunities for trade through others. For instance, the temporary movement of natural persons as service suppliers (mode 4) can make businesses in the host country aware of the pool of skilled labor in the worker's home country and lead to outsourcing of work to (modes 1 and 2), or investment in (mode 3), that country. This has been the experience of India, whose ICT workers temporarily in the U.S. encouraged U.S. companies to see the opportunities for outsourcing work to, or establishing in, India (Chanda 2003a).

Many of the firms in developing countries undertaking work outsourced from developed countries are themselves subsidiaries of developed country

Figure 4.2

Average growth rate of exports of business services for selected countries, 1995–2000

Source: IMF balance-of-payments statistics, cited in Mattoo and Wunsch (2004).



companies (such as IBM India Research Laboratory in New Delhi), an illustration of developed country mode 3 exports leading to developing country exports under modes 1 and 2. These developing country subsidiaries of developed country companies may also bring workers from the developing country back into the parent company in the developed country as intracorporate transferees (mode 4). Further, as noted in the previous section, subsidiaries (mode 3 imports) in developing countries can expand services exports by those countries—Indian subsidiaries of U.S. companies now export services both back to the U.S. and to a range of other markets, contributing to the growth in India's services exports.

Equally, some Indian companies are now establishing their own subsidiaries in the U.S. (mode 3) and bidding for contracts in the U.S. domestic market. These developing country subsidiaries in developed countries (developing country mode 3 exports) are also bringing in workers from their home country as intracorporate transferees (mode 4). This has given rise to a new controversy. Intracorporate transferees have not traditionally been viewed as competing with local labor and so are exempt from some of the stricter requirements applying to other categories of mode 4 entrants (wage parity, labor market tests, or quotas). However, some U.S. firms now complain that they are being underbid on contracts within the U.S. market by local branches of Indian companies using cheaper Indian workers brought in as intracorporate transferees. This has led to calls to make the conditions for intracorporate transferees (L1 visa) closer to those for other kinds of skilled workers (H1B visa), in particular to introduce wage parity requirements, labor market tests, or quotas.

The inclusion in trade in services of mobility of capital and labor raises new and complex choices and challenges for societies seeking to benefit from the global market for services. These are addressed in the following section.

Addressing concerns about liberalization

There are substantial gains from liberalizing key services sectors, but these gains are not automatic. Producing an outcome that supports development is a much greater challenge in services than in goods, given the need for regulation to address more complex issues of market structure, market failures, and noneconomic objectives. Sound domestic regulation—prudential regulation in financial services, consumer protection in professional services, and procompetitive regulation in a variety of network services—is critical to realizing the benefits of liberalization. Credible regulatory frameworks are also important for attracting investors, especially in infrastructure services often characterized by large sunk investment costs (that is, those costs that produce a stream of benefits over a long horizon but can never be recouped). In services, liberalization is emphatically not a synonym for deregulation; it is normally a process of both deregulation and re-regulation, that is, of regulatory reform.

This is not easy, and a number of concerns have arisen with regard to services liberalization: first, that services liberalization does not result in competition; second, that liberalization will limit the access of the poor to basic services; third, that many developing country governments lack the regulatory capacity for effective and well conceived services liberalization; and fourth, that export of labor-intensive workers will lead to the "export" of local jobs and, in the case of mode 4, to a brain drain and unregulated permanent migration.

Liberalization and competition

Ensuring that services liberalization results in a genuinely competitive market requires attention to the nature and sequencing of liberalization. Many countries have privatized without creating competition, effectively turning public monopolies into private ones by opening sectors to FDI without removing restrictions on new entry. Even if new entrants are permitted, competition will not be created if the conditions under which they enter discriminate heavily in favor of the incumbent. While privatization and liberalization can result in some benefits (increasing available capital and technology transfer), the main gains come from competition.[16]

South Africa's experience in telecommunications is salutary. South Africa privatized 30 percent of the public telecommunications provider (Telkom) and granted it a five-year monopoly on fixed-line services. The monopoly period was supposed to facilitate the rollout of infrastructure to previously underserviced areas. Results were disappointing. Network growth picked up but rollout obligations were not met, and Telkom sought to renegotiate the targets. Productivity gains were not passed to the consumer, leading to higher margins rather than lower prices. Labor productivity remained at one-quarter of leading international operators, with the lack of competition identified as a major contributing factor (World Bank 2002).

Competition requires a genuinely contestable market where new entrants are free to compete on price and quality. Many of the infrastructure services that are critical to development—transport, energy, telecommunications, finance—are industries in which network externalities are important. Regulation to ensure that markets are contestable needs to focus not only on "traditional" types of entry barriers, but also on the ability to connect to the network at a reasonable price and to apply the relevant technologies (changes that can also have major implications for the design of appropriate regulation).

The sequencing of reform matters. Poor sequencing has been blamed for some of the unsatisfactory results in Latin America, where regulatory reform was concluded after firms were privatized (Pinheiro 2000). By contrast, simultaneous introduction of regulation to ensure competition and privatization contributed to successful telecommunications reform in 86 developing countries in Africa, Asia, and Latin America. For all these countries, both privatization and competition in telecommunications led to significant improvements

in performance between 1985 and 1999: reform involving both policies produced 8 percent more mainlines and a 21 percent higher level of productivity compared with years of partial and no reform, but mainline penetration was lower if competition was introduced after privatization rather than at the same time (Fink, Mattoo, and Rathindran 2001).

Designing, sequencing, and enforcing reforms can be extremely complex. Regulatory thinking and economic analysis are still evolving rapidly, especially for network industries, and solutions that have proved successful in some countries or some sectors may not be readily transferable to others. Careful assessment of the implications of alternative types of regulation is required to determine which options might be most appropriate for developing countries. This situation has an important consequence for the Doha negotiations: it argues for a degree of caution in making binding commitments in areas where significant regulatory experimentation is still under way, as well as caution in GATS rulemaking with regard to regulation (see appendix 5).

Liberalization and access to basic services by the poor

A key concern in liberalization is that poor households may lose their access to affordable services as new entrants "cream-skim" and focus only on the profitable sectors of the market, leaving the former public monopoly to provide services to the poor, threatening the sustainability of the service supply and the viability of the former monopoly.

This concern raises a first—factual—question. If state monopolies in utilities can cross-subsidize to provide services to poor households, available evidence suggests that they have often not done so, or not done so efficiently. Subsidized services often end up with the middle classes while the poor often remain without services (Simpson 2003). For instance, most of Panama's poor live in rural areas, but the public water and sanitation utility operates almost exclusively in towns. While only 16 percent of its customers live below the poverty line, two-thirds are subsidized (Forster, Gómez-Lobo, and Halpern 2000).

Similarly, while governments devote about a third of their budgets to health and education, they do not always spend it on the poor: in a number of developing countries the percentage of spending on the richest quintile greatly exceeds that on the poorest. For instance, in Nepal, 46 percent of education spending accrues to the richest fifth and 11 percent to the poorest (World Bank 2003b).

Second, liberalization can be a way of, or can contribute to, making services available to the poor (box 4.6).

Third, within liberalized markets, universal service provision can be ensured by a wide range of regulatory mechanisms. Some can target producers. Equal universal service obligations can be placed on all market participants and can include incentives for implementation. For instance, funds for universal service

Box 4.6

Liberalization in the service of the poor—GrameenPhone

Source: Lawson and Meyenn 2000, Burr 2002.

In Bangladesh, liberalization of mobile telephony enabled GrameenPhone, a joint venture between Grameen Telecom (a spinoff of the successful microcredit Grameen Bank) and Telenor (the Norwegian telecommunications company), to sell handsets and airtime to women who provide mobile pay phone services in their villages. The local branch of Grameen Bank pays the price of the phone and connection in the form of a microloan and handles billing, phone maintenance, and investment finance. Each village pay phone covers around 2,500 people, and the repayment rate is 98 percent. In less than three years, telephone access was provided to 2.8 million villagers in 1,100 communities.

In this remarkable case, liberalization has done more than simply deliver access: it has empowered the poor as village women increased their capacity to negotiate with traders, resulting in lower input prices and higher output prices. What remains to be fixed is the remaining monopoly on fixed-line services, which imposes high interconnection and long-distance call costs.

can be pooled and allocated through competitive tender to the firm that offers to provide the necessary service or infrastructure at the least cost.

Alternatively, regulatory mechanisms ensuring universal service provision can target consumers. Nondiscriminatory levies can be placed on all service providers, with the proceeds used to directly subsidize poor households—say, through rebates or vouchers. Progressive tariffs can be applied in some sectors (such as electricity), with low-income consumers paying a "social tariff" (with the government paying the remainder as an implicit subsidy). Consumer subsidies have the advantage of being more easily directly targeted at the most needy consumers and not discriminating between providers. However, they can involve administrative costs in identifying target groups and distributing funds, unless they can leverage existing administrative arrangements. Where the subsidy is not funded from industry levies or the proceeds of privatization, there may also be costs to the government in funding the subsidy. In either case, poor countries are likely to need international assistance to help meet the costs of subsidy programs.

While a range of options exists for ensuring access to basic services by the poor, the most appropriate mechanisms to use will vary according to the conditions and capacities of the country concerned (box 4.7). Again, however, considerable experimentation is still under way in this area, and there are many instances in which privatization and liberalization of infrastructure services in developing countries have failed—sometimes dramatically (as in the case of water services in Bolivia). Getting the pricing right is no easy task, particularly where governments have traditionally held prices of key services below their economic costs—in developing countries at the beginning of the 1990s, revenues for electricity on average recovered only 60 percent of costs; for water the figure was 30 percent. Under public ownership, these deficits were often made up either by transfers from public finances or by the deterioration of assets through inadequate maintenance. Regardless of who owns the assets, in

Box 4.7

Ensuring universal service under competition and privatization

Source: World Bank 2002; Gómez-Lobo 2001; Harris 2002.

Telecommunications

Chile adopted competitive provision of subsidized public access that helped to increase household ownership of a telephone from 16 percent in 1988 to 74 percent in 2000.

In Peru the government imposed a universal service levy of 1 percent on gross operating revenues of telecommunications companies to finance a fund dedicated to providing universal access in remote areas. Funds were then allocated through a competitive bidding process that encouraged operators to adopt the best technology and other cost-saving practices at a minimum subsidy.

To create competition in telecommunications sector liberalization, Brazil was divided into four regions with, in a first phase, two carriers competing for the market in each of those regions. All carriers were subject to universal service and rollout obligations to be met by a set deadline. At the end of that deadline, all carriers would be allowed to operate in other regions. But they were allowed to do so earlier if they managed to meet the universal service obligations before companies operating in other regions, thus creating a powerful incentive for obligations to be fulfilled.

Water distribution

In Chile water privatization and liberalization was accompanied by means-tested subsidies targeted to individual consumers, with the objective that no household should pay more than 5 percent of its income for water and sewage. To encourage efficient resource use and ensure that only the subsistence level was being subsidized, subsidies were capped at the subsistence level. Under that level, eligible households have 25–85 percent of their bill paid by the government, depending on need. Of the benefits, 52 percent have gone to the three lowest income groups, with only 23 percent leakage to the five highest income groups.

Electricity

Guatemala integrated a rural electrification program into the concession contract of its new foreign private electricity operator. Households within a 200-meter radius of the existing network fell under a universal service obligation (connection without subsidy) while those outside attracted a $650 connection subsidy. The subsidies were set aside in a trust fund to prevent diversion to other uses, with revenue from the privatization of the distribution assets earmarked for the trust fund. Between May 1999 and May 2002, 122,000 rural electricity connections were added.

the end infrastructure services must be paid for either by users or by taxpayers (Harris 2003). Finding the right balance to ensure provision of services to the poor remains a major and complex challenge in services liberalization, the difficulty of which should not be underestimated.

Fourth, government withdrawal from provision of services that can be more efficiently provided by the private sector has a large opportunity benefit: it frees up its resources for core services of wide public interest, such as primary education. This benefit is compounded if revenues from privatizations are also earmarked for basic services such as building new schools and recruiting teachers in underserved areas. Liberalization can also generate revenue for government services on an ongoing basis. Some developing countries are now active providers of health services to patients from other countries and can use the

revenue generated (or, for private clinics, the tax revenue generated) to subsidize the public health system (Nielson forthcoming).

Liberalization and regulatory capacity

As the cases above indicate, there can be significant regulatory challenges associated with services liberalization. Meeting these challenges requires sound and effective regulatory frameworks and institutions—which require resources and knowledge. While regulatory failure also occurs in OECD countries, many developing countries face particular challenges in services reform. These include a lack of experience with regulation and a limited capacity to assess either the various policy options or the impact of services reforms undertaken to date. Experience in Africa with financial services liberalization suggests that one major shortcoming was the lack of adequate regulatory and supervision mechanisms to monitor the functioning of the financial system (World Bank 2002). Regulatory reform can also be more difficult where there are risks of industry capture, such as where the new regulator has to draw staff entirely from the former monopoly due to the small pool of persons with expert knowledge of the sector. There are also knowledge gaps about the functioning of services markets in developing countries and the kinds of policy frameworks and complementary policies that best support development. Further research and information exchange on concrete country experiences will be essential to getting policy settings right.[17]

Liberalization in many developing countries will also require significant investment in regulatory institutions and human capital. In many cases, international assistance will be required, to provide either technical advice and expertise or, more directly, resources for the development of institutions and frameworks. The GATS negotiations could provide an opportunity to link liberalization to regulatory capacity building and to marshal resources to this end. This is discussed further in "Priorities for liberalization" below.

Even with assistance, the development of sound regulatory frameworks takes time, and developing countries should sequence and phase liberalization accordingly. They should also make full use of the progressive liberalization envisaged under the GATS to keep their GATS commitments in line with their capacity to regulate—and experience of regulating—liberalized services markets.

A final issue is whether investment of resources in developing these regulatory institutions and frameworks is a development priority for the poorest countries. This concern is something of a vicious circle: countries that do not have adequate regulatory institutions may choose not to liberalize their services sectors, but then may find their development constrained by lack of efficient basic services. That is, the lack of efficient services can constrain opportunities for growth-inducing activities that would help generate the resources to fund the necessary regulatory institutions to underpin the services liberalization that would increase the efficiency of those same services. This circularity is a powerful argument for increased international assistance.

Liberalization and regulatory creativity

Greatly increased assistance could usefully be targeted to identifying appropriate regulatory solutions for poor countries with limited resources. The poorest countries may face particular challenges in establishing regulatory frameworks, given their cost (for example, it is estimated that even a minimal telecommunications regulatory authority would cost Dominica $2 million a year, or 5 percent of its government budget). These countries also face challenges in balancing the need for regulation with the need to remain attractive to foreign investors, and they can be in an unequal bargaining position in such negotiations.

In other words, solutions implemented in OECD or even middle-income developing countries may not be easily introduced in poor countries. These countries may need serious "regulatory creativity," that is, regulations designed to take specific account of their particular conditions and constraints. For instance, settling disputes about cost-based interconnection between telecommunications operators can be carried out through competition authorities or ad hoc regulatory agencies. But these solutions require years of regulation-building and training to attain adequate practices. However, there may be scope to develop alternative approaches that are less resource intensive, as illustrated by the "final offer arbitration" adopted by Guatemala in the mid-1990s (Spiller and Cardilli 1997). Under this procedure, the arbitrator chooses only between the two final offers presented by the parties, and the chosen offer becomes binding on both sides. Such a mechanism is fast (no endless lawsuits, since the process is limited by law to four months) and relatively inexpensive (due to the limited use of lawyers). More important, it induces the parties to make "reasonable" offers from the start, as it is in each party's interest not to make an offer that would seem unreasonable to the arbitrator, but rather to make a marginally more favorable offer than the other party's.

Another solution could be to take a regional approach. In May 2000 St. Lucia, Dominica, Grenada, St. Vincent and the Grenadines, and St. Kitts and Nevis set up the Eastern Caribbean Telecommunications Authority (ECTEL). Established with World Bank support, it is the first regional telecommunications authority in the world. Countries retain power over licensing and regulation, with ECTEL providing technical expertise, advice, and support. The aim is to promote the development of harmonized and transparent regulation, allow for a greater degree of independence in regulatory advice, and enhance bargaining power with incumbents and new entrants (World Bank 2002).

There are many possible solutions and approaches yet to be explored. What is important is that developing countries have the scope to develop regulatory frameworks, appropriate to their circumstances, that will enable them to reap the benefits of services liberalization, and that they receive sufficient international support and assistance to do so.

Liberalization and adjustment in labor-related services

As for trade in goods, there are concerns about the adjustment costs following trade liberalization in services, particularly in labor-related services—even if, it is worth noting, there is some evidence that adjustment costs may be lower for trade in services than for manufacturing (OECD 2002c). As for other sectors (see agriculture), adjustment can be facilitated by the adoption of appropriate complementary policies. Attention to the nature, pace, and sequencing of liberalization is essential, an understanding reflected in the progressive liberalization envisaged under the GATS and the flexible variable geometry of GATS commitments (appendix 5).

However, some are now questioning whether the adjustment problems raised by the import of labor-intensive services from developing countries (outsourcing and mode 4) are the same as those for trade in goods. As outsourcing has grown, so have concerns about the exports of jobs to developing countries. Currently only around 5 percent of U.S. firms with revenues from $100 million to $4 billion have started to outsource (Mattoo and Wunsch 2004). But large growth is predicted, and political initiatives have been taken (in the U.S. Senate) or are being considered (in some U.S. states and in the United Kingdom) to prevent companies bidding for government procurement contracts from using offshore workers.

Despite the increasingly rancorous debate, in-depth analysis has been limited to date and certainly does not prove the pessimist case—and the wild exaggerations of the export of jobs in trade in goods during the late 1980s and early 1990s suggest a certain caution in the current debate. Indeed, there is little in the evidence to date to suggest that adjustment to outsourcing will be very different from that required by liberalization in other sectors—that is, it will not be qualitatively different from that in labor-intensive manufacturing. All analyses to date agree that jobs will be lost and advocate measures to ease adjustment pressures—wage or company insurance schemes, as well as skill-building, through resources for retraining, tax credits for human capital development, and increased investment in math and science education and training. However, available analyses also suggest that losses need to be put in context and that there will be a number of offsetting gains (box 4.8).

At this stage, it is hard to assess the specific impact of mode 4 on local workers as most countries have introduced measures to limit mode 4 and to constrain any possible impacts on local workers (labor market tests, wage and social security parity requirements). Existing trade has also tended to be concentrated in shortage areas (nurses, ICT workers). Concerns about the impact of mode 4 are thus conditional upon significant liberalization, in particular if this were to include more low-skilled workers (Winters 2003). As for trade in goods, these concerns suggest a need for sensitivity about the timing and extent of liberalization, and for available adjustment mechanisms (Chaudhuri, Mattoo, and Self 2004). Once again, it is hard to see, to date, why many of

Box 4.8

Outsourcing—four questions

Source: McKinsey Global Institute 2003; "India's plan to beat the off-shoring backlash," *Financial Times,* 27 January 2004; Mann 2003; Mattoo and Wunsch 2004; OECD 2005.

First, are projected job losses overstated? Estimates based on boom-era baselines would appear to be so. They are not borne out by employment data, which show that the highest job losses are still in manufacturing and management occupations. Job growth in white collar occupations deemed at risk from outsourcing is actually expanding (computer and mathematical occupations up by 6 percent and business and financial occupations by 9 percent during 1999–2003), and demand for U.S. services remains high—companies still do much at their headquarters, and the U.S. trade surplus for other private services (which includes financial, business, professional, and technical services) actually increased between 1997 and 2003. Moreover, there are intrinsic limits to the number and types of jobs that can be moved offshore, given that some services require proximity between the provider and consumer.

Projected job losses also need to be seen in context. The much-cited projection from Forrester Research—that the U.S. will lose 3.3 million jobs by 2015—should be seen in the light of the constant destruction and creation of jobs in the U.S. labor market. Indeed, the average number of jobs destroyed every quarter in the private sector in the U.S. economy has fluctuated between 7 and 9 million over the last 10 years (2.2–3 million on average per month). And the number of jobs created has exceeded the number of jobs destroyed during most quarters of the same period.

Second, are the issues different from the loss of manufacturing jobs from imports over the last 20 years? When manufacturing jobs moved to developing countries, new jobs were created. While trade-related job displacement is estimated at around 270,000 jobs per year between 1989 and 2000, over the past 10 years, the U.S. economy also generated 35 million new private sector jobs. With service sector jobs moving, the supply of jobs will not run out. New services jobs will continue to be created, for example in personal services associated with an aging population, and in new fields of technology.

Indeed, while low-wage, low-skill information and communication technology (ICT) jobs are likely to be lost (in some cases due to technology as much as outsourcing), higher paid, higher skilled ICT jobs will grow quickly in the U.S. Job growth to 2010 in occupations requiring ICT skills is still predicted to be more than three times the rate of job growth in the overall economy.

Third, what are the benefits flowing back to the country that sent the jobs? Estimates are that, for every dollar of outsourcing by U.S. companies to India, the U.S. gains 67 cents in savings and direct returns, plus an additional 45 cents in new value from redeploying U.S. labor ($1.12, or 79 percent of the total gains), while India gains 33 cents of the dollar in terms of increased employment and investment. In sum, movement of jobs is not a zero-sum game.

Further, developing countries to which jobs have moved also increase their demand for imported goods and services. Savings from outsourcing may be used for new business investment or fed back into the economy through savings or consumption. Where outsourcing is undertaken by subsidiaries of U.S. firms located in India, profits can also be repatriated and invested in the U.S. economy.

Fourth, what are the benefits to consumers—a question that has received little attention perhaps because most outsourcing relates to business services? Consumers not only benefit indirectly from lower cost business services where savings are passed on. They can also benefit directly from the lower cost and increased availability of other services, such as diagnostic health services. The fact that MRI scans can be read by medical personnel in India at a fraction of the cost increases the access of many patients to this technology.

these issues would be more serious than those posed for less-skilled workers by imports of labor-intensive goods from developing countries.

Labor adjustment costs are also not limited to mode 4 in developed countries. In particular, mode 3 liberalization in developing countries—while generally raising employment—can entail labor adjustment, particularly in cases where former state monopolies have played a politically convenient role in absorbing surplus labor.[18] For instance, privatization of electricity distribution in Argentina led to a 40 percent reduction in the workforce after privatization (Alexander and Estache 1999). For all modes of supply, costs associated with liberalization—including retraining and safety nets—need to be set against the gains to the domestic economy as a whole from cheaper, more efficient services.

In this sense, it is ironic that outsourcing (modes 1 and 2) was originally welcomed as a means of avoiding some of the risks and difficulties involved in bringing foreign workers into the country (mode 4). As noted above, restrictions on mode 4 meant that outsourcing was the best way to reap the cost advantage from developing country labor. Of course, mode 3 is also important, as companies establish branches and subsidiaries in other countries, to take advantage of local labor skills and costs. The bottom line is that, in a more global economy, production, jobs, and workers are increasingly able to move—through modes 1 and 2, 3, or 4. The question is how those opportunities can be harnessed and the adjustment costs managed.

Liberalization, mode 4, brain drain, and permanent migration

A specific concern for mode 4 is the prospect that the temporary movement of workers can become permanent. Countries of origin can fear the permanent loss of their (sometimes scarce) skilled workers, while destination countries can fear loss of control over regular migration.

Some developing countries are concerned that the loss of skilled people, even temporarily, reduces total output, and hence the tax base. Depending on the extent of the skilled workers' absences, it could also reduce an economy's entrepreneurship, ability to absorb new technologies, and various positive spillovers from skilled to other workers and society in general. But these losses are not inevitable, and are much less likely with mode 4 than permanent migration. For example, skilled workers from developing countries are likely to be more productive and have higher earnings in advanced economies, and the earnings that they bring home may more than fully offset their loss locally. This is particularly true if the developing country had not been able to make optimal use of its skilled labor initially.

Further, while temporary migrants temporarily withdraw the flow of their skills from the local economy, they do not withdraw their citizenship or their offspring. Thus general spillovers and the intergenerational benefits of education are likely to persist. Temporary workers abroad are likely to provide ideas,

technology, markets, or networks for those who remain, increasing the latter's productivity and market opportunities. This is particularly likely where schemes permit workers to move regularly between home and host country. Another possibility is that mode 4 mobility increases the returns to education. If the resulting increase in the supply of skilled workers exceeds the actual loss through temporary movement, the domestic economy in the developing country becomes a net gainer of skills (Commander, Kangasniemi, and Winters 2002).[19]

That said, brain drain can be a real concern when even the temporary loss of skilled personnel cannot be borne, such as when countries facing health crises lose scarce health workers. Several initiatives aim to address this. In 2002 the Commonwealth countries approved an International Code of Practice on Ethical Recruitment applying to all major importers of doctors and nurses, and the UK nursing association has developed a similar code. Home countries have also introduced community service requirements and improved pay and conditions in an effort to ensure that temporary movement by their health workers does not turn into permanent migration.

While it is a reality that temporary movement can be a first step to permanent residence, it is not a simple one because many factors influence whether temporary movement leads to permanent migration. In some countries, temporary entry can legally lead to permanent stay, with temporary entry used as a means of preselecting permanent migrants, and even here, evidence varies on the extent to which temporary movement becomes permanent.[20] Illegal overstaying is a different issue that arises with all forms of temporary movement, including tourists and students. Regular schemes for the temporary movement of workers could actually help to discourage illegal movement (OECD 2002d).

Governments of both sending and receiving countries are also developing incentives or sanctions to ensure return. For example, temporary worker schemes can involve sanction mechanisms to prevent overstaying, such as withholding part of the pay of contractual service suppliers until they (or, for a firm, their workers) leave the country, requiring firms or individuals to place a bond that is forfeited in the case of nondeparture (Hatcher 2003), or fining the domestic sponsoring company for workers who do not leave and withdrawing their right to sponsor future workers. Migration officials also undertake monitoring, including site visits.

Bilateral labor agreements use the prospect of re-employment the following year as an incentive for return for both workers (who receive a slightly higher wage next time) and employers (who, knowing they can rehire the same workers next year, have an incentive not to allow illegal overstaying).[21] Home countries also operate initiatives to encourage the return of highly qualified nationals, including specific incentives (tax exemptions, financial assistance with removal costs or business seed capital, citizenship rights for spouses and children); the creation of more attractive opportunities in the home country,

including by encouraging domestic investment in research and development; or reintegration assistance for returnees.

Priorities for liberalization

The GATS is a relatively development-friendly agreement, affording a high degree of flexibility to WTO Members to determine what kind of market opening they will undertake and in what sectors (appendix 5). The 2004 Doha Work Programme (DWP) text thus does not specify particular types of market opening that members should undertake, but sets out general principles in line with the GATS negotiating mandate (box 4.9). However, the attention to mode 4 underlines that an outcome on this issue will be essential in the negotiations. Against this background, what should the priorities for developing countries be?

Commitments under mode 4

Mode 4 liberalization faces three main challenges. First, GATS commitments are guaranteed minimum treatment, while migration regulators in all countries seek to maintain maximum flexibility to respond to changing labor market and other circumstances. Second, GATS commitments are on an MFN basis, while some countries prefer to maintain special migration arrangements with particular countries, especially for low-skilled workers. Third, issues related to labor mobility go beyond trade, and there is a real need to identify how each can promote the other. This is no easy task: there is a real gap in understanding between the trade and migration communities on mode 4; migration officials often do not see the importance of mode 4, while trade negotiators lack an

Box 4.9

The 2004 Doha Work Programme text on services

Source: WTO 2004b.

Offers: Members who have not submitted offers must do so as soon as possible, and revised offers should be made by May 2005. Members should strive to ensure a high quality of offers, particularly in sectors and modes of supply of export interest to developing countries, with special attention to Least Developed Countries.

Liberalization: Members should aim to achieve progressively higher levels of liberalization with no *a priori* exclusion of any service sector or mode of supply and should give special attention to sectors and modes of export interest to developing countries. Members note the interest of developing countries, as well as other members, in mode 4.

Rules: Members must intensify their efforts to conclude rules negotiations in accordance with the respective mandates and deadlines.

Technical assistance: Targeted technical assistance should be provided to enable developing countries to participate effectively in the negotiations.

Review: For the purposes of the sixth ministerial meeting, members should review progress in the negotiations and make a report to the Trade Negotiations Committee, including possible recommendations.

understanding of current migration regimes. Further, migration remains an area of unilateral government action, subject to few if any international treaties and without a strong culture of negotiation.

These tensions are not easily resolved and a degree of pragmatism might be required. Insistence upon binding all current schemes could result in the creation of more restrictive conditions in the short term. There is no virtue in radical schemes that stand no chance of success: not only will they fail, but they could also undermine progress in other areas of negotiation. As with other areas of services trade, liberalization on the ground might be more important than whether the full extent of this openness is reflected in GATS commitments at this stage. Crucially, progress on mode 4 will require the early and active engagement of migration and labor market regulators; all the issues arising from labor mobility cannot be addressed under the GATS, and complementary policies will need to be developed, and trust built. The GATS negotiations are nonetheless an important opportunity to bring labor and migration regulators to the table and to create a sense of urgency about facilitating mobility.

For all these reasons, it makes strategic and political sense to think of mode 4 liberalization in terms of goals for the longer term and key objectives for this Round (box 4.10).

Longer term goals

In the longer term, WTO Members should agree that foreign employees of domestic companies, as well as foreign employees of foreign established (mode 3) companies, are included under the scope of mode 4. The lack of consensus on this point at present (see appendix 5) creates an anomaly whereby foreigners working on contract and those working as employees for the same domestic firm can be treated differently under trade rules. In addition to limiting the potential gains from mode 4 mobility, it is not clear that this distinction is enforceable in all jurisdictions. For instance, some WTO Members deem almost all types of foreign temporary workers to be employees for the purposes of bringing them under domestic labor law. As a practical matter, the distinction between employees and contract workers may also be hard for migration officials to enforce. Agreement by all WTO Members to include foreign employees of domestic companies in mode 4 would open the door for real global gains on labor mobility by enabling agreements to be reached on expanded quotas of foreign workers. While quotas are not ideal, they are transparent and negotiable. By contrast, economic needs or labor market tests would be abolished.

The scope of mode 4 should also be broadened beyond service suppliers to include workers related to agriculture and manufacturing. The current distinction is artificial and in line neither with migration regimes (which generally do not distinguish between sectors of employment) nor with the commercial reality of firms providing both goods and services. This is not necessarily unrealistic: a number of regional trade agreements contain provisions related to the

Box 4.10

The way ahead on mode 4

In the Doha Round, WTO Members should seek to:

- Expand the range of commitments for firms as contractual service suppliers (subcontractors), including the expansion of opportunities for lower skilled labor.
- Improve access for intracorporate transferees, including for categories beyond managers, executives, and specialists, and remove preemployment requirements.
- Improve the clarity and usability of commitments by developing common definitions of key categories; improve the transparency of economic needs tests; specify durations of stay in commitments and extend the period for contractual service suppliers; and encourage adoption of a GATS visa or improvement to existing relevant visa regimes.
- Improve transparency through single windows or specialized enquiry points in migration authorities, notifications of all information necessary to give practical effect to commitments, and additional commitments on prior consultation on relevant regulations.
- Separate short-run social programs (health) and long-run social protection for temporary foreign workers and refund contributions upon departure.
- Use GATS Article VI.6 to gain information on the procedures for recognition of their professionals in key trading partners and to push for improvements.

In the longer term (beyond the Doha Round), WTO Members should:

- Agree that GATS mode 4 covers foreign employees of domestic as well as foreign established firms.
- Abolish economic needs tests.
- Expand mode 4 beyond service suppliers to include temporary workers related to agriculture and manufacturing.

As an interim step, WTO Members could enter into bilateral or plurilateral agreements. These could cover a broader range of workers and provide scope to develop complementary policies, such as those related to brain drain, remittance transfers, return, and recognition. Over time, recruitment of workers under these schemes could be opened on an MFN basis to any country that could meet the requirements and implement the other side of the agreement. Agreements would be notified to the WTO, and interested WTO Members would have the opportunity to indicate their interest in joining or negotiating similar agreements. An MFN waiver would likely be necessary.

temporary movement of investors and businesspeople from other sectors (such as manufacturing) as well as service suppliers.

An important complementary effort to help build the basis for multilateral action over the longer term may be to explore the scope for further bilateral or even possibly plurilateral labor agreements in the short to medium term. These agreements are more likely to include the sorts of workers not covered by the GATS definition (agricultural workers) or current commitments (low-skilled workers in hospitality or construction or health workers). They also provide scope for regulatory experimentation to develop the necessary complementary policies to address issues related to mobility but not properly the subject of the GATS. These include, for example, assistance programs to combat brain drain and compensate for loss of investment in education, mechanisms for improved remittance transfer, incentives and cooperative mechanisms to ensure return,

and incentives and mechanisms to promote recognition of qualifications in particular areas. They may also enable equitable solutions to be found for the movement of shortage workers. For example, agreements covering nurses could involve the host country contributing to the cost of training nurses in the home country, with a certain percentage of nursing graduates receiving fixed-term visas to work in the host country.[22]

The most successful schemes to date (such as the APEC Business Travel Cards) have combined national sovereignty with cooperation and capacity building. Over time, a more multilateral approach could be encouraged—for instance, by encouraging the extension of successful agreements to more countries and by opening recruitment of workers under these schemes on an MFN basis to any country that could meet the requirements and implement the other side of the agreement. In a sense, this approach mirrors that taken to recognition of qualifications under the GATS—acknowledging that it will most likely happen bilaterally or plurilaterally at this stage, but requiring the opportunity to be given to all other WTO Members to prove they can meet the same nondiscriminatory standards. As for recognition agreements, these agreements could be notified to the WTO to promote transparency and give interested WTO Members the opportunity to indicate their interest in negotiating similar agreements. An MFN waiver for agreements covering certain types of workers would be necessary.

This approach would both help spur domestic reform and promote the development of strategic policies related to mobility in both developed and developing countries. It also permits a broader approach to be taken than that permitted by the scope of the GATS to ensure that mobility benefits development.

Key objectives for the Doha Round

These priorities for liberalization suggest several key objectives for the Doha Round.

Improving the scope of commitments.

- *Contractual service suppliers.* Negotiating effort should be directed toward improving access for contractual service suppliers not tied to investment. These include not simply individuals, but also companies (subcontracting). Subcontracting could offer substantial economic benefits to developing country exporters because it offers access for small- and medium-size enterprises that may not be able to invest abroad as well as the greatest chance of extending mode 4 to lower skilled workers. With well defined parties on both sides of the transaction—incorporated firms—enforcement of conditions for mobility is much easier than for individual workers. Subcontracting thus responds to developed countries' concerns about ensuring the return of temporary workers. For greatest benefit, developing countries should seek

removal of requirements for prior employment with the subcontracting firm. These requirements are intended to ensure that the workers are genuinely attached to a well defined undertaking to which they can return and which can guarantee their return after the completion of the project. However, preemployment can be a burden for firms set up largely for the purpose of exporting, as it involves periods of low or zero productivity at home. On the downside, subcontracting is not appropriate for many service transactions, and being restricted to incorporated firms, limits the potential set of services providers. Further, the subcontracting firm has to be approved by the host authorities.

- *Intracorporate transferees.* Developing countries might also have interests in improving conditions for intracorporate transferees—and not simply to create a broader alliance for mode 4 (important though that is). Some developing countries are already establishing subsidiaries in developed countries and using intracompany transfer schemes. Scope exists for others to make greater use of this, including joint ventures in the context of mode 3 liberalization. Further, many nationals of developing countries are employed by multinational companies, and their home countries reap some benefits from better intracorporate mobility (technology transfer, remittances, building awareness of the skills in the home country of the workers). Benefits for developing countries would increase were the scope of intracompany transferees to be broadened beyond managers, executives, and specialists, to trainees and a wider range of skill groups. Preemployment requirements for intracorporate transferees should be removed because they restrict the ability of companies to recruit talent globally.

Improving the usability and clarity of commitments.

- *Common definitions.* Without clear definitions of occupations and related skills levels, regulatory authorities have huge discretion in deciding what constitutes a specialist (and, presumably, to change the definition according to political or labor market pressures). More uniform definitions and coverage of service personnel categories would help. The existing ILO classification of occupations could be a good place to start, as could the definitions used in RTAs, which share some common elements (OECD 2001b). Moves toward common definitions would also make it easier to extend commitments to include middle and lower level professionals.
- *Specify and extend periods of stay.* Periods of stay should be specified in commitments and extended in duration, in particular for contractual service suppliers (who are often limited to 3–6 months, restricting the type of contracts for which they can bid).
- *GATS visa.* WTO Members without adequate temporary entry schemes could be encouraged to adopt a GATS visa, along the lines of that

proposed by India.[23] In other cases, it might be more efficient to identify the existing temporary entry schemes under which most mode 4 entrants fall and to focus on improving those schemes. More countries could join or create facilitation schemes, along the lines of the APEC Business Travel Card, which, while more modest in scope, offer some benefits and help to build trust between regulators.

- *Economic needs or labor market tests.* Developing countries should seek removal of labor market tests or—at a minimum—regular notifications on their operation (decisions taken, time frames), along with adherence to the existing requirement to specify their criteria in schedules.
- *Transparency.* Single windows or specialized enquiry points in migration authorities should be established to answer queries about mode 4 access and collect feedback on difficulties encountered with the system.[24] WTO Members should also notify all information necessary to give practical effect to commitments (such as relevant visas) in a user-friendly standard format. Developing countries should also seek additional commitments from their trading partners to afford them prior consultation and the opportunity for comment on regulations relevant to mode 4 commitments.

These measures would have the additional benefit of encouraging dialogue between trade and migration authorities. Notifications could assist mutual understanding of mode 4 and help to ensure that practical effect is given to commitments. Over time, they could contribute to increased convergence between mode 4 and migration categories and terminology. Prior consultation would promote awareness of the possible trade impact of migration regulations and help to mainstream mode 4 into migration policy.

Other concerns.

- *Social security contributions.* The inequity of workers contributing to schemes from which they do not benefit can be addressed by separating short-run social programs (health) and long-run social protection for temporary foreign workers. Host governments can legitimately insist on contributions to ensure that service providers are fully insured for work-related accident and health matters. Contributions to long-run social protection could be refunded upon departure. Alternatively, employers or users of overseas contractors could fund the workers' social security contributions at their home rates (although this may be politically controversial as it could accord a further cost advantage to temporary foreign workers).
- *Recognition.* Given the importance of the regulatory objectives at stake, and the need for incentives to embark on long and complex recognition negotiations, recognition agreements cannot be made to happen. A more feasible path in the short term is to use the existing GATS

obligation (Article VI.6) that, where they make commitments on professional services, Members provide for adequate procedures to verify the competence of professionals from any other WTO Member. On the basis of this obligation, developing countries should use the negotiations to gain information on the procedures for recognition of their professionals in key trading partners and to push for improvements.

Locking in market access for outsourcing

This trade is currently largely market-driven and free of restrictions, and this desirable state of affairs should be locked in through the GATS. Two problems arise in this regard. First, the range of services covered by outsourcing is poorly covered in the GATS classification and second, there is no agreement among WTO Members about whether electronic supply should be covered by mode 1 or 2. Neither of these problems is likely to be solved in the short term.

In the interim, developing countries should seek to agree with trading partners on the widest possible definitions of categories of relevant services (such as data processing services), perhaps using formulas along the lines of "and any closely related services that may be developed." Another approach could be to seek commitments from trading partners that all future services that might be developed under current classification headings would automatically be included in the scope of a commitment (Mattoo and Wunsch 2004).[25] However, this ambitious approach is likely to be met with requests for similar treatment by developing countries in other sectors. To address the problem of modes, developing countries should seek commitments in both modes 1 and 2 in this Round (the latter are already reasonably liberal) (Mattoo and Wunsch 2004).

Given that some WTO Members are introducing measures to prevent outsourcing in government procurement, developing countries might also want to consider their position on future coverage of government procurement in the GATS (appendix 6).

Commitments under mode 3

Developing countries have a lot to gain from making mode 3 commitments. Infrastructure services (telecommunications, financial, energy, and transport) should be the priority—they promise the greatest downstream benefits for the domestic economy; they function as inputs for other services whose successful liberalization may depend on the prior liberalization of the input services (Hodge 2002); and they tend to be subject to relatively high barriers in developing countries. Mode 3 imports can form the basis for exports in professional, financial, and education services (including mode 4 exports). They also offer opportunities for other developing countries, which are increasingly providers of FDI, in particular at the regional level.

While promising the most gains, liberalization of infrastructure services can pose regulatory challenges. Developing countries should condition

liberalization on the existence of appropriate safety nets and regulatory intervention to ensure that reforms will be beneficial. Precommitments (commitments to liberalize at a certain future date) could link market opening to the provision of assistance for the development of adequate regulatory frameworks, along with the institutions and trained personnel required to implement them. Developing countries would undertake an assessment of their regulatory needs and the resources required, and time frames for liberalization would be established on this basis—rather than arbitrarily in negotiation (Mattoo 2003). Developed countries would have an incentive to provide the required assistance in order to benefit from the expected market access. This explicit link between commitments and building of the regulatory capacity is a practical example of operational special and differential treatment used to encourage and support liberalization.

Focus on the rules negotiations

The GATS is an unfinished agreement, with rules in important areas—government procurement, domestic regulation, safeguards, and subsidies—still being developed (appendix 6). While complex, and not necessarily likely to be finalized in the short term, the rules will determine the future shape of the agreement. Market access negotiations will come and go—the GATS mandates progressive liberalization through successive rounds of negotiations—but the rules framework, once agreed, is almost permanent (changing rules in the WTO is very difficult). Rules could have important impacts on countries' choices in domestic reform, as well as in ensuring the integrity and effectiveness of market access. Participation in the rules negotiations can also assist developing countries in learning about their own system for regulating services and in thinking about the sorts of instruments they use in terms of GATS disciplines.

Understanding and identifying their interests in the rules negotiations should perhaps be the priority for the poorest developing countries in the current Round. Even if these countries were to be largely excluded from additional obligations at this stage, they still have a longer term interest in shaping the agreement and a shorter term interest in using the rules to address problems encountered by their exporters in the markets of other WTO Members on whom such obligations fall. In both the short and the long term, the nature of the rules will matter for the poorest developing countries.

By contrast, participation in the complex GATS market access negotiations is a major resource challenge for these countries and may not represent the best investment of scarce negotiating resources at this stage. Many of the market access interests of the poorest developing countries may be covered by requests from other better resourced (including other developing) countries, so free-riding is an option.[26] GATS commitments also need to be entered into carefully, and governmental coordination and regulatory resources in the poorest developing countries may be insufficient to ensure a well informed

negotiating position. Limited governmental resources may also imply a need for scope for regulatory creativity.

But the fact that negotiating GATS commitments may not be a priority does not mean that services liberalization is not important for the poorest developing countries. As part of an overall process of domestic reform, liberalization can provide the poorest developing countries with access to basic services (telecommunications, energy), leaving scarce government resources to focus on other priorities (basic education). Liberalization efforts should continue, regardless of the GATS commitments. [27]

Benchmarks and reviews

One option is to establish benchmarks and formulas to increase the level of bound commitments. The simplest benchmark would be to define a percentage of services sectors to be covered by bound commitments or the number of sectors subject to full market opening. However, use of such benchmarks could undermine efforts to encourage countries to base liberalization decisions on a sound assessment of their priority sectors and regulatory readiness. It may encourage liberalization of sectors that are politically easiest, rather than those promising the greatest benefits. A quantitative benchmark may also be more burdensome for developing countries (which have generally made fewer commitments), without guaranteeing additional commitments in areas of interest to them.

A different approach might be to encourage Members to bind the status quo wherever possible, in particular in areas where the current market conditions represent well established reforms. The main aim would be to encourage Members to reduce the margin between their actual level of market opening and their GATS commitments. This would increase the predictability and transparency of policy, as well as the credibility of GATS commitments. Equally, where countries have undertaken more ambitious liberalization in the context of RTAs, they should be encouraged to multilateralize these commitments to the extent possible to narrow the gap between preferential and MFN access.

Further, a review could be undertaken prior to the conclusion of the negotiations to assess the extent to which the obligation in Article IV to make commitments in sectors and modes of interest to developing countries has been met. This process could build upon the report due to be made to the Sixth Ministerial Conference (see box 4.9).

Environmental services

Paragraph 31 of the Doha Work Programme mandates negotiations on the reduction or, as appropriate, elimination of barriers to environmental services (see box 1.5). There are certainly gains for developing countries from liberalization of these services. Globally, 2.4 billion people lack access to basic sanitation and 1.2 billion to safe drinking water. More than 90 percent of

sewage overall in developing countries is discharged directly into rivers, lakes, and coastal waters without any treatment and about half of the urban population lacks adequate waste disposal. When they do exist, sewage systems and garbage collection services may cover only rich residential areas. Air pollution, which causes premature deaths and chronic illness, has also been a steadily growing problem in developing countries (Zarilli 2003). Increased trade and investment in environmental services could provide countries with greater access to these services, benefiting the poor and the environment. Further, the presence of foreign suppliers (mode 3 trade) creates opportunities for technology transfer, both in terms of environmental management education and training and skills transfers and in terms of making available a larger choice of environmental technologies, which can promote a greater focus on preventive solutions (OECD 2001c).

However, there are also a number of reasons for caution, particularly with regard to making fast track commitments binding under the GATS.

First, while the potential benefits of liberalization of environmental services may be large, they depend crucially on the quality of the underlying regulatory framework. Having the right frameworks in place requires resources that may not be easily available in developing countries. This is all the more true because liberalizing environmental services will generally require the government to move from being the provider to being the regulator. This poses many challenges, including how to ensure appropriate competition or other disciplines on suppliers in view of the market structure (some environmental services, such as water distribution, may be natural monopolies and competition is largely for, rather than within, the market); increased access by the poor; flexibility to change arrangements as circumstances change; adjustment measures for firms that previously provided the services in poor areas; and adequate transparency and consumer input into service provision. An additional and most important requirement is that regulations on environmental services ensure that suppliers respect sustainable resource use, including through appropriate arrangements for public control over water resources, and that high standards of water quality are maintained. This can be a challenge, as strong regulatory oversight equipped to conduct sophisticated testing can be required (although it should be recalled that regulatory failures in this regard also occur in cases of government provision, due to conflicts of interest where the government is both provider and regulator).

Given these challenges, it is not surprising that considerable regulatory experimentation is still under way and that many countries have taken a gradual approach to liberalization of environmental services (the private sector currently supplies water services to about 5 percent of the world's population, 3 percent in developing countries). Making binding the GATS commitments on environmental services too early would limit the scope for governments to change course and reverse failed policies.

Box 4.11
Other key points on services

- To preserve the liberal conditions for outsourcing, developing countries should seek commitments under both modes 1 and 2, and explore ways to give the broadest possible definitions of the relevant services so that rapidly developing new services are covered.
- Developing countries should make commitments in mode 3, in particular for infrastructure services, and should use precommitments to condition mode 3 market opening on the provision of adequate assistance to establish the necessary regulatory framework.
- All Members should accord priority to the rules negotiations, which will determine the future shape of the agreement.
- For the poorest developing countries, the rules negotiations should be the highest negotiating priority, with liberalization pursued unilaterally and not necessarily translated into GATS commitments at this stage.
- As a benchmark, Members should aim to reduce the margin between WTO Members' actual level of market opening and their GATS commitments. A review of the negotiations should be held to assess the extent to which Article IV has been honored.
- Given the complexities and uncertainties that surround them, it is inadvisable for environmental services to be singled out for fast-track GATS commitments.

Second, there are a number of legal questions regarding the coverage of certain forms of trade in environmental services under the GATS. The GATS excludes services "in the exercise of governmental authority," defined as services supplied "neither on a commercial basis nor in competition with one or more service suppliers." This definition is seen as being rather imprecise, and a number of WTO Members have further specified in their schedules the types of services they see as falling under the scope of their commitment.[28] At present, government procurement of services is also excluded from the scope of commitments. However, there is no agreement among WTO Members on the status of the types of public-private partnerships commonly involved in liberalization of environmental services, such as build-operate-transfer contracts[29] and concessions, and the form that these arrangements take can also vary considerably among Members. There is also confusion about what certain types of market access commitments may mean for some environmental services.

Third, as for environmental goods, there is no agreement on what exactly is covered by "environmental services." The existing GATS classification is seen as narrow and out of date, and several WTO Members have suggested alternative definitions. Some of these propose an approach that identifies "core" environmental services and a "cluster" or "checklist" of other services that are not environmental, but that are nevertheless important to the provision of environmental services, for instance because they have environmental end uses (such as engineering or research and development). Lists for analytical purposes have been developed by the OECD and Eurostat[30] and by UNCTAD.[31]

In sum, given the above complexities and uncertainties—and the importance of other infrastructure services—it is inadvisable for environmental services to be singled out for fast-track GATS commitments. Each WTO Member should assess for itself whether liberalization of these services serves its development interests more than liberalization of other services and what sort of regulatory flexibility it requires.

Chapter 5

Nonagricultural merchandise trade

As wtih services, but again in sharp contrast to agriculture, significant unilateral liberalization of merchandise trade has been undertaken over the last two decades. Developing countries have reduced their applied tariffs either autonomously or as part of IMF or World Bank structural adjustment programs. However, they have been less active in multilateral and reciprocal liberalization: much of their unilateral liberalization is not reflected in lower tariffs bound under the WTO.

The opportunity thus exists to make real progress in the Doha negotiations simply by increasing tariff bindings in the WTO, including at levels at or close to applied rates.[1] The value of binding tariffs is clear: it provides a guarantee to traders that the tariff will not be raised above a given, transparent level—or at least that compensation would be payable were that level to be breached. Given the relative ease of raising tariffs (as compared, for example, with changing the conditions applying to foreign-established companies under GATS mode 3), the certainty provided by bindings has real commercial value.

Further, while substantial liberalization has been undertaken, significant protection also persists, particularly on products of export interest to developing countries. The ability of developing countries to move up the export value chain is hampered by the fact that tariffs on some products increase with the level of processing. This protection is not only a feature of developed country markets: developing countries also maintain high barriers against each other's exports, and against the exports of LDCs, for whom they are important potential markets.

The key questions in the negotiations on nonagricultural market access to date have been who should liberalize, in which sectors, and by how much? These may seem odd questions, given that tariff protection is demonstrably a cost to the domestic economy of the protecting country, with reductions benefiting

domestic consumers—and the poorest among them most (chapter 2). However, in the mercantilist world of trade negotiations, countries seek to be "paid" for reducing and binding tariffs, to trade these "concessions" for outcomes in other parts of the agenda. In the context of the Doha Round, binding tariff reductions on nonagricultural market access is likely to be an important part of the price for further agricultural liberalization. That is, in addition to being in WTO Members' own self-interest, reducing and binding tariffs on nonagricultural market access are likely to play a key role in the overall Doha deal.

While beneficial in the longer term, tariff reductions can impose adjustment costs on developing countries, including in terms of lost government revenue, with the poorest developing countries facing particular problems in bearing these costs. As for other sectors, liberalization will need to be underpinned by appropriate complementary policies and supported by international assistance.

Current levels of protection

The Uruguay Round witnessed some moves toward bound tariffs by developing countries. The share of developing country imports subject to tariff bindings rose from 13 percent to 61 percent (Blackhurst, Francois, and Enders 1996), mainly because of commitments by Latin American countries to bind 100 percent of their tariff lines and commitments by some Asian countries to bind significant proportions of their tariff lines. (Indonesia bound more than 90 percent of its tariff lines; India, Singapore, the Philippines, Malaysia, the Republic of Korea, and Thailand between 70 percent and 89 percent.) However, other developing countries (such as Sri Lanka and Zimbabwe) bound fewer than 15 percent of their tariff lines. There remains thus a sharp contrast with the major developed countries: the EU and U.S. have bound virtually all of their tariff lines; Japan has left around 7 percent of lines unbound in wood, pulp, paper, and furniture and almost 13 percent unbound in fish and fish products (Francois and Martin 2002).

However, the number of bound tariff lines is not a perfect measure of the effective level of liberalization of the domestic economy. In a number of cases, bindings have been imposed on goods not produced by the country—hence with a limited impact on domestic producers. Or they have not been taken on tariff lines with high trade volumes. Many developing countries (Cameroon, Chad, Gabon, India, Macao (China), Malaysia, the Philippines, Senegal, Sri Lanka, Thailand, Tunisia, Turkey, Zimbabwe) have actually left more than 60 percent of trade unbound for most product categories (Francois and Martin 2002).

Additionally, there remain—often considerable—gaps between the bound and applied rates, creating uncertainty for traders and trading partners (table 5.1). The gap is particularly high in LDCs, where the difference between applied and bound rates expressed as a percentage of applied rates is around 290 percent. The figure is also high for low- and middle-income countries

Table 5.1
Simple average tariffs
Percent

Source: OECD 2004c.

Reporting group	Bound rate	Applied rate	Absolute difference	Difference as proportion of applied rate
Developed countries	8.5	3.8	4.7	124.1
Low- and middle-income countries	30.7	11.1	19.6	176.4
East Asia and Pacific	28.8	13.5	15.3	113.6
Europe	10.2	7.0	3.2	45.8
Latin America and the Caribbean	39.1	10.4	28.7	275.2
Middle East and North Africa	34.0	21.3	12.7	59.6
South Asia	33.7	18.8	14.9	79.5
Least Developed Countries	51.5	13.2	38.4	291.0

(around 175 percent), in particular those in Latin America and the Caribbean (275 percent). Given that many tariff lines are not even bound in developing countries, these figures can underestimate the actual level of uncertainty generated in the market. For developed countries, the gap is small in absolute terms (4.7 percent), but is also high (more than 120 percent) as a percentage of applied rates (OECD 2004c).

Tariff peaks

Tariff averages give a very incomplete story. Developed countries often have relatively low average tariffs, but this hides the fact that they keep very high tariffs (often called tariff peaks) on certain products, particularly on those of key export interest to developing countries. For example, simple average bound tariffs on textiles and clothing, leather, rubber, footwear and travel goods, transport equipment, and fish and fish products are higher than those on other industrial products (Bacchetta and Bora 2001). In terms of applied tariffs, textiles and clothing have the highest or second-highest applied tariff averages of all nonagricultural goods in most countries and the highest instance of international tariff peaks (tariffs over 15 percent) (WTO 2003d).

Within the Quad (Canada, EU, Japan, U.S.) tariff peaks (tariffs of more than 15 percent) are found on 6 percent to 14 percent of total tariff lines (IMF and World Bank 2002), though these figures include agricultural products, and there are important differences in the proportions of peaks in nonagricultural products among Quad countries. While the majority of tariff peaks in the U.S. (85.7 percent of all peaks) and Canada (88.4 percent of all peaks) are found in industrials, this is not the case for Japan (23.6 percent of all peaks) or the EU (8.5 percent of all peaks), where peaks are heavily concentrated in agriculture (figures adapted from Olarreaga and Ng 2002).

The concentration of these tariff peaks in areas of export interest to developing countries means that the average OECD tariff on imports from developing countries is four times higher than that on imports originating from within the OECD (Laird 2002). In more concrete terms, this means that Bangladesh's

$2.4 billion a year in exports to the U.S. attract duties amounting to $331 million—around the same amount of duties ($330 million) collected on French exports to the U.S., valued at $30 billion a year. Likewise, Cambodia's exports to the U.S. face $152 million in duties, while Norway's face just $24 million, even though Norway's exports are five times higher (Gresser 2002). Exporters of cotton T-shirts from China to the U.S. face tariff and nontariff barriers amounting to more than 350 percent of their net returns—20 times the rate applying to exports from industrial countries.

But the story is not all one way. Despite steady progress in bringing down tariffs over the last 15 years, protection on nonagricultural goods in middle- and low-income countries is still just under three times that imposed by rich countries—on average 11.1 percent (see table 5.1).[2] The LDCs maintain even higher average tariffs on manufacturing imports—13.2 percent. Tariff peaks are also common in developing country tariff schedules—Bangladesh, Costa Rica, Egypt, India, Mexico, Morocco, Pakistan, Ukraine, and Zimbabwe (among others) have tariffs above 100 percent for some products. These peaks adversely affect trade among developing countries: by some estimates, barriers in other developing countries could actually account for more than 70 percent of the tariffs levied on developing country industrial exports (Hertel and Martin 2000).

Further, developing countries and LDCs impose higher tariffs on each other's imports than those imposed by developed countries (table 5.2). On a regional basis, tariffs are particularly high in South Asian countries, the Middle East and North Africa, and—to a lesser extent—in Latin America in the Caribbean. Exports from low- and middle-income countries and LDCs face on average the highest tariffs in all markets, with those from South Asia and East Asia and the Pacific facing the highest protection. It should be noted that these are most favored nation (MFN) rates, and preferential access to products from LDCs granted by developed countries are not accounted for in these figures. Generally, there is a tendency for LDCs' exports to face higher tariffs in developing country markets than in developed country markets (UNCTAD 2004b). It should also be noted that low trade values, themselves a result of restrictive trade policies, also generate low weights in trade-weighted tariff figures.

Tariff escalation

The tariff structures of both developed and developing countries also show significant tariff escalation (the more processed the product, the higher the tariff), resulting in more restricted market access for more processed products embodying greater value added. The average post–Uruguay Round tariff for all industrial products is six times higher for finished products (at 4.8 percent), than for raw materials, for which the average tariff for all industrial products is 0.8 percent (bearing in mind that these are average figures for all industrial products and that tariffs for individual products can be much higher) (OECD 2001a).

Table 5.2

Trade-weighted averages of most favored nation applied rates on industrial products, 2002

Percent

Source: OECD 2004c.

	Country source of imports							
		Low- and middle-income countries						
Reporting group	Developed countries	Least Developed Countries	All	East Asia and the Pacific	Europe	Latin America and the Caribbean	Middle East and North Africa	South Asia
Developed countries	2.2	9.8	3.7	3.5	3.1	4.0	1.9	6.4
Least Developed Countries	10.8	8.8	14.0	17.5	7.5	8.6	8.7	18.7
Low- and middle-income countries	11.0	7.6	8.9	10.5	6.4	10.4	6.4	11.4
East Asia and the Pacific	9.6	5.4	7.5	8.9	6.2	5.1	6.7	9.0
Europe	7.1	6.5	5.2	6.6	5.2	4.4	1.0	6.9
Latin America and the Caribbean	12.8	10.0	11.1	12.8	7.6	11.5	2.8	13.0
Middle East and North Africa	20.9	18.9	20.6	25.9	24.1	21.0	14.7	19.9
South Asia	24.3	22.0	20.9	19.7	26.7	16.7	17.4	17.8

Tariff escalation is most prevalent in textiles and clothing, leather and leather products, rubber products, wood, pulp, paper, furniture, and metals—all important developing country exports. For instance, the MFN tariff for prepared or preserved fish is around twice that for fish fillets or other fish meat in the EU (18.4 percent and 10.2 percent, respectively) and Japan (9.2 percent and 4.4 percent, respectively), with even greater differences—albeit on lower tariffs—in the U.S. (5.2 percent and 0.7 percent, respectively) and Canada (which applies a 5.4 percent tariff to prepared or preserved fish but allows fish fillets and other fish meat to enter duty-free).[3]

A similar pattern holds for agriculture, where processed foods exported by developing countries are particular victims of tariff escalation. For instance, fully processed manufactured food products face tariffs twice as large as products in the first stage of processing in the EU and Japan, with final goods confronting an average MFN tariff of 24 percent and 65 percent, respectively. In Canada the ratio is even higher: at 42 percent, tariffs on fully processed food products are 12 times higher than for first-stage processed products (Hoekman, Ng, and Olarreaga 2002). Likewise, Chilean fresh tomatoes enter the U.S. with a 2.8 percent tariff rate, while dried and packaged tomatoes attract a tariff of 8.9 percent, and salsa and ketchup are subject to an 11.6 percent tariff rate.

The consequences for developing countries trying to move up the value chain are clear. For instance, the EU tariff on cocoa beans is 0.5 percent, while the tariff on cocoa paste (semiprocessed) is 9.6 percent and the tariff on chocolate can be up to 25 percent. That is part of the story of why 90 percent of the world's cocoa beans are grown in developing countries, while these countries

account for only 44 percent of cocoa liquor, 29 percent of cocoa powder, and 4 percent of global production of chocolate—and Germany is the world's largest exporter of processed cocoa (IMF and World Bank 2002; International Cocoa Organization cited in UNCTAD 2003c).[4]

Textiles and clothing

The most pernicious protection has, however, been reserved for the sector in which developing countries arguably enjoy the greatest comparative advantage: clothing and, to a lesser extent, textiles. (Some textiles are highly capital-intensive, hence developed countries may have a comparative advantage in their production.) Trade in textiles and clothing accounts for around 8 percent of overall world trade in manufactured goods (around $370 billion in world exports), but it is enormously important to developing countries. It represents more than a quarter of total merchandise exports for 10 developing countries and more than 50 percent for 6 countries: for Bangladesh and Cambodia trade in textiles and clothing is more than 80 percent of their merchandise exports; for Pakistan it is more than 70 percent; for India and China the figure is around 20–30 percent (IMF and World Bank 2002).

While the use of quantitative restrictions (quotas) is generally prohibited by the GATT/WTO, trade in textiles and clothing has been subject to quotas for more than 50 years, under various derogations from GATT rules. The last of these were the successive versions of the Multi-Fibre Arrangement (MFA), which essentially embodied a system of bilateral quotas negotiated between textile importing and exporting countries. By 1994 the MFA consisted of 4 developed country importing members (Canada, EU, Norway, and U.S.) and 30 developing countries, and covered 1,325 bilateral quotas.[5]

The Uruguay Round Agreement on Textiles and Clothing (ATC) was designed to progressively phase out these MFA quotas and integrate the sector into the GATT (bring it under GATT rules) by January 1, 2005.[6] The ATC was seen as one of the main gains for developing countries from the Uruguay Round, a key part of the "grand bargain" under which developed countries would liberalize in agriculture and textiles, in exchange for services liberalization and intellectual property protection by developing countries. However, as with agriculture, the promised gains in textiles have been slow to materialize, though gains should greatly accelerate by January 1, 2005 (box 5.1).

Implementation of the ATC will greatly advance the liberalization of global trade in textiles and clothing. However, it will not solve all problems: the ATC removes quotas, but not tariffs. The average tariff on textiles and clothing in developed countries is 12 percent (9 percent in the EU, Canada, U.S., and Japan only), compared with an average of 3.8 percent (4.4 percent for the Quad countries) for all nonagricultural products. Tariff peaks (of up to 30 percent or 40 percent) and escalation (tariffs on clothing remain higher than those on textiles) remain common. Developing countries also maintain tariff

Box 5.1

The Uruguay Round Agreement on Textiles and Clothing

Sources: IMF and World Bank 2002; Malaga and Mohanty 2003; Oxfam International 2004a; World Bank 2003a; Kyvik Nordås 2004.

The ATC establishes three stages for the phase-out of MFA quotas: 1995–97; 1998–2001; and 2002–04, under which importing countries are to integrate 16 percent, 17 percent, and 18 percent of 1990 import volumes, respectively. While this schedule is heavily backloaded (leaving 49 percent of imports to be integrated on January 1, 2005), the ATC was nonetheless expected to greatly expand trade during its implementation.

This has not happened because the list of products used in the ATC covered those subject to restriction in any agreement in any one country. As this list was the basis for reductions, it artificially inflated the starting point for liberalization. Out of the original 1,325 quotas, only 219 had been eliminated by 2002, with 1,106 (83 percent) left to be removed in January 2005. Norway abolished its quotas early, but the numbers of remaining quotas still to be abolished by Canada, the EU, and the U.S. are high. On January 1, 2005, the U.S. must abolish 701 quotas (out of an original 758 quotas), the EU must abolish 167 quotas (out of an original 218 quotas), and Canada must remove 239 quotas (out of an original 295 quotas).

Even the limited number of quotas removed were, by and large, not commercially meaningful—in clothing, the main interest of developing countries, only 6–7 percent of quotas were removed. Canada, the EU, and the U.S. on average integrated 31 percent low-value products and less than 3 percent high-value products. While this fulfills the target established in the ATC of 33 percent of imports by volume, it leaves around 80 percent of import value still to be freed from quotas.

Given the extent of this backloading, and thus the size of the adjustment required by January 1, 2005, there are reasonable doubts about whether the commitments in the ATC will be honored. Calls for continuing protection are also emerging from those likely to lose from quota removal. Implementation of the ATC is also likely to bring increased pressure in importing countries for the maintenance of high tariffs on textiles and clothing and for the increased use of contingent protection, such as antidumping and safeguard measures.

Experience with the ATC has influenced the caution with which some developing countries approach the Doha negotiations. It has engendered distrust for the fine print, and underlined the need for implementation deadlines to be considered carefully—leading some to argue that it was a mistake not to make the deadlines for TRIPS (2000 for developing countries) and the ATC (2005) the same, as considerable potential leverage was lost. Failure to honor the ATC would be a serious mistake and would greatly prejudice the chances of progress in the Doha Round.

peaks, burdening an important form of intra–developing country trade in the context of global production chains—around half of textiles exports and 20 percent of clothing exports go to other developing countries (IMF and World Bank 2002). Use of antidumping and safeguard actions have also severely affected trade (chapter 6).

The losses from such a persistent and high protection are large. The combined income effect for developing countries of tariffs and quotas on their textiles and clothing exports is estimated at around $24 billion a year, and the export revenue loss at $40 billion (IMF and World Bank 2002). Tariff and quota restrictions combined may also result in as many as 27 million jobs forgone in developing countries. On average, each job saved in developed countries by protection is estimated to cost 35 jobs in developing countries (IMF

and World Bank 2002). The poor suffer most on both counts: in developing countries textiles jobs are mostly filled by poor (low-skilled) workers, while in rich countries the cost of this protection is borne disproportionately by poor consumers (chapter 2).

Benefits of liberalization

The above analysis shows that, contrary to common perception, substantial barriers to trade in nonagricultural products are still imposed by developed and developing countries alike. There is scope for further liberalization by all WTO Members—a 40 percent cut in applied tariffs on manufactures by all countries would result in an expansion of global trade of about $380 billion by 2005 (Hertel and Martin 2000). Trade would create opportunities not only for developed countries but also for developing countries, for which manufactured exports are increasingly important (developing country exports of manufactures grew by 12 percent a year between the mid-1980s and 2000) (Oxfam 2002). In particular, removing high tariffs on textiles and clothing could benefit people in poverty in both developed and developing countries (Oxfam International 2004a) and seems a necessary complement to removing farm protection—giving to developing countries with limited comparative advantages in agriculture alternative opportunities for growth.

Notwithstanding this, many people involved in trade negotiations tend to view tariff cuts as concessions, rather than acts of self-interest, and discussion has all too often focused on which countries should not have to liberalize.

Developed countries

Developed countries clearly bear a special responsibility to eliminate or considerably lower their tariffs, particularly in areas of export interest to developing countries. Developed countries remain major markets for developing countries, accounting for 75–80 percent of the total trade of those countries. Likewise, the U.S., EU, and Japan alone account for 60 percent of total LDC exports (table 5.3). Against this backdrop, the fourfold difference between the average OECD tariff on imports from developing countries and that on imports originating from within the OECD clearly illustrates the scale of action required if the benefits of freer trade are to be truly global. Tariff peaks and escalation are clearly antidevelopment and are prime candidates for early removal, with particular attention to tariff peaks on clothing, as a complement to full implementation of the ATC. With developing countries now active participants in the negotiations, developed countries must be prepared to address the longstanding discrimination against products of their export interest.

Developing countries

Some have argued that, because most (but certainly not all) remaining high tariffs are in developing countries, developed countries will be the primary

Table 5.3

Merchandise exports and imports of Least Developed Countries by selected country grouping, 2003

Importers	Imports from Least Developed Countries ($ millions) 2002	2003	Share of total (%) 2002	2003
All reporters (world)	37,794	44,914	100.0	100.0
EU 15	13,057	14,186	34.5	31.6
United States	9,591	11,525	25.4	25.7
China	3,502	6,268	9.3	14.0
Thailand	—	2,346	—	5.2
Japan	1,591	1,584	4.2	3.5
India	1,312	—	3.5	—
Korea, Rep.	990	—	2.6	—
Taiwan (China)	870	999	2.3	2.2
Canada	403	771	1.1	1.7
Singapore	547	508	1.4	1.1
Saudi Arabia	445	—	1.2	—
Malaysia	438	361	1.2	0.8
Indonesia	221	293	0.6	0.7
South Africa[a]	252	238	0.7	0.5
Hong Kong (China)	237	225	0.6	0.5

— Not available.

a. Excludes trade with Lesotho.

Source: UNSD Comtrade Database, cited in WTO (2004a).

beneficiaries of nonagricultural market access liberalization—further unbalancing the Doha Round—and they conclude that developing countries should not participate in nonagricultural market access liberalization. This view ignores three points.

First and foremost, the economic reality is that tariff reductions primarily benefit the country undertaking them. The costs of protection are paid by the domestic economy—by its households, which pay more for goods and services they consume, and by its firms, which pay more for the protected goods they use (consume) as inputs. Protection creates a bias against exports by raising the costs of inputs; that is, protection on imports reduces the competitiveness of exports. It distorts the allocation of resources in the domestic economy, encouraging investment in the most protected—not the most potentially efficient—sectors. In sum, it creates an unfriendly environment for implementing development and poverty reduction strategies. Liberalization works in the converse direction, and while estimates of welfare gains vary according to the assumptions used, there is general consensus that these gains are significant and that developing countries capture the largest gains relative to their GDP (OECD 2004c). Most of these gains could be achieved with unilateral liberalization. Multilateral negotiations are simply a mechanism for countering the political pressure of domestic interests enjoying protection by creating equal and opposing pressure from exporters who will gain from increased access to other markets.

Second, tariff reductions promise real gains not only to the liberalizing country itself, but also to other developing countries. As in the case of farm

liberalization, nearly all analyses of the benefits of removing restraints to trade show that most of the gains to developing countries—some 60–80 percent—result from trade reforms in developing countries themselves. Trade among developing countries is growing faster than developed-developing country trade and now constitutes 20–25 percent of the total trade.

Liberalization by the more advanced developing countries is not only in their own interest, but would benefit the poorest developing countries as well. The U.S. and EU remain the major markets for LDC exports, accounting for approximately 57 percent of LDC exports—and together North America and Western Europe account for 96 percent of LDC clothing exports. However, only two other developed countries figure in the top 10 export markets (Japan is the fifth-largest market and Canada the ninth). China is now the third-largest market, accounting for 14 percent of LDC exports, and other developing economies in East Asia are also important markets for LDCs. In declining order of importance, they are Thailand, India, the Republic of Korea, Taiwan (China), Singapore, Saudi Arabia, Malaysia, Indonesia, South Africa, and Hong Kong (China) (see table 5.3).[7] In 2002 developing countries accounted for 34 percent of LDC exports (UNCTAD 2004b). There is a large regional variation, however; the share of African LDC exports going to other African countries remains around 7–10 percent, while the share of Asian LDC exports going to developing Asia was around 41 percent in 2002 (UNCTAD 2004b).

Third, experience has amply shown that nonreciprocal participation in negotiations results in unequal outcomes. Clearly, the current pattern of tariff peaks in areas of interest to developing countries is related to the lack of developing country presence in GATT Rounds until the mid-1990s. Liberalization by middle-income developing countries would also maximize strategic linkages and leverage; these developing countries could link their own liberalization of industrials to OECD performance in reducing tariff peaks, including on agriculture, and in reducing agricultural support. Leverage could also be important in terms of ensuring the full implementation of the ATC by importing countries and constraining their use of antidumping and safeguards after 2005. While not necessarily the first-best strategy in economic terms, a linkage approach may help to build support for further reforms in developing countries and to assuage fears that governments may be "giving away" one of the few instruments they have to counteract to some extent the effects of protectionist policies in the OECD.

The poorest developing countries

What of the poorest developing countries—should they be exempt from tariff bindings and cuts altogether? This is not the good idea it seems at a first glance. The above arguments for developing countries are true for the poorest developing countries. Were the poorest developing countries not to participate in the tariff cutting process, they would lose an opportunity to remove policies that constrain their own economic development.

Tariff cuts can pose particular problems for the poorest developing countries, however, given their significantly more limited capacity to bear adjustment costs. This is discussed more fully in the following section, but two approaches might help. First, the poorest developing countries should focus their tariff cuts on their very high tariffs, those which create the most costly domestic distortions without generating tariff revenues (high tariffs actually inhibit imports, while moderate tariffs generate tariff revenue). Second, they should bind all their tariffs at a moderate level—hence moving toward a more uniform tariff structure that will still be a source of public revenues while minimizing the largest economic distortions (box 5.2).

In sum, in the Doha Round the poorest countries should cut their tariff peaks (to align them as much as possible with their other tariff rates) and reduce the huge gap between their bound and applied tariffs (see table 5.1). In other words, the poorest countries will not touch their applied nonpeak tariffs. This is a much less demanding effort than that required by current negotiations on regional agreements, which generally insist upon reciprocity from the poorest countries. Although much less demanding, this effort will still bring most of the economic gains to be expected from liberalization.

Managing adjustment

However, trade-related gains are not without adjustment costs. These costs may be larger in developing countries, where unemployment rates may be

Box 5.2

Development benefits of uniform tariffs

Sources: Tarr 2002; Messerlin 2003.

First, uniform tariffs force domestic firms to compete on a level playing field in the domestic market. No domestic firm will be able to benefit from higher domestic prices permitted by higher trade barriers. As a result, no domestic firm will unfairly attract the resources badly needed by other domestic firms, which may be more efficient but are less protected. Similarly, uniform tariffs do not distort the investment decisions of foreign firms, as these decisions will be made according to a country's comparative advantages, and not its tariff regime. By ensuring a continuous reallocation of resources in accordance with the evolving comparative advantages of the country, uniform tariffs serve long-term growth.

Second, uniform tariffs narrow the gap (often very high in the poorest developing countries) between bound and applied tariffs, a significant source of uncertainty (and ensuing chill effects) in trade, including between developing countries. Uniform tariffs also help to force the conversion of remaining specific tariffs (tariffs set at a certain percentage per unit of quantity) into *ad valorem* equivalents. Specific tariffs tend to discriminate against developing countries that tend to have lower unit value exports, and their protectionist effect is further exacerbated when prices are low.

Third, uniform tariffs offer a range of governance benefits. They make it easier for governments to take on vested interests; they reduce the tax-evasion and anti-export biases usually generated by highly differentiated tariffs; and they eliminate the causes of fraud and smuggling, which are inevitably triggered by such differentiated tariffs. Further, they can serve as a first step toward the creation of a modern and manageable regime of domestic indirect taxation based on a uniform rate (such as a uniform value-added tax).

higher and where safety nets and risk markets are weaker (Stiglitz and Charlton 2004). But allowing developing countries to retain protection indefinitely is not the solution; adjustment may be costly in the short term, but protection is even more costly over the longer term. Developing countries are better off moving to a policy of lower bound tariffs combined with appropriate complementary policies—in macroeconomic, social, and labor market policy—including allowing resources to move easily between sectors. That said, they will require both more time to make the required adjustments and more international assistance to do so (chapter 12).

Adjustment challenges for some of the poorest developing countries posed by the erosion of their preferential access into developed country markets caused by multilateral liberalization are discussed in chapter 7.

Loss of government revenue

A major developing country concern is the loss of government revenue following tariff reductions. This is not surprising: developing countries have a much greater reliance on tariffs as a source of revenue than developed countries—tariffs account for an average of 18 percent of government revenue in developing countries, but only 2 percent in developed countries. For LDCs in Africa the figure is even higher—34 percent on average in 1999–2001, but more than 50 percent in some countries (UNECA 2003). However, many developing countries are making a shift away from reliance on tariffs as a source of tax revenue—down by 20 percentage points in Tunisia, 17 in Jordan, 16 in Pakistan, and 14 in Mauritius and the Democratic Republic of Congo over 1994–2001.

Tax reform is seen as key to avoiding major government revenue shortfalls following tariff liberalization. However, introduction of taxes on alternative sources—income, sales, and value added tax—and developing the means to collect them are not easy. Agricultural economies can face difficulties in assessing and collecting income taxes; low urbanization also makes tax collection harder. Inefficient, underfunded, and corrupt tax administrations may struggle with assessing and collecting broad-based tax liabilities, and large informal sectors, high numbers of small establishments, small shares of wages in national income, and small shares of consumer spending in large modern establishments can all complicate the use of income and, to a lesser extent, value added tax (OECD 2004c; Tanzi and Zee 2000).

That said, tariffs remain a relatively inefficient way to raise revenue, and while the costs of appropriate compensatory taxes are temporary, the gains they induce through an improved allocation of resources are permanent.[8] Indeed, revenue neutrality should not be the aim because tariff reform brings welfare gains, net of any loss in tariff revenues (OECD 2004c). While revenue neutrality is not the aim, the need to avoid large and abrupt reductions in revenue is clearly a powerful argument both for phased tariff reductions to allow time for

alternative tax sources to be developed and for substantial international technical and financial assistance to assist in their implementation.

There are also several mitigating factors when tariffs are reduced. A tariff decrease does not necessarily lead to reduced revenue. The actual outcome will depend on the response of import demand to changes in price due to the tariff cut. Indeed, sometimes revenue can increase as very high tariffs do not generate revenue, but either encourage smuggling or wipe out imports entirely. Empirical evidence from major trade liberalization programs suggests that revenue implications are not always significant, in part due to accelerated import growth (Bacchetta and Jansen 2003). Trade facilitation improvements in collecting existing (particularly more uniform) duties can also boost revenue in the face of tariff cuts.

Finally, the structure of the initial tariff structure of the country concerned will also affect the impact on government revenue. Where bound rates are significantly above applied rates, cuts in bound rates could well have no effect on revenue. There is also scope to increase trade without reducing tariff revenue by focusing initial cuts on high tariff rates on price-elastic goods (increasing trade and welfare), while leveling tariff rates on price-inelastic goods. This would also have the benefit of creating a more uniform tariff profile. Countries with high tariffs and not much difference between the bound and applied rates are likely to experience deeper revenue loss—but they also experience greater trade creation and welfare gains. Equally, the choice of method for tariff reduction can affect the extent of revenue loss.

Adjustment to implementation of the Uruguay Round Agreement on Textiles and Clothing

Implementation of the ATC raises a different issue—adjustment to the removal of a significant number of quantitative restrictions. The progressivity built into the ATC should have allowed for an orderly adjustment to the removal of quotas over a 10 year period. But systematic backloading by developed countries has made the adjustment challenge confronting all countries as of January 1, 2005, much more difficult. Massive restructuring is expected, particularly in the clothing sector.[9]

While the size of existing distortions in the clothing and textile trade make the impact of quota removal difficult to predict, the main beneficiaries are expected to be developing country producers with scale economies, low labor costs, vertical integration, and underutilized capacity—such as China and India (OECD 2005) (box 5.3). Given that around 560 million people live in poverty in these two countries alone, the potential impact on poverty reduction could be significant (Oxfam International 2004a).[10] But adjustment is predicted to be hardest for developing countries without these comparative advantages, and whose industries have been largely supported by quotas—for example, where investment has been attracted that otherwise would not have

Box 5.3

Estimates of the impact of quota removal in textiles and clothing

Sources: Kyvik Nordås 2004; Francois and others 1997.

Some estimate that quota removal could increase export volume in textiles anywhere from 17.5 percent (for static gains only) to 72.5 percent (if dynamic gains are factored in). For clothing, estimates range from 7 percent to 190 percent. However, dynamic gains are hard to assess, and the most optimistic estimates should be treated with great caution. Global Trade Analysis Project (GTAP) models also suggest that removal of quotas will increase the import share of clothing in the U.S. and Canada market by as much as one-third, from 33.8 percent to 45 percent, and in the EU, from 48.5 percent to 51 percent.

In the EU China will make the largest gains from removal of quotas on textiles (from 10 percent to 12 percent of market share), followed by India (9 percent to 11 percent). Other OECD countries and Sub-Saharan Africa will lose market share. In clothing both India and China will increase their market share (China from 18 percent to 29 percent; India from 6 percent to 9 percent), while Africa and richer Asian countries such as the Republic of Korea and Taiwan (China) will lose.

In the U.S. and Canada elimination of textile quotas will see China increase its market share by just under 50 percent (from 11 percent to 18 percent), while the other top 10 exporters remain the same, though their respective rankings change. Bangladesh and Sri Lanka will increase their market share, but from a low base, and the combined market share of small exporters increases. Those losing market share will be African countries with preferential access and Latin American countries. For clothing, China and India will take 65 percent of the export market (China's share increases from 16 percent to 50 percent; India's from 4 percent to 15 percent). All others will lose market share, with the largest losses incurred by African countries and Mexico (whose share declines from 10 percent to 3 percent).

However, it should be noted that these models focus on price and do not take account of increased wages and decreased cost competitiveness as demand increases, changes in technology, or the effect of proximity to markets.

been and where the segmenting effect of quotas has left the industry with little experience of real competition (box 5.4).

However, two other factors should be taken into account in assessing the relative competitiveness of countries after the ATC. First, the increasing importance of vertical specialization in the textiles and clothing trade means that parts, components, and semifinished goods cross borders several times.[11] This has greatly increased the effect of tariffs and thus the impact of preferences. Second, new trends in retailing, especially in the fashion clothing sector, have increased the importance of time to market in competitiveness. Some models estimate that the effect of a shared border with a major market can be strong for clothing, potentially multiplying trade flows by a factor of nine, other things being equal. In other words, countries close to major markets (Mexico, and countries in Latin America and the Caribbean and North Africa) may be better able to withstand competition from India and China than is commonly assumed. Hence the impact for preference-receiving countries, or those close to markets, may be less negative than the above estimates predict (Kyvik Nordås 2004).

The scale of adjustment has led some groups to call for extensions of quotas. That would be a mistake. "Temporary" textile and clothing protection

Box 5.4

Quotas and Least Developed Countries—the case of Cambodia

Source: Cattaneo 2004.

Cambodia's textile industry employs 200,000 people and accounts for 80 percent of merchandise exports. Around 70 percent of its textile exports go to the U.S., with no preferential tariff treatment (although Cambodia, along with Nepal, is lobbying the U.S. Congress to extend to non-African LDCs the preferential treatment offered to African LDCs under the U.S. African Growth and Opportunity Act). While in principle eligible for preferences in its second major export market, the EU, three-quarters of Cambodia's textiles exports are excluded by strict rules of origin.

Around 50 percent of companies in the sector receive foreign investment from China and Hong Kong (China). This investment might relocate back to China, where production costs are 10–20 percent lower, once quotas are removed, though investors might wish to diversify their export bases—especially given threats to Chinese exports from safeguards and antidumping.

Competitiveness gains could come from reducing the administrative and financial burdens on exporters, both formal (export taxes) and informal (corruption). Improving the efficiency of export formalities and procedures, as well as improving basic infrastructure, would also facilitate trade and reduce costs. Creating a favorable environment for investment is also crucial. International assistance should be targeted at these areas.

Cambodia is also trying to develop niche marketing on the basis of its respect for core labor standards. Some companies (such as Nike) have proven to be sensitive to consumer concerns on labor issues, and buyer standards are increasingly incorporating these elements. Standards also involve implementation costs, however.

has been around for 40 years; continued protection is only likely to prolong and further distort the adjustment process—addicts always promise that they will quit tomorrow.[12] The difficult process of adjustment must be started now. Given the role that developed countries have played in creating the scale (if not the fact) of this challenge, they must now be prepared to contribute to its costs—a point at the core of the priorities for liberalization designed below.

How might developing countries concretely position themselves for the post-ATC world? (Developed countries will also need to undertake their own significant and long-delayed adjustment but are better placed to bear the related costs, so their case will not be analyzed in what follows). Several strategies are being tried to maintain competitiveness in the post-ATC world:

- *Moving into niche markets or up the value chain.* Cambodia is looking to market its adherence to labor standards (see box 5.4), while Colombia has improved the quality of its labor and management to move out of assembly (where labor costs are key and competition is fierce) into higher value-added activities and full-package production. Developing countries could also integrate specialist local skills (embroidery, lace, stitching) into the production chain, though this will require investment in training (ITC case studies, cited in UNCTAD 2003d). Funding from the international community will be indispensable if these developing country initiatives are to be intensified and expanded to the necessary scale.

- *Strengthening networks of suppliers and clients to meet "just-in-time" production deadlines.* Bangladesh is developing alliances between textiles mills and garment manufacturers to jointly develop fabric design, facilitate participation in overseas trade fairs, and coordinate production plans to cut delivery time. Some of these networks with downstream suppliers also involve close relationships with textile mills in China, India, Indonesia, Malaysia, and Thailand (ITC studies cited in UNCTAD 2003d). Improving transport and communications links is also central to this process and is another area where international assistance could support domestic reform.
- *Removing trade barriers and domestic distortions.* Barriers and distortions raise prices for exporters and reduce their competitiveness. Bangladesh has reduced barriers on imports of capital goods and other inputs to reduce costs for apparel producers. In addition to easing the burden of tariff and taxes, it has freed the exchange rate and is addressing corruption and administrative inefficiency. Colombia has also undertaken similar, and more extensive, reforms (OECD forthcoming). India has also recently substantially reduced tariffs on synthetic fibers (Kyvik Nordås 2004), and it is estimated that its welfare gains from quota elimination could be tripled if combined with domestic reforms (Kathuria, Martin, and Bhardwaj 2001).

Preferential trade agreements are also being used to cushion adjustment pressures. For developing countries, these are a way of ensuring ongoing access to major markets, while developed countries seek to promote coproduction between domestic textile producers and developing country apparel producers. These are not necessarily a desirable solution, however, as their effect is to keep other developing country suppliers (not just India and China) out of the market (and even in the case of India and China, it must be recalled that textiles and clothing employ a significant proportion of the urban and rural poor). Further, preference schemes often require the use of textile inputs from the importing (developed) country, thereby undermining both potential export markets for other developing country textile producers and efforts to establish a broader production base within the preference-receiving country (chapter 7). In addition, use of uncompetitive inputs can increase dependency on the preference-granting country's market at the expense of diversification of export markets. Lastly, preferences create incentives for countries to oppose MFN tariff reductions.

However, given the size of the adjustment challenge, tariff preferences under existing preference schemes could be an important factor, in the short term, in buying additional time for smaller producers faced with increased competition from India and China (neither of which qualifies for preferences on textiles). However, for them to be really effective in helping textiles adjustment, their requirements for use of developed country inputs and their restrictive rules

of origin (which set stringent conditions for when a product can be said to be "from" an eligible country) will need to be removed (chapter 7).

It has also been suggested that duty-free and quota-free treatment for textiles and clothing exports should be extended until 2010 to other poor country producers that are not LDCs but are heavily dependent on those exports (that is, that earn more than 50 percent of their current export revenue from the sector) to help them cope with the shock of adjustment (Oxfam International 2004a). Five countries are involved: the Dominican Republic, El Salvador, Mauritius, Pakistan, and Sri Lanka.[13] However, if such solutions are to be considered, more helpful and (more crucially) less distorting breathing space might be afforded to the poorest countries were all developed countries to extend duty-free and quota-free access to all products from the poorest developing countries from January 1, 2006. (While this date is after the implementation of the ATC, realistically, an agreement to extend this market access could be reached only at the WTO Ministerial Conference scheduled for the end of 2005 in Hong Kong, China.)

While such additional access would acknowledge the size of the adjustment problem in textiles and clothing and the role of developed countries in creating it, considering the problems inherent in preferential access (chapter 7)—not least that it creates incentives for recipients to oppose MFN liberalization that would benefit a broader group of countries—it must be seen as a second-best solution and in no way a substitute for significant financial and technical adjustment assistance. In addition, such preferential access would need to be considered very much as a form of adjustment assistance—that is, assistance that is by its very nature temporary and subject to reduction over time (in this instance through MFN tariff reductions).

Equally important will be adjustment programs to help countries get out of the industry. For those developing countries where production will drop and jobs will be lost, international financial assistance for adjustment, safety nets, and retraining workers will be essential.

Priorities for liberalization

To warrant being called a development round, the Doha Round must remove high tariffs on developing country exports. The primary responsibility falls on developed countries to end discrimination against developing country exports and to offer meaningful market access for all products, removing tariff peaks and escalation. An ambitious but achievable target should be set at the highest political level to ensure that the Doha Round delivers for development. To this end, developed countries should bind all tariffs on nonagricultural merchandise exports at zero by 2015, the due date for the achievement of the Millennium Development Goals.

But a development round should also encourage good trade policies in developing countries that import from and export to each other in rapidly

growing volumes and varieties. Again, a target should be set, but one that acknowledges the greater adjustment challenges faced by developing countries. Developing countries should reduce their tariffs on all nonagricultural merchandise to zero by 2025.

In their own development interests, the poorest developing countries should aim to bind all their tariffs at a uniform and moderate rate—higher than most of their current applied tariff rates, but much lower than their current applied tariff peaks.

How do we get there from here?

The 2004 Doha Work Programme (DWP) nonagricultural market access text provides some, but limited guidance, on how liberalization of nonagricultural products is likely to be approached in this round. Nonagricultural market access was the last issue to be resolved, partially because discussions on it did not really start in earnest until the outcome on agriculture was clear. Unlike for agriculture, there is no final agreed text on nonagricultural market access; the July text is essentially the Derbez text from Cancún, with an additional paragraph at the start, outlining developing concerns and areas to be the subject of further discussions.

The 2004 DWP text "contains the initial elements for future work on modalities" noting that "additional negotiations are required to reach agreement on the specifics of some of these elements." The areas for further negotiation are the formula for reductions; how the formula should be applied to unbound tariffs; flexibilities for developing countries; the question of developing country participation in sectoral initiatives; and preference erosion (box 5.5).

There are of course, many different ways to achieve the targets set in the July text. Whatever approach is taken, several elements will be important from a development point of view:

- *All tariffs should be bound.* In many cases this will require developing countries to adopt bindings for the first time. Full binding—even if at rates above applied rates—would constitute an important move toward full participation in the trading system. This would also mean that developing countries have a lot to offer in terms of gaining credit for binding past unilateral liberalization—essentially the difference between the applied rate in the base year and the much higher ceiling bindings or the complete absence of bindings. Granting some flexibility to developing countries in binding their tariffs would smooth the process. But then there should be a tradeoff between the wedge remaining between the bound tariff rates and the applied tariff rates and the number of tariff lines involved: the larger the wedge, the smaller the number of tariff lines concerned.
- *Higher tariffs should be cut by more than lower tariffs.* The July text rightly advocates the use of a formula approach, though the possibility of using other modalities is kept open. While there are many possible

Box 5.5

The 2004 Doha Work Programme text on nonagricultural market access

Note: Areas where agreement is yet to be reached are indicated by square brackets.

Source: WTO 2004b.

Formula. Members agree that a formula approach is key to reducing tariffs and reducing or eliminating tariff peaks, high tariffs, and tariff escalation. The special needs of developing countries and LDCs will be taken fully into account, including through less-than-full reciprocity. Elements of the formula include:

- A nonlinear formula applied line by line, with no *a priori* product exclusions.
- Reductions to be based on bound rates; for unbound rates the basis for reductions shall be [two] times the MFN applied rate in the base year. The base year is 2001.
- Credit will be given for autonomous liberalization, provided that tariff lines have been bound in the WTO.
- All non–*ad valorem* tariffs shall be converted to *ad valorem* equivalents on the basis of a methodology to be determined and bound in *ad valorem* terms.

Participants with less than [35] percent of tariff lines bound would be exempt from the formula, but would be expected to bind [100] percent of tariff lines at an average level that does not exceed the overall average of bound tariffs for all developing countries after implementation of current concessions.

Developing countries will have longer implementation periods, plus they can apply less than formula cuts to up to [10] percent of tariff lines, provided that the cuts are no less than half the formula cuts and that these tariff lines do not exceed [10] percent of the total value of a member's imports; or they can keep, as an exception, tariff lines unbound, or not apply formula cuts for up to [5] percent of tariff lines provided they do not exceed [5] percent of total value of a member's imports. This cannot be used to exclude entire chapters from the Harmonized System of tariff classification.

LDCs are not expected to apply the formula or participate in sectoral approaches. They are expected to substantially increase their level of bindings. Duty-free and quota-free access for LDCs is to be extended by all developed countries on an autonomous basis by a date to be decided.

Newly acceded countries shall have recourse to special provisions to take account of their extensive reductions and current phased implementation.

Sectoral initiatives. Discussions are to be pursued with a view to defining product coverage, participation, and adequate provisions for flexibility for developing countries.

Supplementary modalities. The possibilities for zero-for-zero initiatives, sectoral harmonization, and request offer should be kept open.

Low duties. Developed countries and others that so decide are to consider their elimination.

formulas, the Swiss formula has the advantage of fitting this progressivity in cuts, while allowing for different reduction rates for developing and developed countries (see box 3.9). This progressivity prevents developed countries from being able to shield from meaningful cuts the sectors of greatest interest to developing countries currently subject to tariff peaks. It would also help prevent textile tariffs from rising in response to increased protectionist pressure in the wake of the removal of quotas. Lowering tariffs and removing quotas simultaneously may

also ease the adjustment pressures faced by many developing country exporters of textile and clothing, though it could create additional difficulties for those currently receiving preferences, and additional assistance will clearly be needed (chapter 7).

- *Dispersions in tariffs should be reduced to the maximum extent possible.* Cutting higher tariffs by more than lower tariffs would reduce dispersion (increase tariff uniformity), promoting greater domestic efficiency (see box 5.2) and eroding tariff escalation.
- *Reductions should be phased in to facilitate adjustment.* For example, in order to reach the ultimate goal of zero tariffs by 2015–25, developed countries could be required to reduce tariffs to a maximum of 10 percent by the end of the round, and 5 percent by 2010. For developing countries the targets could be 25 percent at the end of the round, 20 percent by 2010, 15 percent by 2015, and 10 percent by 2020, moving to zero percent by 2025. However, such targets need to be set with care—hence the key role of the tariff-cutting formula (setting targets at maximum average tariffs allows countries more room to determine for themselves which tariffs to cut, but may not result in sufficient cuts on tariff peaks in developed countries, given that their average tariff is already relatively low).
- *Developing countries should have additional flexibility.* Bearing in mind that these disciplines are new to many developing countries, these countries should have longer to phase in reductions, and possibly more flexibility to determine which products to cut to meet a target. Consideration could be given to using different approaches for setting targets in developing and developed countries—by using ceiling or average rate targets, by taking into account the issue of potential government revenue losses in developing countries, and so on. However, while developing countries need flexibility, given the desirability of achieving greater uniformity of protection and reducing tariffs to zero by 2025, any exceptions from formula reductions should be kept to a minimum. Monitoring and quantification of the implications of proposed exceptions is a key task for national policymakers.
- *As a transitional measure to assist with adjustment to the end of textile quotas, all developed countries should grant duty-free and quota-free market access to all exports from the poorest developing countries by January 1, 2006.* Developing countries would be encouraged, but not obliged, to provide duty-free and quota-free access for all exports from the poorest developing countries. This access would not substitute for financial and technical assistance for adjustment (chapter 12) and would be strictly transitional to avoid the risk, inherent in preferential access, of creating a constituency opposed to the further MFN liberalization that would benefit a wider group of countries (chapter 7).

- *All non–*ad valorem *tariffs should be converted to* ad valorem *tariffs, and nuisance tariffs should be eliminated.* Specific tariffs have a very undesirable feature: the lower the world prices, the more protectionist such tariffs are. This feature is particularly harmful for the developing countries at the early development stages that tend to produce low-priced products. Tariffs of less than 3 percent should be eliminated at the end of the round because they tend to be a mere nuisance: the protection value of such tariffs is normally outweighed by the administrative costs incurred in collecting them and by exchange rate fluctuations.

Initiatives for sectoral liberalization are not a priority and should be treated with caution. While developing countries have key interests in sectors such as textiles and clothing, such initiatives often tend to favor products of export interest to developed countries. Participation in any such initiatives should be strictly voluntary, and they should not be conditional on participation by a critical mass of world trade in the products concerned. It is unclear, in any event, how much scope remains for such initiatives after the Information Technology Agreement and whether there are similar products on which agreement is likely to be reached.[14] That said, one proposal is already on the table: environmental goods.

Environmental goods

The July text states that WTO Members will continue to work closely with the Committee on Trade and Environment, with a view to addressing environmental goods per paragraph 31 of the Doha Agenda (see box 1.6). Progress has been limited to date.

A threshold problem has been the lack of agreement over what would constitute an environmental good. For example, should products be defined by their end-use and, if so, what should be done with products with multiple end-uses, only some of which are "environmental?" Should the way in which a good is produced determine its status as an environmental good? Distinguishing between products in this way would have major implications for the WTO system, where process and production methods (PPMs) have never been used as the basis for claiming that two products were not "like." Lastly, there is the fundamental problem that the idea of "environmentally friendly" varies among countries.

Discussions on potential criteria and definitions of environmental goods have been influenced by lists of environmental goods that were developed even before the Doha Round negotiations started. The list drawn up by the Asia-Pacific Economic Cooperation (APEC) forum emerged from an ultimately unsuccessful attempt by that forum to include environmental goods in an early voluntary sectoral liberalization initiative. The other list, developed by the OECD, was created simply for the purpose of a trade analysis. In addition, Japan and Qatar have submitted their own lists of environmental goods. However, several developing countries have argued that the WTO must identify its

Box 5.6

Liberalizing nonagricultural market access—key elements

- All tariffs on manufactures by developed countries should go to zero by 2015, the target date for the achievement of the Millennium Development Goals.
- Developing countries should bind all their tariffs in the Doha Round and reduce them to zero by 2025.
- The poorest developing countries should reduce their high tariffs in order to remove the most costly domestic distortions and anti-export biases and to move toward a more uniform tariff schedule. They should bind all tariffs at a maximum rate.
- All developed countries should extend duty-free and quota-free access to all products of the poorest developing countries by January 1, 2005. Developing countries would be encouraged, but not obliged, to do so.
- Whatever approach it taken, it is important that higher tariffs are cut more than lower tariffs; reductions are staged to avoid adjustment shocks; some flexibility is extended to developing countries; dispersion in tariffs should be reduced to the extent possible; minimal tariffs are eliminated; and all non–*ad valorem* tariffs are converted into *ad valorem* tariffs.
- Increased international assistance should be given to help developing countries address adjustment costs, including loss of government revenue, from tariff liberalization.
- Full and faithful implementation of the ATC should be accompanied by removal of tariff peaks in textiles and clothing and substantial assistance to help developing countries manage the adjustment costs.

own list of environmental goods, one that reflects the (export) interests of the organization's entire membership.

There is also no agreement on how liberalization of environmental goods should be approached. The Doha Agenda mandate refers to negotiations on "the reduction or, as appropriate, elimination of tariff and nontariff barriers to environmental goods and services." This instruction could, of course, be satisfied if, at the end of the market access discussions, some progress had been made in reducing tariffs on all nonagricultural goods, and if environmental goods (however defined) faced tariffs that were no higher than those applied to other goods. Many readers of paragraph 31(iii) assume, however, that the mandate was intended to make barriers to trade in environmental goods lower than the average for other goods, and perhaps to eliminate them completely.

Assuming that was the intention, it would seem to have the undesirable consequence of diverting valuable negotiating energy and resources into an unending process of determining whether a particular good qualifies as suitably "environmental" or not—with potentially a 5–10 percent difference in the tariffs applied at stake. Further, the political economy of preferences—witness the current resistance to the possible erosion of other forms of preferences (chapter 7)—is driven by the distortions in the pattern of investment and trade, and thus the rents, they create. It is thus likely that, in any future trade round, suppliers of environmental goods will be joined by environmental interest groups in arguing for the maintenance of the status quo, undermining the achievement of the elimination of tariffs on all goods (Steenblik 2004).

Chapter 6

Keeping markets open

Hard-won gains in market access in agricultural and nonagricultural products can be eroded where other policies re-create trade barriers or create transactions costs and uncertainty regarding the conditions of that access. This chapter looks at two very different kinds of instruments that can prevent developing countries from being able to take advantage of negotiated market access.

The first, contingent protection, refers to limits on market access by the imposition, under certain circumstances, of traditional instruments of protection—tariffs, import quotas, or other nontariff barriers, such as minimum prices. The second, norms and standards applied to products, are not necessarily trade policies at all, but part of the normal domestic regulatory structure of importing countries. Such standards can be designed to ensure the quality or safety of products, or aimed at achieving environmental objectives. Concerns have arisen about the potential for abusing these standards for protectionist effect. Even where there is no protectionist intent, compliance costs related to increasingly high standards in OECD markets can pose major challenges for developing country exporters.

Notwithstanding their differences, in both cases, there is considerable scope for such measures to have a disproportionate impact upon developing countries. And in both cases, WTO rules have been developed with a view to narrowing the scope for abuse, but serious concerns have arisen about the effectiveness of those rules, particularly for developing countries.

Contingent protection

Contingent protection, including antidumping, antisubsidies, and safeguards can all prevent developing countries from taking advantage of negotiated market access.

Antidumping

As of today, the most frequently used instrument of contingent protection is antidumping. Antidumping permits a WTO Member to impose special import duties when a firm, following an investigation, is found to have sold a product in the importing market at a price below the one it charges for the same product in its home market. Under GATT Article VI, antidumping duties may only be imposed if this price difference is found to be causing material injury to the domestic industry producing like products.

While this technical definition may sound relatively anodyne, the reality of antidumping is quite different. Antidumping has rightly been dubbed "ordinary protection with a good public relations program," the rhetoric of foreign unfairness providing an effective vehicle for building a political case for protection (Finger and Zlate 2003). However, the existence of antidumping induces rent-seeking behavior on the part of import-competing firms, and creates substantial uncertainty regarding the conditions of market access facing exporters.

Antidumping allows particular exporters of certain products to be singled out (duties are not applied on a most favored nation basis) and is initiated and carried out unilaterally by the importing country (no compensation or renegotiation of commitments is required). Further, the mere initiation of an antidumping investigation itself tends to have a significant chilling effect on imports. This is because exporters bear significant legal and administrative costs and importers face the uncertainty of having to pay backdated antidumping duties once an investigation is completed. This effect is compounded by the fact that petitions for antidumping measures by domestic industry are not subject to prohibitions on double jeopardy—that is, if one petition against an exporter fails, minor respecification generates a valid new petition, and a new investigation. Last but not least, antidumping measures often ultimately serve to encourage the conclusion of market-sharing or price-fixing agreements among import-competing firms, and between those firms and affected exporters.

Who uses antidumping? Who are the targets? There has been an explosion in the total number of antidumping investigations initiated by WTO Members in the last decade. Used almost exclusively by the U.S., EU, Canada, and Australia until the 1980s, antidumping spread to other countries in the 1990s. Since the end of the Uruguay Round, use by developing countries has greatly increased. Between 1995 and 2002 developing countries initiated 1,144 antidumping cases, or just under 60 percent of all antidumping initiations. Over the same period, developed countries initiated 819 cases, or around 40 percent of all initiations (a small number of cases were also initiated by transition economies) (table 6.1).

Table 6.1

Numbers and percentages of antidumping initiations by initiating economy group, 1995–2002 (June)

Initiated against → / By ↓	Industrial economies	Developing economies (including China)	China	Transition economies	All economies
Number of antidumping initiations					
Industrial economies	198	494	104	127	819
Developing economies	357	649	172	138	1,144
Transition economies	4	6	2	6	16
All economies	559	1,149	278	271	1,979
Percentage of antidumping initiations					
Industrial economies	24	60	13	16	100
Developing economies	31	57	15	12	100
Transition economies	25	38	13	37	100
All economies	28	58	14	14	100

Note: Industrial economies include Australia, Canada, 15 European Union members, Iceland, Japan, New Zealand, Norway, Switzerland, and U.S. Transition economies are those defined by World Bank (1996): Albania, Armenia, Azerbaijan, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Macedonia (FYR), Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, Russian Federation, Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan, and Yugoslavia. Developing economies include all economies except industrial economies and transition economies. China is included in the totals for developing economies. China excludes Hong Kong (China), Macao (China), and Taiwan (China).

Source: WTO Antidumping Committee, cited in Finger and Zlate (2003).

Most cases have been initiated by the U.S. (279 cases), India (273 cases) and the EU (255 cases). Other major users are Argentina (176 cases), South Africa (157 cases), Australia (142 cases), Canada (106 cases), and Brazil (98 cases).[1] However, consideration of the number of antidumping cases initiated per dollar of imports reveals a slightly different picture. On this basis, Brazil's intensity of use is 5 times the U.S. intensity, Australia's 7 times, South Africa's 20 times, India's 21 times, and Argentina's 25 times the U.S. figure (Finger and Zlate 2003).

The targeted countries are predominantly developing countries, especially small ones, regardless of who the initiator is. About 70 percent of developing country investigations are against other developing and transition economies, and more than 75 percent of industrial country initiatives are against developing and transition economies (see table 6.1). Again, the picture is different if the level of trade is taken into account. Here, the bias against imports from developing countries becomes evident: per dollar of imports, developing countries are six times more likely to be targeted by industrial countries and three times more likely by other developing countries than other countries (table 6.2).

Developing countries, especially small ones, are not only targeted more frequently in investigations, they are also more likely to be confronted with higher duties than those imposed on exports from developed countries. In part, the incidence of antidumping reflects differences in capacity across countries to defend their interests. Such capacity constraints may be physical (a lack

Table 6.2

Intensity of antidumping initiations across different groups of economies, 1995–2002 (June)

Initiated against → / By ↓	Industrial economies	Developing economies (including China)	China	Transition economies	All economies
Industrial economies	36	210	257	411	100
Developing economies	51	155	511	560	100
Transition economies	35	366	325	197	100
All above economies	43	192	316	371	100

Note: Number of antidumping initiations against the country group per dollar of imports from the group, scaled to figure for initiations against/imports from all economies. For example, industrial economies, per dollar of imports, had 2.57 times more antidumping initiations against China than against all countries. Economy classifications as in table 6.1.

Source: Finger and Zlate 2003.

of expertise) or reflect incentive constraints (expected returns to the level of work and organization required are too low).

What can be done to discipline antidumping? The observed bias against developing countries underscores the importance and urgency of disciplining the use of antidumping. The challenge is how to do so most effectively, given that the first-best solution—a ban on antidumping use—is unlikely to be feasible in the foreseeable future. Three options are discussed here: the first being feasible and providing substantial welfare gains, particularly to the poorest developing country exporters (and other countries' consumers); the second being feasible, but more doubtful in terms of welfare gains; and the third bringing substantial welfare gains, but highly unlikely to prove feasible at this stage.

The first option would be to draw on the WTO Agreement on Antidumping, which includes a variety of provisions that aim to reduce the probability that developing country exporters will confront threats. For instance, Article 5.8 of the Antidumping Agreement requires that allegedly dumped imports from developing countries should represent more than 3 percent of the total imports of the product in order to be subject to antidumping measures. This so-called *de minimis* threshold is particularly perverse for developing countries' exporters: as soon as it is passed, import-competing firms lodge antidumping complaints that generally lead to protectionist measures. In sum, as soon as imports from developing countries emerge from being insignificant, they are smashed by high antidumping barriers. The first option, therefore, for reducing the protectionist bias of antidumping procedures is to increase the *de minimis* threshold in order to allow some more reasonable room for developing countries. And the threshold for exports from the poorest countries could be higher than that for exports from developing countries.

The second option would be to rely on Article 15 of the Antidumping Agreement, which states, "[I]t is recognized that special regard must be given

by developed country Members to the special situation of developing country Members when considering the application of antidumping measures under this Agreement. Possibilities of constructive remedies provided for by this Agreement shall be explored before applying antidumping duties where they would affect the essential interests of developing country Members." However, this approach has several weaknesses. In particular, "constructive remedies" need only to be "explored," and—even if found—might include instruments of dubious value, such as informal pressure on exporting countries to reduce their exports.[2]

The third option would be to require a change in national antidumping laws to consider not just the interests of import-competing industries, but also the interests of consumers and users of the products claimed to be dumped and causing injury to competing domestic firms. In short, all affected domestic interests—import-competing industries, consumers, and users—would be treated as equal (Finger and Zlate 2003). Such a "public interest"–type of rebalancing the antidumping law could do much to mitigate asymmetries in administrative and organizational capacity and expertise, and also help overcome foreign-policy-type constraints that could reduce the willingness of developing country governments to take cases to the WTO. If users of imports had to be heard—and the effects of possible protection on the profitability and health of their businesses were to be considered and balanced against the interests of import-competing firms—much of the imbalance in capacity to engage in antidumping litigations would be removed. Moreover, with fewer cases presumably having a protectionist outcome, there would be less need to resort to the WTO as an enforcement device. However, it should be recognized that the antidumping regulations already implementing this option (such as those in the EU) illustrate how easily it could be circumvented. For instance, it is routinely mentioned in EU cases that the interests of the European consumers is to keep alive EU firms—hence the public interest clause is used for justifying the adoption of antidumping barriers.

Antisubsidy and safeguards

Antidumping is the most used but not the only contingent protection instrument. GATT Articles XVI and VI allow WTO countries importing subsidized goods to "countervail" the subsidies granted by imposing antisubsidy (or countervailing) duties. The above arguments related to antidumping are also relevant to antisubsidy measures. In particular, expanding *de minimis* thresholds would provide a simple, better answer to the request by many poor countries for more freedom in the use of export subsidies. Export subsidies by most poor countries are unlikely to affect a significant proportion of the imports of their trading partners, meaning that their use would be constrained by domestic considerations (the recognition that export subsidies are unlikely to be an efficient trade instrument for the country using them), not by WTO rules (see chapter 11 on special and differential treatment).

GATT Article XIX permits WTO Members to take "safeguard" (protective) measures when they face "unforeseen import surges." Until the mid-1990s, safeguards have been rarely implemented because their use was subject to much stricter conditions than those prevailing for antidumping procedures. The Uruguay Round modified this situation, and safeguard measures may become an increasingly serious threat to existing liberalization (Kommerz Kollegium 2004). One of the best illustrations is the safeguards in steel taken by the U.S. and the EU in 2002: these were the equivalent of 30–50 antidumping actions because they covered a much broader range of steel products and exporters, and they introduced many distortionary trade barriers.

Standards

While debates on trade and standards often focus on concerns about a potential "race to the bottom," a far more immediate problem is the "race to the top" that has actually occurred. In response to rising consumer concerns about food safety and health, as well environmental and social issues, OECD countries are adopting ever more—and ever more stringent—standards. It is now estimated that almost 90 percent of internationally traded goods are subject to measures for the protection of human health and the environment (UNCTAD 2003c). The ability to meet such standards at minimum cost is an important determinant of competitiveness. But for many exporters in developing countries, meeting these standards is a major challenge, one that often prevents promised market access from being utilized.

Standards relate both to the product itself, defining the quality, safety, and authenticity that goods should possess ("product standards"—such as minimum nutrition content, maximum pesticide residue content, performance requirements for machinery) and to the conditions under which goods are produced, packaged, or refined ("process standards"—such as inputs into crop or livestock production, technical processes for fishing, forestry management, labor standards for workers). They can take the form of voluntary or industry standards, or government regulations (technical regulations). Products that do not comply with technical regulations are often excluded from the market entirely; those that do not meet voluntary standards may be permitted entry, but can face problems in gaining consumer acceptance (World Bank 2003c).

There is no doubt that standards are fundamentally important to correct domestic market failures (say, with regard to the provision of health, safety, and quality) and to pursue public policy objectives (such as protecting the environment or workers). Standards can also facilitate trade—without the codification of an agreed standard for the dimensions of A4 paper, trade in paper products, printers, photocopies, and fax machines would be significantly more difficult (Rotherham 2003).

While the right of countries to use standards to safeguard health, safety, and other public policy objectives is not in doubt, there are important concerns

about the impact of rising standards on developing country trade, in terms of both the nature of the standards themselves and the costs of compliance.

Whose standards?

All countries should have the right to set their own regulations, but not without challenge, especially if the costs will fall primarily on other countries (DFID 2002). Standards that deviate from international norms raise the costs of market entry. The costs of meeting the proliferation of differing national standards act as a major brake on the ability of developing country companies, in particular small and medium-size enterprises, to enter into the export trade. This has been a focus of concern, particularly for their impact on countries in Africa that have been dependent on two primary commodities for around half their export earnings (World Bank 2003c). For these countries, the difference between international and higher standards in export markets is millions of dollars in lost trade (box 6.1). It is not surprising that product standards are highlighted as one of two important concerns by African leaders in the "NEPAD Market Access Initiative" document (2002) (the other is OECD farm subsidies).

There can be good reasons for standards to differ among countries in view of the differing conditions they face—earthquake zones require different standards for building products—and, generally, demand for higher standards of quality and safety tends to rise with income. Moreover, different societies may take a different view of the acceptable level of risk (DFID 2002). However, the proliferation of standards has also given rise to concerns that they are being used as discriminatory barriers to trade, providing for excessively stringent

Box 6.1

The cost of standards for Africa's trade—some examples

Source: Otsuki, Sewadeh, and Wilson 2001; Otsuki and Wilson 2001; World Bank 2003c; Wilson 2003.

Costs can flow from multiple standards and noncompliance. The first source of costs can be illustrated by the proposed imposition of EU standards for alfatoxin B1 above international standards, which was estimated to reduce EU health risks by only about 1.4 deaths per billion people a year, but cut African exports of nuts and grains by more than 60 percent, or $670 million a year. In all, the cost of not adopting a uniform international standard on alfatoxin B1 is estimated at $38.8 billion in lower global cereals and nuts trade.

In the same vein, the use of international standards for pesticide residue in bananas rather than divergent national standards could increase African banana exports by about $410 million a year. However, if the international standard were to be set at the level used by the EU, rather than the CODEX standard, there would be a $5.3 billion loss in world banana exports. For beef, adoption of science-based international standards for minimum residue of veterinary drugs could boost South Africa's beef exports by $160 million a year.

Compliance with international standards could increase African exports by $1 billion a year. The World Bank recently surveyed 700 firms in 17 developing countries, including Kenya, Mozambique, Nigeria, South Africa, and Uganda on standards and technical barriers to trade. For these five countries, 70 percent of firms (except in Kenya where the figure was around 50 percent) indicated that compliance with technical regulations is important to increase export sales.

levels of protection that favor particular producers or interest groups. Concerns about the manipulation of standards by protectionist lobbies are heightened by the tendency of some standards to be moving targets, becoming more stringent as soon as exporters achieve compliance.

But even where international standards are used, they may not adequately reflect the concerns and circumstances of developing countries. Many developing country standards bodies lack the resources, including skilled human resources, to either send representatives to international meetings or to conduct the necessary research to have an impact on the debate. International standards tend to be developed in areas of OECD interest and at levels that reflect their standards and regulatory capacity, while developing countries suffer from a lack of systematic research into standards for their products.

Further, the trend in developed countries toward more extensive regulations on quality and process attributes, rather than just on product characteristics, poses a problem for developing countries. In effect, it tends to divide the world market into high value products sold on the basis of real or perceived attributes identified with location and production method and lower value "commodities" that have little differentiation. The market for high value products has grown at a faster rate than for undifferentiated and raw commodities. If developing countries are confined to the production of these lower value products, then their terms of trade will continue to deteriorate and they will become marginalized in world trade (Josling 2003).

The impact of process standards is controversial, as demonstrated by the case of South African citrus exports to the EU subject to standards relating to environmental requirements in the production process (level of pesticides used) and work practices (washing facilities and potable toilets for every 600 meters in the orchard). In one view, these standards have effectively overridden lower domestic environmental and workplace standards for exporters and have helped to decrease pesticide use and improve working conditions (IISD/ICTSD 2004). However, others claim that South African citrus producers saw these standards as interference in a matter that should be dealt with between them, their workers, the unions, and the government. Producers are said to feel that that they are being forced to comply with standards out of line with domestic norms and not related to the quality of fruit they produce (World Bank 2003c).

In this case the standards at issue were not imposed by government regulation, but by industry. This reflects a general trend whereby standards are increasingly developed by the private sector, or by large-scale international buyers. This is especially the case in sectors of interest to developing countries, such as food and timber products and textiles. Concerns in the food sector have been sharpened by the consolidation of the global retail distribution sector (UNCTAD 2003d). However, as retailers tend to buy "local" in the farm and food business, their influence may also be seen as positive—helping to upgrade the quality of local food, hence making it easier to export.

A key problem is the lack of information on private sector standards and buyers' requirements. For example, the Colombian flower-growing sector has encountered export restrictions resulting from the proliferation of private environmental labels. Labels are not based on common minimum parameters so the consumer does not receive comparable information, and it is impossible for exporters to satisfy all the different requirements. Labels can also be poorly supervised and not subject to internationally accepted standards of transparency, impartiality, and objectivity (Rojas Arroyo 2003).

What are the costs of complying with standards?

Even where standards are fair, compliance costs vary across countries due to differences in, for example, institutional, financial, and technological capacity, human capital, consumer preferences, and local conditions (World Bank 2003c). Many standards place a larger financial burden on companies in developing countries than on their counterparts in the developed world (Rotherham 2003).

Many of the costs of meeting standards are related to establishing the necessary institutional infrastructure. First, countries need to have a standards body to set standards, coordinate information and comments on standards in export markets, and participate in international standard-setting bodies. In developing countries, relevant national authorities often lack resources and clear lines of responsibility, and communication and coordination among them is poor. Standards and industry bodies lack information about standards in export markets and have limited capacity to assess the potential impact of, or coordinate comments on, proposed standards. Information on standards in export markets is especially lacking among small and medium-size enterprises and in rural areas where most producers are located. Poor telecommunications infrastructure is a major contributing factor—lack of information and communication technology means that information is slow to reach producers and traders who need it most. There are also often few effective channels for the private sector to feed in information about what standards would be desirable, including in terms of aligning national standards more closely with major export markets.

Second, countries need to have conformity assessment facilities to test compliance with standards. The standards and monitoring required in the local market might be much lower and not easily ramped up to the level of international standards, and substantial investments in sophisticated technology may be required. For some countries, facilities with the required level of technical sophistication are too costly to establish, and the local market for their services is too small. Even where local compliance and verification procedures exist, they may not be accredited internationally. Where exporters are obliged to pay for testing overseas, it raises their production costs and decreases the competitiveness of their products.

Third, these testing facilities need to be accredited by relevant authorities in export markets for their certification of compliance to be accepted.

Separate accreditations can be required for each export market, although some moves are being made toward mutual recognition of accreditations.[3] In some cases, governments require certification to be undertaken by their own domestic agents and do not grant accreditation to foreign certifiers. Some private sector standards have their own bodies, accreditation to which can be costly—accreditation to the Organic Accreditation Service of the International Federation of Organic Agriculture Movements costs $14,000 a year (IISD/ICTSD 2004).

Adjusting production facilities to comply with standard requirements can generate significant costs to producers. Investment in capital equipment can be particularly burdensome for small and medium-size enterprises, whose main cost advantage lies in low capital inputs and high labor inputs and whose access to credit might be limited (Rotherham 2003) (box 6.2).[4] In Bangladesh, shrimp processors spend around $2.2 million a year to meet international standards, and the government spends an additional $225,000 on monitoring and certifying compliance. Even then, processors may not be able to guarantee compliance

Box 6.2

The costs of standards

Source: OECD 2002b; World Bank 2003c.

The costs of certification under the ecolabeling program set up by the Flower Campaign (a group of German NGOs and consumer organizations) have been estimated at a relatively low $2,500 a year. However, exporters must also pay $1 per label for each crate of exported flowers, which could raise costs by as much as $20,000 a year for some producers. The producer generally assumes these costs, as few ecolabels command a significant price premium.

In Uganda it is estimated that construction of processing facilities and purchase of equipment necessary to upgrade a honey processing center to conform to ISO food safety standards would be up to $300 million. Likewise, average coffee production costs are said to increase by about 200 percent when compliance costs for good quality coffee are factored in.

The need to segregate organic and nonorganic produce along the production and distribution chain for certification may mean that small producers can no longer take advantage of economies of scale offered by marketing boards and cooperatives unless these organizations make expensive changes to ensure that goods are segregated.

The Marine Stewardship Council (MSC, a partnership between the Worldwide Fund for Nature International and Unilever) provides certification regarding responsible and sustainable fisheries management but has been controversial, in part because of the costs to developing countries. For example, an MSC certification of the Philippine blue crab fishery in the Sulu Sea was deemed prohibitively expensive due to the genetic tests of the blue crab stock required.

An EU ban on azo dyes resulted in substantial compliance costs for Indian exporters. The cost of azo-free substitutes was estimated at 2.5 times that of azo dyes, a prohibitive difference for the small and medium-size enterprise textile producers that make up 60 percent of the Indian textile industry. Further, it cost the Indian government about 1 billion rupees to establish the testing facilities necessary to comply with the new standards. Some developing country exporters argued that the ban on azo dyes only came into effect once European manufacturers had developed patented substitutes.

with all standards, as they have little control over the production process, 50 percent of which is in the hands of small producers who may be unaware of the standards, unable to implement them, or unable to afford the necessary monitoring systems to prove that they meet them. The fact that a certain scale of production can be needed to make compliance systems affordable poses problems for small producers. For example, certification costs for organic wine production in Chile are 5 percent of operating costs for vineyards of 50 hectares, but 25 percent for vineyards of 10 hectares (IISD/ICTSD 2004).

High compliance costs can act as a powerful deterrent for companies, especially small and medium-size enterprises, against engaging in exports.[5] While this is a problem for small producers in both rich and poor countries, small producers are more prevalent in developing countries and less likely to have access to support services. The inability to enforce compliance with national standards is also a problem. For local firms in developing countries, lack of compliance with domestic standards means that they lag even further behind foreign standards and can lack experience in finding efficient ways to adapt to new quality requirements. Some developed country exporters, while legally obliged to meet their domestic standards, may also take advantage of weak enforcement capacity in developing countries to export substandard products (DFID 2002).

What can be done?

The basic dilemma could be sketched as follows. On the one hand, developed countries are adopting increasingly stringent standards that developing countries have to try to meet in order to gain market access, but for which they often lack the infrastructure and production conditions, and which may be inappropriate for their domestic markets because, as a matter of priorities, they are too high or costly for local conditions. Investment in sophisticated technical and administrative infrastructure needed to meet high standards in export markets could crowd out more urgently needed investment in social services or public utilities, especially in resource-constrained countries.

On the other hand, seeking exemptions from these standards is unlikely to help, serving only to brand exports from developing countries as inferior or unsafe (and providing no incentive to raise standards in developing countries for the benefit of domestic consumers). Where standards are imposed by private buyers, there is even less scope for—or point in—seeking exemptions. And there can be development benefits. The need to implement foreign standards for export markets can raise overall standards, with flow-on benefits for the local market. Investing in the capacity to meet higher standards in export markets may result in increased resource efficiency, higher occupational safety, improved health conditions and consumer protection, and less environmental pollution (Jha 2003; Henson and Wilson 2002). Certain standards, such as those for organic produce, may even create export niches for developing

countries, though these opportunities should not be overstated in the absence of a domestic market for "green" products (IISD/ICTSD 2004).

Two things are thus essential if developing countries are not to be left behind by rising standards. First, there is a need to ensure that standards are not abused for protectionist purposes and do not contain additional impediments to the exports of developing countries. Second, significant assistance must be provided to developing countries to construct the institutional frameworks and infrastructure to meet standards.

Preventing the protectionist abuse of standards

The WTO Agreements on Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) aim to address two main concerns: the scope for otherwise legitimate trade barriers standards to be used as a shelter for protection (precaution used as protection); and the lack of information on the regulations to be complied with in export markets. While regulatory and technical barriers related to trade in goods are covered by the TBT Agreement, standards related to animal, plant material, and human health are covered by the SPS Agreement.

Under the TBT Agreement, no country is prevented from taking measures necessary for the protection of human, animal, and plant life or health, or the protection of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate. However, the agreement requires that technical standards not create unnecessary barriers to trade (box 6.3).

Similarly, the SPS Agreement has two aims: to maintain the sovereign right of any government to provide the level of health protection it deems appropriate, and to ensure that these rights are not misused for protectionist purposes and do not result in unnecessary barriers to international trade (box 6.4).

In principle, these agreements should deliver real gains to developing countries by ensuring that their exporters only expend scarce resources conforming to legitimate measures (Jensen 2002). However, there have been limits to these gains.

First, the strongest disciplines in these agreements apply only to a subset of standards in the marketplace. Within the realm of government standards, only mandatory standards are subject to the strictest disciplines—voluntary standards are subject to the weaker Code of Good Practice. Private or nongovernmental standards bodies are encouraged to accede to the Code, but adoption is voluntary.

The gap matters: from the perspective of a developing country exporter, there is little difference between a government regulation and the standards imposed by private sector buyers, yet the extent to which they are disciplined by trade rules is hugely different. Considerable problems with private sector or NGO standards have been reported—for example, ecolabeling organizations have a poor record of soliciting input from foreigners on draft standards (IISD/ICTSD 2004).

Box 6.3

The Agreement on Technical Barriers to Trade

Source: WTO 1998; Rotherham 2003.

The agreement distinguishes between mandatory technical regulations, to which most obligations apply, and voluntary standards, which are subject only to the Code of Good Practice (see below). It applies to national governments and subnational governmental or nongovernmental bodies. Key principles include:

Avoidance of unnecessary obstacles to trade. Technical regulations and conformity assessment procedures must not be prepared, adopted, or applied with a view to, or the effect of, creating unnecessary obstacles to international trade. Technical regulations must be not more trade restrictive than necessary to fulfill a legitimate objective, taking account of the risks that nonfulfillment of the objective would create. Legitimate objectives include national security requirements, prevention of deceptive practices, protection of human health or safety, and protection of animal and plant life or health or the environment.

Nondiscrimination and national treatment. Apply to both technical regulations and conformity assessment procedures.

Harmonization. Members must use existing international standards for their regulations unless their use would be ineffective or inappropriate to fulfill the legitimate policy objective. International standards are rebuttably presumed not to create unnecessary obstacles to international trade. Similar provisions apply to conformity assessment procedures. Members are also encouraged to participate in the work of international bodies.

Equivalence of technical regulations/mutual recognition of conformity assessment procedures. Members are encouraged to recognize others' technical regulations as equivalent and are required to consider recognition of conformity assessment procedures.

Transparency. Members must provide advance notification and opportunity for comment on regulations that are not based on international standards and that may have a significant effect on the trade of other members. Each member must establish a national enquiry point. A Technical Barriers to Trade (TBT) Committee allows Members to consult on any matters relating to the agreement.

Special and differential treatment. Developing countries have additional flexibility in applying the Agreement, and developed countries must pay special attention to the trade interests of developing countries when applying their own technical regulations and conformity assessment procedures.

Technical assistance. Members shall, on request, grant technical assistance to developing countries on mutually agreed terms and conditions.

The Code of Good Practice for the Preparation, Adoption, and Application of Standards applies to voluntary standards developed by government, nongovernmental, and regional standardizing bodies.

Recognition of these difficulties has led to the development of a Code of Good Practice for Setting Social and Environmental Standards by the ISEAL alliance, for international standard-setting and conformity assessment organizations to promote practices such as consultation with stakeholders (OECD 2003a).

Equally, the extent to which the disciplines requiring the provision of technical assistance apply to voluntary standards introduced by private sector groups is unclear (see box 6.3). While WTO Members can be held accountable to provide assistance to combat the trade effects of standards they introduce, it is less clear

Box 6.4

The Agreement on Sanitary and Phytosanitary Measures

Note: The Codex Alimentarius Commission, run jointly by the Food and Agricultural Organization and the World Health Organization, develops standards on food-related issues. The International Office of Epizootics is responsible for animal diseases, while the International Plant Protection Convention, administered by the FAO, covers plant pests and diseases.

Source: Josling 2003; Jensen 2002.

The Agreement has three basic principles.

First, sanitary and phytosanitary (SPS) measures should be based as far as possible on objective and accurate scientific data. The use of scientific risk assessment enables regionalization—where a region within an exporting country is declared free of a disease or pest even when the country as a whole does not achieve that status.

Second, national regulations should be based on international standards, where they exist, as agreed by the Codex Alimentarius Commission, the International Office of Epizootics, and the International Plant Protection Convention. The importance and legitimacy conferred on these international standards encourages harmonization. However, countries can still choose higher standards, but these must be based on scientific evidence and consistent with the acceptable level of risk chosen by that country. As a practical matter, if international standards are not appropriate, importers are also encouraged to recognize the equivalence of standards and certification procedures in the exporter country if they provide the same level of protection.

Third, the transparency of SPS regulations and adequate information for exporters is to be accomplished through enquiry points, notification of any new or changed SPS measures that affect trade in time to facilitate compliance, and the establishment of the WTO SPS Committee.

The general functioning of the SPS Agreement is basically the same for developed and developing countries; the main differences are in implementation and provision of assistance. Major special and differential treatment provisions for developing countries include the provision of technical assistance to help them meet SPS standards; care in preparing and applying SPS measures when their interests are involved; longer phase-ins, where possible, for SPS measures affecting their products; the possibility of time-limited exemptions from obligations under the agreement; and encouragement and facilitation of their participation in standard-setting organizations.

Implementation of the agreement was delayed for developing countries by two years (until 1997) and for LDCs by five years (until 2000).

that they are obliged to do so for voluntary standards. But the private sector bodies responsible for voluntary standards generally have neither the resources nor the capacity to provide assistance (Rotherham 2003). Further, while the notification system for mandatory technical regulations has generated a comprehensive list of notifications on products of export interest to developing countries, there is no parallel obligation for notification of voluntary standards and buyers' requirements, and no information clearinghouse services exist as yet (Jha 2003)—though some are proposed (see below). In addition, the treatment of non-product-related process standards under these rules also remains unclear.[6]

Second, even where the rules do apply, developing countries may be unable to take advantage of them due to resource and capacity constraints.

Countries seeking to exercise their rights and responsibilities under the Agreement need a functioning standards regime—the requirements of which are a heavier burden for developing than developed countries (Finger and Schuler 2000). As noted above, developing countries often lack the necessary institutional framework (agencies with rules, enforcement capability, communication

mechanisms, and transparency), infrastructure (labs for testing, surveillance and research facilities, and hygiene controls in production and processing facilities), and human resources (technical and scientific expertise and experience). In the absence of these, the full benefits of the agreements—in particular harmonization and the establishment of equivalence, plus regionalization under SPS—have not been realized for developing countries. Experience with SPS suggests that negotiations on equivalence have often in effect amounted to requests for the adoption of the developed country standard rather than an attempt to recognize alternative ways of accomplishing the same level of protection (Josling, Roberts, and Orden 2003, Josling 2003). Experience with the TBT Agreement has been more limited, with few efforts made, but to date WTO Members have had little success in negotiating equivalence on technical regulations (Rotherham 2003).

Additionally, while the agreements make international standards more important, resource constraints limit the participation of developing countries in the development of those standards. In the case of SPS, membership of the three international bodies (the Codex Alimentarius Commission, International Office of Epizootics, and International Plant Protection Convention) is correlated with income (Jensen 2002), and even members may lack the resources to participate effectively in the standards-making process. As noted above, international standards tend to be developed in areas of developed country interest, and at levels that reflect their standards and regulatory capacity.[7]

Finally, the poorest developing countries struggle to fulfill notification responsibilities and, perhaps more important, to monitor the notifications of others and initiate challenges. In the case of the SPS Agreement, by March 2002, only 56 percent of low-income countries had established a national Notification Authority, and only 64 percent an Enquiry Point, compared with 89.3 percent and 92.9 percent respectively for upper-middle-income countries, and 100 percent on both counts for high-income OECD countries. While 30 developing countries have either raised or supported an SPS challenge within the WTO SPS Committee, these have been dominated by only a few countries (Argentina, Thailand, Philippines, Brazil, Chile, Uruguay), with most African countries and LDCs practically absent (Jensen 2002). Further, few developing countries have made formal complaints through the dispute settlement system on SPS matters (Jensen 2002).[8] Participation by developing countries in these bodies remains clearly inadequate, given their trade interests in the issues at stake.

Neither the TBT agreement nor the SPS agreement is mandated for renegotiation as part of the Doha Agenda. That said, the significant problems that developing countries have encountered with implementation of these agreements has generated a number of proposals in the implementation discussions. It is clear that the same infrastructure and resource constraints that prevent developing countries from being able to meet standards in the market also prevent them from being able to take advantage of the TBT and SPS Agreements. Nonimplementation of

these agreements will not solve the problems developing countries face in the marketplace but could only increase them, by removing a tool for keeping standards as fair and transparent as possible. Any assistance provided reaps multiple benefits: improving domestic standards infrastructure; improving the development-friendliness of international standards and the capacity of developing countries to meet them; and increasing their ability to use the TBT and SPS agreements to challenge standards that unfairly keep them out of the market.

All these aspects might induce developing countries to consider seriously the option of "importing" standards (in part or in totality) from a developed country, including the standard and certification bodies (be these bodies private or public) that could establish subsidiaries in the developing country in question (Messerlin and Zarrouck 2000). In the case where public bodies from the developed country are involved, such an "import" of institutions should be seen as a component of the technical assistance of the developed country chosen by the developing country (see below).

Assistance for developing countries

Assistance to developing countries to date has clearly been inadequate and a substantial increase is clearly needed—but what should it be aimed at and what is already being done?[9]

What sort of assistance would help?[10]

- International standard-setting bodies could prepare a user-friendly inventory of standards of interest to developing countries and accelerate consideration of issues of specific interest to developing countries. International standard bodies could also be asked to review their working methods to minimize constraints on developing country participation. For example, the International Office of Epizootics (OIE) funds some developing country participation, has lowered its fees for LDCs, and has also introduced written submissions.
- International standard-setting bodies could also help to increase the capacity of developing countries to participate fully in the SPS and TBT Committees, for instance by providing assistance with preparation of challenges to notifications. Technical agencies could also identify situations where equivalent levels of protection could be provided by different means and assist developing countries to prepare documentation for negotiating equivalence agreements. Similar assistance could be granted to prepare negotiations on regionalization in SPS, as well as assistance in providing monitoring and certification schemes.
- Developing country national and regional capacity to conduct risk analysis and other scientific and policy research could be strengthened by encouraging conformity assessment facilities in developed countries to develop twinning relationships with their counterparts in developing countries. Equally, public laboratories in OECD countries could be

encouraged to set up branches in developing countries. This could help to build local capacity by training staff, provide technology transfer on meeting international standards, and help to create international trust in the local standards conformity capacity.

- A regional approach could be taken, including building on existing links in regional trade agreements. For instance, international technical and financial assistance could support the development of joint certification schemes and common research facilities, pooling resources to create a scientific base. Existing schemes for information-sharing could be expanded. A United Nations Industrial Development Organization (UNIDO) project in the context of the West African Economic and Monetary Union is working toward harmonizing standards within the region and helping testing laboratories upgrade technical competence to levels required for accreditation.
- A regional approach could also be taken in international standard-setting bodies and the SPS Committee, rotating responsibilities at a regional level for representation. Designated scientific support groups for particular SPS issues could help to reduce the resource and financial burden on individual countries. In this instance, a sensible alternative to a regional approach would be cooperation or coordination among developing countries sharing similar concerns.
- Support for greater involvement by small and medium-size enterprises could be expanded by encouraging backward and forward linkages between local small and medium-size enterprises and large export firms. For example, South Africa uses an incentive scheme called the "Competitiveness Fund" under its Department of Trade and Industry (DTI), which offers grant fund assistance and comprehensive support of conformity assessment activities to small and medium-size enterprises. DTI also hosts a "Sector Partnership Fund," which supports five or more firms and organizations in the development and execution of collaborative projects. Local or regional certification systems could be customized to better meet the needs of small and medium-size enterprises by providing group certification schemes.
- Assistance could also be provided to help small and medium-size enterprises form industry associations. For instance, in 1995 UNIDO helped to establish the Eastern and Southern African Leathers Industry Association, which helped to increase awareness of European chemicals restrictions among small leather goods producers and to coordinate technical assistance projects (Rotherham 2003).
- Assistance could also be devoted to helping developing countries promote standards at the national level. For example, studies could assist developing countries in examining how compliance with standards could help to improve economic efficiency and export competitiveness.

Box 6.5

Some examples of where assistance has made a difference

Source: UNIDO 2003; World Bank 2003c.

In 1999, following a contamination, the EU imposed an import ban on fish from the Lake Victoria region, resulting in a 50 percent drop in fish exports from Tanzania and Uganda and a 30 percent drop in employment in the fish sector. The ban cost around $36.9 million, and around 35,000 people lost their jobs. With funds from UNDP, WHO, FAO, UNIDO, and a range of bilateral donors, a program was established to improve the management and oversight of the fish industry, including inspection; install locally laboratories able to test to international standards; train 950 persons in 17 companies on standards; and improve the control of standards and quality at all levels.

Investments in technology were also necessary: additional costs in equipment ranged from $12,000–$13,500 for a representative fish firm in Uganda to $2,500–$5,000 for training of personnel on fish processing and handling. Initial cost of certification for each individual firm was $15,000, while hired testing and certification services ranged from $2,000 to $4,000. These costs were borne by the firms themselves, apart from the training provided by UNIDO, USAID, and the World Bank.

The EU ban was lifted in 2000, and exports resumed. The investments have paid off; Ugandan fish exports increased from 14,075 tons before the ban to 28,119 tons afterward, partly due to the compliance enabling the upgrading of the status of the fish.

In Sri Lanka UNIDO assistance helped introduce new industrial metrology and upgrade chemical and textile testing laboratories to international accreditation. Standards and conformity assessment bodies were transformed into business-oriented organizations. Textile lab income increased by 70 percent and local capacity for ISO 14000 was created. As a result of the improved facilities and international accreditation, 14 Sri Lankan companies have started exporting food, and many international buyers are now accepting the Sri Lanka laboratory certification. The existence of adequate testing facilities has also enabled niche products, such as organic tea to be explored.

The experience of those developing countries that have moved to becoming standard setters would be useful. Countries could also be encouraged to develop high impact awareness campaigns on the importance of standards and to create incentives for private sector compliance with national laws.

In addition to assistance, domestic reform can contribute to the ability of developing countries to comply with international standards. For example, given the importance of information and communication technology (ICT) in the dissemination of standards information, developing countries could be encouraged to explore telecommunications liberalization as a means of increasing domestic access to ICT. Equally, priority should be accorded to improved infrastructure for transport of goods and other shared facilities that may reduce the cost of supply chain management and increase the delivery quality of export products. Here again, services trade liberalization, as well as trade facilitation initiatives, may play an important role.

Foreign direct investment (FDI) can play a major role in helping developing countries to meet standards. Multinational companies operating in developing countries often dominate exports because they are more aware of, and have greater resources to implement, international standards. FDI can help in

overcoming supply-side constraints that hinder competitiveness, bringing in financing and technology transfer to improve product quality and production practices. For example, the first dyestuffs manufacturer in China to become ISO 14001 certified (a certification for continuous environmental management improvements) was a joint venture between a domestic firm and BASF (IISD/ICTSD 2004). Working with developed country retailers can help small producers in developing countries adapt to higher international standards.

Action in OECD countries could be an important complement. Resources could usefully be devoted to education campaigns for consumers in developed countries to increase awareness of the impact of ever-higher standards on developing countries. Such campaigns could increase the political scope of regulatory agencies in developed countries to pursue policies that provide a better balance between risk and the need to provide developing countries with trade opportunities in the interests of their economic development.

Box 6.6

Activities of selected international organizations on standards and trade

In 2001 the World Bank, WTO, World Health Organization (WHO), Food and Agriculture Organization (FAO), and the International Office of Epizootics (OIE) established the Standards and Trade Development Facility. The Facility has three primary objectives: provision of small grants for pilot projects that build capacity in SPS-related standards in developing countries; assistance to governments and private sector in meeting international standards; and strengthened interagency coordination and donor collaboration in the delivery of technical assistance in standards. The WTO has also put in place procedures to monitor the provision of assistance by WTO Members, and the Secretariat has solicited requests for assistance from developing countries.

UNCTAD's work in standards aims at building consensus, promoting policy dialogues, strengthening the capacity of developing countries in research, and responding to emerging requirements. Three main types of activities are undertaken: expert meetings bringing together experts from government, private sector, academics, and NGOs[a]; technical cooperation and capacity building projects[b]; and policy-oriented research.

UNCTAD, with other organizations, has also been exploring the possibility of creating a Consultative Task Force (CTF) on Environmental Requirements and International Trade. Funded by the Netherlands, it is envisaged that this would be a multistakeholder forum of government, private sector, and NGO representatives from developed and developing countries.

The CTF would look at ways to improve collection and dissemination of information. It would study the contours of an international clearinghouse mechanism for voluntary environmental and health requirements and synergies with comparable existing public and private databases on voluntary standards. It would review best practices in the development and implementation of regulations and standards. And it would discuss adjustment policies and measures in developing countries.

Established in 2003 the FAO–UNTCAD–International Federation of Organic Movements (IFOAM) International Task Force on Harmonization and Equivalence in Organic Agriculture is an open-ended dialogue between public agencies and private sector institutions and companies involved in trade and regulatory activities in organic agriculture. It aims to facilitate international trade by exploring opportunities for harmonization, equivalence,

a. See www.unctad.org for summaries of "Ways to Enhance the Production and Export Capacities of Developing Countries of Agriculture and Food Products, including Niche Products, such as Environmentally Preferable Products" (July 2001); "Environmental Requirements and International Trade" (October 2002); "Definitions and Dimensions of Environmental Goods and Services in Trade and Development" (July 2003); and "Market Entry Conditions Affecting Competitiveness and Exports of Goods and Services of Developing Countries: Large Distribution Networks Taking into Account the Special Needs of LDCs" (November 2003).

b. These include studies on standards and trade in South Asia, Eastern and Southern Africa, and Central America funded by the Canadian International Development Research Centre and two UK-funded projects on trade and environment—one on research and policymaking capacity and another on improved policymaking and negotiation.

Box 6.6

Activities of selected international organizations on standards and trade

(continued)

Source: Josling 2003; Vossenaar 2003; UNIDO 2003.

and mutual recognition of organic agriculture standards, regulations, and conformity assessment systems and discusses measures to facilitate access to organic markets by developing countries and smallholders.

UNIDO undertakes extensive capacity-building projects related to TBT and SPS, some in cooperation with other international organizations. It focuses on technology diffusion and capacity building for market access, including development of productive capacity in selected export sectors; upgrading technical, physical, and institutional infrastructure for standards and conformity assessment; and analysis, advice, and technical solutions to TBT and SPS problems. UNIDO is undertaking surveys to assess TBTs faced by enterprises, in particular small and medium-size enterprises, in developing countries (such as Bahrain) and is exploring the establishment of an early warning mechanism to work in parallel with existing enquiry points and information dissemination systems to make small and medium-size enterprises in developing countries aware of new standards.

Where countries have been successful in meeting standards, it has required increased FDI and donor assistance backed by political will and direct government support. The impact of technical assistance on standards has also depended upon the general effectiveness of the regulatory framework, including the rule of law and transparent and consistent administrative procedures. It is clear that prompt, comprehensive, and targeted assistance can help (box 6.5).

While more remains to be done, international organizations have stepped up their efforts to assist developing countries in meeting the challenges of standards, including increasingly working together (box 6.6).

Chapter 7

Preferential market access

While the previous chapters have addressed the core market access of the WTO—most favored nation (MFN) liberalization—this chapter addresses market access granted outside of the WTO; that is, preferential access for developing countries (normally access at a lower tariff rate) to the markets of donor developed countries. While not formally part of the WTO, preferential access has become a key issue on the Doha Agenda, largely because of an increasing dissatisfaction on the part of some countries that are excluded from preferences at the favored treatment being accorded to other countries, and because of fears about the impact of MFN liberalization on the preference margins currently received by some developing countries and the Least Developed Countries. Fears about preference erosion have become a powerful argument in some quarters against ambitious liberalization—by developed countries—in the Doha Round. But is this correct? Have preferences conferred significant benefits, and what are the consequences of eroding them?

Trade preferences have become a feature of the trade landscape; first, with the Generalized System of Preferences (GSP) for developing countries, and more recently, with a range of initiatives aimed at providing preferential access for LDCs to the markets of certain developed countries.

As discrimination among WTO Members in the application of tariffs would normally be prohibited, WTO rules include a special Enabling Clause, which permits (but does not require), GSP schemes, reciprocal agreements among developing countries, and special treatment for LDCs, among other measures.[1] (Agreements not falling under this clause must be the subject of a waiver agreed by all WTO Members.)

Preferential access for developing countries is not negotiated under the WTO and differs from WTO market access in several key respects. First, it is nonreciprocal: the recipient country is not expected to grant any access in

return.[2] Second, it is applied to some countries and not others on the basis of criteria determined by the importing country alone. Third, preference schemes are unilateral: they can be withdrawn or changed at any time, without recourse. In sum, unlike negotiated WTO market access, preferences are not a legal right—they rely on the goodwill of the importing Member.

Preference schemes are usually viewed as a positive contribution to the development of the poorest countries by helping to offset competitive disadvantages that impede or lower the incentives to invest in new activities. They have also been used as a substitute for development assistance, in that they offer higher prices for traditional commodities in the protected importing market. If preferences were to result in the first outcome by helping to establish a viable new export industry, they would certainly be "developmental." However, insofar as they simply transfer rents to beneficiary countries for their traditional exports, they are not—it would be more appropriate to provide development assistance directly, without distorting trade. Further, unless any new production stimulated by preferences also strengthens the development of national technological and entrepreneurial capabilities through learning by doing, the sustainability of the development processes might be questionable. Experience with the Caribbean Basin Initiative has suggested that the fragmented type of industrialization process that follows from the nature of the preferences may actually slow down the type of technological capacity-building and learning necessary for economic sustainability (Mortimore 1999).

Unfortunately, overall experience suggests that preferences do little good, and may even do harm, in that—insofar as they have had a significant impact—they have mostly been of the rent transfer type and have not done much to foster diversification.

Has preferential access conferred the expected benefits?

The first major attempt to use trade preferences for development is GSP schemes. Fifteen such schemes were in operation in 2001 (IMF and World Bank 2002). While intended to be "generalized" (covering all products), nondiscriminatory (covering all developing countries), and nonreciprocal, in reality, country and product coverage varies considerably, and "nontrade" conditionality may be used as a substitute for traditional trade reciprocity.

Experience with GSP schemes has been disappointing. During the first 11 years (1968–78) less than 11 percent of eligible imports received GSP treatment. By 1988 this figure had increased only to 27 percent (Oyejide 2002). Further, the benefits have been heavily concentrated among a few recipients. In 1999 the top 15 GSP exporters to the Quad countries (Canada, EU, Japan, U.S.) accounted for 88 percent of all qualifying imports. And these were not always the poorest countries: in descending order, the main recipients were China, Thailand, Brazil, Indonesia, India, the Republic of Korea, Malaysia, the Philippines, Viet Nam, Taiwan (China), South Africa,

Chile, Argentina, the Russian Federation, and Mexico (Laird, Safadi, and Turrini 2003).

In general, utilization rates of preference schemes tend to be low. For instance, with limited exceptions (alcohols, sugar, flowers, and jewelry), only around one-third of eligible products—and only 65 percent of eligible apparel exports from the Caribbean and Central America, despite a preference margin of 14 percent—are estimated to enter the U.S. under all preference programs (World Bank 2003a). For all Quad countries, rates of preference utilization are low and declining—by 2001 only an estimated 38.9 percent of eligible imports entered under reduced tariffs (table 7.1). In all, only 68.5 percent of total imports from LDCs eligible to enter Quad markets at a preferential duty actually do so; the rest pay MFN duties (UNCTAD 2004b).

In addition to the GSP, new initiatives have aimed to reduce or eliminate tariffs on products from certain groups of low-income countries. The EU's Everything But Arms (EBA) initiative (2001) and the U.S. African Growth and Opportunity Act (AGOA) (2000) offer deep preferences to recipient countries that can satisfy strict eligibility constraints. For instance, EBA eliminates tariffs on all tariff lines, but only for LDCs and with long transition periods for three critical products—bananas (2006), rice (2009), and sugar (2009). Australia, New Zealand, Norway, and Switzerland also offer duty-free and quota-free access for all products from LDCs (Canada excludes certain agricultural products).

Overall, the impact of these schemes has not yet been very significant, with the exception of African apparel exports to the U.S. under AGOA (World Bank 2003a).[3] The impact of the EBA has been relatively limited, largely because the vast majority of EU imports from LDCs (99.5 percent in 2001) were already eligible for preferences under other schemes—notably, the Lomé-Cotonou Conventions that cover ACP (African, Caribbean, and Pacific) countries (see appendix 2). However, non-ACP countries are underusing the EBA—in 2001, 50 percent of their exports to the EU did not receive preferential access and paid the MFN tariff (Brenton 2003).

Table 7.1

Quad country imports from Generalized System of Preferences beneficiaries (billions of dollars) and ratio of use of available preference (percent), 1994–2001

Year	Total imports	Dutiable imports	Eligible for preference	Receiving preference	Rate of use of preferences (percent)
1994	448	283	162	83	51.1
1995	539	331	195	108	55.1
1996	585	351	178	100	56.0
1997	575	346	200	100	50.1
1998	543	311	183	74	40.6
1999	548	290	166	68	40.7
2000	623	308	171	72	42.0
2001	588	296	184	71	38.9

There are several reasons why utilization rates of preference schemes tend to be low: complex regulations and rules of origin, exclusion of key exports from the recipients, uncertainty and conditionality of the preferences, non-production of relevant goods, or administrative failure (Stevens and Kennan 2004). Further, many LDC exports remain unable to meet relevant standards (see chapter 6); no preference schemes currently include any capacity-building programs to assist in this regard (UNCTAD 2004b). Countries must have a minimum base of production and supply capacity in order to be able to take advantage of preferences—supply-side constraints could also be an important contributing factor to the low utilization rates of a number of preference schemes. Indeed, the low level of industrialization and diversification in many ACP countries has contributed to the low utilization (although comparisons with other preference schemes, such as the U.S. AGOA, suggest rules of origin may be an important barrier) (Page and Kleen 2004). The choice of product coverage under preference schemes will also affect the extent to which supply-side constraints are binding (that is, where schemes exclude or offer less favorable treatment to the very products that preference-recipient countries are best placed to produce—see below).

Preferences are undermined by complex regulations and rules of origin

Countries benefiting from preferential access are subject to administrative requirements, and rules of origin are often complex. The result: countries are often forced to pay the MFN tariff because they cannot satisfy the requirements. The specificity, design, and application of rules of origin can make it particularly difficult for LDC exporters to benefit from preference schemes (UNCTAD 2001). For instance, underutilization of the EBA has been attributed in part to its rules of origin, which are stricter than those for ACP preferences (Brenton 2003).

Strict rules of origin requiring local sourcing (or at best regional cumulation) are often defended on the grounds that they help to encourage the development of integrated production structures in the recipient country.[4] It is questionable whether integrated production structures are a sensible aim in the context of increasingly global production networks. In any case, there is little evidence to date that this actually happens. Further, this objective would surely be better served by the development of rules of origin in consultation with the recipient country, rather than unilaterally by the donor, as is currently the case.

Restrictive rules of origin are particularly hard on small countries with limited capacity to source locally. Regional cumulation can help, but it still limits sourcing choices, and there does not appear to be any development rationale for choice of countries for which cumulation is permitted—Sri Lanka is penalized for using inputs from Indonesia, but not from India (Oxfam International 2004a). Use of cheaper inputs from excluded countries can limit the eligibility

of the final product for preferential treatment, but not using them can either raise costs and reduce competitiveness or render production unfeasible.

This is a particular problem in textiles and apparel, which are key exports for LDCs. Many clothing exports from Bangladesh and Cambodia do not qualify for preferences under the EBA because of fabric sourcing requirements—and the competitiveness of fabric from external suppliers can be more important than the preference margin (UNCTAD 2004b). Likewise, the requirement to use U.S. fabric or yarn in manufacturing apparel limits the exports of some countries under AGOA, due to the higher cost of U.S. fabric and inefficient transport logistics in Sub-Saharan Africa—whereas the very poor countries that are exempt from this requirement (such as Lesotho) have benefited significantly (Garay and Cornejo 2002). It is estimated that the basic AGOA rules of origin would reduce the potential benefits of the agreement by up to a factor of five (Mattoo, Roy, and Subramanian 2002)—although the relaxation of the standard rules of origin for qualifying AGOA countries has meant that beneficiaries have been able to significantly expand their garment exports to the U.S. In sum, restrictive rules of origin have a perverse effect: the smaller and poorer a country is, the less likely it is to be able to establish a textile industry that would qualify for preferential access to developed country markets (Oxfam International 2004a).

Complex rules of origin also impose high costs simply in terms of providing the necessary documentation. These costs can be compounded where, for example, products are required to be shipped directly to the preference-granting country or, if they transit another location, written proof must be provided that the products stayed under the control of customs at all times and did not enter the domestic market or undergo any operations other than loading or unloading. Transit is very common for products from LDCs, and acquiring this documentation can be costly and difficult.

Preference schemes continue to restrict certain products of major export interest

Many preference schemes exclude or continue to restrict products of major export interest to recipient countries, often products in which these countries have a genuine comparative advantage. Often the most sensitive products with the highest tariffs also have the lowest preference margins or are subject to some type of quantitative limitation or safeguard. Further, preference margins do not address escalation since tariffs tend to remain higher on more processed products.

Product exclusion has been a major source of criticism of the GSP. In the EU, "sensitive" products receive only a 3.5 percentage point reduction in the MFN rate, except for clothing, which receives a 20 percent reduction (though in most cases this amounts to only 3.5 percentage points). Sensitive products include many of those of interest to developing countries—most chemicals,

almost all agricultural and food products, and all textiles, apparel, and leather goods. There seems to be less of a problem with product exclusion for LDC trade, where the products with the highest margin between the MFN rate and LDC preferential duty appear to correspond quite well to major LDC exports. For example, apparel and processed fish have some of the highest preference margins in a number of markets (WTO 2003d). A number of new schemes reduce tariffs for all LDC exports to zero, though exceptions tend to remain in areas of key interest, such as farm products (dairy, eggs, and poultry are excluded in Canada; bananas, rice, and sugar are subject to extended phase-outs in the EU) or textiles and apparel (excluded in the U.S., with the exception of AGOA) (WTO 2003d). These exclusions matter: up to 70 percent of the potential positive trade effects for LDCs from the EU's EBA could come from free access for sugar, rice, and beef (UNCTAD 2003c).

Preferences are also often subject to special safeguards. Under the U.S. GSP, a country's eligibility for a given product may be removed if its annual exports of that product reach a certain level or if there is significant damage to domestic industry. Likewise, the EU GSP allows preferences to be suspended if imports cause, or threaten to cause, harm to a community producer. The EU's EBA scheme also contains a mechanism for the temporary suspension of preferences in the event of massive increases in imports from LDCs, as well as a special safeguard for bananas, rice, and sugar. Whenever LDC imports of these products exceed or are likely to exceed the previous year's level by more than 25 percent, the Commission will automatically examine whether the conditions for applying a safeguard are met (Hoekman, Ng, and Olarreaga 2002). Preference schemes also contain in-built mechanisms for graduation, which can lead to fine-tuned discrimination between eligible developing countries.

Since countries whose exports increase can be removed from preference schemes, including because of lobbying by import-competing groups in the donor country, some preference-receiving countries try to curb their export performance in order not to lose the preferential access altogether. Hence one of the many perverse incentives of preferences: countries that actually benefit from preferences are more likely to lose them (Özden and Reinhardt 2003).

Preferences are uncertain and subject to conditions

Preferences are uncertain, subject to unilateral change or withdrawal by the donors and to nontrade conditionality. They can be used as bargaining chips against developing countries across a range of areas—directly related to the WTO (dispute cases), related to trade issues in general (intellectual property rights), or unrelated political issues—and can be withdrawn at any time without recourse (Özden 2003).[5] Further, they are often of short duration and subject to periodic renewal. For instance, to prove eligibility for U.S. AGOA preferences, countries must document not only GSP criteria and satisfy rules of origin, but also criteria related to child labor and respect for internationally recognized

workers' rights (IMF and World Bank 2002). U.S. GSP eligibility has also been used to promote increased protection of intellectual property rights in some developing countries (World Bank 2003a). Similarly, the EU's GSP scheme contains conditions related to, for example, compliance with international anti-money laundering agreements and measures to fight the drug trade, as well as conditions related to environmental and labor standards. A major advantage of the EU's new EBA scheme is that it is granted for an unlimited period and is not subject to periodic review (though it is subject to temporary suspension in the event of significant import increases, as noted above).

Has preferential access caused harm?

Returning to the distinction between "development preferences," motivated by assisting recipients to overcome competitive disadvantages that constrain investment in new activities, and "rent preferences," motivated by a desire to transfer resources to traditional suppliers of commodities, the evidence suggests that exports under "rent preferences" account for the lion's share of current benefits of those recipients that have exploited preferential access opportunities (Page and Kleen 2004). This in turn suggests that the benefits from a global development perspective have been limited. Moreover, preferential access carries some significant downsides: it distorts developing countries' trade and creates vested interests and the potential for unholy alliances.

Preferences divert trade from other developing countries

A key problem is the impact of the preferences granted to one developing country on the trade of other developing countries. Preferences can give rise to serious trade diversion. While this is also the case with preferential trade agreements, it is likely to be more of a problem with preferences because the set of goods that developing countries produce will overlap much more with other developing countries that are not recipients than with the output of donor developed countries (Hoekman, Michalopoulos, and Winters 2003).

Trade diversion can be particularly pernicious where the preference margin is sufficient to divert trade from a relatively efficient developing country producer toward one that may never be competitive in the product concerned in the absence of this preference margin. Rather than encouraging diversification (a frequent argument among supporters of preferences), preferences tend to encourage specialization, including inappropriate specialization in uncompetitive sectors which, without the preferences, would have disappeared in the recipient country. This danger is particularly great in the case of preferences given in areas of very high protection, such as agriculture.

Equally poor—but non-ACP or non-LDC or non-African—developing countries are disadvantaged by preferences granted to ACP countries, to the countries covered by the EU's EBA initiative, or to those covered by the U.S. AGOA initiative. This was made abundantly clear in the 1990s during the

dispute-settlement case that was brought to the WTO concerning the EU's banana import regime. For every dollar of benefit that the banana policy brought to producers in ACP countries, the regime harmed non-ACP developing country producers by almost exactly $1—and in the process harmed EU consumers by more than $13 (Borrell 2004). It is difficult to imagine a more inefficient way of transferring income to the poorest countries, since EU citizens could have, through direct payments, been 13 times more effective in helping ACP banana producers and not hurt non-ACP banana producers at all. Such wasteful trade diversion is avoided under nondiscriminatory MFN liberalization under the WTO.

Preferences create vested interests against multilateral liberalization

Fears of preference erosion and a desire to maintain preference margins clearly impede moves by many developing country preference recipients toward multilateral liberalization in areas that should be of key concern to them—such as agricultural support policies. There is a danger that a desire to keep preferences will allow the donor countries—the EU in particular—to bolster support from developing country recipients in an effort to keep protection high (such as the Common Agricultural Policy, see chapter 3) while not really sharing much, if any, of the resulting rents with preference recipients.

While the highest preference margins are not granted to farm products, the high level of protection in agriculture implies that even modest preference margins can create artificial markets for particular exporters. Estimates of preference margins for LDCs into four markets—Australia, Canada, the EU, and the U.S.—for those agricultural products where the difference between the donors' MFN rate and the preferential rate granted to the LDCs was greatest show that margins vary widely. Not surprisingly, those in the less protected OECD countries are relatively low: 5 percent in the case of Australia, and 11 percent to 19.6 percent, with most around 12.5 percent, in the case of Canada. Those in the most protectionist OECD countries are much higher: 18 percent to 25 percent in the case of the U.S., and 24 percent to 74.9 percent in the case of the EU (see appendix 7) (WTO 2003a). The key problem is that, where this has encouraged inappropriate specialization, the erosion or removal of the preference may cause painful adjustment problems to the recipients of preferences (see below).

Preferences may undermine trade reform in developing countries

Finally, the fact that preferences are by definition not reciprocal makes life easy for politicians. But that contributes nothing to the removal of the wasteful trade-restrictive policies of recipient countries. Given that exporters are normally a strong voice for liberalization at the domestic level, the capture of this group in the cause of preferential access can retard the process of liberalization. In fact, countries tend to undertake more trade reform (they reap the efficiency

gains of removing protectionist policies) after withdrawal of GSP (Özden and Reinhardt 2003). By contrast, market access negotiations under WTO are characterized by reciprocity: you receive greater access to your trading partner's market (on an MFN basis) on the condition that your trading partner receives a similar degree of improvement in access to your market.

More generally, and perhaps most important, preferences divide developing countries on the issue of securing tariff reductions in OECD markets on an MFN basis. They do this in two ways: by reducing the number of developing countries arguing against protection and by creating a subset of developing countries that have an interest in supporting OECD protectionist policies in order to continue to receive the high domestic prices in those markets. The case of the ACP waiver deal that was negotiated in Doha—which pitted developing country exporters against ACP preference beneficiaries—is a clear illustration of how preferences can create conflicts among developing countries and allow donors to divide and rule. In that case, Thailand and the Philippines joined the consensus to grant a waiver for the EU's preferences for ACP countries only after the EU agreed to consultations on the impact of these preferences on their exports of canned tuna (under the waiver, ACP countries would continue to be exempt from the 24 percent tariff applied to all other imports of canned tuna). The EU ultimately agreed to establish an MFN tariff quota on canned tuna of 25,000 tons at a 12 percent tariff, but it did so in the face of opposition in ACP countries. Preferences limit the ability of developing countries to maximize their leverage in the WTO by negotiating as a bloc and undermine the formation of alliances to open protected OECD markets.

This point is crucial, and yet it is often not appreciated. Perhaps if these preferences had not been offered in the first place, developing countries would have negotiated much more vigorously in previous GATT rounds for lower tariffs on agricultural and other imports into the EU. That in turn would have placed greater pressure on Japan and other OECD countries to reduce their agricultural protectionism also. The end result would have been higher international prices for agricultural products that, for developing country producers as a group, may have been more than sufficient to offset the lower prices received in the EU market for a favored subset of those producers.

Preference erosion

Although many preference programs have had only limited benefits for recipients, the scope for preference erosion resulting from a Doha Round set of global reforms could be considerable for some countries. In part this will depend on the notional preference margins. But the real costs of preference erosion will depend on a much wider range of factors. These include the extent of trade actually taking place (determined by other factors, such as regulations and other nontariff barriers, as well as supply-side capacity), the extent of preference utilization (which, as shown above, can be limited), and the extent to

which any rents actually accrue to producers in the poorest countries. Indeed, even if preferences have value—that is, they apply to highly protected sectors in donor countries and thus generate rents—in practice these rents will not accrue completely to the recipient developing countries.[6] Instead, a share of the rents, and perhaps most of the rents, will be captured by importers (distributors, retailers, distribution subsidiaries of producers) (Tangermann 2002).

Moreover, insofar as a developing country sells only part of its exports into a protected market to which it has preferential access, it receives a lower price for the rest of its exports than would be the case under free trade (because of the price-depressing effect of that OECD protection on the free international market). It is therefore conceivable that the weighted average price for its exports is lower than it would be under free trade, notwithstanding the benefit of preferential access for some of its exports.

The costs of preference erosion also need to be set against gains from MFN liberalization—both for the recipient country and other developing and Least Developed Countries. Available evidence suggests that preference erosion is unlikely to be a major issue for many countries once the compensatory effect of broad-based multilateral liberalization is taken into account (World Bank 2003a). Under a variety of scenarios, developing countries would receive tens of billions in welfare gains from an across-the-board reduction in MFN rates. For instance, a 50 percent reduction in agricultural and industrial tariffs would potentially yield welfare gains of $28 billion for developing countries, more than nine times the loss associated with the complete removal of GSP schemes (Lippoldt and Kowalski 2003).

The more detailed assessments of this potential problem suggest that because only a few commodities account for the lion's share of preference-generated benefits (rents) (table 7.2), and that the number of countries that have an export structure that is highly dependent on such commodities is small, preference erosion is a significant economic issue for only a limited number of countries. Moreover, most of these countries are not the poorest countries, but middle-income economies (box 7.1).

The impact of abolishing GSP schemes is likely to be relatively small overall, with limited impact on the poorest developing countries, because they are not the main recipients. Reducing MFN duties to existing GSP rates (leaving other preferences untouched) would result in export losses in all beneficiary regions, but the losses are not large (0.4 percent and 1.6 percent of trade in the base period). Globally, the loss is estimated at $3.3 billion, with most ($2 billion) borne by the Asian newly industrialized economies and China (as the largest beneficiaries of existing schemes). For these countries this represents only 0.2 percent of real income. Effects are also concentrated in textiles and apparel and processed agriculture. These sectors do not receive the biggest preferences, but beneficiary countries tend to specialize in sensitive sectors with high MFN protection (Laird, Safadi, and Turrini 2003).

Table 7.2

Contribution of major export products to preference margin

a. As a percent of the trade-weighted average world market price of the country's exports.

b. Average for 76 middle-income developing countries, weighted by margin.

c. Eighteen countries with average preference margins greater than 5 percent.

Source: Alexandraki and Lankes 2004.

	Proportion of margin accounted for by preferences for:				
	Total preference margin[a]	Sugar	Bananas	Textiles and clothing	Other products
Middle-income countries[b]	**4.9**	**42**	**19**	**12**	**27**
Largest beneficiaries[c]	**15.6**	**51**	**24**	**8**	**17**
Mauritius	39.9	84	0	13	3
St. Lucia	32.9	0	94	2	4
Belize	29.3	47	23	0	30
St. Kitts and Nevis	28.7	94	0	0	6
Guyana	24.2	95	0	1	4
Fiji	24.1	96	0	1	2
Dominica	15.9	0	97	0	3
Seychelles	12.2	0	0	0	100
Jamaica	9.7	67	8	7	18
St. Vincent and the Grenadines	9.4	0	89	0	11
Albania	8.9	0	0	48	52
Swaziland	8.2	97	0	1	2
Serbia and Montenegro	7.6	28	7	10	56
Honduras	6.7	56	9	19	15
Tunisia	5.9	0	1	79	20
Côte d'Ivoire	5.7	8	51	2	38
Morocco	5.7	0	4	64	33
Dominican Republic	5.5	23	16	27	34

Erosion of all preferences, both GSP and the deeper, more recent preferences such as EBA and AGOA as a result of MFN Doha reforms, would have a substantial impact on some countries, especially those with high concentrations of exports in heavily protected commodities. However, the number of countries that are in this situation is small (IMF 2004; Alexandraki and Lankes 2004). The problem is heavily concentrated in small island economies dependent on sugar, banana, and—to a lesser extent—garment exports (see table 7.2). These are the commodities for which protection and thus preference margins are high. Preference-dependent or -sensitive countries include Mauritius, Malawi, Mauritania, Cambodia, Maldives, Haiti, Cape Verde, Sao Tome, Tanzania, and the Comoros (Stevens and Kennan 2004). The limited number and small size of most of the economies concerned imply that measures to help mitigate the impact of preference erosion can be closely targeted at the countries at risk (Alexandraki and Lankes 2004). The only large country expected to suffer from preference erosion is Bangladesh, which has benefited significantly from the textile quota restrictions imposed on other large competitive developing countries such as China—restrictions due to be removed at the end of 2004 under the WTO Agreement on Textiles and Clothing.

Box 7.1

Measuring preference erosion

Note: Only preference erosion vis-à-vis Canada, the EU, Japan, and the U.S. is considered. Current preference margins are calculated using tariff data per two-digit tariff line for each preference scheme. Direction of trade data is then applied to obtain a trade-weighted preference margin.

Source: Subramanian 2003; Alexandraki and Lankes 2004.

Simulations of the likely impact of a 40 percent reduction in MFN tariffs by Quad countries suggest that only a few countries will face significant losses.

The magnitude of the potential shock for middle-income countries is small in aggregate, ranging between 0.5 percent and 1.2 percent of total exports of those middle-income countries that are most preference-dependent.

Six countries (Mauritius, St. Lucia, Belize, St. Kitts and Nevis, Guyana, and Fiji) would incur significant adjustment shocks, ranging from 11.5 percent for Mauritius to 7.8 percent for Fiji.

For the LDCs the overall impact is again likely to be limited, at some 1.7 percent of total trade. But here also there are some countries that will lose more: Malawi stands to lose 6.6 percent, and other countries confronting potentially significant losses include Mauritania, Cambodia, and Bangladesh.

Potential export losses

(percent)

Other developing countries		Least Developed Countries	
Mauritius	11.5	Malawi	6.6
St. Lucia	9.8	Mauritania	4.8
Belize	9.1	Cambodia	4.1
St. Kitts and Nevis	8.9	Bangladesh	3.9
Guyana	7.9	Maldives	3.5
Fiji	7.8	Haiti	3.3
Dominica	5.5	Cape Verde	3.3
Seychelles	4.2	São Tomé and Principe	2.7
St. Vincent and the Grenadines	3.4	Tanzania	2.4
Jamaica	3.3	Comoros	2.0
Albania	3.3		
Nicaragua	3.2		
Swaziland	3.0		
Serbia and Montenegro	2.9		
Tunisia	2.2		
Côte d'Ivoire	2.2		
Morocco	2.1		
Dominican Republic	2.1		

Those LDCs and small middle-income economies that will confront possible large losses from preference erosion will require concrete assistance. Given that they have been obtaining transfers from the importing countries, an appropriate response would be for these countries to convert these transfers into equivalent development assistance, which could be used by the recipient governments to fund adjustment costs. This first-best solution may face the opposition of the preferences beneficiaries in the developing countries in

question. For instance, farmers having benefited from EU banana or sugar regimes may insist on being compensated for the losses of their rents. The simplest way to handle this issue would be to make these farmers an integral part of the shift of OECD farm policies away from product-support to pure income-support (see chapter 3).

Given the history of preference programs, developed countries as a group should pay: they instituted and preserved the system of discretionary preferences, and they also have the largest interests in the trading system (Page and Kleen 2004). How to operationalize this shift from preferences to aid is something that should be considered explicitly as part of a Doha deal. A number of issues would have to be resolved: ensuring that financing commitments were (and were seen to be) credible; guaranteeing that the associated aid would be additional to existing official development assistance (ODA); and ensuring that the aid was used to effectively address the adjustment burden in recipient economies (Hoekman 2004) (chapter 12). It would also need to be determined how the funds would be administered, and specifically, whether to give the WTO the mandate to manage them. Whatever is done in terms of management of a funding entity, it is important that this be a temporary mechanism that is meant to deal with the adjustment costs associated with preference erosion. Insofar as developed countries desire to support the countries concerned on a longer term basis, the appropriate vehicle is ODA.[7]

Another possibly complementary approach is the idea of "supply-side preferences" to assist affected LDCs (UNCTAD 2004b). While this proposal requires further fleshing out, the basic idea is for further measures in developed countries to promote the transfer of technology to LDCs and to promote increased foreign direct investment (FDI) in LDCs. For instance, measures to promote FDI could include financial support in the form of equity and loans, the provision of fiscal incentives and insurance, or the dissemination of information services and match-making services. Measures to mitigate risks in LDCs could also be considered,[8] as could measures to encourage maximum forward and backward linkages with local companies. Here there is a need to ensure that the focus is on market failures and that the programs are designed so as to minimize the prospects of capture by interest groups.[9]

Conclusion

Rich countries have used preferences to divide developing countries and promote their narrower regional, sectoral, and political objectives, often establishing complicated regulations whose effect is to exclude exports from otherwise eligible countries. The poorest countries have seldom received more than limited benefits from preferences, in part due to the shortcomings of the schemes and in part because preferences are only an opportunity for market access—they do not address the multiple supply-side constraints that limit the participation of the poorest countries in world trade. Benefits are also often at

the expense of other developing countries, and are smaller than would be the case with either direct transfers or multilateral liberalization. Ultimately, the price of defending preferences is continuing protection in rich countries. Given this, MFN liberalization—plus appropriate compensation for those countries that may suffer adjustment problems—is likely to be a better path.

2

Rules-related issues

Chapter 8

What should be the scope of WTO rules?

There is more to the Doha Agenda than market access—the "rules of the game" are also the subject of intense debate. At the heart of this debate is the question of what sort of trade rules make sense for development. Answering this question requires considering not simply how existing trade rules can best be adapted, including through special and differential treatment, to address the needs of developing countries, especially the poorest ones at the core of the Millennium Development Goals. It also requires considering the more fundamental question of what, from a development perspective, should properly be the scope of trade rules in the first place. That is, are there issues that simply do not belong on the WTO agenda?

This question has become more pressing with proposals to include on the WTO agenda issues such as the Singapore issues, which relate ever more closely to "behind the border" or domestic regulatory issues. Such proposals are unsurprising, as the reduction of traditional trade barriers has increased the visibility of differences in national regulatory regimes. But while trade liberalization may have thrown these differences into sharper relief, it does not follow that trade rules are the best means of addressing the issues arising from these differences. Three tests can usefully be applied to determine whether rules on regulatory issues should be included in the WTO. First, is the issue related to trade, specifically to market access? Second, is it in line with broader development priorities? Third, what is the specific value added of a WTO agreement? These three criteria are of course related and should be considered in light of each other.[1]

Is there a link to market access?

The threshold question is whether a particular regulatory policy is being used or can be used to restrict market access. This is the traditional WTO criterion

for inclusion of an issue on the agenda: whether a policy is trade-related, that is, whether it impedes market access or distorts competition on a third market. Regulatory measures can be a substitute for explicit barriers (such as product standards) and, as seen in chapter 6, multilateral rules on preventing protectionist abuse of such measures can be warranted in order to ensure market access. WTO rules in this context may also lead to reciprocal benefits similar to traditional trade liberalization: greater contestability of domestic markets and improved market access abroad. Where the link to market access is not clear-cut, serious doubts can be raised regarding the appropriateness of including the policy areas in the WTO.

Are there domestic benefits to negotiating rules on regulation?

A key question is whether proposed regulatory rules make sense from a national perspective in terms of addressing development policy priorities, even if there are no market access considerations. Some domestic regulatory issues that have been proposed for inclusion on the WTO agenda are not priorities for low-income countries and risk diverting scarce administrative and political resources from those that have higher development payoffs. Where agreements on regulation require significant investment of real resources by poor countries, a strategy of "just say no" may make sense if a cost-benefit analysis suggests that the net benefits are less than would be feasible if resources were invested elsewhere. It must be recognized that scarce policymaking resources in many low-income countries imply that there are opportunity costs associated with an expansion of the negotiating agenda.

Determining national priorities on regulatory issues requires country-specific evaluation of policy and institutional options. Assessing the relative development contribution of reform in a particular policy area will thus require proactive engagement by national stakeholders and extensive policy research.

Is there specific value in a WTO agreement?

A major function of international agreements is to overcome domestic constraints that prevent the adoption of welfare-improving policies. They can tackle domestic vested interests that are blocking reforms in the general interest to preserve their narrow group interests. International agreements may also be useful in cases where the benefits of reform are maximized when others reform as well—as in the case of customs procedures. Finally, they may be necessary to deal with situations where a country's policies generate negative spillovers or where problems go beyond the ability or scope of national authorities to handle (such as where the same information is required in different formats by exporting and importing countries, thereby raising transaction costs for firms).

That there are benefits to collective action does not necessarily mean that the WTO is the right forum. Other international organizations or fora could take the lead. Here the extent to which the issue meets the first criterion

(trade-related) is essential. While certain policies may be desirable for any sound, modern economy, they may not necessarily be appropriate subject matter for—or be appropriately promoted by—trade rules. The dispute settlement system, with its promise of more effective enforcement, may be a powerful attraction, but just because a certain policy is desirable does not mean that it is best fostered by international rules backed by formal dispute settlement. The WTO's remit is trade; it is not the world economic organization, and it cannot carry the load of ensuring that countries have all the policies they need in a globalized economy. In many cases, other forms of international cooperation, such as voluntary agreements, information exchanges, and peer reviews, may be more appropriate. Even where action may be appropriately undertaken in the WTO, mechanisms and linkages are crucial to ensure the close involvement of other organizations with technical expertise in the issues at stake.

It is also inherently difficult to design generic rules that apply to all when it comes to behind-the-border policies. Given the general presumption that regulatory regimes should reflect local conditions, substantive harmonization may well be inappropriate. What is needed in the behind-the-border regulatory areas is to design agreements that are flexible and encourage experimentation, learning, and competition. The easiest way to ensure "regulatory creativity" is not to include issues too early in the WTO. Indeed, countries with only limited experience of implementing certain policies at the national level may not be ready to sign onto binding multilateral rules governing their application. Alternatively, flexibility can be maintained by limiting agreements on regulatory subjects to due process and transparency-type requirements.

Even if negotiators get the economics right, there is a danger that good policies will be resisted because dealing with these types of issues in the context of negotiation may lead countries to perceive reforms as costly concessions to foreign interests, as opposed to being in the national interest. Further, the dynamics that drive the WTO require countries to bring "concessions" to the table if they are to induce partners to liberalize politically sensitive sectors. Such linkage strategies may require consideration of negotiations in a particular area because of expected payoffs in other areas. In this case two considerations are paramount. First is that any negotiation be in the national development interest (as underlined above) and involve policy commitments that are seen to be desirable. Agreements that involve a welfare loss should not be accepted. Second is to avoid "paying twice" for the same reforms by trading partners. The linkage question boils down to how to design a socially beneficial grand bargain scenario—what can and should be offered in the context of WTO talks in order to obtain a desirable outcome?

These tests form the backdrop to the major questions addressed in this part of the report: What issues should, from a development perspective, be the subject of trade rules? And what sorts of trade rules on those issues make sense from a development perspective?

Chapter 9

The Singapore issues

At the Doha Ministerial Conference it was decided that negotiations would be launched in Cancún on competition law, trade and investment, transparency in government procurement, and trade facilitation—if an explicit consensus was reached on the modalities for these talks.

That this deal was open to different interpretations emerged strongly at the Cancún Ministerial Conference. While the EU insisted that the talks on all four issues were mandated to begin, most developing countries argued that—particularly in the absence of adequate progress on issues of interest to them, notably agriculture—there was no consensus for negotiations on the Singapore issues. The EU offered to drop two of the issues, but the African Group insisted that all four be taken off the table, while Japan and the Republic of Korea insisted that all four be kept.

After Cancún it was apparent to almost all but the most die-hard supporters that three of the Singapore issues (competition, trade and investment, and transparency in government procurement) were effectively off the table. Debate in the lead-up to the 2004 Doha Work Program (DWP) text thus largely focused on whether negotiations would be launched on trade facilitation. Developing countries, in particular the G-90, remained concerned that such negotiations could impose heavy implementation costs and overload their limited negotiating capacity. Intensive consultations were undertaken with developing countries stressing that any such negotiations should be limited in scope (bearing in mind the experience with TRIPS, which began with agreement to negotiate on trade in counterfeit goods and ended with harmonization of patent protection) and that special and differential treatment (SDT) and provision of assistance should be integral parts of any negotiations.

The 2004 DWP text states that members agree to launch negotiations on trade facilitation "by explicit consensus," but that the other Singapore issues

"will not form part of the Work Programme [set out in the DDA] and therefore no work toward negotiations on any of these issues will take place within the WTO during the Doha Round" (although there may be some ongoing argument about what precisely this means and whether the WTO Working Groups on these issues can continue).

First, this chapter assesses the exclusion of trade and investment, trade and competition policy, and transparency in government procurement from the WTO agenda against the general criteria set out in the previous chapter for determining whether particular issues should be subject to multilateral trade rules. It then explores the rationale for an agreement on trade facilitation in light of these same criteria, and discusses possible ways in which any such agreement could be responsive to the needs and concerns of developing countries.

The Singapore issues left out of the Doha Round

Trade and competition, trade and investment, and transparency in government procurement have rightly been left off the negotiating agenda for the Doha Round. None appears to meet all three of the tests set out in chapter 8: are they related to trade and market access? are they in line with broader development priorities? and what is the specific value of a proposed WTO agreement?

In terms of the first criterion, all three issues are in some way related to market access—investment most directly, competition and transparency in government procurement more indirectly.[1] However, in terms of the second criterion, many of these issues would not seem to be development priorities. In the case of competition law, for example, many of the poorest developing countries do not have such laws; most developing countries that have them have not had them for long, have often not been enforcing them, and generally need to develop much more experience to determine what works and what does not. Finally, it is not clear for any of these issues that a WTO agreement would contribute significant value added to existing international initiatives in terms of overcoming domestic or international collective action problems.[2]

Trade and competition

It is hard to see what benefits a WTO-based initiative on competition policy could bring. All but a handful of the poorest developing countries' economies are small. A sound trade policy based on moderate and as uniform as possible tariffs, on the absence of nontariff barriers, and on a liberal investment policy is likely to ensure the highest possible level of competition in their domestic markets. That small markets do not necessarily attract enough competitors is a problem that competition policy cannot handle. While a multilateral ban on export cartels would be beneficial, it was not at all clear that OECD countries would have been willing to put this on the table or what price would be demanded. This is an issue where unilateral action could be taken if there was a serious interest in promoting development—the same is true with respect to

other pro-developing country proposals that had been identified in some of the proposals that were put forward in the Working Group: such as introducing competition law criteria in the enforcement of antidumping actions, or explicitly taking into consideration the effects of anticompetitive behavior by national firms operating on developing country markets.

Trade and investment

A multilateral agreement on investment is unlikely to increase protection of investor rights beyond what is already provided for in the more than 2,000 existing bilateral investment treaties, and countries are already undertaking massive unilateral and plurilateral liberalization of investment (UNCTAD 2003f). Nor is action at the WTO likely to add much to existing international initiatives to curb improper public or corporate practices. Where a multilateral agreement could be useful is in addressing "beggar thy neighbor" policies to attract investment, in particular competitive subsidizing. However, available evidence about the capacity to discipline such subsidies suggests that the WTO is unlikely to succeed where governments have generally failed.

Transparency in government procurement

There are clearly potential domestic governance benefits from increasing transparency in government procurement, though they depend crucially on whether the reforms are backed by senior political leadership in the context of broader governance reforms. Would a trade agreement help?[3] Given the difficulties in pulling off unilateral domestic procurement reform in developing countries, a trade agreement might galvanize political constituencies behind domestic reform in return for some other benefits—such as improved market access abroad. However, putting transparency provisions at the core of such an international agreement is unlikely to stimulate much support from domestic exporters who are mainly interested in market access (Evenett 2003). The developmental impact, therefore, of WTO discussions on only transparency in government procurement is likely to be limited.

Trade facilitation

The current conditions of trade facilitation in the world suggest strong handicaps for developing countries—particularly for the poorest ones, and even for those located in the most dynamic regions of the world, such as the Asian-Pacific countries (Wilson, Mann, and Otsuki 2003). For instance, customs clearance for sea cargo takes an average of 2.1 days in developed countries and 4.8 in East Asia and the Pacific. But traders in Latin America and the Caribbean must wait up to 9 days, and those in Africa and South Asia, 10 days (World Bank 2003a).

Port charges, delays, and freight costs are significant constraints to exporting, and the availability of adequate transport and logistics infrastructure and

management greatly affects market delivery of products. The "list of detentions" published by the U.S. Food and Drug Administration reveals that the main reason for detentions from Africa was that most food exports from the region were rotten (Jha 2002). Availability of sound logistics also influences investment decisions. With intrafirm trade now accounting for 33 percent of total world trade, companies' choice of location is heavily influenced by the ease and cost of import and export (World Bank 2004).

What is the rationale for disciplines on trade facilitation?

Trade facilitation is directly related to trade gains from market access (the first of the three tests), and it brings a range of other development gains that make it a more general development priority (the second test). The list of handicaps above implies that gains to be expected from allowing customs and firms to operate in a more competitive framework—a mix of improving customs procedures and related services—are large. Initial estimates of such gains suggest magnitudes equivalent to those brought by tariff liberalization, though they vary depending on the definition of trade facilitation used (that is, the extent to which it includes broader factors such as transport costs) (box 9.1). Moreover, such gains are likely to be larger for small and medium enterprises, which tend to suffer most from current poor trade facilitation—hence they tend to be larger for the poorest developing countries, which tend to have the worst

Box 9.1

Gains from trade facilitation

Source: Wilson 2003; Wilson, Mann, and Otsuki 2003; Australian Department of Foreign Affairs and Trade and Chinese Ministry of Foreign Trade and Economic Cooperation 2001; Walkenhorst and Yasui 2003; Hummels 2001; WTO 2000b; Staples 1998; Guasch and Spiller 1999.

- The cost of moving goods across international borders is now as important as tariffs in determining the cost of landed goods.
- Enhanced capacity in global trade facilitation would increase world trade by roughly $377 billion, or 9.7 percent. About $107 billion (2.8 percent) of the total gain would come from improvements in port efficiency and about $33 billion (0.8 percent) from those in the customs environment. The largest gains would come from an improvement in service sector infrastructure and e-business usage ($154 billion or 4 percent). Gains from the exporter's improvements in trade facilitation would dominate those from the importer's improvements.
- Improving specific aspects of trade facilitation can already bring large benefits. If developing countries were able to shave off an average of one day in the time spent handling all of their trade, the savings would amount to some $240 billion annually. Documentary red tape in customs procedures can increase the cost of imports substantially—under one estimate, by up to 7–10 percent of the value of world trade. Inefficient regulation of port operations can give rise to implicit tariffs of 5–15 percent in exports in Latin America. Each day saved in shipping time, in part due to faster customs clearance, is worth a 0.5 percent reduction in the *ad valorem* tariff. Within APEC, moving to electronic documentation for trade could yield cost savings of some 1.5–15 percent of the landed cost of an imported item. The introduction of electronic data interchange (EDI) systems in Chilean customs led to savings of more than $1 million a month for a system cost of $5 million. Duty shortfalls traced to irregular customs have been estimated as up to 50 percent, harming those poorest developing countries for which tariff revenue is an important source of public finances.

current trade facilitation practices and a larger share of small and medium enterprises. New security demands underline the interest of all WTO Members in upgrading the world's trading machinery.

As a result, many developing countries recognize that improved trade facilitation is in their own interests and are already taking steps to make the necessary improvements (though progress is slow, often due to resource constraints).

But does trade facilitation satisfy the third test? That is, what is the rationale for a WTO agreement on trade facilitation? And under what circumstances would such an agreement serve development?

Developing countries have raised a number of concerns about negotiating trade facilitation in the WTO (World Bank 2004). First, they fear being required to take on obligations that are expensive, difficult to administer, and require investment in infrastructure beyond their capacities. These fears are not unjustified: costs of customs reforms are high, and reform cannot be achieved overnight. Second, in the face of these costs, there is concern that adequate technical assistance may not be forthcoming. Again, experience with other WTO agreements (notably TRIPS) suggests that these fears are not unjustified. Third, there is the fundamental question of whether binding WTO rules are the appropriate way to promote what is essentially institutional development in poor countries. Building institutions and infrastructure requires sustained effort and investment over a long period; WTO agreements are argued to be a blunt instrument for ensuring such efforts.

The 2004 DWP text on trade facilitation provides little guidance on what could be a WTO agreement on trade facilitation, and it leaves some key questions open. WTO Members agreed "by explicit consensus" to launch negotiations on trade facilitation, but they did so "without prejudice to the format of the final result of the negotiations and would allow consideration of various forms of outcomes." The negotiating mandate recognizes the implementation challenges faced by developing countries and provides for SDT and enhanced assistance and capacity building (box 9.2). The scope of the negotiations is also clearly limited. While trade facilitation can encompass the whole raft of domestic policies, institutions, and infrastructure associated with the movement of goods across borders, the scope of WTO negotiations on trade facilitation is narrower, focusing on three GATT Articles that directly concern aspects of trade facilitation: transit of goods, fees charged for customs clearance, and transparency in applicable legislation and administrative requirements.

There are three main arguments in favor of a WTO agreement on trade facilitation. First, the existence of an agreement galvanizes political will to ensure that reforms are actually undertaken within a meaningful time frame. But this gives rise to concerns that it will divert spending from other, greater development priorities. While investment in trade facilitation will be compensated over the longer term by increased exports, in the short term there may be

Box 9.2

The 2004 Doha Work Programme mandate on trade facilitation

Source: WTO 2004d.

Aim. Negotiations shall aim to clarify and improve relevant aspects of GATT Articles V (Freedom of Transit), VIII (Fees and Formalities Connected with Importation and Exportation), and X (Publication and Administration of Trade Regulations) with a view to further expediting the movement, release, and clearance of goods, including goods in transit. A further aim is effective cooperation on trade facilitation and customs compliance issues.

Special and differential treatment. The negotiations should take "fully into account the principle of special and differential treatment for developing and least developed countries" and this should "extend beyond the granting of traditional transition periods for implementing commitments." The timing and extent of commitments shall be related to implementation capacity and countries. LDCs will be required only to undertake commitments "to the extent consistent with their individual development, financial and trade needs or their administrative and institutional capabilities."

Technical assistance. The negotiations also aim to enhance technical assistance and support for capacity building, and developed countries are to provide assistance for both the negotiation and implementation of commitments. In the "limited cases" where infrastructure is required, developed countries will make every effort to ensure that support and assistance directly related to the nature and scope of the commitments is provided—although such commitments are not open-ended. Where assistance is not provided, implementation is not expected. The effectiveness of assistance will be subject to review. A collaborative effort on assistance is foreseen, involving the IMF, OECD, UNCTAD, WCO, and World Bank.

greater immediate priorities (clean water, HIV/AIDS programs, and the like) in a context of very limited government spending.

This is where the second rationale for a WTO agreement comes in. The main benefit of a WTO agreement in trade facilitation would lie in providing a mechanism for channeling international assistance into meeting these costs. There is a strong case for international assistance. In addition to the fact that it allows developing country government spending to focus on core development issues such as health and education, trade facilitation is also a global public good; all countries benefit from improvements in others' trade management capacities. Gains may increase when improvements are concurrent. Conversely, all countries are affected by weak links in others' export and import capability; in the new security environment, such weak links can be a major source of vulnerability. There is also a strong argument that international assistance for developing countries should focus not simply on meeting basic needs and providing social infrastructure, but on building the production and trade capabilities that can in turn generate growth (UNCTAD 2004b). The real value added of a WTO agreement on trade facilitation would thus depend on how effective it is in providing a mechanism to attract additional resources—from both developed and, to a lesser extent, developing countries—for trade facilitation.

The third argument is that the trade facilitation agenda spans matters that revolve around the traditional domain of GATT/WTO negotiations: cross-

border negative (monetary) spillovers. An example is the conditions that are imposed on transit trade, something that is of great importance for landlocked countries. Another example concerns the negative impacts of trade costs for express carriers, which may impede them from offering their services, or may greatly reduce the extent of their potential market in specific countries.

Options for a trade facilitation agreement

A WTO agreement on trade facilitation cannot be business as usual. It should not impose heavy obligations on developing countries and make light promises of assistance. A new approach is needed so that the agreement provides something in the trading interests of all countries, but in a way that ensures that the entirety of the implementation burdens do not fall on the countries least able to afford them. How might this be achieved?

Should it apply to all WTO Members? The 2004 DWP text does not refer to a trade facilitation agreement but to disciplines on trade facilitation. The absence of a reference to an agreement is argued by some to mean that the disciplines need not apply to all Members. However, others note that the language referring to clarification of GATT Articles V, VIII, and X, along with the reference to the negotiations having been decided by "explicit consensus," make it clear that the negotiations are part of the single undertaking of the Doha Agenda. They also note that the reference to the extent and timing of entering into commitments by developing and Least Developed Countries being related to their implementation capacities implies that all will be subject to the rules. However, the words "entering into" commitments also imply a possible GATS-like structure where countries only undertake market-opening commitments when they are ready to do so. This could imply that trade facilitation disciplines could be signed onto on an *à la carte* basis.

These options do not provide for differential commitments, however—although it is possible that the timing for implementation of certain provisions could be so long as to be indefinite. There are several reasons for this. First, improvements in trade facilitation are in a country's own interests, so if there are grounds for a WTO agreement at all, it is as a mechanism for helping countries to achieve those gains, not for excusing them from doing so. Second, if a WTO agreement is to prove a meaningful instrument for marshaling resources, the "public good" argument must be stressed—and this argument leaves more limited scope for some countries never to have to contribute to its provision. Third, a WTO agreement should not include provisions that any of its Members can never implement. If the provisions are so demanding or resource intensive they arguably have no place in a WTO agreement. Either certain provisions are truly necessary to promote trade facilitation, in which case it is in everyone's interests that they be implemented at some point, or they

are not, in which case there is no need for them to be in a WTO agreement, given that Members are always free to exceed their obligations if they wish.

This argument is analogous to the consideration given to a possible plurilateral agreement. Under a plurilateral approach, all countries are involved in the negotiations, but can choose whether to join the agreement or not. However, plurilateral agreements pose several problems. Once the agreement is in place, countries gradually come under pressure to join (acceding countries in particular), especially if the agreement aspires to covering a certain percentage of world trade. Plurilateral agreements also run the risk of discriminating against nonparties. Some developing countries have also expressed concerns that a plurilateral approach on the Singapore issues could set a precedent for similar approaches on environment or labor standards. These problems are likely also to arise in the context of a trade facilitation agreement where not all provisions applied to all Members.

Types of obligations. A trade facilitation agreement is likely to work best where the commitments to be undertaken take the form of general principles and are not overly prescriptive on the precise means to achieve them. Most WTO agreements specify general objectives without being too specific as to how countries achieve them or the technological means they use to do so. Where they have ventured into more specific and prescriptive disciplines—such as the precise periods specified for patent protection under TRIPS—they have been open to charges of "one size fits all" and have experienced considerable problems with implementation. Further, in the trade facilitation case, the Kyoto Convention of the World Customs Organization (WCO) already provides detailed instruction for national authorities on the improvement of customs procedures.[4]

Given that most OECD countries have the required trade facilitation frameworks largely in place, the implementation burden of any new disciplines would fall on developing countries. In view of this asymmetry, and the fact that some developing countries face real resource constraints in implementing trade facilitation reforms, the agreement should match these country obligations on trade facilitation disciplines with developed country obligations to provide the necessary assistance. That is, binding commitments by developed countries on the provision of adequate technical and financial assistance to developing countries facing implementation difficulties should be negotiated as part of any new trade facilitation agreement.

Such assistance could be provided bilaterally or could tap into the considerable assistance in this area under way or planned through international or regional organizations. For example, given that a number of developing countries are currently taking out loans from the World Bank for trade facilitation or related infrastructure, one option in terms of provision of assistance could be for developed countries to fund the provision of interest-free or otherwise

subsidized loans to developing countries for trade facilitation infrastructure. The World Bank at Cancùn also launched a major new initiative on trade facilitation, including a review of the Bank's project portfolio in ports, customs, and other trade-related infrastructure. Additionally, considerable assistance with customs reform is provided by the IMF and the WCO. Bilateral donors including the EU, U.S., and Japan are already funding projects tied to strengthening the WTO system, security upgrades, and related trade facilitation infrastructure (World Bank 2004). WTO Members could fund country-specific projects under these and other existing programs.

Five options. The five options presented below aim to take into account these aspects. They range from a traditional WTO agreement with SDT to a GATS-type approach providing greater flexibility for countries to choose the timing of their commitments. They are all based on the assumption of general disciplines and parallel commitments by developing and developed countries on substantive obligations and the provision of necessary assistance to implement them respectively.

Option 1. The "GATS commitments" model

Countries would sign onto individual disciplines related to trade facilitation as they were ready to implement them. They would not undertake commitments until they felt comfortable that they could implement them, or had already implemented them. Developed countries would be under a general obligation to provide the necessary assistance to help developing countries reach the point where they could agree to be bound by certain disciplines.

This approach provides a high degree of flexibility to countries to prioritize implementation costs against other priorities for development spending.

This option has two main drawbacks. First, it is unlikely to provide any great impetus for the improvement of trade facilitation procedures in developing countries. This is a disadvantage for those countries, as many costs are incurred because of lack of trade facilitation infrastructure and procedures—costs that must be weighed against the costs of implementation. Second, there is likely to be parity between the nature of developing country commitments on trade facilitation and the nature of developed country commitments to provide adequate technical and financial assistance. Open-ended time frames for developing countries to undertake commitments are unlikely to result in greatly increased assistance from developed countries.

Option 2. The "unilateral GATS precommitments" model

A particular technique used in the GATS—precommitments—would form the basis of the agreement. Under the GATS a country can commit itself to implementing a particular obligation for a specific service from a certain date in the future. Under this option, developing countries would autonomously

indicate, for each discipline in the agreement, the future date by which they would implement it.

This approach provides for some certainty and an end date by which obligations will definitely be implemented, but still allows individual WTO Members the freedom to select those dates according to their existing capacities, development spending priorities, and the relative resource-intensiveness of different obligations.

This option has three main drawbacks. Some countries may opt for end dates that are so far into the future as to render the agreement meaningless—and such commitments are also unlikely to attract meaningful technical and financial assistance. It may also leave those obligations that would confer the most benefit in terms of improvements in trade facilitation to be last. Countries may also have difficulty in predicting realistic dates for implementation of parts of the agreement.

Option 3. The "negotiated GATS precommitments" model

Instead of being determined unilaterally, precommitments could be reached through a process of request-offer negotiations (as they are in the GATS). This same process would be used to negotiate parallel commitments by developed countries for the provision of adequate assistance to facilitate implementation by the given date.

There are several benefits to this approach. First, it allows for differentiation among developing countries based on their capacity to implement, without the need for creating new categories among them. This is particularly useful as *a priori* categories may be based on criteria that do not reflect their actual capacity to implement a trade facilitation agreement. For example, despite being at comparable levels of GDP, countries may have quite different problems and capacities—some will be landlocked; others might face difficult geographical conditions (natural disasters, remoteness). Equally, given the heavy role of governments in providing many of the necessary services for trade facilitation (such as customs inspection), governance issues and the political circumstances may have a particular influence on ability to implement. The request-offer process would allow for these individual circumstances to be taken into account in agreeing deadlines for particular provisions.

Under this option, the poorest countries may choose to use an additional possibility, that is, to negotiate as a group to maximize their resources and negotiating power. A regional, coordinated approach may make sense for countries whose own progress on trade facilitation is partially dependent on that of their neighbors—as is the case for landlocked countries. A group approach may also facilitate the creation of regional technical assistance schemes. The group approach would not preclude individual countries from establishing their own implementation deadlines, however.

Negotiations may also result in a more sensible differentiation between developing countries in the sense that major traders are more likely to be subject to greater pressure for early compliance than poorer countries. Equally, the fastest reformers among developing countries can set the pace and encourage others to speed up the reform process. A major benefit is that countries are more likely to respect deadlines that they have developed and agreed to in negotiations, rather than dates they may feel have been arbitrarily established.

The second benefit of this approach is that, by subjecting the provision of assistance to the negotiation of bound commitments, it forces greater coordination among developed country donors. Given that countries will be negotiating implementation dates simultaneously with commitments for the assistance to help make implementation by that date feasible, it will be in the interests of major donors to coordinate among themselves to determine how the cost of assistance will be distributed and who will take the lead in providing assistance to individual countries. In practice, countries tend to devote more assistance to those closer or more important to them—this model would likely reflect that reality, with major donors taking primary responsibility for providing assistance to their traditional recipients. Arrangements among donors would need to be made to ensure that all countries were covered. While there is a potential free-rider problem, developed countries are likely to place sufficient pressure on each other to ensure that all pay their share of assistance.

In addition, within governments, this system could assist in better coordination between trade and aid ministries, as aid officials would be involved in the negotiations from the start. Instead of the trade agreement being signed and the aid agencies later being approached for help in implementation—without any sense of ownership on their part—under this process, they would be involved throughout the process in negotiating their own commitments. This need not involve—or solely involve—visits to Geneva; negotiations could also take place in the capital of the developing country concerned through local embassies and specialist delegations. This would foster a more integrated approach to such trade-related assistance in bilateral aid programs and greatly increase the chances of adequate follow through.

This option has three main drawbacks. First, the potential downside of negotiating commitments to provide technical assistance is the risk that it could undermine efforts to take a more demand-driven locally owned approach to the provision of assistance. Much would depend on the extent to which the relevant authorities were involved in the negotiations and in the level of specificity used in the identification of assistance. While the risks might be lower were an envelope of assistance to be agreed, there is still the question of whether ear-marking an envelope of funds for this specific purpose would cut across efforts to move toward greater budget, not program, aid (designed to promote the ability of individual countries to set their own priorities). Second, any assistance negotiated under this scheme would simply displace exist-

ing bilateral assistance. It could be argued, however, that the transparency of this arrangement and the scope for concerns to be raised in negotiations (and traded off against implementation deadlines) would go some way toward helping to ensure that trade facilitation assistance was genuinely additional to existing assistance. A third drawback is that this process may be relatively time-consuming and resource-intensive.

Option 4. The standard GATT agreement model, including enhanced SDT

A fourth option would be for the agreement on trade facilitation to consist of a set of obligations that would be implemented immediately by OECD countries, with developing countries given an extended period of time to implement the agreement—say, 5 years. The poorest developing countries would be given 10 years.

Developed country commitments to provide adequate technical and financial assistance would be applied over the same time frames, and failure to provide assistance could be raised by developing countries as a defence in any dispute settlement case regarding the agreement.

One or two reviews of each implementing member would be held during the implementation period. Reviews would cover both the developing country in question's progress in implementing the agreement and the adequacy, quality, and effectiveness of the assistance provided by developed country members. Expert advice would be given by the WCO, World Bank, UNCTAD, and any regional organization involved in the provision of assistance (such as APEC). The reviews would be seen as an opportunity to identify problems with implementation and gaps in the provision of assistance. That is, the process would be strictly disconnected from any dispute settlement action.

Attendance at implementation reviews by appropriate capital-based experts from each country under review could be facilitated by the creation of a fund administered by the WTO Secretariat to which all developed country members would contribute as part of their assistance obligations. Developing country members could then request assistance from the fund. Participation by other developing countries in the review process would be encouraged as they might be able to offer useful perspectives from their own experience. Scheduling reviews should, to the extent possible, aim to facilitate opportunities for networking by developing countries facing similar issues.

In addition, the following SDT provisions would apply:

- A "Peace Clause" (that is, a moratorium on dispute settlement) would exist for a further, say, five years after the end of the implementation period. During this period, WTO Members would be free to consult about matters related to implementation, but no dispute settlement processes could be brought. For the poorest developing countries, the moratorium would apply for another, say, 10 years.

- Developing countries would also have the possibility to seek an extension of time to implement the agreement. These extensions would be subject to negotiation with the Trade Facilitation Committee, but would be subject to a requirement that requests receive sympathetic consideration. (A similar provision exists in the Customs Valuation Agreement.) Consideration of requests would also take into account the assessment of assistance received in the previous reviews. Negotiated extensions would include review provisions—again of both implementation and assistance received—and they would draw on expert advice from the WCO plus any other organization substantially involved in the provision of assistance to the country concerned (similar to the advice of the IMF used with regard to exercise of the exceptions related to balance of payments concerns). The Peace Clause would continue in effect for the additional implementation period, and would expire as normal five years after the original implementation date or two years after the end of the new agreed date for implementation, whichever is the longer. A variation on this model would make the extension provision available only with regard to the most complex or resource-intensive provisions of the agreement, rather than the whole agreement.

This option provides for a clear timetable for implementation of the agreement and thus provides incentives for both developing and developed countries to take their obligations seriously. It also affords some flexibility for developing countries in implementation, through the possibility of negotiating extensions and the Peace Clause—giving the poorest countries an incentive to implement, while shielding them from dispute settlement action. And it combines the best elements of technocratic assessment of actual capacity, including by drawing on external expertise, and the use of the WTO as a mechanism for countries to coordinate, negotiate, and agree among themselves on a reasonable overall package.

Its main drawback is that developing countries are still required to implement the agreement by a set date and thus it could still be argued to distort development spending priorities. The monitoring and review process is also somewhat resource-intensive.

Option 5. The "GATS precommitment" model, with review

This proposal would combine the GATS precommitment models with the review mechanism outlined above. The dates for the reviews would also be negotiated as part of the request-offer process. The possibility of extension would exist as for Option 4, to be negotiated for each provision for which the implementing country was seeking an extension. The Peace Clause would apply for an additional one year after each implementation date for the relevant provision for developing countries. For the poorest developing countries this period could be, for example, five years.

This option combines the strongest elements of all the systems outlined above. Implementation deadlines could be customized in negotiations with individual countries and are thus more likely to be feasible and respected. Technical and financial assistance packages could be likewise negotiated and customized, with the greater involvement of aid ministries at an early stage, which should result in greater ownership and follow through. The regular review and monitoring process would allow for problems to be identified and addressed in a timely fashion, with input from expert organizations and other developing countries with similar experiences, and the possibility of negotiated extensions would exist to deal with unforeseen difficulties or where the time and assistance required had been underestimated. Lastly, the Peace Clause would provide some final breathing space for countries experiencing final implementation problems.

The main drawback is that it makes the agreement longer to negotiate, the implementation less even, and the monitoring and review process more complicated.

Should dispute settlement apply?

The 2004 DWP text is silent on the issue of whether trade facilitation disciplines should be subject to dispute settlement.

The key issue is the extent to which commitments by developing countries to implement trade facilitation and those by developed countries to provide the necessary assistance would be parallel from the point of view of dispute settlement. Developing countries could bring a case against a developed country for failure to provide the promised assistance; however, this may not always be a good use of their scarce dispute settlement resources. That said, in the case of a pattern of nondelivery by a donor country, the lodging of a complaint by a group of developing countries could be feasible. This situation is not inconceivable—for instance where a donor country's political processes had tied up the necessary funds (perhaps due to linkages to unrelated issues in parliamentary bodies), the lodging of a WTO complaint might be a useful boost to those domestic agencies trying to push the funding through.

Most of the time, however, developed country commitments on assistance will be used as a form of counter-claim in any disputes on developing country nonimplementation brought by developed countries. The effect could be to make developed countries think twice about bringing disputes, given that they would be required to prove that the full extent of their promised assistance had been provided. In this way, the onus of proof is also reversed—in arguing that a developing country had not complied with the agreement, the developed country would have first to prove that all its promised assistance had been provided in a timely manner.

This is a powerful incentive for developed countries to implement their assistance obligations. Developed countries wish to see trade facilitation improvements in developing countries, and the effect of this system is to strengthen the link between that implementation, the ability to enforce it through dispute settlement, and their own role in providing assistance.

Conclusion

The options proposed above are designed to play to the strengths of the WTO as a forum for the negotiated exchange of "concessions," while making this process more balanced and responsive to the needs of developing countries by ensuring that the provision of assistance is subject to the same negotiating and dispute frameworks as developing country implementation obligations.[5]

On balance, Option 5 would seem to be the most promising approach. Out of the proposals above, it comes closest to providing a framework to effectively channel increased international resources into the promotion of trade facilitation, while minimizing to the extent possible the disproportionate burden on developing countries.

The options outlined above apply to trade facilitation, but they could be adapted to fit other types of WTO agreements related to rules with implementation costs. This possibility is discussed in chapter 11 on special and differential treatment.

Chapter 10

The TRIPS Agreement

In debates about the scope of WTO rules, no area has generated more controversy than the TRIPS Agreement. For some, the protection of intellectual property rights (IPRs) has no place in the trading system; others view their inclusion as in principle legitimate, but believe the TRIPS Agreement to be seriously flawed; still others view it as perfectly legitimate. This chapter explores whether developing countries have an interest in IPR protection in the WTO and whether the existing agreement affords them sufficient flexibility with reference to two issues that dominate the TRIPS negotiating agenda: access to medicines, and geographical indications (GIs).

Access to essential medicines came close to derailing the Doha negotiations, first during the 2001 Doha Ministerial Conference, then in subsequent negotiations leading up to the 2003 Cancún Ministerial. A belated solution was only reached less than two weeks before the Cancún Ministerial, when the U.S. finally dropped its reservation to the text previously agreed by all other WTO Members nine months earlier. However, by that stage, serious damage had already been done by months of often acrimonious negotiations and a very public, equally acrimonious, debate between the pharmaceutical industry and a number of high-profile NGOs. At issue was both the nature and legitimacy of intellectual property rights protection for medicines and whether the trading system should be used to enforce those rights.

GIs are the main current TRIPS issue on the negotiating agenda. These negotiations are likely to attract less public attention—though some products, such as tobacco or traditional knowledge or designs, could become the center of attention from some NGOs—but they are also shaping up to create deep divisions among the WTO membership. Unlike access to medicines, however, these divisions do not split along developed-developing country lines. In particular, and somewhat ironically, the positions of most WTO Members—from

the U.S. or the EU to India or Egypt—on GIs are the complete opposite of their position on the drug issue: the U.S. is the hardliner on drugs against India, but India, along with the EU, is among the hardliners on the GIs issue.

This fluidity of interests and positions may be seen as reflecting the inherently second-best feature of the TRIPS Agreement in a world of multiple distortions. Drugs and GIs require countries to find a balance between the interests of inventors-producers and the needs of the public for access to products, information, and services—and there is no reason that this balance should be the same for each TRIPS topic in every country.

This fluidity also suggests that some developing countries might have growing interests in IPR protection in the WTO. Despite the fact that economists would have preferred that the complicated TRIPS issues would be dealt with in a more pragmatic way and outside the WTO, an increasing number of WTO Members appear to have some interests in the TRIPS Agreement. These interests may be actual (GIs) or potential in areas not covered, or insufficiently covered, by the agreement to date. For instance, developing countries are well endowed with traditional knowledge and genetic resources for which they are seeking increased protection under the agreement (chapter 12).

There is perhaps more agreement on the extent to which the TRIPS Agreement provides sufficient flexibility for developing countries. As a basic matter, there is wide agreement that the time and resources required to implement the Agreement were greatly underestimated and that implementation has (and will, if nothing is done) put a considerable strain on many developing countries. Assistance from developed countries, and the additional implementation periods permitted developing countries, have not been commensurate with the size of the task.

Additionally, in some cases, the substance of the Agreement provides insufficient flexibility, imposing a "one size fits all" model of IPR protection on countries at widely differing levels of development and requiring protection of the full range of IPRs despite varying interests and priorities. In other cases, the problem may be not so much that the Agreement has no in-built flexibility. Rather, it is that some WTO Members are not permitting others to take advantage of the existing flexibility. For instance, while the agreement provides for differing implementation periods, countries acceding to the WTO may not even have access to these normal flexibilities. Additionally, certain WTO Members—the U.S. on drugs, the EU on GIs—are trying to impose strict (and thus unacceptable for a vast majority of the rest of the world) limits on the existing TRIPS flexibility.

Both these issues—the potential areas of developing country interest and the question of how much flexibility the agreement provides and whether countries are actually able to use it—are discussed below with reference to access to medicines and GIs. It is important to remember during the following discussions that, in the absence of any new decision, the full effect of TRIPs

will be felt only after 2005 by the developing countries, and after 2016 by the poorest countries.

At the outset, it is useful to revisit some of the reasons why the TRIPS Agreement was introduced into the WTO. In the middle of the Uruguay Round negotiations, support for freer trade in developed countries was fading. The U.S. coalitions for investment, and later for services—the engines of the negotiations during the first years—had disappeared or were in disarray. By contrast, opponents of a Uruguay Round deal in the U.S. and EU farm and clothing sectors were strong. The support of IPR-intensive sectors (drugs, software) became essential to move the negotiations forward. The Uruguay Round became a "TRIPS for textiles (and agriculture)" deal in which the developing countries agreed to extend protection for IPRs in exchange for liberalization of trade in textiles and clothing (and agriculture) (Panagariya 1999).[1] However, relatively little has been achieved on textiles liberalization to date (chapter 5), and farm barriers were left almost intact by the Uruguay Round Agreement on Agriculture (chapter 3).

TRIPS and access to medicines

The signatories of the TRIPS Agreement were aware that extension of IPRs to all WTO Members would have the effect of increasing the price of essential medicines—and other IPR-based products—in developing countries, and reducing the ability of many developing countries to access new technologies.[2] For this reason, they included certain provisions intended to lessen some of the most severe potential negative consequences by balancing the interests of IPR-holders with those of the society at large. As will be discussed further below, the extent of some of these flexibility provisions was the focus of the negotiations at Doha and during the following year (box 10.1).[3]

Between the signing of the Uruguay Agreement (1994) and the 2001 Doha Ministerial, the spread of HIV/AIDS reached pandemic proportions. But research into detection and treatment yielded a cocktail of drugs that could reduce the viral load almost to zero. A disease that had been a death sentence two decades previously could now be treated, affording its victims a near normal life. However, the new drugs are subject to patent protection, with a typical treatment costing $12,000 a year per person in developed countries—a sum far out of reach for most AIDS victims in the developing world. This situation prompted a discussion of possible interpretations of the TRIPS provisions on patents that would enable consumers in developing countries, particularly in the poorest ones, to have access to essential drugs under patent protection. This discussion was only partly about legal interpretations of the TRIPS provisions—most legal experts already agreed that these flexibilities exist—and the Doha Declaration itself adds little in legal terms. What was really at stake was the ability of countries to actually make use of the TRIPS flexibilities, in light of political pressures not to do so. A clear political message of the legitimacy of such use was needed to help in countering this pressure.

Box 10.1

Key concepts and provisions for TRIPS and medicines

Source: Lehmann 2002.

A patent is a property right granted by a state to the inventor of a novel (not previously disclosed anywhere in the world, or only in the national territory, according to domestic law), non-obvious, and useful invention. The purpose of a patent is to provide incentives for creation and investment by granting a limited-term exclusive property right over the invention.

Under the TRIPS Agreement, WTO Members are obliged to extend patent protection without discrimination as to field of technology (TRIPS Article 27). Patents have to be made available for both processes and products. The term of patent protection is to be 20 years from the date of filing. WTO Members have discretion to adopt measures necessary to protect public health, but they should be consistent with the provisions of the Agreement (TRIPS Article 8).

Developing countries have until 2005 to implement patent protection for pharmaceuticals. At the Doha Ministerial it was decided that LDCs would not be obligated to implement, apply, or enforce the TRIPS obligations on patents or undisclosed information before 2016. However, the exclusive marketing rights provision in TRIPS specifies that new drugs invented between 1996 and 2005 will qualify for patent protection when they come onto the market after 2005. Indeed, some of those drugs are already on the market, benefiting from protection in countries that have already implemented their patent obligations.

Governments can authorize the use of a patented invention by someone other than the right-holder by issuing a compulsory license (TRIPS Article 31). However, they must first make efforts to obtain authorization from the right-holder on reasonable commercial terms and conditions. This requirement can be waived in a national emergency. Products produced under a compulsory license should be predominantly for the domestic market of the member authorizing the use, and the right-holder is to be paid adequate remuneration.

WTO Members can provide limited exceptions to patent rights provided that these do not unreasonably conflict with the normal exploitation of the patent and do not unreasonably prejudice the legitimate interests of the patent owner, taking account of the legitimate interests of third parties (TRIPS Article 30). For example, a WTO panel has ruled that drugs producers can develop and submit for regulatory approval a generic product before the patent life of the original product has expired (the "Bolar" or "early working" exception, see below).

Exhaustion of intellectual property rights refers to whether countries permit products legitimately marketed under a patent right in other countries to be sold in their market without prior permission of the domestic IPR-holder. National exhaustion, as opposed to international exhaustion, means that patented drugs initially marketed outside the territory cannot be resold without the domestic patentee's consent within the domestic market. TRIPS leaves all members free to take their own approach (TRIPS Article 6). (The exhaustion issue raises important questions from a domestic competition policy perspective, given that what is really at stake is arguably exclusive distribution rights in a particular market.)

Initially, the solution was to rely on existing provisions under the TRIPS Agreement—hence at the Doha Ministerial, the WTO Members affirmed the use of TRIPS Article 31, which permits the use of compulsory licensing, including in the event of a national health emergency. However, these existing rules contained an important gap: under TRIPS Article 31(f), drugs produced under compulsory licenses must be intended primarily for domestic use. In other

words, countries with little or no drug production capacity—mostly the poorest countries—still would have difficulty gaining access to the necessary quantity of essential drugs once they were covered by patent protection after 2005 (although it should be mentioned that most of the drugs on WHO's list of essential drugs are off-patent). The Doha Ministerial thus directed the TRIPS Council to make recommendations concerning access for these countries by the end of 2002.

Interpreting the TRIPS patent regime on essential drugs

In 2002 the TRIPS Council undertook the challenge of finding some means to provide access to AIDS drugs and other pharmaceuticals for countries lacking manufacturing capacities without undermining the value of the TRIPS Agreement and the patent system in stimulating and rewarding innovation.[4] There were essentially three general approaches that could be taken to the issue—leaving aside the option of building sufficient domestic manufacturing capacity in the poorest countries to enable them to take advantage of the existing compulsory licensing provisions of the TRIPS Agreement.[5]

Expanding the exceptions provision. One proposal was for an authoritative interpretation of TRIPS Article 30. This solution was based on the fact that Article 30 does not enumerate the subject matter scope of exceptions, thus leaving the freedom to provide an exception to patent rights for the purpose of exporting essential medicines to countries with insufficient drug production capacity. TRIPS Article 30 already provides for limited exceptions to patent rights (see box 10.1), which have been interpreted to mean, for example, that persons other than the patent holder can undertake testing and seek regulatory approval for their generic drug prior to expiration of the patent.[6] This was the main proposal favored by developing countries.

However, the U.S. noted, among other arguments, that the proposed interpretation of Article 30 would violate the Article 30 requirement that exceptions not unreasonably prejudice the legitimate interest of the patent holders (U.S. Department of State 2002). It suggested two variants on this proposal: either a waiver on the obligations of TRIPS Article 31(f) or a moratorium on dispute settlement on the same provision. Neither of these proposals found favor with developing countries, which preferred the greater legal certainty conferred by an authoritative interpretation of the agreement. A waiver is normally time limited, subject to periodic renewal and negotiation of conditions. Likewise, a moratorium on dispute settlement would also normally be time limited. Crucially, instead of conferring cover by means of an agreed exception, a moratorium would also have still left members exporting drugs produced under compulsory license technically in breach of the agreement.

Relying on exhaustion and differential pricing. Another, earlier approach promoted by developing countries before the Doha Ministerial was to facilitate

deeper price discounting in developing countries, that is, by boosting incentives for patent-holders to price-discriminate across markets (after the Ministerial, they mostly favored the Article 30 solution above).[7] This approach relied on the existing flexibility under the TRIPS Agreement for each country to establish the terms under which property rights are exhausted in its own territory (see box 10.1). For instance, the U.S. has adopted the principle of national exhaustion: patented drugs initially marketed outside the U.S. cannot be resold on the U.S. market without the express permission of the patent holder. The EU has adopted the principle of regional exhaustion covering all EU member states. National (or regional) exhaustion facilitates market separation, hence price discrimination across national markets, since patent holders have a profit-incentive to charge a profit-maximizing price in each market.

There are problems with this approach, however, all related to the lack of incentives for drug companies to serve the markets of the poorest countries in the first place. First, given the very limited ability to pay for essential medicines in the poorest countries, the profit-maximizing price may not even constitute a tiny mark-up over marginal cost. Even priced at marginal cost, essential medicines may be prohibitively expensive for many developing country consumers. Second, drug companies feared that deep price-discounting in developing countries would undermine their ability to charge a profit-maximizing price in developed country markets. They argued that public health agencies in developed countries that purchase large volumes of essential medicines would press their suppliers to offer discounts similar to those offered to developing countries. This fear would seem unwarranted, however; generic equivalents of drugs patented in the Western world were available for years in places such as India at a fraction of the price charged in the developed countries, without these price differences leading to a collapse of prices in the rich world. That said, from the point of view of the companies, the sorts of complications created by price discrimination between industrial and developing country markets may override the negligible profit opportunities available on sales to developing country markets. Third, during a severe health emergency, drug companies may prefer, in terms of their image, to present price discounting as a donation motivated by humanitarian concern for the very poor and very sick, rather than profit-maximizing price discrimination (donations are not a perfect substitute in any case, in view of problems with their scope and sustainability).

Using compulsory licensing for other than the domestic market. The third proposed solution referred to a permanent amendment of the requirement under Article 31(f) that production under a compulsory license be predominantly for the domestic market, to allow some countries to supply drugs to other countries without manufacturing capacity at lower cost. Again, this solution opened the possibility that some of these drugs might find their way into developed

countries' markets—although it should be noted this problem would have also existed in the case of an Article 30 solution.

The U.S. sought to limit the scope of diseases, medicines, and beneficiaries to be covered because they were concerned about an agreement being abused for "industrial policy objectives." There was a long debate about whether the discussions during the Doha Ministerial had focused on the few always-named diseases (AIDS, tuberculosis, malaria, and "other epidemics") as argued by the U.S. and a few other countries, or whether they referred to a broader set of diseases ("public health concerns") as argued by the developing countries.

The interim solution

On August 30, 2003, the U.S. joined the consensus, enabling the adoption of a waiver to TRIPS Article 31(f). Under the waiver, patented drugs may, on certain conditions, be produced by a compulsory licensee exclusively for export into countries that lack domestic drug manufacturing capacities. U.S. agreement to the deal was secured by the Chair's reading a written statement to the effect that the flexibility being granted to developing countries was to protect public health and not to pursue industrial and commercial policy objectives through compulsory licensing. The statement also referred to 11 countries that had voluntarily agreed to opt out of using the agreement except in situations of national emergency or other circumstances of extreme urgency or in cases of public noncommercial use.[8] Additionally, in the text of the decision itself, a number of developed countries indicated that they would not use the system as importing members.[9]

Under the deal, all LDCs are entitled to import drugs from other members under compulsory license; other importing members must notify the WTO of their intention to use the system, although no approval is required. Some developed countries (such as Canada, Norway, and those of the EU) are also currently in the process of implementing changes to their laws to enable their domestic generic industry to export to developing countries. Developing countries that still enjoy the TRIPS transitional provisions will need to issue a compulsory license to export drugs under the system after 2005, when they must fully implement patent protection for pharmaceuticals. Both importing and exporting members are obliged to provide information on their use of the system for transparency purposes.

Compulsory licenses issued by the exporting member must be limited to the amount necessary to meet the needs of the importing member, with the entirety of production exported to that country. In addition, there are several measures designed to prevent products leaking into the markets of other countries, including:

- Products produced under the license are to be clearly identified through specific labeling or marking. Suppliers should use special packaging or special coloring/shaping of the products, to the extent feasible and without a significant impact on price.

- Importing members must take reasonable measures within their means to prevent re-exportation of the products (technical and financial cooperation should be available on request).
- All members must ensure the availability of effective legal means to prevent the importation into, and sale in, their territories of these products.

While this deal originally took the form of an interim waiver from the existing rules on compulsory licensing under TRIPS, the TRIPS Council was instructed to initiate work on an amendment to the TRIPS Agreement to replace the waiver, with a view to its adoption by the end of June 2004. This is still ongoing, but progress is difficult. In particular, controversy has arisen over the status of the Chair's statement made at the time the U.S. accepted the deal: the U.S. argues that it should form part of the amendment, but most others are refusing on the grounds that the amendment should be based on the agreed legal text only. A further disagreement has emerged about whether the legal solution takes the form of a footnote to the text (the U.S. preferred option) or a new paragraph in Article 31. The latter is favored by developing countries as it affords greater legal clarity and certainty. Members have now agreed to extend the deadline for approving an amendment to March 2005.

The solution has attracted criticism from a number of NGOs on the basis that it still fails to provide sufficient flexibility for developing countries. While some of this criticism is based on the premise that pharmaceuticals should be excluded from patent protection altogether, others criticize particular aspects of the scheme—for example, the notification requirements before using the system are argued to be too burdensome and in need of revisiting. The greatest concerns, however, have been expressed about additional conditions being placed on compulsory licenses in the context of preferential free trade agreements (FTAs). The U.S. in particular has included a range of TRIPS-plus provisions in its recent FTAs, which, *inter alia*, place additional limitations on the use of compulsory licenses and extend the effective term of protection for pharmaceutical products (chapter 13).

Alternative approaches

Just as countries (such as Brazil, Canada, and the U.S.) [10] have in the past used the threat of issuing a compulsory license to negotiate reduced prices from pharmaceutical patent-holders, this solution might also give patent-holders stronger incentives to supply the poorest countries in health crises at a price at (or even below) marginal cost. A regime capable of preventing re-export of deeply discounted products from the poorest countries to the rest of the world may also increase the willingness of drug firms to price-discriminate across markets. The simplest, most natural regime may be national exhaustion, that is, a complete ban of parallel imports from poor to rich countries. A more complicated approach would be to allow developed countries to impose an appropriate tariff against drug re-exports (Brown and Norman 2003). The

bans or the tariffs could be a powerful instrument—in terms of both implementation and economic benefit. They could potentially be used as the basis for arguing for reduced terms of patent protection, as drug firms would have the opportunity to make profits on both developed and developing markets. Lastly, assistance organizations could also exercise additional controls when distributing drugs, in order to minimize the emergence of gray markets in essential drugs.

In any event, these solutions will be insufficient if not combined with aid (subsidized purchases of essential medicines) because even generic drugs offered at marginal cost remain prohibitively expensive in the poorest countries. For example, a generic package of HIV/AIDS drugs currently costs about $200 annually. While considerably below the $12,000 charged in developed countries, such a sum is a substantial share of the GDP per capita in the poorest countries severely affected by the AIDS epidemic. Moreover, this gap is not covered by insurance; health insurance coverage in most developing countries is confined to a small share of the population, the people with higher incomes.

From an economic perspective, the best approach to intellectual property in the drug industry would be to subsidize research and development and to grant no patent rights (or to grant patent rights and subsidize production up to the point where the patent-holder maximizes profits by setting price equal to marginal cost). However, this approach seems out of reach for a long time.

In fact, the international extension of intellectual property rights, as it applies to drugs, may progressively become (as the effect of TRIPS-induced patent protection will be felt mainly in the future) welfare-reducing from a world perspective and particularly from a developing country point of view. This is because most developing countries have virtually no ability to contribute meaningfully to the costs of developing major drugs, and there is little worldwide gain in terms of new product development funded by developing country purchases.[11] By contrast, the cost of drug protection to developing countries may increase because the monopolies created by the extension of patent protection may progressively cut many developing countries off from essential medicines. In sum, no innovation gain may ultimately compensate the monopoly-related loss brought about by extending patent protection to the developing countries. A related and important point is that the research priorities of pharmaceutical companies are based on rich-country demands. They thus concern lifestyle drugs and diseases that do not represent the heaviest health burden in poor countries—raising the crucial issue of the alternative policy mechanisms that could promote research and development specific to poor country needs.

Ideally, dealing with health crises would have been achieved by not including medicines, essential or otherwise, in the TRIPS Agreement, and by encouraging countries to use their domestic regulatory process to enforce property

rights. Then the use of drugs in the developing countries would have risen from almost zero to a point where price equals marginal cost, while, in the developed countries, the prices paid by consumers and the incentive to innovate would not have been disturbed.

The agreement reached on the interpretation of TRIPS Article 31 is an approximation of this solution. How good an approximation remains to be seen. In this context, it should not be forgotten that developing countries could have unilaterally suspended the enforcement of the TRIPS Agreement as it pertains to essential medicines. They would have run the risks of the U.S. and EU retaliating and withdrawing concessions of equal value. The blow to the multilateral trade regime would have been enormous—for all WTO Members.

Interpreting the TRIPS regime on geographical indications

Geographical indications (GIs) are place names (or words associated with a place) used to identify the origin and quality, reputation or other characteristics of products. GIs have a long history of controversial negotiations, dating back from the first (and failed) effort to include the word "origin" in the 1958 Lisbon Conference for the Revision of the Paris Convention. Similarly, their inclusion in the TRIPS Agreement was so difficult that the only way to avoid blocking the TRIPS negotiations was to agree to further talks—hence the mandate that appears on the list of negotiating issues in the Doha talks. GIs are the only TRIPS issue mentioned in the July 2004 Doha Work Programme framework as part of the continuation of the ongoing consultative process on implementation and as an issue of interest, but not agreed, in agriculture.

Under the TRIPS Agreement, GIs must identify goods with "a given quality, reputation or other characteristic essentially attributable to its geographical origin." GIs move thus beyond the usual concept of "appellation of origin" in two important ways. They may identify a particular geographical area through words and pictorial symbols, not necessarily through the place name itself. They refer not only to quality, but to a much broader concept of reputation or characteristic that can cover, for instance, local innovativeness (craft goods) rather than physical characteristics emanating from climate or soil quality—as long as this reputation or characteristic is tied to a unique geographical origin.

The TRIPS Agreement creates two layers of GIs protection: a basic one for products other than wines and spirits, and a higher one for wines and spirits.[12] In the latter case, it requires WTO Members to prevent the use of GIs identifying wines and spirits that do not originate in the place indicated, even where the true place of origin is indicated or the GI is used in translation or accompanied by such expressions as "kind," "imitation," or the like. It also mandates negotiations concerning the establishment of a multilateral system of notification and registration of GIs for wines and spirits eligible for protection in those Members choosing to participate in the registration system.

This two-layered GIs structure has generated international and domestic tensions—not surprisingly because exclusive rights emanating from GI-based production may enhance export prospects and raise value added (monopoly rents) for those regions that can establish distinctiveness of this kind. International tensions have been visible since the 1996 Singapore Ministerial Conference, which had to address the question of extending the GIs higher protection for wines and spirits to other products. This was based around a provision in the Agreement (TRIPS Article 24.1) mandating further negotiations on higher protection for individual GIs (not related to wines and spirits). The meaning of this provision was the subject of much debate, with some members arguing that the reference to higher protection for individual GIs did not provide a mandate to negotiate extension of such protection to an entire new category of products.

In 1998 the EU mixed the two mandates, by proposing a register not limited to wines and spirits (opening the door to products such as cheese, chocolates, beer, and embroidery designs). This register was conceived as a complex process of registration and challenges, and as a source of substantive obligations for all WTO Members as they would be required to protect all GIs in the register (which is thus not a mere database). In particular, registration itself would create the presumption of eligibility, thereby restricting the scope for flexibility on the part of members. Australia, Canada, Chile, Japan, New Zealand, and the U.S. (joined later by Argentina and Mexico, among others) argued that the EU proposal interfered with the WTO Members' right to choose appropriate national implementation methods (Members are required only to provide "the legal means" to protect GIs) and that it raised unreasonable administrative burdens. These countries proposed a voluntary register without legal effect, but which participating Members would agree to refer to when making decisions regarding national protection of particular GIs.

These international tensions are also mirrored in domestic tensions. For instance, the EU negotiators worked hard to broaden the scope of the register to products beyond wines and spirits (foodstuffs, tobacco products, artisan goods, goods based on collective knowledge, and even services) with the aim of trying to get support from more countries (Bulgaria, the Czech Republic, Egypt, India, Mauritius, Pakistan, Slovenia, and Sri Lanka). But these efforts are attracting increasing criticism from the EU wine and spirits sector, which fears that the disciplines they would like to get for their own products will be diluted.

These tensions make GIs quite different from drugs because it is by no means an issue pitting developed against developing or poorest countries. Instead, it is largely one in which some exporters see potential benefits for their producers by claiming distinctive place-based qualities and thus exclusive rights to certain terms, arrayed against other exporters, who perceive that their commercial interests lie in being able to continue to use those same commercially

valuable terms—which they consider to be generic, or common, names for certain types of products—to market their products.

That the disagreements remain wide implies that cross-issue negotiations may be required to achieve consensus. In particular, it is often said that the EU and other participants preferring a strong system will need to offer other concessions, especially in agriculture. However, this tradeoff is a potentially dangerous one—market access granted for agricultural products could be undermined where foreign producers are not permitted to use commercially valuable product descriptors.

Economic perspectives on geographical indications

Geographical indications share many features of trademarks, another form of IPR.[13] Both aim at guaranteeing the ultimate origin of a product (Landes and Posner 1987). By permitting firms to attach their reputation for quality to particular symbols or expressions, trademarks offer a solution to the fact that information is costly to acquire and asymmetrically distributed between consumers and producers. In the absence of trademarks, consumers would have higher search costs for finding quality of the desired level and, if they are risk-averse in the presence of uncertain information, would consume less. Hence selling under trademarks gives firms an incentive to sustain quality, but it also provides incentives to seek out profit-maximizing market segments (such as consumers of high-fashion goods at low volumes versus consumers of low-quality products at high volumes). The result is extensive product and quality differentiation. This is reinforced by the fact trademarks induce new firms with distinctive products to enter markets, providing the foundation for interbrand competition among firms in similar but differentiated products—all key processes for market deepening and growth in developing countries.[14]

As GIs bear all the above characteristics, with potentially stronger, more direct information content on quality or reputation, they may be expected to have some pro-competitive and pro-development features, and to provide global consumers lower search costs, greater choice, and a deeper continuum of quality.

However, there are important differences between GIs and trademarks. Primarily, a trademark attaches to a firm regardless of its location, whereas a GI designates a particular area, within which many firms may have rights to its use. In this context, a number of complications arise.

Even though a product may come from a region that has a particular reputation, the product of specific firms may still be differentiated by quality (and therefore require supplemental trademark protection). Some wines from Bordeaux are surely better than others, and their relative price premia reflect both the geographical designation and their individual reputations. In this context, GIs are hardly sufficient to encourage competition among member firms in quality. Rather the firms might be expected to migrate toward some average or

least-cost quality, meaning that GIs may not carry with them automatic pressures among firms to sustain quality.[15]

There is also no necessary restriction on entry of firms into the area covered by a GI, implying that popular ones may become congested in a "commons" overuse of the joint property right. Under an arbitrary initial allocation of a fixed bundle of rights, participants may be expected to achieve maximum rents from the location and improve incentives for maintaining quality. However, this raises at least two difficult—and costly—issues. First, many regions can be expected, prior to the adoption of GIs, to have both firms that are solidly within some notion of its boundaries and firms that are on its margins. Determination of whether the latter firms should be awarded GI use is liable to be costly and litigious, as experience has suggested in the case of Australian wine regions.

Second, and related, the very definition of how broad a region a GI should cover is difficult. Consider the use of a GI to register and protect traditional clothing designs. It is likely that many villages or provinces within a developing country have skilled artisans making such clothing. It might be sensible, therefore, to register a broad territory (even the country) as a GI in order to economize on registration and marketing costs. However, the broader the territory, the more difficult the coordination problem, and the greater the incentives to cheat on quality.

Put differently, while GIs solve one market failure (information asymmetry) they give rise to another (coordination difficulties). Producer associations may be capable of managing this difficulty, but they may equally act in an exclusive and monopolistic fashion, reducing the net gains (and their diffusion) to small firms and potential entrants. At the not-so-unlikely extreme, authorities may need to be involved in the definition of specific geographical areas and GIs.

As a result, the fixed costs of organizing and sustaining a system of GIs are far higher than in the case of trademarks. Little surprise, then, that while there are hundreds of thousands of registered trademarks in the world, there are fewer than 1,000 registered GIs (Fink, Smarzynska, and Spatareanu 2003; Escudero 2001). In this regard, small regions in poor developing economies may not be able to marshal the resources needed for an effective use of geographical indications on a global scale. Technical and financial assistance, both for identifying appropriate market niches and for establishing the right forms of registration and marketing, may be central in this area of TRIPS.

GIs and the developing countries

A number of developing countries have indicated interest in expanded protection for GIs on products other than wines and spirits. For some, GIs are seen as a useful way to differentiate their agricultural products and benefit from niche markets (Sichuan pepper, Madagascar vanilla). For basic agricultural products,

this may be the best—or often only—way to negotiate higher prices. For others, GIs are seen as an important mechanism for defining and protecting the commercial fruits of certain forms of traditional or collective knowledge. Undeniably there is a link here, for GIs may be scaled to incorporate all local users of knowledge regarding the exploitation of natural resources or design traditions. Indeed, GIs are the only form of TRIPS that provides this kind of collective right, albeit based on production location rather than underlying knowledge. They also have the benefit of being not limited in time, as opposed to copyright or patents. Thus there is scope for combining these two concepts in order to reduce poverty. However, the coordination costs noted above for GIs are of much higher magnitude in the area of traditional knowledge, and it is not clear whether these costs would be offsetting or cumulative (Luthria and Maskus 2003).

In sum, this analysis suggests that determining whether particular countries or regions would benefit from a rigorous multilateral and extended system of registration of GIs is not at all straightforward, all the more because existing GIs regulations are notoriously arcane and difficult to implement in a costless way (Rangnekar 2002).

However, it is possible at this stage to set out some useful guideposts for thinking about this question. First, GIs are clearly most applicable to agricultural goods and foodstuffs. Their application to designs, services, and traditional knowledge are less concrete. Second, the establishment of GIs on their own is likely to be insufficient to provide significant incentives for building markets and exports. Complementary technical and financial assistance may be required. More centrally, other forms of TRIPS (trademarks, trade secrets, design protection) and competition regulation are required complements. Third, careful consideration needs to be paid to the tradeoffs between economies of scale (large area GIs) and problems of coordination. Fourth, because most conceivable GIs would implicate firms that are already producing with some access (perhaps remote) to the associated region or knowledge, instituting a system of GIs will generate significant redistribution of opportunities and wealth across actors—a key difficulty inhibiting these newcomers in the GI field, the developing countries to benefit from GIs.

Some additional factors should be borne in mind in the context of the TRIPS negotiations on GIs. Terms are normally required to have a history of domestic protection before being eligible for recognition by others as a GI. For some developing countries with no history of IPR protection, establishing that their terms warrant recognition as GIs on a TRIPS register may thus not be a straightforward prospect. Equally, developing countries should weigh the relative benefits of international protection through a register for their own GIs against the costs of having to ensure protection at the national level for the large number of GIs likely to be claimed by the EU and others. These costs are both administrative (and unlikely to be a development priority) and actual—as

producers and exporters incur costs, and risks of lost market share, in finding different terms to describe their products.

The proposed register would arguably severely limit the existing flexibility under TRIPS for countries to determine at the national level, taking account of local conditions (whether a domestic consumer is likely to be misled as to the origin or nature of the products by the use of a certain term), whether any particular term qualifies as a GI in their market. That is, while TRIPS currently provides for the protection of GIs, it does not stipulate *a priori* that any given term actually qualifies as a GI—that is left to each member to determine. The effect of a register would be that certain terms would be considered to be automatically protected as GIs in all countries, with exceptions only for countries that specifically objected. Given the likely volume of registrations, developing countries could find themselves having to protect a large number of terms simply because they were not able to lodge objections in time.

In light of these uncertainties it is surprising that so many developing countries are advocating for a multilateral registration system with strong legal effect. For most nations, especially the poorest ones, it is probably advisable at this point to maintain as much flexibility as possible. This would mean not linking themselves to the extensive registration system, and taking advantage of the limitations on GIs set out in TRIPS.

However, as with the U.S. and pharmaceuticals, this process is already happening in the context of bilateral or regional agreements pursued by the EU—as illustrated by the bilateral wine agreement with Australia or the GI element in the free trade agreements with Chile and South Africa. The EU is also pursuing higher protection for other terms that it deems to be "traditional expressions" in the context of these and other preferential agreements.

Conclusion

Should IPRs have been included in the WTO? From an economic point of view, probably not, because IPRs require a very delicate balance of market forces and public action—a balance unlikely to be the same for countries with wide differences in terms of income and technology, all the more because obligations of the TRIPS Agreement also tend to be "one size fits all," taking no account of levels of development and varying interests and priorities.

That said, the TRIPS Agreement would appear to be here to stay. And it is not without areas of actual or potential interest for developing countries (although the balance of costs and benefits will vary among developing countries and according to the issue), nor is it without some flexibility in its provisions. However, the flexibility provided for implementation of TRIPS seems yet insufficient on paper, and even more so in practice, and the assistance provided is clearly inadequate. Just as for access to medicines, there is a clear case for revisiting more of the rules to determine their impact on developing countries and whether any additional flexibility is required. This issue is discussed

further in the following chapter on special and differential treatment. In other cases, the Agreement provides for flexibility, but certain WTO Members—the U.S. on drugs, the EU on GIs—are trying to narrow unacceptably the scope of that flexibility. Developing countries should resist this trend—that it is taking place in the context of preferential free trade agreements (chapter 13) should give countries pause to reflect on the value of those agreements versus multilateral rules.

Chapter 11

Special and differential treatment

Previous chapters have focused on the issue of what, from a development perspective, should be the subject of trade rules and have considered the sort of trade rules on those issues that make sense from a development perspective with regard to specific—and controversial—issues on the Doha Agenda: TRIPS and the Singapore issues. But the debate over what sort of trade rules make sense from a development perspective applies across the entirety of WTO agreements, and is at the heart of the debate over special and differential treatment (SDT).

Broadly speaking, SDT has three main dimensions. First, exemptions from specific WTO rules, implying either greater freedom to use restrictive trade policies that are otherwise subject to WTO disciplines, or exemptions from rules requiring the adoption of common regulatory or administrative disciplines. Second, making promises to provide technical and financial assistance to help developing countries implement multilateral rules binding, and thus enforceable. Third, expansion in development aid to address supply-side constraints that restricted the ability of firms to take advantage of improved market access.

The SDT agenda thus encompasses both the issue of the appropriateness of the rules themselves for developing countries and the need for developed countries to ensure provision of adequate assistance to implement those rules. While developed countries have tended to focus on the latter issue, many developing countries have also argued that the rules are unbalanced. There is a strong perception that the rules have been imposed on them through the Single Undertaking (the fact that WTO Members had to sign all the Agreements negotiated during the Uruguay Round, with the exception of the Agreement on Government Procurement) without their having been given the opportunity to participate meaningfully in their design. Many also argue that they did not understand fully what they were signing.

Discussions in the WTO have been plagued by both procedural and substantive disagreements. A fundamental problem is the absence of serious analysis underpinning the SDT debate. Proposals rarely, if ever, offer a robust rationale in terms of developmental significance or a justification for what is being sought. The assumption behind many of the proposals seems to be that development will be best served by the lowest possible level of policy commitments in the WTO. That is, if obligations can be diluted or ways found of ensuring they do not apply, this is beneficial for development. Aside from the problem already highlighted—that in the contractual environment of trade negotiations, the price of exemption has too often been loss of bargaining power—a case can be made that exemption may not confer development benefits.

This chapter considers whether different treatment is justified on development grounds—first, in the context of rules on traditional trade policy instruments and second, on those with a regulatory dimension. It also offers some thoughts on moving forward on SDT in the WTO.

Is there a development case for different treatment on "traditional" trade policy instruments?

For agreements and disciplines that pertain to the bread and butter of the WTO—traditional trade policies such as tariffs, quotas, and export subsidies that can be implemented readily—a good case can be made that developing countries should abide by the same core trade policy disciplines that apply to developed countries. The case for using traditional trade policy instruments to achieve economic development objectives is weak, and some of the exemptions found in the GATT for "more favorable" treatment of developing countries are not actually beneficial (box 11.1).

Infant industry protection

Some developing countries have asked for additional flexibility to use GATT Articles XVIII:a and XVIII:c to raise tariffs or impose quotas to afford protection to infant industries.

However, infant industry protection has a poor record of encouraging the growth of competitive sectors and kick-starting broader industrial development. It is more likely to create vested interests that seek to prolong protection, imposing costs on the domestic economy and prolonging misallocation of resources. Such protection also puts the government in the position of "picking winners," requiring that it be prepared to set—and stick to—a clear timetable for reduction of protection and to allow firms that cannot become viable within that time period to fail. For this to work, a strong framework of accountable, stable, and sufficiently expert institutions must be in place, a particular challenge for many of the poorest developing countries.

Using trade policy to promote industrial development is also an outdated and self-defeating strategy in a world of tradable services, increased foreign

Box 11.1

Major provisions allowing greater freedom to use traditional trade policies

Source: Hoekman and Kostecki 2001.

Infant industry protection

GATT Articles XVIII:A and XVIII:C allow for removal of tariff concessions or use of quotas if they are necessary to establish an industry in a developing country. Compensation must be offered to countries that would be negatively affected.

Balance of payments protection

Article XVIII:b allows for trade measures to be imposed to safeguard the balance of payments. In contrast to Articles XVIII:A and XVIII:C, surveillance and approval procedures are less burdensome, and there is no need to offer compensation to affected countries. As a result, since 1967 no country has invoked the infant industry provisions of the GATT, but numerous countries have made use of Article XVIII:b. Most developing countries had no need to invoke GATT articles to protect their industries, as their tariffs generally were not bound or were bound at high levels. However, GATT Article XVIII:b was needed to use quotas, as these are generally prohibited by the GATT. In the Uruguay Round, Article XVIII:b was revised, and surveillance procedures were tightened. WTO Members must now publicly announce time schedules for the removal of restrictive import measures taken for balance of payments purposes and in principle use price-based measures (tariffs).

Subsidies

The WTO Agreement on Subsidies and Countervailing Measures (ASCM) attempts to distinguish between subsidies—defined as financial contributions by government—that can be justified on market failure or noneconomic grounds and those that distort the incentive to trade in a major way. Nonspecific subsidies—defined as those where access is general or eligibility is automatic on the basis of clearly spelled-out, objective criteria—are nonactionable; that is, they are permitted and cannot be countervailed. Subsidies that are contingent on export performance or on the use of domestic over imported goods are prohibited (except for a group of poor countries—see below). Measures that in principle are permitted but create "serious prejudice"—defined to exist if the total *ad valorem* subsidization of a product exceeds 5 percent, if subsidies are used to cover operating losses of a firm or industry, or if debt relief is granted for government-held liabilities—can be countervailed or give rise to dispute settlement. The same may be possible if it can be shown that a subsidy has had a negative effect on a partner's exports.

LDCs and countries with GNP per capita below $1,000 are exempt from the prohibition on export subsidies. The prohibition on subsidies contingent on the use of domestic goods (local content) does not apply to developing countries for a period of five years (eight years for LDCs). Developing countries that have become competitive in a product—defined as having a global market share of 3.25 percent—must phase out any export subsidies over a two-year period.

direct investment (FDI) flows, and global production chains (Hoekman, Michalopoulos, and Winters 2003). Openness to trade and FDI allows developing countries to improve the productivity of domestic firms, increase the efficiency of domestic resource allocation, and reap the positive externalities associated with learning through the diffusion and absorption of technology (see box 11.1). Protection, by contrast, is more likely simply to retard technological development and inhibit growth.

From an economic viewpoint, the drafters of the GATT were therefore justified in placing relatively stringent conditions on the use of trade policy for industrial development purposes, and in particular, on being most restrictive on the use of quantitative restrictions and local content requirements. Moreover, in cases where import competition proves too fierce, the WTO allows for safeguards—"emergency" and transitory protection. The conditions that the WTO imposes on the use of safeguards are useful because they help to enhance certainty and ensure that there is a good case for intervention.

Subsidies

Subsidy-type policies will generally be less distorting (more efficient) than trade policy in offsetting an externality or pursuing a noneconomic objective. WTO rules do not constrain the ability of governments to address market failures through subsidies or taxes. Interventions that are horizontal (general), not sector-specific or industry-specific, are deemed nonactionable under WTO rules. Consumption subsidies that do not affect the prices of tradable goods in a significant way are not covered by WTO rules. Thus, for example, food subsidies, household energy subsidies, and health and education programs are not vulnerable to WTO action. Similarly, factor-use subsidies—for example, to the wages of workers taken directly off the unemployment register—are not covered unless they are configured so as to make them *de facto* subsidies to specific sectors. Overall, therefore, the sorts of subsidies of most use in fighting poverty and offsetting market failures are not constrained by WTO disciplines (McCulloch, Winters, and Cirera 2001).[1]

In other cases the flexibility in WTO rules regarding subsidies can impose difficult choices on governments. For instance, the poorest countries (with a per capita income below $1,000) are exempt from export subsidy disciplines—that is, for more than 70 WTO Members, export subsidy disciplines do not bite. This flexibility is somewhat paradoxical—the poorest countries are given freedom to use instruments that they can ill afford and that raise domestic prices and adversely affect domestic consumers. (Unless the subsidized goods are produced in significant amounts by the poor, such subsidies are likely to worsen poverty.) However, governments may be attracted to export subsidies as a means to overcome the threshold barriers to engaging in an activity or to developing new lines of business—and these barriers are likely to be many in the case of the poorest countries. (Once a product line has become successful enough to lead to exports that exceed the market share threshold set out in the Agreement on Subsidies and Countervailing Measures, serious consideration would need to be given to eliminating the subsidy in any event). In sum, WTO rules on export subsidies leave to the governments of the poorest countries the very difficult task of assessing whether the possible gains from such subsidies outweigh their costs for the domestic economy and for the poor. Such assessments require stable and competent institutions and governance structures

(particularly given that sectoral producer interests can be adept at portraying themselves as the national interest).

The WTO prohibition on export subsidies is also a means of avoiding subsidy competition between governments. Such competition not only may lead to the transfer of rents to companies that can play governments off against each other, but would almost certainly harm the poorest countries, which cannot afford to play this game. Experience with export subsidies in agriculture all too clearly demonstrates the harm done to the poorest countries by such subsidies—as well as their diversion of domestic resources toward powerful vested interests. Indeed, the challenge in the Doha Round is to tighten the rules to prevent the use of such subsidies by those who can afford them—as best illustrated by developed countries in agriculture—not to extend the right to use them to other WTO Members. Developing countries do not benefit from greater freedom to use such bad and inefficient policies.

Given that a substantial dose of flexibility exists in the system (safeguards, general subsidies to address market failures), committing to abide by the same procedural rules on the use of traditional trade polices that pertain to developed countries makes good sense, as it will both benefit consumers and enhance welfare in developing countries.

Is there a development case for different treatment on regulatory-type rules?

But what of WTO rules that relate to regulatory disciplines and require investments of resources to establish (or strengthen) implementing institutions? These are fundamentally different from the traditional trade policy instruments above. The ability to implement and benefit from WTO disciplines on regulatory matters varies from country to country, depending on size and income and on factors such as institutional capacity and available human resources. There may also be uncertainty regarding the appropriateness of particular policy instruments for individual countries, given differences in capacity and domestic priorities.

Disciplines on regulatory matters thus pose quite different cost-benefit calculations for developing countries. This heightens the need for stringent application of the threshold tests of whether the issue should be included in the trading system at all.

First, where the implementation costs of an existing or envisaged agreement are very high and the tests—particularly of whether an agreement is serving domestic trade interests and development objectives—are not satisfied, the question is not so much one of how to manage difficulties in implementing rules through SDT, but whether the rules themselves belong in the trading system—as best illustrated by the Singapore issues left off by the Doha Round (see chapter 9).

Second, there are a number of existing agreements where the market access test is met but the test of alignment with broader development priorities is

not—that is, where the rules are market-access related but the development benefits are only a longer term priority. For such agreements, there is a case for flexibility in terms of their application. Flexibility must be proportionate: the more long-term the development benefit, the more extensive the flexibility. Just as the implementation costs differ among countries, so too does the alignment with development priorities—for more advanced developing countries the development benefits may be more likely to be realized in the short to medium term. There is also arguably a greater case for flexibility where the impact on others of nonimplementation will not be great, or not great in comparison with the size of the implementation effort required. Of course, this consideration is also related to the third test about the value of WTO agreements in contexts where the value of reform is raised if others reform as well, or in the achievement of global public goods (see chapter 8).

These considerations are particularly relevant in the case of the poorest countries with limited participation in international trade. For example, the poorest developing countries could be given considerably greater flexibility in terms of their obligation to implement the Customs Valuation Agreement. Implementation for these countries could be on a best endeavors basis for an extended period, in recognition of the fact that this agreement is likely to take a disproportionate share of government resources to implement and is really only a longer term priority. However, implementation costs may be lower and the agreement more in line with overall development priorities for more advanced developing countries and thus more limited flexibility may be appropriate (Mattoo and Subramanian 2004).

Third, implementation of a number of other agreements may be resource-intensive, and there are differences of view among countries about the development benefits of the agreement. For example, in the case of TRIPS there are differences of view about the scope for developing countries to gain from the agreement, as well as the extent to which they might be harmed by it (see chapter 10).

Where implementation is costly but development benefits are greater, agreements for those countries could be pursued along the lines of the model proposed for trade facilitation (see chapter 9). Under that model, countries could negotiate implementation dates individually (per GATS precommitments), and as a package with developed country commitments to provide adequate technical and financial assistance. Different dates could be agreed for different provisions—a useful flexibility in areas such as TRIPS where countries' priorities may vary considerably across the agreement For example, for some developing countries, pharmaceutical patent protection may not be a priority, but for those with geographical indications or software industries, other intellectual property rights may be more so. Technical reviews would assist in ensuring that assessments on effectiveness of assistance and capacity to implement were based, to the extent possible, on sound analysis, and a peace clause

would provide further flexibility with regard to the timing of the application of dispute settlement. Negotiated commitments on assistance by donors could ensure more assistance, better follow through, and improved coordination.

From a WTO systemic perspective, such resource-intensiveness, for both developed and developing countries, is not necessarily a bad thing. First, it serves as a natural brake on the number of new issues and agreements that can be pursued under the trading system at any given time. This should help keep the development of multilateral trade agreements more in step with the political and financial commitment of developed countries and with the political and technical capacity of developing countries to implement them.

Second, for the justifiable WTO agreements (those where the trade and development tests are met) resource-intensiveness is an opportunity to make these WTO agreements an effective lever to marshal the required level of international assistance. The WTO agreements on standards (Sanitary and Phytosanitary Measures, or SPS, and Technical Barriers to Trade, or TBT), for instance, are very burdensome to implement. However, they serve the trade interests of developing countries in helping to safeguard their market access interests (see chapter 6) and are not counter to their overall development interests (higher standards are also desirable at the national level of the developing countries). It could be argued that while there are gains in terms of raising domestic standards, meeting OECD-level standards might not be such a high development priority. However, the inability to meet these standards has ongoing costs in terms of lost trade opportunities and the loss of a potential means of generating growth—and of generating resources for achieving other development priorities.

If the real answer is greatly increased assistance, how can WTO agreements help achieve this? Both the TBT and SPS agreements are interesting illustrations because they include different kinds of obligations on developed countries to provide assistance (box 11.2). The TBT obligations are relatively strong—members "shall" provide assistance—although the proviso "on mutually agreed terms and conditions" means that it is not a blank check. However, it is worth noting that no developing country has made a request for assistance under these provisions (Rotherham 2003).[2] The SPS obligations are weaker in some respects—members are to "consider" technical assistance where developing countries face substantial investments in fulfilling their standards—but have likewise a poor record of meaningful implementation.

What can be done to strengthen these provisions?[3] One approach would be to make the provision of assistance to the poorest developing countries mandatory. For example, contributions to an SPS assistance fund by trading partners could be calculated on the basis of a percentage of the value of overall imports in relevant products. These contributions could be set at a certain level per year, or triggered when a developed country introduces an SPS measure significantly affecting the import of particular goods from a developing country.

Box 11.2

Current assistance obligations under the agreements on Technical Barriers to Trade and Sanitary and Phytosanitary Measures

Under the SPS Agreement, members agreed to facilitate the provision of technical assistance to developing countries through bilateral or relevant international agreements. This includes assistance in processing technologies, research, and infrastructure, advice, credits, donations, and grants for the purpose of seeking technical expertise, training, and equipment, and the establishment of national regulatory bodies so that countries can adjust to and comply with SPS measures in their export markets. Where developing countries face substantial investments in fulfilling the SPS standards of an importing member, that member is to consider technical assistance to the extent which would permit the developing country members to maintain and expand their market access opportunities for the products involved.

Likewise, under the TBT Agreement, members shall, on request, grant developing countries technical assistance on mutually agreed terms and conditions regarding the preparation of technical regulations; the establishment of national standards bodies and participation of these bodies in international standardizing bodies; the establishment of regulatory bodies or bodies for the assessment of conformity with technical regulations; information on how to implement technical regulations; the establishment of bodies for the assessment of conformity with standards adopted within the territory of the requesting member; the steps that should be taken by the producers if they wish to have access to systems for conformity assessment operated by governmental or nongovernmental bodies within the territory of the importing member; and the establishment of the institutions and legal framework to enable them to fulfill obligations of membership or participation in regional or international systems for conformity assessment.

Under the trigger approach, affected developing countries could petition specific assistance through the SPS Committee. This might permit both some multilateral scrutiny of the request and the possibility that other members might contribute to the necessary assistance. The trigger approach might also encourage more targeted assistance on the part of donors and limit the scope (to the extent possible) for them simply to shift funds from existing development projects. A tighter nexus between negotiating assistance and standards might have a useful chilling effect, discouraging the adoption of unnecessarily high standards that pose additional implementation burdens on developing countries.

Negotiations for extensions of time to implement should also be provided, for all suppliers to the market, not just major suppliers (smaller suppliers are more likely to have difficultly in implementing new standards). A model such as that proposed for trade facilitation could be considered to draw on expert advice and negotiate appropriate assistance at the same time. Assistance could be delivered on a bilateral basis, or through international organizations, perhaps using the recently created International Standards and Trade Development Facility.[4] A review process similar to that proposed for trade facilitation could also be used—or regular reports from both donors and recipients on the efficacy of assistance could simply form part of the SPS Committee agenda. This type of concrete assistance is likely to be more valuable over the longer

term, is more likely to result in tangible increases of agricultural exports from the poorest developing countries than preference regimes, and would represent a better use of donor resources.

Moving forward on special and differential treatment

SDT for the rules cannot be considered in a monolithic fashion. Not all rules are the same, and their cost-benefit analysis for developing countries varies considerably. The key question is what development purpose exemption would serve, since exemption from the rules is not synonymous with encouraging the development of efficient policies. Instead, the answer is to make the rules in such a way that development concerns and constraints, as well as capacities to undertake obligations, are factored in. And when the rules require actual investments of resources, the guiding principle for answering the two key questions—what SDT to grant and to whom—should be a cost-benefit analysis taking into account the relationship of the issue to trade, the extent of its alignment with broader development priorities, the costs of implementation, and the relative costs to others of nonimplementation.

In the case of rules on "traditional" trade policies, there does not seem to be a strong case for exempting developing countries from WTO rules. Additional freedom to use inefficient policies promises few development gains—and they may cause additional damage to other developing countries (such as subsidy wars). Indeed, rather than seeking greater flexibility to use these policies, the aim of the negotiations should be to remove the SDT that gives rich countries such flexibility—for export subsidies in agriculture and quotas in textiles and clothing.

In the case of WTO rules on domestic regulations, implementation costs can be high, and—more important—a positive cost-benefit balance cannot be taken for granted. Where the implementation costs are high and the trade and development tests are not satisfied, there is a strong case that the issue should not be subject to rules in the WTO. In other cases, assessments of the relative costs and benefits of WTO rules will vary among issues, and careful calculations are needed on an agreement by agreement country basis.

Where the costs are high, the trade test is met, and development benefits are present—but only a longer term priority—and the impact on others marginal, there is a strong case for extensive flexibility. But this flexibility should have some end-point, however distant. If an agreement is such that some WTO Members will never be able to implement it, or it will never be a development priority at any level of development, then it should not be part of WTO rules—it could be pursued in other international fora (chapter 8).

In other cases, where the development benefits are greater or more immediate, a model that calibrated commitments with assistance and gave greater flexibility to countries to determine appropriate implementation periods might be useful. Where implementation costs are high but the WTO rules promise

real and short-term benefits in terms of the trade and development interests of developing countries, full implementation may be desirable but not affordable. In these cases, concrete technical and financial assistance is required to ensure that developing countries can benefit from the rules, and agreements must be made more effective in generating the required assistance—for instance, through mandatory commitments subject to review and linked to implementation requirements of developing countries (and to dispute settlement—see chapter 9). However, making mandatory assistance work is not without challenges—for example, to ensure that such assistance is truly additional and well coordinated (Mattoo and Subramanian 2004).

Implementation costs, trade and development benefits, and impacts of nonimplementation on others are all variables that will also vary depending on the level of development of the country. The important consideration is that assessments of relative costs and benefits be based on sound analysis and not mere political bargaining. Effective SDT will require a pragmatic approach rather than abstract discussion. In the absence of concrete considerations, it can be too easy to slide from one dangerous extreme—"one size fits all"—to another—"one size doesn't fit any, ever."

Introduction of more concrete and usable SDT into the multilateral trading system will be no easy task. There is considerable debate over the approach to be used.[5] The choice of which type of approach is "best" requires considerable thought and discussion. What matters most at this point is first, that WTO Members recognize that capacities and priorities differ hugely across the membership, and second, that this discussion is based, to the greatest extent possible, on robust analysis rather than political bargaining. More information and analysis on the costs and benefits of alternative rules for all countries, and on the distribution of these costs and benefits within countries, are essential (see chapter 12).

In the context of this report, and in particular for market access (part 1 and box 11.3) we have used the concept of "poorest countries" as a way to address the needs of those developing countries that do not qualify as LDCs but are nonetheless low (or very low) income and suffer from a range of serious development challenges. Clearly, there are a wide range of factors that could be taken into account in thinking about which countries might fall under such a heading (see appendix 4), and other approaches may be equally feasible.

Whatever the approach taken, a balance will need to be found between targeting SDT more closely to the actual implementation needs of specific countries and avoiding overly substantial transaction costs and uncertainty. Moreover, in determining SDT eligibility, nonnegotiability once a deal has been reached is of great importance. A crucial contribution of the WTO to world welfare is the promotion of transparency and predictability. These are essential for producers and users of internationally traded goods, for investors, and ultimately for consumers. With this in mind, WTO Members will need to

Box 11.3

Special and differential treatment for market access

The key message from part 1 on market access is that there is a case for SDT for developing countries to allow them to undertake less market opening in goods, services, and agriculture. There is no doubt that the primary responsibility for delivering on market access for development in the Doha Round rests with the developed countries, which—being both primary beneficiaries of the current system and better able to manage adjustment—now bear a special responsibility to remove their egregious support and trade barriers in agriculture, their high tariffs and quotas in nonagricultural products, and their barriers to trade in labor-intensive services.

However, while lesser obligations for developing countries make sense, zero obligations do not. No obligations equals not only no ability to effectively prosecute negotiating interests across the agenda, it also means no ability to use the trading system to promote domestic reform and increase national welfare. The emphasis is on an approach that requires developing countries to participate in liberalization in a way that is both commensurate with their current level of development and likely to serve their long-term development interests.

It is not in developing countries' interests to remain completely outside of the reciprocal bargain that underpins the trading system. Developing countries have real export interests in agriculture, nonagricultural market access, and services to pursue for which they will need to make some—although not equal—concessions in return. Most important, middle-income developing countries are now far too important as markets for each other and for the poorest developing countries to leave their own barriers in place, particularly when those barriers actually harm the domestic economy.

What is expected from developing countries in terms of market access varies depending on their level of development and capacity to bear adjustment costs. Hence the greatest degree of flexibility is granted to the poorest developing countries, given the very serious constraints on their ability to adjust (for example, to reform the tax system to provide alternative sources of revenue as tariffs decline), to devise and provide complementary policies and safety nets, and to establish sound regulatory frameworks to underpin liberalization.

Equally, the implications for what should be done can also vary by sector. The chapters on agriculture, services, and nonagricultural trade all propose concrete ways forward for both developing and the poorest developing countries in this regard.

Finally, preferential market access is not a viable solution for addressing development needs in the context of market access. While the benefits have been, with few exceptions, relatively modest, the costs have been high—in terms of trade diversion from other developing countries, inappropriate specialization, and lost opportunities for domestic reform. Preferences can also prevent developing countries from forming alliances to combat the protectionism in OECD markets that causes real harm to their development interests.

be careful to avoid having SDT merely traded as a "concession" in the negotiation of agreements.

Efforts to make SDT more effective will also require strengthening the mechanisms for regular monitoring of SDT implementation. This should extend to the provision of information on national trade-related priorities by developing countries eligible for SDT, the funding and investment requirements these priorities involve, and the extent to which international and bilateral donors have provided assistance. Some of the proposals above already

include such mechanisms, including as part of mandatory developed country obligations. Equally, whatever approach is eventually adopted on SDT in the WTO, enforcement will be important. One question that arises then concerns the ability of low-income countries to defend their rights in the WTO. This is of course also a more general dimension of participation by developing countries in the system and is dealt with in chapter 14.

Any reform of SDT will also need to be underpinned by greatly increased international assistance—not simply to implement agreements, but also to help developing countries combat the many structural disadvantages they face in global trade. How to increase this assistance, and the priorities for its use, are discussed in the next chapter.

Box 11.4

Key points on special and differential treatment

SDT for the rules cannot be considered in a monolithic fashion. Not all rules are the same, and their cost-benefit balance for developing countries varies considerably.

For rules on traditional trade policies (tariffs, quotas, subsidies, and so on), exemption is unlikely to encourage the development of efficient policies. Additional freedom to use bad policies promises few development gains, and risks harming other developing countries (through subsidy wars).

For rules on domestic regulations requiring actual investment of resources, a cost-benefit analysis should guide the answer to the two key questions: what SDT to grant and to whom? This analysis would take into account several factors: the extent to which the rules are related to trade (market access); the extent to which they are in line with broader development priorities; the costs of implementation; and the relative costs to others of nonimplementation. Assessments of costs and benefits will vary by issue and also according to the level of development of the country concerned. The important consideration is that assessments be based on sound analysis and not mere political bargaining.

- Where the costs are high and the trade and development benefits minimal, there is a strong case that the issue should not be subject to rules in the WTO.
- Where the costs are high, the trade test is met, development benefits are present but only a longer term priority, and the impact on others is marginal, there is a strong case for extensive—but not eternal—flexibility.
- Where the development benefits are greater or more immediate, a model that calibrates commitments with assistance and gives greater flexibility to countries to determine appropriate implementation periods might be useful.
- Where implementation costs are high, but WTO rules promise real and short-term benefits in terms of the trade and development interests of developing countries, full implementation may be desirable, but not affordable. In these cases concrete technical and financial assistance is required to ensure that developing countries can benefit from the rules, and agreements must be made more effective in generating the required assistance—for instance, through mandatory commitments subject to review and linked to implementation requirements of developing countries.

3

Other systemic issues

Chapter 12

Coherence

For trade to contribute to poverty reduction, several elements need to work together in synergy: better national development strategies that integrate trade as a key component; increased and effective international financial and technical assistance for developing production and trade capacities; and a more enabling international trade environment. Improvements in the international trade regime will have an impact on poverty only if countries have sound policies and receive the necessary assistance to build the productive capacity to take advantage of new opportunities (UNCTAD and ICTSD 2004). The previous chapters have discussed the ways in which the international trade regime could be more supportive of developing countries; this chapter focuses on the other two elements: national strategies and international technical and financial assistance.

Against this backdrop, a "coherent" approach in the context of trade and the Millennium Development Goals has three interlinked dimensions. First, at the national level, coherence means the adoption of sound complementary policies by national governments where necessary to manage liberalization, as well as ensuring that trade policymaking is appropriately informed by expertise across a range of policy areas. It means integrating trade policy into national development plans and ensuring that trade policy is subject to public debate including all relevant stakeholders. Second, at the international level, coherence calls for a significant ramping-up of "aid for trade" by the development community and for a clear and realistic view on the WTO's role in technical assistance. Third, coherence means a mutually supportive relationship between trade and other policies at the national and international levels with a view to achieving the Goals. Clearly, while the three are all linked, policy coherence at the national level is the key to creating the conditions for the effectiveness of all other actions.

Policy coherence at the national level

Trade liberalization can require a range of complementary policies to ensure that gains for the economy and society as a whole are realized and the needs of the most vulnerable groups addressed. While liberalization results in overall gains in terms of economic growth and wealth creation, it does not by itself address the ultimate distribution of those gains. The immediate effects of trade liberalization can also vary among different groups—those in import-competing sectors may suffer adjustment costs in the face of increased competition, while those in export sectors may experience gains from new opportunities. Governments need to make choices about whether and how adjustment assistance may be offered to those who suffer losses, and how the gains from growth may be distributed—or redistributed—within a society. Such choices can be crucial in determining the outcomes of trade liberalization for particular groups and for the economy as a whole.

Complementary policies for the poor

One of the most important complementary policies for the poor is an efficient social safety net. Trade liberalization will have some impact upon those poor households that may be incapable of sustaining even short periods with adverse adjustment costs because they do not have the savings. The policy choices broadly defined are: general social safety nets, safety nets targeted to those who are harmed by the trade reform, and selective limitation of the reforms or intervention in markets for the purpose of limiting the impact of market reforms on the poor.

In terms of the third option, a fundamental problem in using government interventions to limit market reforms ostensibly for the benefit of the poor is that these interventions are subject to political lobbying. The poor typically lack political power, so that political intervention in market processes will typically result in outcomes that are even worse for the poor. Indeed, a variety of efforts are under way in many countries to replace parastatals and similar bodies with more efficient private sector entities.[1] In the poorest developing countries, such alternatives may not be a viable option, however. Complementary actions may be called for, such as improving and reducing the cost of education to poor households.

Regarding the second option, specialized safety nets linked to trade reform have a spotty history. In practice it is difficult to distinguish workers who are harmed due to trade reform from those who are harmed due to normal turnover or displacement in an economy. Fundamentally, it is morally difficult to justify safety-net programs to poor people who are harmed due to trade reform, and to deny assistance to other poor people who suffer equivalent harm from fluctuations such as technological displacement or price changes due to domestic demand shifts. Consequently, it is best to employ general, countrywide safety nets to deal with problems linked to trade reform, rather than to establish special safety net programs for trade related problems. As the main need for the poor during a difficult transition period is likely to be food,

one approach is a time-limited food subsidy and distribution program. Given that targeting of food subsidies is difficult, an untargeted subsidy on "inferior" goods may be a better approach.

This leaves the first option: provision of a general social safety net. Direct income support tends to be the most efficient type of social safety net, provided it can be administratively arranged. A problem is that it is very hard to identify who actually needs the money and even harder to get it to all those who need it. One approach is to provide a money payment to all households initially, subsequently narrow this to middle and low-income families, and finally give it only to low-income families. Because distinguishing the poor from the non-poor may be difficult, workfare programs may be more generally applicable, and have been proven effective under various circumstances, as individuals can self-identify for these programs.

Some poor countries may not be able to afford a full-fledged safety net. This implies that development aid has an important role to play in supporting the operation of such safety nets, as is discussed further below. In terms of the design of trade policy reform, it also strengthens the need for up-front analysis of where the poor are located in terms of production (income) and consumption, assessing which groups may be seriously detrimentally affected, and determining what types of complementary reforms would best offset these potential losses.

Identifying the national interest

Research efforts at the national level should aim to ensure that trade policy decisions, including WTO negotiating positions, are based on sound analysis of the costs and benefits of different options for the domestic economy. This assessment has become all the more important in the context of WTO rules subject to binding dispute settlement, and all the more complex as trade rules move further into domestic regulatory areas. Evaluating and understanding the implications of alternative rules is not straightforward, especially when it comes to the regulatory, "behind the border" policies—such as food safety or product standards, labeling requirements, and regulations for all the services sectors, from financial markets to auditing services, to conditions for building new large retail shops—that are increasingly the subject of multilateral discussions. Too often deliberations in the WTO are not informed by economic analysis or a good understanding of the costs and benefits of specific proposals or rules, or how these costs and benefits are distributed across or within countries. This is another form of policy coherence, namely coherence between analysis of what makes sense in terms of trade policy reform for development and negotiating positions and dynamics in Geneva.

The role of domestic institutions is crucial because trade policy raises domestic issues, and vice-versa. In some countries, domestic universities or independent think tanks conduct much of the needed research and policy analysis. In other countries, government agencies undertake this analysis. For

instance, the Australian Productivity Commission conducts public inquiries and research into a broad range of economic and social issues, including trade and industry assistance. Recent reviews have focused on, for example, assistance to the automotive and textile industries, as well as barriers to trade in services in the Asia-Pacific region. The role of the Productivity Commission has been instrumental in turning Australia from a protectionist country in the 1960s to a free-trade-minded country today.

Well informed domestic debates are particularly critical for a number of the poorest developing countries, where assessing the impact of existing or possible policy choices in the context of negotiations remains a major challenge. International organizations, nongovernmental organizations (NGOs), and others in the development community can do much to assess the costs and benefits for individual countries of various liberalization scenarios. International organizations—such as UNCTAD, the World Bank, and OECD—and local and international NGOs fill part of the gap, but their supply falls short of demand, in particular for country-specific analyses. Moreover, they do not address the crucial (and in all countries difficult) problem of the extent to which these debates effectively feed into the policymaking process. The best way forward is likely to involve leveraging the expertise of international organizations and international NGOs to help countries develop such research capacity at the national level. Strengthening and expanding existing linkages and networks between international organizations and local NGOs and researchers could be an important starting point.

More generally, greater efforts should be made to support developing countries at the national level in efforts to involve a wider range of national stakeholders in the debate about trade policy and assessment of different policy options. This is essential to ensure that assessments of policy options are grounded in local realities and that realistic and sustainable positions that reflect the views of a range of constituents are adopted.

In addition to greater involvement of local NGOs, business in developing countries could usefully be assisted to become better organized and better able to promote their interests in national policy debates. Business groups are vital in identifying offensive interests—governments may not always be aware of which companies are exporting what and to which markets, or indeed of the types of problems being encountered (such as on standards). Equally, the small and medium-size enterprises that account for the bulk of businesses in developing countries may benefit particularly from the certainties provided by international trade rules. Increasing the capacity of business to communicate export interests to governments is also critical to balancing the (generally more organized) voice of the protectionist lobbies.

Finally, better efforts are also needed at the national level to explain the gains from trade and trade rules. The survival of the WTO depends on the willingness of the Members to undertake necessary reform at the national

level. The case for reform and the role of the rules-based multilateral trading system in supporting that has to be explained and defended at the national level. Increasing the profile and informed debate about trade issues in the media will be a critical element in building support for policy positions and reforms at home.

Achieving whole-of-government positions

Complex trade agreements intersecting with a wide range of domestic regulatory issues also place new demands on coordination within government at the national level. Trade negotiations are no longer the exclusive domain of trade ministries; at some point almost all government agencies will be called on to feed into the assessment of policy options, the development of "whole of government" negotiating positions, or the design of appropriate complementary policies. Most important, responsibility for actually implementing commitments is likely to fall to government agencies beyond those responsible for trade.

But coordination is no easy task. Many government agencies have limited knowledge of—or often interest in—trade agreements or negotiations, even where their own areas of responsibility might be involved. Overburdened and underresourced agencies with heavy domestic responsibilities may legitimately view trade negotiations as a lower priority. A survey of countries' preparations for the GATS negotiations revealed that, while many countries had some sort of mechanism for intragovernmental coordination in place, attracting interest from other agencies was often a major challenge. Even where agencies were engaged, considerable time, effort, and resources needed to be devoted to explaining the issues and providing information about the trading system. Developing countries with limited administrative resources faced particular obstacles in pursuing and servicing the coordination process (OECD 2003d). Further, where other agencies are motivated to be engaged in the negotiations, this can be due to regulatory capture (where the agency's strong links with the domestic industry for which it has regulatory responsibility lead it to view their interests as being the national interest).

Lack of policy coherence poses real risks in terms of inappropriate WTO commitments, or failure to implement those commitments. By contrast, the gains from sound policy coordination are large, and include:

- Early involvement by relevant agencies assists in government understanding of the various policy options and maximizes the knowledge of both the current situation and alternative approaches taken by other countries. Similarly, involving regulatory agencies in the negotiations helps them to establish their own international networks, fostering dialogue and encouraging the development of regulatory cooperation to address cross-border issues.
- Experience suggests that ministries with responsibility for particular sectors or issues are less resistant to the development of trade rules if

they are involved in the discussions and negotiations from an early stage.

- Involvement of other agencies also assists with the implementation of WTO commitments by ensuring that liberalization is underpinned by necessary and appropriate regulation; and by generating both awareness of the potential impacts and prior planning of programs and strategies to manage those impacts.
- Coordination can also assist in the identification of areas where trade liberalization can contribute to other national policy goals. For example, improving access to higher education might be achieved by allowing foreign universities to establish in the country; access to health care might be served by promoting health tourism and using the proceeds to cross-subsidize the national system; or, more generally, importation of food might lower the costs of basic items for poor consumers.
- Coordination can also help to identify and promote policy "win-wins." A number of these have been identified in trade and environment—for instance, trade disciplines on environmentally harmful subsidies (in agriculture or energy services) or through trade in environmental goods and services.
- Coordination is also important for avoiding contradictory policy, such as pursuing curbs on greenhouse gases while subsidizing the extraction of coal.

Policy coherence at the international level

International policy coherence refers not simply to the provision of international assistance to help countries participate in the trading system and to integrate into the world economy. It also refers to the need for such assistance to be better coordinated among key donors and international organizations.

This international level is not unrelated to coordination at the national level. One reason for the post-Uruguay Round difficulties with implementation is that commitments by OECD countries to provide assistance were made without the involvement of their aid agencies (who actually have responsibility for disbursing funds). Equally, to the extent that aid is demand-driven, developing countries must also nominate trade-related assistance as a priority for bilateral aid programs. Donors have indicated that, while they planned to put more emphasis on trade in their bilateral country programs, the outcome would depend on the priorities of the partner country (WTO/OECD 2003).

Current aid for trade

In recent times, and in response to the Doha Agenda, most donors have increased both the quantity and value of their Trade-Related Technical Assistance and Capacity Building (TRTA/CB) (WTO/OECD 2003) (box 12.1). Given this increase, donor coordination is all the more important, and some

Box 12.1

Trade-related technical assistance and capacity building

The Doha Development Agenda Trade Capacity-Building Data Base, launched in November 2002, contains information from 39 bilateral donors and multilateral agencies[a] on three categories of assistance: trade policy and regulations (participation in the trading system), trade development (business climate and trade promotion), and infrastructure.[b]

On average, some 3,500 trade-related technical assistance and capacity-building activities were committed in 2001 and 2002, almost equally distributed in number between trade policy ($719 million) and trade development ($1,408 million). Some 1,900 activities were committed for infrastructure ($8,144 million—not all directed at trade).

Most commitments under trade policy went to trade facilitation (mostly Africa), regional trade agreements (mostly Asia), technical standards (mostly regional), and aid to integrate trade into development plans (mostly Asia). For activities related to WTO negotiations, most assistance went to competition and environment. Under trade development, most were business support services, trade finance activities, and trade promotion and market development.

Since 2001, 177 developing countries have received some assistance in trade policy and 163 in trade development, with the number of activities per recipient ranging from 1 to 260. Five countries (China, Indonesia, Thailand, Uganda, and Viet Nam) received more than 150 activities. Africa received more than one-third of total infrastructure activities and 31 percent of trade development but only 21 percent of trade policy and regulations. Asia received one-third of trade policy activities but only a quarter of trade development and infrastructure.

Commitments to trade-related technical assistance and capacity-building activities constitute 4.8 percent of total aid, on a par with population programs and more than basic education or basic health. Multilateral programs remained the main channel for such activities, but some large donors also run substantial bilateral programs.

a. Australia, Belgium, Canada, Denmark, EC, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, the United States, plus 16 international organizations including APEC, FAO, IMF, ITC, OECD, UNCTAD, UNDP, UNIDO, WTO, and World Bank.

b. Trade policy and regulations: effective participation in negotiations, analysis, and implementation of multilateral trade agreements; trade policy mainstreaming and technical standards; trade facilitation, including tariff structures and customs regimes; support to regional trade agreements and human resources development in trade. Trade development: business development and activities aimed at improving the business climate; access to trade finance; and trade promotion in the productive sectors, including at the institutional and enterprise level. All aid to infrastructure is deemed to assist international trading.

Source: WTO/OECD 2003.

initiatives have been taken. The WTO and OECD secretariats have combined to create a Doha Development Agenda Trade Capacity-Building Data Base (TCBDB), which aims to help the development and trade policy communities to achieve higher degrees of coordination and coherence, avoid duplication, share information, and monitor the implementation of commitments in the Doha Agenda. The TCBDB enables donors to view the multiplicity of programs (national and regional) already available and to identify gaps.

Another important initiative has been the Integrated Framework for Trade-Related Technical Assistance to LDCs (IF). A partnership between the International Trade Centre, UNCTAD, WTO, UNDP, World Bank, and IMF, it aims to take a coordinated approach to identifying and prioritizing trade-related assistance needs in LDCs, as well as projects for donor funding. It also aims to mainstream trade into national poverty reduction and development strategies. The IF is now on a more stable footing, having had a few false starts, but more effort is still required to achieve the kind of cooperation between donors and organizations that the IF was supposed to engender. Turf protection and other priorities of international organizations have been an

issue, as has a lack of willingness of major donors to act through the IF and not their own channels.

Finally, there is also considerable scope to deepen the treatment of trade and trade-related policies in the Poverty Reduction Strategy Papers (PRSPs) prepared by developing country authorities, with input from the IMF and World Bank, as well as donors and NGOs, which set out policy and donor priorities for many of the poorest developing countries. Links could also be made between the domestic PRSPs and, where available, the studies conducted for the IF.

The role of the WTO

Whereas the GATT was essentially conceived as a contract between the parties, with an interim secretariat to support it, the WTO is an organization with 148 Members. This change of status has given rise to many new and conflicting expectations.

On one hand, the WTO is strongly member-driven. The WTO as such does little—as evidenced by the relatively small size of the organization (500 employees, compared with 2,000 for the OECD). The media and others often use expressions such as "the WTO requires," but this is completely misleading. WTO obligations are owed not to the organization, but to the Members, and the organization undertakes no independent monitoring of its Members' implementation of their obligations. That is, commitments are owed to other WTO Members, and only other Members can claim that those commitments are not being met and initiate a dispute. Even notification obligations are owed to other Members—specifically, to the bodies (such as the Council for Trade in Services) that those Members constitute. In other words, the WTO is merely the channel.

On the other hand, the new status of the organization, and the greater reach of its rules, bring new factors into play. Unlike much of the GATT, WTO obligations apply to all developing countries and those obligations were (and are increasingly) linked in negotiations to the provision of assistance for their implementation. The perception thus became that "WTO obligations" should be accompanied by "WTO assistance" with implementation. As became rapidly apparent—from TRIPS to customs valuation—this is a task that the organization is ill-equipped to undertake. The WTO's role on technical assistance will continue to evolve, but the following principles might serve as useful "rules of thumb":

- *Focus on what the WTO Secretariat can and cannot do.* The main form of assistance that the WTO Secretariat can provide is to explain the legal requirements of WTO agreements. Even for this limited task, demand greatly outstrips the capacity of the Secretariat to deliver. There is a need to increase resources to some extent (as already took place pursuant to the Doha Agenda) but also to outsource more—using local consultants

can both be cheaper and have a useful flow-on effect in helping to establish local networks. The challenge is to maintain quality control.

- *Manage expectations about what assistance the WTO can provide.* This is not assistance to trade—the WTO does not fund the development of new ports or roads—nor even all the assistance that is required to meet the obligations of agreements (the WTO does not fund the creation of national SPS standards bodies). It is limited to explaining what the agreements require and providing advice on the range of ways in which Members might be consistent with their commitments. Other organizations and forums exist to provide countries with advice about development policy, organizations that come accompanied by funding to implement those policies.
- *Improve cooperation and coherence with other organizations.* The WTO needs to share with others the burden of helping countries identify options for reform and draw on those with greater experience on the practical solutions—such as WIPO on intellectual property, and the WCO on customs reform and trade facilitation. This should be part of an ongoing loop—input from these organizations should also inform Members' deliberations of what obligations they should negotiate in the first place, as well as how to implement them.

Looking ahead

While trade policies create market access opportunities for developing countries, increased aid must be forthcoming if developing countries are to be able to benefit from these opportunities. A major constraint limiting export growth in many small and low-income countries is a lack of supply capacity and a high-cost business environment. Firms in these low-income countries may also find it difficult to deal with regulatory requirements such as health and safety standards that apply in export markets. Development assistance can play an important role in helping to build the institutional and trade capacity needed to benefit from increased trade and better access to markets. As noted above, this assistance must go beyond the implementation of trade agreement rules narrowly defined and focus on supply capacity more broadly, as well as addressing adjustment costs associated with reforms (including with others' reforms, as in the case of those countries that will experience losses from preference erosion).

More aid for trade. Clearly, significantly stepped-up funding is required. Donors should create an international "aid for trade fund" to assist developing countries to benefit from and undertake trade reforms. The size of the fund should reflect the scale and importance of the task at hand.

Mobilizing such funding should be feasible as the aggregate (global) gains from trade are much greater than the aggregate losses associated with restructuring. The problem is that in practice the compensation (transfers) that is

called for often does not occur domestically, and barely occurs at all internationally, as reflected in low official development assistance (ODA) levels—$69 billion in 2003—relative to the estimates of the net income gains associated with past multilateral rounds (in the $200–$500 billion range), the magnitude of total support to farmers in OECD countries (currently some $350 billion), or the potential gains from further global liberalization (upward of $500 billion, especially if services trade is included).[2]

There are various ways in which such redistribution could be realized (Hoekman 2004). For instance, it could be through a small consumption tax on the goods whose prices will be falling as a result of the implementation of negotiated multilateral liberalization commitments. However, administrative convenience and collection costs considerations might make a small uniform levy on imports whose tariffs are being cut more feasible. To give a sense of the orders of magnitude involved, a 0.25 percent levy on imports of OECD countries would be equivalent to more than $12 billion (total OECD imports are some $5 trillion). However, as much of trade into OECD countries is duty free, and it is not desirable to re-impose duties on such trade, any such levy should be restricted to currently dutiable imports where tariffs are subject to reduction commitments. An option here would be to agree to allocate a certain share of currently collected revenue to low-income countries. As tariffs are gradually lowered following a Doha Round negotiated outcome, the total revenue available would automatically decline over time, which is appropriate given that the motivation is to facilitate adjustment.

Indeed, it is important that there be general acceptance that any such levy not be an additional tax, but be explicitly based on the recognition that any process of multilateral liberalization will create losers as well as winners. Despite the well known case for and potential feasibility of compensating losers, in practice this often does not occur. A small reduction in the price gains/benefits that will accrue to consumers as a result of liberalization is one practical means of redistributing some of the gains from trade reform to those who gain less or may lose.

A key challenge will be to ensure that these additional funds are used most effectively, including within the existing structures and mechanisms for "aid for trade." There are a variety of potential channels where this additional funding could usefully be absorbed—notably the Integrated Framework—and ensuring coordination and cooperation with existing initiatives will be an important task for the trade and development communities. A priority task could be the identification of new and existing channels through which this additional funding could most efficiently be made available for relevant, targeted projects in developing countries.

In terms of the types of activities to which such increased international assistance could be devoted, four main areas can be identified: assistance for trade policymaking and participation in negotiations; for implementation of

WTO agreements; to manage the costs of adjustment; and to participate in trade itself. Under each of these headings, some work is already under way (see box 12.1), although amounts remain small compared with what is needed, and there is considerable scope to scale up activities.

A few additional words of caution are required, however. First, care must be taken to ensure that additional assistance to participate in WTO negotiations does not reflect OECD priorities more than those of developing countries—as, for instance, has been the case with the focus on competition and environment, and the scarcity of assistance to help developing countries address antidumping complaints. Second, in regulatory areas, vigilance is necessary in the face of the risk that OECD assistance may be used to create regulatory "spheres of influence"—that is, OECD countries might seek to propagate their own regulatory systems in developing countries (however inappropriate they may be for the country concerned). While this may be legitimately motivated by the belief that their approach is the best, it can also be used to create a critical mass of countries that share their approach for the purpose of new rule-making negotiations in the WTO. Third, additional assistance should aim at maximizing the benefits for, and building genuine local capacity in, developing countries—goals that cannot be achieved where aid is conditional on the use of inputs from the donor (so-called "tied aid").

Finally, additional assistance will also be most effective where developing countries also create supportive conditions for trade and investment as part of their national development strategies (UNCTAD 2003c). Trade liberalization requires international negotiations and international assistance, but its benefits and challenges remain fundamentally a question of domestic economic and policy reform.

Aid to assist trade policymaking at the national level and participation in WTO negotiations. As noted above, international organizations can play an important role in assisting countries in identifying their interests in negotiations and in assessing the impact of various policy choices, in particular in relation to the poor. This analysis can be specific to the negotiations—as in the assessments of different tariff reduction formulas (see chapter 3), or more generally related to liberalization, with or without WTO commitments (such as efficient regulatory policy for energy liberalization). Much analysis is, and should be, devoted to seeking insights for the current negotiations from assessments of the impact, including that on the most vulnerable groups, of Uruguay Round agreements. This can be important both in overcoming short-term resistance to change and in learning from past mistakes. As noted above, however, international organizations are a complement to domestic research capacity, not a substitute; their efforts should ultimately aim at developing local capacity for analysis.

Exchanges among countries on their experiences with liberalization and policy reform are also valuable, either bilaterally or regionally (for example,

APEC combines research projects with intergovernmental dialogue on services and regulatory reform). International organizations can also serve as a forum for the exchange of views, with the additional benefit of subjecting their research to the "reality check" of policymaker input.

Finally, programs run by international organizations, NGOs, or bilateral donors can help developing country trade negotiators to participate in WTO negotiations. These courses, of which the best known is the WTO Trade Policy Training Course, normally cover the specifics of individual agreements, as well as insights into the negotiating process.

Aid to assist with implementation of WTO agreements. This has been the focus of much international assistance, and rightly so. Initially this assistance focused on explaining the legal provisions and requirements of the new agreements. However, what was required to implement WTO agreements went well beyond this. The new agreements required not only new laws, but new institutions, with trained staff and enforcement capacity. The involvement of other international organizations with expertise—and resources—has proved critical (such as WIPO on intellectual property and the WCO on rules of origin and customs valuation). But WTO Members greatly underestimated what would be required to implement the new agreements, and more time and far more resources than anticipated are required. Some additional key areas for assistance include institutions, infrastructure, and human resources for Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) (the Standards and Trade Development Facility is a positive development—see chapter 6); and assistance to develop and implement regulatory frameworks in services (chapter 4).

Aid to manage adjustment from liberalization. This report has highlighted many areas where international assistance—often financial assistance—will be required to help countries operate the complementary policies needed for successful trade liberalization. These include assistance to operate social safety nets (chapter 12); assistance with the funding for universal service mechanisms targeting poor consumers in liberalized services markets (chapter 4); assistance with reform of the tax system to help compensate governments for loss of tariff revenue (chapter 5); assistance with land reform, education of farmers, and research and technology in agriculture (chapter 3); and compensation mechanisms to address concerns about preference erosion—given that estimates to date indicate that the amounts involved may not be enormous, this should be feasible (chapter 7).

The IMF's Trade Integration Mechanism (TIM), approved by the IMF Board in April 2004, is designed to help mitigate adjustment costs of liberalization for developing countries. It is intended to address not only preference erosion but also developing country concerns that multilateral trade liberalization

might temporarily affect their balance of payments. That is, the TIM will also cover cases such as balance of payments shortfalls as a result of ATC quota integration and the possible impact on net food-importing developing countries of higher foods import prices. The TIM is not a new facility but operates through existing IMF facilities. A further suggestion is for compensation by developed countries for loss of agricultural preferences to be covered by the Green Box (chapter 3). Addressing this issue would do much to ease the concerns of the recipient countries and remove an important roadblock in the negotiations.

The magnitude of adjustment shocks and the associated costs are of course a function of the magnitude of the underlying policy changes. Insofar as a developing country does little to open its own markets, and the Doha Round outcome is not very ambitious, by definition there will be little in the way of adjustment costs—or potential net gains for that matter. However, even an ambitious Doha Round may have only limited benefits for many of the poorest countries without assistance to better integrate them into the world economy (see below).

Aid to participate in trade. Finally, increased assistance is required to address the supply-side constraints on poor countries, affecting their ability to take advantage of new market access opportunities. Such assistance could include, for example, support for measures to improve the investment climate and raise productivity in agriculture. In many cases, assistance may also be required to tackle transaction costs and institutional weaknesses obstructing trade and develop the necessary infrastructure (as in relation to transportation of goods for export). Here, liberalization may increase capacity (as in telecommunications and financial services—chapter 4), though assistance may still be needed in creating a sound regulatory environment to underpin this liberalization. Finally, assistance may be necessary to improve the performance of institutions for trade (such as customs reform—chapter 9).

Additional assistance will be necessary to help developing country exporters meet health or other technical standards in key export markets. This should include assistance to increase developing country participation in relevant international standard-setting bodies, to ensure that international standards take account of their interests and to promote the development of standards in their products (chapter 6).

Other policy coherence for development

While beyond the immediate scope of this study, a critical area for attention is the relationship between trade, debt, and finance and how the level of external debt affects developing countries' participation in international trade. The creation of a WTO Working Group on Trade, Debt, and Finance is an important step in encouraging greater coherence between the WTO and the Bretton Woods institutions. Developed countries need to take greater account of

the full range of policies and circumstances affecting the ability of developing countries to participate in world trade, particularly in assessing the actual or potential impacts of WTO obligations.

More generally, in the globalized economy, ever more domestic policies have international effects. Consideration of the potential impact of domestic policies on developing countries must become an automatic part of the policy-making process in developed countries. From the impact of domestic standards for goods and services on the potential trade opportunities of developing countries, to the impact of agricultural, financial, and aid policies, if developed countries are serious about their commitment to achieving the Millennium Development Goals by 2015, a more comprehensive approach to ensuring the consistency of the whole range of their domestic policies with this objective will need to be taken.

Policy coherence in practice: trade and environment

Coherence between trade and environment policy has been on the international agenda for some years.[3] The first "trade and" issue to be included in the WTO, the trade and environment work program has aimed at identifying the synergies and areas of potential tension between these two key national policies aimed at international problems and with international ramifications. Considerable work has been undertaken by a wide range of international organizations, NGOs, and researchers to identify the linkages and synergies between trade and environment policies, including the scope for "win-win-win" outcomes (for environment, development, and trade) from the removal of environmentally harmful—and trade-distorting—subsidies in agriculture, fisheries, and energy (box 12.2). In agriculture, for instance, trade-distorting domestic support policies encourage environmentally harmful agricultural practices, such as intensive farming, including high use of fertilizers and pesticides. The result is resource degradation and environmental stress. Furthermore, trade-distorting support, including export subsidies, can have negative environmental effects in third countries, particularly developing countries.

The relationship between WTO rules and trade obligations in multilateral environmental agreements. A key aspect of policy coherence with regard to trade and environment is also on the negotiating agenda of the Doha Round. The Doha Agenda mandates negotiations, without prejudging their outcome, on the relationship between existing WTO rules and specific trade obligations in multilateral environmental agreements (MEAs) (the other major issues mandated for negotiations—environmental services and goods—are dealt with in chapters 4 and 5, respectively). At issue is whether WTO rules and specific trade obligations under MEAs are always compatible and, if not, which takes precedence. Some careful limits are placed on the negotiations, however. They shall not "prejudice the WTO rights of any Member that is not a party to

Box 12.2

Win-win-win scenarios? Fishery subsidies

The current WTO negotiations on fisheries subsidies could set an important precedent in an area where trade and conservation objectives intersect (see box 1.6). Subsidies to marine capture fisheries, which have been estimated to be at least $15 billion a year worldwide, are believed by a number of countries to be contributing to overcapacity and overfishing, putting enormous strain on fishing stocks already threatened by the destruction of coastal habitats and the pollution of the seas. Developing country exporters of fisheries products compete not only against the highly subsidized fleets of developed countries—some subsidies also support distant-water fishing by developed country fleets in the exclusive economic zones of developing countries, which may stunt the development of their own fishing fleets and exports.

Not all the money spent by governments in support of their fishing industries is harmful. Indeed, a not insignificant proportion of it is used to fund research, monitoring, and enforcement—activities that are vital for ensuring the effective management of a vital natural food resource. The focus of the current negotiations, therefore, is on crafting effective disciplines that will prohibit or discourage subsidies that are capacity-enhancing or effort-enhancing, while allowing space for governments to spend money on protecting their fishery resources and encouraging structural adjustment, such as through decommissioning vessels and retraining displaced workers.

How to provide developing countries with special and differential treatment remains one of the thornier issues. Some developing countries would like to maintain or even increase employment in their fishing industries, especially in the small-scale and artisanal segments, and feel that subsidies are necessary to accomplish that goal. Other developing countries, speaking from experience, warn that subsidizing the expansion of fishing capacity risks overshooting the target of maximum sustainable yield. It is apparently a risk that some countries would nonetheless prefer having the option to take.

the MEA in question," nor "add or diminish the rights and obligations" of any WTO Member under existing WTO agreements, in particular the SPS Agreement. That is, the negotiations do not include discussion of the situation where there is a conflict between WTO Members when one is not a party to the MEA in question, the more likely source of possible tensions.

There are currently approximately 200 multilateral environmental agreements in operation, of which only 20 contain specific trade provisions. These include, for example, the Montreal Protocol for the protection of the ozone layer, which applies restrictions on the production, consumption, and export of aerosols containing chlorofluorocarbons (CFCs); the Basel Convention, which controls trade or transportation of hazardous waste across international borders; and the Convention on International Trade in Endangered Species. To date, no measure affecting trade taken under an environmental agreement has been challenged in the GATT-WTO system.

Given the cautious pace of discussions in the WTO to date (where much time has been devoted to coming to a common understanding on the scope of the mandate), and the fact that this issue has rightly not been a priority for developing country resources in the Doha Round, it would be premature to advocate any particular outcome as being in the interests of all developing

countries. Two general points could be made, however. First, improved coordination between trade and environment officials at the national level is the key to a more mutually supportive trade and environment relationship and is the best way to limit the potential for future problems. But this is not easily achieved: divisions within governments on several trade and environment issues appear to be as great as between governments. But trade and environment is an area that demands true policy coherence and whole-of-government positions, rather than replays of battles between different ministries and interest groups at the international level and among international organizations.

Second, developing countries have an interest in ensuring that trade measures are seen as part of a package of measures in MEAs and not taken out of context. Trade measures play a certain role in such a package and contribute as such to the overall effectiveness and efficiency of the package. Developing countries have a key interest in supportive measures—such as financial and technical assistance, training, transfer of technology, and so on—that generally contribute to reducing adjustment costs in developing countries to meet MEA objectives. Developing countries also have an interest in ensuring that trade measures do not pursue one-size-fits-all approaches, but are customized to the specific situation in different country groups. Finally, developing countries need to emphasize the interrelationship between flexibility in MEA trade measures and the size and effectiveness of supportive measures. In short, the more rigid a trade measure in a MEA, the higher the need for supportive measures and their flexibility in application for developing countries.

The Doha Agenda also mandates work programs to explore the effect of environmental measures on market access (see chapter 6), TRIPS, and environmental labeling, with recommendations to be made to the WTO Ministerial Conference on future action, including the desirability of negotiations.

TRIPS and the Convention on Biological Diversity. Discussions on TRIPS have focused on the relationship between the TRIPS Agreement and the Convention on Biological Diversity (CBD), including the protection of traditional knowledge. Developing countries have a particular interest in the CBD, as the vast majority of global biodiversity and traditional knowledge lies within their territories. They also wish to make full use of these resources for their long-term sustainable development.

Article 16(5) of the CBD recognizes that patents and other intellectual property rights may have an influence on the CBD implementation and requests parties to cooperate in this regard to ensure that such rights are supportive of and do not run counter to the objectives of the Convention. The TRIPS Agreement makes no mention of the CBD or its principles.

The type of knowledge protected under the TRIPS Agreement (patents, trademarks, copyright, and so on) is predominantly held in developed countries. Some 95 percent of patents are in developed countries, and a large proportion

of the 5 percent in developing countries is held by developed country companies. Developing countries are, on the other hand, well endowed with traditional knowledge. The nature of this knowledge—for example, it is often held collectively, passed down orally from generation to generation—makes much if not most of it difficult to protect using the conventional IPR instruments required by the TRIPS Agreement. Thus there exists an imbalance, whereby the knowledge predominant in developed countries is protected, whereas that predominant in developing countries is not.

Moreover, there are concerns that the genetic resources and traditional knowledge of developing countries are often used commercially and patented in developed countries with little or no benefit to the owners of genetic resources (the sovereign states, as per the CBD) or traditional knowledge, and without their prior informed consent. With the TRIPS Agreement being implemented by more WTO Members, there are concerns that this situation will only be exacerbated, to the detriment of developing countries and the holders of traditional knowledge.

To this end, developing countries have sought to amend the TRIPS Agreement so that applications for patents relating to biological materials or to traditional knowledge shall provide, as a condition to acquiring patent rights: disclosure of the source and country of origin of the biological resource and of the traditional knowledge used in the invention; evidence of prior informed consent through approval of authorities under the relevant national regimes; and evidence of fair and equitable benefit sharing under the national regime of the country of origin. This would provide a legally binding defensive protection against "bad patents" based on misappropriation of genetic resources and traditional knowledge, and facilitate benefit sharing. But it would not prevent genetic resources or traditional knowledge being inappropriately acquired, used commercially, but just not patented. There is therefore also a need for positive protection, such as national *sui generis* systems for the protection of traditional knowledge, traditional knowledge registries, and databases. There have also been many calls from the developing world for an international framework, which would recognize protection of traditional knowledge at the national and regional levels.

Ecolabeling. Ecolabeling could represent a potentially attractive way to provide consumers with information about the environmental impact of purchased products, as well as provide producers in developing countries with market access, and possibly a price premium, for products that are environmentally friendly (as products from organic agriculture or certified sustainably managed forests). While there is still no evidence of changes in trade flows arising from ecolabeling programs, there are a number of concerns (noted in chapter 6) related to the costs of compliance and compliance assessment; the appropriateness and comparability of the information provided to consumers; and

the potential use of ecolabels based on a life-cycle approach, which would take account of non-product-related process and production methods (see also chapter 5 with regard to environmental goods). Particular attention needs to be paid to this issue, because mandatory ecolabels based on non-product-related process and production methods could undermine what is perceived to be a competitive advantage of developing countries. In addition, this approach may open the backdoor for consideration of the precautionary measures that go beyond the current approach in the SPS Agreement, which require that precautionary measures be: temporary and subject to review in the light of new scientific evidence; based on scientific evidence; and subject to a risk assessment (Article 5).

Ecolabeling is currently being discussed in the WTO, but the debate has not progressed much. Given that the majority of ecolabeling schemes are voluntary, and that there is no obligation to notify voluntary labeling schemes to the WTO, progress on this issue may be beneficial to developing countries, because as long as ecolabels remain outside the scope of WTO agreements they can lead to inappropriate discrimination (see chapter 6). At a minimum, developing countries should demand greater transparency in the establishment and application of such schemes.

Box 12.3

Did we say policy coherence?

- Total aid from OECD countries amounts to around $69 billion a year, but total OECD spending on agricultural subsidies is $300 billion a year. In 2001 net flows of ODA to LDCs would have been doubled if 14 percent of the 2001 value of the fiscal support for OECD producers had been redirected in aid to LDCs (UNCTAD 2004b).
- Aid programs encourage crop diversification in developing countries, but preference programs encourage specialization.
- Aid includes assistance to help countries upgrade their production capacity and increase their value added, but tariff escalation discourages further processing.
- Trade preferences are granted to help developing countries to integrate into the global trading system, but they create incentives for them to oppose further liberalization of global trade.
- Developed countries promote intra-developing country trade, but the rules of origin in their own preferential agreements with developing countries discourage it by preventing sourcing of inputs from other developing countries on a global basis or by requiring use of developed country fabric.
- Developed countries have long promoted the idea that developing countries have export interests in services, as well as the possibilities of making use of information and communication technology for development. But some have responded to increased outsourcing to developing countries (a services export).

Chapter 13

Free trade agreements

The proliferation of preferential trade agreements poses major challenges both for the multilateral trading system and for trade. It has led to the creation of a tangled web of differential treatment, adding complexity and uncertainty to trade, and to the development of different trade rules under different agreements—rules that may not be in the interests of developing countries.

Virtually all WTO Members are party to one or more free trade agreements (FTAs). More than 170 FTAs are currently in force; an additional 70 are estimated to be operational though not yet notified to the WTO. The WTO estimates that, by the end of 2005, if FTAs reportedly planned or already under negotiation are concluded, the total number of FTAs in force might well approach 300. Developing countries are involved in 149 agreements (76 notified to the WTO, 34 concluded but not notified, and 39 under negotiation), of which 76 are intra-developing country agreements (27 notified to the WTO, 26 concluded but not notified, and 23 under negotiation) (Schott 2003).

Do free trade agreements confer benefits?

Notwithstanding their popularity, FTAs are often tools of geopolitics (or domestic public relations and marketing) rather than economics. They have a mixed record in terms of the extent of real liberalization achieved, particularly in sensitive sectors and once the impact of sometimes restrictive rules of origin are taken into account. Developing countries negotiating FTAs often have limited bargaining power and, unlike in the multilateral setting, have limited ability to form coalitions to take on more powerful trading partners—Cancún is a timely reminder of the importance of coalitions in defending and promoting developing country interests. Some developing countries may find themselves excluded from FTAs altogether, as they offer limited economic or geopolitical benefits to trading partners.

Even where parties to the FTA benefit in terms of significant market access gains, it is often at the expense of nonparties to the agreement—that is, there is trade diversion from other efficient suppliers, many of which may also be developing countries. There are also costs to the countries in the FTA: under trade diversion, the importing country ends up paying more for imports, with money that was initially going to the government as tariff revenue now accruing to producers in the partner countries. Part of this extra cost is a simple transfer from the taxpayers in the importing partner to producers in the exporting partner, but because the real cost of imports has risen (the partner is less efficient than "outside" producers), real resources are also wasted by trade diversion. When all the commodities covered by the FTA are considered together, if trade diversion predominates, the FTA can reduce the welfare of some or all of the member countries.

Further, from a political economy point of view, FTAs that are trade diverting are likely to encounter less resistance from domestic industry than those that are trade creating. The reason is simple. Trade creation occurs when domestic production is replaced by cheaper imports from partner countries. While beneficial for the economy as a whole, it damages domestic producers, which will oppose the agreement or request exceptions. On the other hand, trade diversion means that imports from the rest of the world are replaced by imports from the partner country, and this is less damaging for the domestic industry.

Additionally, FTAs do not address some of the biggest problems in world trade, notably agricultural subsidies. In the case of agriculture, FTAs can be especially damaging—either agriculture is excluded entirely from the agreement, significantly reducing the value of such agreements to countries for which this is a key export interest, or only the market access dimension is covered. This creates the iniquitous situation where some parties to FTAs progressively open their markets to the agricultural produce of other parties, but without means of addressing in parallel the enormous subsidies on those products. Such agreements can serve less to liberalize trade than to legitimize dumping (as happened to Mexico under NAFTA and as threatens to happen to other FTA partners in the absence of significant progress on agricultural subsidies at the multilateral level).

Where FTAs go beyond the multilateral system, this is not necessarily good news. In FTAs, developing countries are more likely to be confronted with provisions on nontrade issues that they have combined with others to resist at the multilateral level—such as those related to adherence to labor standards. More recently, concerns have arisen that FTAs negotiated by the U.S. have the effect of extending patent protection for pharmaceuticals beyond that required by the TRIPS Agreement, perhaps undermining countries' ability to make use of compulsory licensing provisions to ensure access to medicines (box 13.1).

Regardless of the nature of the FTA, there are also dangers in terms of the costs—including opportunity costs—they impose. Multiple FTAs with differing rules of origin impose high transaction costs, particularly on small

Box 13.1

Examples of TRIPS-plus provisions in free trade agreements

Source: Oxfam International 2003, 2004b; Vivas-Eugui 2003; Drahos 2004.

Extension of patent protection beyond the 20 years required under TRIPS: Patent terms should be extended to compensate patent holders for any unreasonable delays in the granting of the patent or unreasonable curtailment of the patent term as a result of the marketing approval process. There are no such requirements under TRIPS, so the effective period of protection under TRIPS is usually less than 20 years.

Limits on parallel imports: The patent holder is permitted to restrict the possibility of parallel imports in the market. TRIPS is silent on parallel importation.

Test data protection: Test data of patent owners must be protected for at least 5 years for pharmaceutical products (10 years for agricultural chemicals) from the date of approval of the patent, delaying the marketing approval of generic drugs. Should this requirement continue to apply even where a compulsory license has been issued, it would effectively prevent the use of such licenses, since the delay and costs would be too great. TRIPS requires only protection of such data against "unfair commercial use."

Compulsory licensing: The grounds on which compulsory licenses can be issued are more restrictive than in TRIPS, or requirements for compensation to the right holder may be higher than required by TRIPS.

Marketing approval and the life of the patent: The patent owner must be notified of the request for marketing approval and of the identity of the applicant; patent holders are claimed to use frivolous lawsuits to unnecessarily delay marketing approval for generics. TRIPS permits generic producers to seek regulatory approval during the life of the patent with no conditions.

traders. For small countries with limited trade negotiating capacity, FTAs can also divert scarce resources from the pursuit of multilateral liberalization. While some argue that FTAs stimulate global trade negotiations, much of the evidence shows that advances in multilateral trade negotiations have led—not followed—the formation of trade blocs.[1] Equally, the perception that trade blocs make global liberalization easier to achieve because they reduce the number of negotiating parties is open to question because blocs may find it just as difficult to achieve internal agreement, while their size can make it easier for them to resist global pressures to liberalize (as in the case of EU agriculture). Even where such agreements may lead to multilateral liberalization, this also involves costs—in encouraging temporary trade diversion, FTAs encourage the temporary growth of some industries, and the adjustment costs of entry and exit can be particularly high for developing countries (Stiglitz and Charlton 2004).

Intra-developing country free trade agreements

However, given the importance of trade among developing countries—by some estimates, 40 percent of all developing country trade (Stiglitz and Charlton 2004)—are there benefits to intra-developing country FTAs? Some argue that where domestic firms have weak technological and productive capacities and the global economic context is characterized by systemic biases and asymmetries,

regional arrangements may well provide the most supportive environment in which to pursue national development strategies (UNCTAD 2002). These studies note that FTAs among developing countries (such as AFTA and Mercosur) tend to be less restrictive to nonmembers than those between developed and developing countries—in the latter case, developing country members tend to gain considerable advantage over other developing countries in access to developed country markets (Mexico under NAFTA), though this advantage can be eroded when new FTAs are signed by the developed country in question (as best illustrated by the "pyramid of preferences" that the EU tried to create during the 1970s). This can alter the distribution of market shares among developing countries, and the outcome is not always favorable to the poorer countries (UNCTAD 2002).

One could also argue that FTAs could solve inherited political problems. For instance, countries in Africa that have inherited inappropriate borders might not be readily able to negotiate them away, but they may be able to render them less important by negotiating the free movement of goods, services, and people. Single markets of this nature might be more attractive to foreign investors and could facilitate the creation of cost-saving regional regulatory frameworks and institutions. However, the question remains whether these offsetting benefits could counterbalance the above problems of trade diversion.

However, others have cast doubt on the gains from intra-developing country FTAs. They argue that an intra-developing country FTA among small economies that provides preferential access to its member states but keeps its external trade policy with respect to the rest of the world unchanged is likely to lower welfare for the bloc as a whole (Panagariya 1997; Schiff and Winters 2002, 2003). The argument is that, as it is likely that members of intra-developing country FTAs will continue to import from excluded countries, prices cannot fall for homogeneous goods because domestic prices continue to be equal to world prices plus the tariff on imports from the rest of the world. And since prices are unchanged, output, consumption, and imports are unchanged as well. Since total imports do not increase, there can be no trade creation. However, imports from other member countries increase at the expense of cheaper imports from excluded countries—and this trade diversion lowers the welfare of the bloc as a whole (Schiff and Winters 2003).

Additionally, the less developed members are likely to lose more. More developed members usually have a trade surplus with the less developed members, and trade diversion from the rest of the world to the partner country results in a transfer of tariff revenues from the poorer to the more developed countries, equivalent to a worsening of the terms of trade for the poorer member countries. Losses may also result from agglomeration effects, whereby industry tends to leave the smaller and poorer members and agglomerate in the more developed ones once trade barriers between them are removed. The best way to ensure that intra-developing country FTAs are beneficial is thus for member countries to liberalize their trade regimes with respect to the rest of the world (Schiff and Winters 2003).

Chapter 14

The Dispute Settlement Understanding

While getting the rules right is important, so is enforcement. The crux of this issue is the ability of developing countries to use WTO dispute settlement mechanisms in instances where they perceive that partners have not been abiding by the terms of an agreement. Suggestions have been made by observers that there may be a potential bias against developing countries in the dispute settlement system due to their resource constraints and lack of retaliatory power. A number of proposals to address such possible biases are discussed below.

Who uses the system?

During 1995–2002, 305 bilateral disputes were brought to the WTO, entailing more than 1,800 "grievances"—specific allegations of violation of a WTO provision. Developing countries brought 124 of the 305 disputes, or about one-third (appendix 8). Most of these countries were middle-income economies; low-income countries (with a per capita income below $800) were plaintiffs in only 18 cases and respondents only 21 times—and much of this reflected the activities of India. That said, many of those developing countries using the system have done so successfully, including against much larger and better resourced trading partners (Ecuador and the EU, and Costa Rica and the U.S. are two such instances). In sum, while some developing countries have been relatively active users of the system, with some success, LDCs did not participate at all, never acting as a complainant or respondent. Well over half the WTO membership does not participate in WTO dispute settlement.

Developing countries accounted for about one-third of complaints under both the GATT and the WTO. However, the share of cases against developing countries rose from 8 percent to 37 percent, suggesting that the shift to the WTO—with the associated expansion of disciplines on developing countries—has given rise to a significant increase in the probability of confronting dispute

settlement. However, the evidence for "bias" is not particularly strong once one controls for the fact that disputes should be correlated with the number of incompatible measures a country's exporters encounter and the volume of trade. It is nonetheless striking that many developing countries have not participated in WTO dispute settlement.

Why has developing country participation been limited?

In part this simply reflects the manifold challenges that arise at various levels. A first necessary condition to defending rights through the WTO is information that a WTO provision may have been violated by a partner government. A second is to convince the government to bring the case forward—enterprises do not have access to the WTO (that is, they have no legal standing). A third is that the expected payoff to bringing a case is positive. This will depend in part on the remedy that is available and the likelihood that the trading partner will implement the proposed remedy, which in turn depends on an implicit cost-benefit analysis that will be a function of facing (and imposing) retaliation in the case of noncompliance. That the incentives to participate revolve around expected net payoffs has, for good (and bad) reasons, involved large OECD countries—in particular the EU and the U.S.—more rapidly in dispute settlement than the other WTO Members.

The problem of asymmetric enforcement ability

There are "asymmetric" incentives for countries to deviate from the WTO, as the ultimate threat that can be made against a Member that does not comply with a panel recommendation is retaliation. Small countries cannot credibly threaten this because raising import barriers will have little impact on the target market while being costly in welfare terms. Thus, pressure to comply with panel rulings is largely moral in nature. In practice, the system has worked rather well, in that recourse to retaliation has rarely been required to enforce multilateral dispute settlement decisions. This reflects the repeated nature of WTO interactions and the resulting value that governments attach to maintaining a good reputation. Nonetheless, asymmetry in enforcement ability can affect incentives to use the system. The classic recommendation to address this asymmetry problem is to change the rules so that nonimplementation of panel recommendations would be punished by withdrawal of market access commitments by all WTO Members. Suggestions to this effect have always been resisted.

A basic problem with retaliation is that it involves raising barriers to trade, which is generally detrimental to the interests of the country that does so, and to world welfare more generally. The power of retaliation may also be captured by protectionist interests in an importing country. A superior approach would be to strengthen compensation provisions. Developing countries have proposed, for example, that WTO panels should be authorized to recommend

payment of financial compensation in cases where a developing country loses its trade in a product as a result of actions by a developed country that are inconsistent with WTO norms. Such suggestions have a long history. Mexico recently suggested allowing countries that have won a dispute but where implementation has not occurred to auction off the resulting retaliation rights.

While compensation or fines would be less distorting than trade sanctions, they may not be very effective in inducing compliance, as the costs would be dispersed over all taxpayers. Other options should therefore be considered, including stronger surveillance mechanisms and greater opportunities for interested parties to bring cases in national forums. Whatever is done, it is important to halt the emerging trend toward escalating retaliation and the use of trade sanctions.

Compensation may be worth revisiting, however, as a possible solution to cases where it is clear that a Member will not (has no intention to) comply with an adverse ruling. At present there are a couple of instances where large Members have chosen to absorb the cost of retaliation on an ongoing basis rather than to bring the nonconforming measure into compliance with their obligations. This has been the case, and other cases are likely to arise in the future, when the noncompliant Member assesses that the political cost of implementation is too high.

This situation is undesirable for several reasons. First, retaliation harms all WTO Members and global welfare, and instituting protection is not a long-term solution (the whole idea of retaliation is to force prompt compliance). In situations of prolonged noncompliance, the WTO dispute settlement system begins to serve the function of legitimizing trade wars, rather than opening markets. This point is particularly resented by sectors that, while not involved in the original complaint, bear the cost of retaliation (companies in these sectors often legitimately argue that it is not they that are refusing to comply). Second, prolonged noncompliance undermines the credibility of the system, the delicate balance that keeps all Members agreeing to play by the rules because they need others to do so. Given that prolonged noncompliance is generally an option only for larger Members whose economies can bear the cost of retaliation, it also adds to perceptions that the system is biased against smaller players. Third, noncompliance creates incentives for the noncompliant party to bring other difficult and contentious disputes into the system, rather than address them through negotiation, in order to create bargaining chips, in the hope that noncompliance by the other party will eventually "cancel out" its own.

All these do considerable harm to the trading system. However, it can be argued that equal—or greater—harm could be done were the noncompliant party to comply with a ruling that was politically or socially unacceptable to most of the populace. This could undermine public support for the trading system in a more fundamental and, in the longer term, more deeply damaging way.

In this situation, it may be better to accept that the noncompliant party has no intention of complying in the foreseeable future and to make a virtue of necessity. That is, after a period (say, two years) of bearing retaliation, the noncomplying Member would be automatically (unless WTO Members agree by consensus to waive the requirement) required to offer compensation to other Members in the form of additional market opening in other areas, to the equivalent value of the retaliation.

While the noncomplying Member would be able to choose the areas in which it offered the compensatory market access, it could be obliged to give serious consideration to the requests of the original parties (and perhaps third parties) to the dispute. Such compensation would in no way imply that the original Member was now in compliance: the compensatory market access would stay in place for as long as the noncomplying measure remained in force. If the value of the access increased over time, this would obviously alter the cost-benefit analysis of the noncompliant party and may encourage ultimate compliance in the longer term.

It could be argued that this undermines the rules-based system, by essentially allowing Members to buy their way out of their obligations. This is a valid criticism. However, it must be pointed out that it is attempting to deal with something that is already happening; as noted above, it attempts to salvage something positive for the system from the reality on the ground.

Chapter 15

Main conclusions and recommendations

Main conclusions

Trade openness can be a powerful driver of economic growth, which is indispensable to reduce poverty and foster development. Trade, however, is not a silver bullet for achieving development. There is no way around the other institutional, macroeconomic, and microeconomic conditions that, along with well designed social policies, must also be met to attain development. Yet it is very likely that if developed countries opened their markets significantly more to developing countries and developing countries also became more open, poverty would fall faster worldwide, including in most of the poorest countries, provided the needed complementary policies were in place.

Achieving more open and fair markets for the promotion of development is the mission of the multilateral trading system. This system has evolved progressively since the end of the Second World War and has delivered impressive results for many countries, particularly those now fully industrialized.

Throughout most of its existence, however, the trading system has mainly served the interests of developed countries. Sometimes by their own decision and other times by explicit exclusion dictated by richer countries, developing countries have not been influential in the design of the multilateral trading system. Moreover, most of the existing multilateral rules, through respective rounds, emulated to a great extent the policies, the practices, and most important, the laws and regulations of a few developed countries.

The system is thus unbalanced against the interests of developing countries. Balancing the system will give developing countries greater economic growth potential, a major stake in developing multilateral trade rules and disciplines and in pursuing trade liberalization, and a more effective capacity to expand trade and defeat poverty.

That goal was the raison d'être of the Doha Development Agenda (DDA) Round of trade negotiations launched in November 2001, at least according to the rhetoric.

But this sense of purpose was short-lived. With key deadlines missed and progress practically nil on every issue contained in the DDA, the WTO Ministerial of September 2003 collapsed amid acrimony. There is no single reason to explain this; however the failure of the U.S., the EU, and Japan to lead by example is a major one.

WTO Members have since made a courageous effort to revive the Doha Round, but a lot more will be required. The 2004 Doha Work Programme framework, while necessary to prevent the collapse of the Round, is far from sufficient to sustain it.

The real work remains to be done, and a sense of urgency is required if the Doha Round is to be completed by the end of 2006 or very early 2007 at the latest. If this narrow window of opportunity is missed, it is hard to see how the round can be completed in time to contribute to achieving the Millennium Development Goals by 2015.

All WTO Members must identify the core priorities of a real development round and make concrete political and financial commitment to achieving them. What must be done in the Doha Round and beyond?

Agriculture—the biggest and costliest aberration

The biggest and most costly aberration of the trading system is to be found in agriculture. Farm producers in rich countries receive support in excess of $250 billion, thanks to which their farmgate prices are almost one-third higher than world prices. Consumers in those countries pay for that protection through higher taxes and higher food prices. It's their choice, but it must be stressed that by doing so they also impose a heavy burden on other agricultural producers, particularly in developing countries. Agricultural protection in both developed and developing countries is most assuredly a cause of poverty in poor countries.

That rich countries should lead farm liberalization is beyond question. They should deliver substantial liberalization under all three pillars of the agricultural negotiations. They should shift their farm policies to income support—helping the poor and small farmers in rich countries adjust to more open farm markets. Export subsidies should be totally and definitively eliminated, as agreed in the DDA framework of August 2004. This will send a powerful signal to developing countries, which will follow suit with their own deeper market opening without the danger of trade and competition being greatly distorted by export subsidies. Negotiations on farm trade liberalization should also broaden their focus beyond elimination of export subsidies to stress reductions in tariffs—themselves a powerful discipline on export subsidies—and reduction in domestic support. Market access negotiations must address

both the unacceptably high tariffs, which remain in agriculture, and tariff escalation, which continues to frustrate developing country efforts to move up the value chain.

The growth of the poorest countries depends crucially on a more dynamic farm sector—coming from increased domestic production for import substitution and/or exports. The fragility of these countries, however, suggests that, as a result of the Doha Round, they should reduce only their bound tariffs—since most of their applied tariffs are moderate—and also their applied tariff peaks, which cost their poor consumers dearly without bringing public revenue. Additional complications for the few poor countries that may be hurt by this modest liberalization could be dealt with by a substantial increase in international aid—to provide the necessary means for a new wave of Green Revolutions and to ensure adequate food security.

Nonagricultural market access—developing countries should also liberalize

Although not as severe as in farm products, trade barriers in nonagricultural products continue to be significant and particularly detrimental to developing countries. For example, developing countries' exports to developed countries face tariffs that are, on average, four times higher than those faced by the exports of other developed countries. Developing countries' exports suffer from tariff peaks, tariff escalation, and quotas imposed by rich countries on goods of great export potential. While over the last few decades developing countries have undertaken an unprecedented level of trade liberalization, both on an autonomous basis and in the context of multilateral and regional negotiations, they still suffer, of course, from their own protection, which not only reduces their competitiveness in world markets but also cancels enormous opportunities of increased trade among themselves.

While developed countries bear a special responsibility to liberalize in this Round, developing countries should also do so—in their own interests and because they are important markets for each other and for the poorest countries. While this would still be less than full reciprocity, the poorest countries should nonetheless bind their tariffs at uniform and moderate rates in their own development interests. Adjustment costs should be economically and socially sustainable in developing countries, for example, by phasing in tariff reductions and providing international technical and financial assistance.

The Uruguay Round Agreement on Textiles and Clothing (ATC) mandated the progressive phasing out of quotas by January 1, 2005. But phase-outs were heavily backloaded, with more than 50 percent of quotas—covering the most commercially valuable products—left to be removed on the final deadline of January 1 2005. This backloading robbed developing countries of one of the major gains expected from the Uruguay Round and gave rise to legitimate doubts about the willingness of the major importers to honor the agreement. It

also undermined any chance of gradual and orderly adjustment in the sector; the abrupt removal of the remaining quotas on January 1, 2005, may create adjustment problems for importers and exporters alike, and is likely to unleash powerful protectionist forces. These must be effectively contained—for example, by restraining the proliferation of contingency protection measures. The correct answer lies not in pursuing protectionism by other means, but in providing adjustment support to the poorest countries and small suppliers highly dependent on this sector through trade and development measures.

This has led some to call for an extension of quotas, but this would be a mistake. "Temporary" textile and clothing protection has been around for 40 years; continued protection is likely only to prolong and further distort the adjustment process. Addicts always promise that they will quit tomorrow—the difficult process of adjustment must be started now. Given the role that developed countries have played in creating the scale (if not the fact) of the adjustment challenge, they must now be prepared to contribute to its costs. Assistance could help developing countries move into niche markets or up the value chain and strengthen their networks of suppliers and clients to meet just-in-time production deadlines. Removal of trade barriers and domestic distortions by developing countries themselves would also help increase competitiveness. Tariff preferences may ease adjustment for some countries in the short term, though restrictive rules of origin will need to be addressed. More helpful and less distortionary temporary breathing space could be provided by all developed countries extending duty-free and quota-free access to all products from the poorest developing countries no later than January 1, 2006.

Services—a major source of gains for developing countries

Liberalization of trade in services, especially of mode 4 (the temporary movement of people to supply services), has been recognized as a major source of gains for developing countries, capable of bringing more benefits to them than perhaps any other part of the Doha Round. Services liberalization promises real development gains—in terms of the efficiency and growth potential of the economy as a whole, the export of goods and other services, and access to basic services to improve the lives of the poor. Done right, services negotiations offer developing countries an opportunity to act in their own economic interest and get paid for it.

But services gains are not automatic, and producing an outcome that supports development can be a challenge, given the need for regulation to address complex issues of market structure, market failures, and noneconomic objectives. Ensuring that services liberalization results in competition and increases access to services by the poor are key regulatory challenges—and will require increased assistance and regulatory creativity. But with appropriate care to the nature, pace, and sequencing of reform, adjustment—including that related to increased imports of labor-intensive services—can be managed.

A serious "Development Round" must make progress on mode 4. Developing countries should seek to expand access for groups of interest to them (such as contractual service suppliers, and intracorporate transferees) and improve the transparency and usability of existing access. Bilateral or plurilateral agreements could also be considered as an interim step. These cover a broader range of workers than mode 4 and provide scope to develop trust and complementary policies (such as on brain drain, remittance transfer, return, and recognition). Over time, recruitment of workers under these schemes could be opened on a most favored nation (MFN) basis to any country that can implement the requirements. Agreements would be notified to the WTO, and WTO Members would have the opportunity to indicate their interest in joining or negotiating similar agreements. An MFN waiver would likely be necessary. While a potentially useful interim step, bilateral or regional agreements are no substitute over the longer term for bound multilateral commitments under the WTO. WTO commitments remain the best and most effective way to deliver gains to developing countries, and commercially meaningful market access commitments on mode 4 are essential to fulfill the development dimension of the services, and Doha, negotiations.

Keeping markets open—avoiding new barriers, added costs, and uncertainties

Hard-won gains in market access in agricultural and nonagricultural products are increasingly eroded by other policies that recreate trade barriers and/or create transaction costs and uncertainty.

Antidumping is used disproportionately against the exports of developing countries, with a severe chilling effect on their actual and potential trade—though some developing countries are now also becoming major users of antidumping measures. The Doha Round could help in several ways. The *de minimis* threshold below which developing country exports are immune from antidumping could be raised—currently, as soon as imports from developing countries emerge from being insignificant, they can be restricted by high antidumping barriers. Additionally, national antidumping laws could be required to treat all affected domestic interests—import-competing industries, consumers, and users—equally.

Many developing countries are being denied effective market access by their inability to meet ever more—and ever higher—OECD standards or market-entry conditions. Exemptions are unlikely to help, serving only to brand developing country exports as inferior or unsafe, and providing no incentive to raise national standards for the benefit of domestic consumers. Where standards are imposed by private buyers, there is even less scope for—or point in—seeking exemptions. Two things are essential if developing countries are not to be left behind: assistance to make effective use of the Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS) disciplines to ensure

that standards are not abused for protectionist purposes; and significant assistance to construct the institutional frameworks and infrastructure required to meet legitimate standards. Further, developing countries must be assisted to become more substantively involved in standard-setting processes and those standard-setting activities themselves need to be oriented toward issues of greater interest to developing countries.

Preferences—liberalization on a most favored nation basis and appropriate compensation are a better way

Rich countries have used preferences to divide developing countries and promote their narrower regional, sectoral, and political objectives, often establishing complicated regulations that exclude exports from otherwise eligible countries. The poorest countries have often received limited benefits from preference schemes, because preferences do nothing to address their multiple supply-side constraints. Benefits are also often at the expense of other developing countries, and are smaller than would be the case with either direct transfers or multilateral liberalization. But the price of preferences is continuing protection in rich countries. MFN liberalization—plus appropriate compensation for countries that may suffer adjustment problems—is likely to be a better path.

While preference erosion is generally less than often thought, some countries may confront possible large losses and will require concrete assistance. Given the history of preference programs, developed countries as a group should pay. They should replace preferences with equivalent development assistance, which could be used by the recipient governments to fund adjustment costs. Operationalizing this deal should be an explicit part of the Doha Round. Any such assistance should be seen as part of a broader effort that is needed to help poor countries build and strengthen their ability to use trade beneficially. However, specifically in the context of a Doha deal, there is a need to accompany global commitments to implement far-reaching trade reforms on an MFN basis with a temporary program to transfer additional resources to developing countries, especially those that will experience preference erosion losses.

Free trade agreements—limited benefits, high costs

Likewise, free trade agreements have a mixed record in achieving real liberalization, especially on the hardest nuts (such as agricultural subsidies or sensitive products). Benefits may be limited (or achieved at the expense of others) but costs can be high. Unlike at the WTO where developing countries can form effective coalitions, in free trade agreements (FTAs) they are at a disadvantage in resisting the inclusion of nontrade issues or erosion of their WTO rights (such as TRIPS+ on patents, especially pharmaceutical patents, and other WTO+ provisions). Multiple FTAs with differing rules of origin impose high transaction costs, particularly on small traders, and divert the

limited negotiating resources of poor countries from the pursuit of multilateral liberalization.

Singapore issues—trade facilitation promises gains but cannot be business as usual

Three out of the four so-called Singapore issues (competition, investment, transparency in government procurement) have rightly been left off the Doha Round. None meets the essential tests of whether rules on regulatory issues should be included in the WTO: Are they trade related? Are they in line with broader development priorities? And what is the specific value of a WTO agreement? These issues are not priorities for poor countries and could divert scarce resources from other issues with higher development payoffs. Even where there are development benefits, they may not be best pursued through a WTO agreement.

Trade facilitation promises trade and development gains, but a WTO agreement cannot be business as usual. It should not impose heavy obligations on developing countries and make light promises of assistance. The main value of a WTO agreement on trade facilitation would be as a mechanism for attracting and channeling international assistance. From a development perspective, the best model is one where implementation deadlines could be customized in negotiations with individual countries (along the lines of GATS precommitments), with technical and financial assistance negotiated and customized as part of a package. A review process, involving expert organizations and other developing countries with similar experiences, could identify problems early, and negotiated extensions would be possible. Flexibility on dispute settlement could be provided by a Peace Clause.

Trade-related intellectual property rights—could be revisited

Should intellectual property rights have been included in the WTO? From an economic point of view, probably not, because they require a very delicate balance of market forces and public action—a balance unlikely to be the same for all countries. TRIPS obligations also tend to be "one size fits all," taking no account of levels of development and varying interests and priorities. While the agreement tries to mitigate this to some extent by providing for differing implementation periods, countries acceding to the WTO may not even have access to these normal flexibilities.

That said, the TRIPS Agreement is not without areas of actual or potential interest for developing countries (although the balance of costs and benefits will vary among developing countries and according to the issue), nor is it without some flexibility in its provisions. However, the flexibility provided for implementation of TRIPS seems yet insufficient on paper, and even more so in practice, and the assistance provided is clearly inadequate. There is a clear case for revisiting more of the rules to determine their impact on developing

countries and any additional flexibility required. In other cases, the agreement provides for flexibility, but certain WTO Members—the U.S. on drugs, the EU on geographical indications—are trying to narrow unacceptably the scope of that flexibility.

Special and differential treatment—making it more effective and operational

While it is clear that developing countries benefit from freer trade, it is equally clear that their capacity to do so is different from that of developed countries. Developing countries generally have a more limited ability to take advantage of new opportunities and to bear adjustment costs. Special and differential treatment makes sense and should be made more effective and operational.

There is no compelling case for exemption for rules on traditional trade policies. Additional freedom to use bad policies promises few development gains and risks harming other developing countries (such as subsidy wars). For rules on domestic regulations requiring actual investment of resources, a cost-benefit analysis based on four factors should guide what special and differential treatment to grant and to whom: the extent to which the rules are related to trade (market access), the extent to which they are in line with broader development priorities, the costs of implementation, and the relative costs to others of nonimplementation. Assessments of costs and benefits will vary by issue and the level of development of the country concerned.

Where the costs are high and the trade and development benefits minimal, the issue should not be included in the WTO. Where the costs are high and development benefits only a longer term priority, there is a strong case for extensive—but not eternal—flexibility. Where development benefits are greater or more immediate, a model that calibrates commitments with assistance and gives greater flexibility to countries to determine appropriate implementation periods is warranted. Where WTO rules promise real and short-term trade and development benefits, concrete technical and financial assistance should be ensured—say, through mandatory commitments subject to review and linked to the implementation requirements of developing countries.

Coherence—adopting sound complementary policies and ramping up aid for trade

If trade liberalization is to contribute to economic growth, expanded trade, and poverty reduction, it must be coordinated with other policies at both the national and international levels. At the national level, policy coherence means the adoption of sound complementary policies by national governments to manage liberalization, as well as ensuring that trade policymaking is appropriately informed by expertise across a range of policy areas. At the international level, coherence calls for a significant ramping up of "aid for trade" by the development community (to negotiate, assess, and implement WTO agreements

and to design and implement adjustment policies) and for a clear and realistic view of the WTO's role in technical assistance. This assistance for increasingly deeper capacity building must be additional to, and not at the expense of, development aid. Trade liberalization requires international negotiations and international assistance, but its benefits and challenges remain fundamentally a question of domestic economic and policy reform.

Main recommendations

A real development round is achievable but will require some enlightened, albeit self-interested, leadership on the part of the major players in both developed and developing countries. Providing this leadership is not within the realm of trade negotiators' capacities. Political leadership must be generated at a higher level, perhaps not even at the ministerial level but at the head of government level as part of a coherent policy approach—economic, political, and social—to meeting the development challenge.

The year 2005 offers a rare opportunity to harness the broader momentum of the "2000 plus 5" high-level review of the Millennium Summit to seek a major political consensus among the heads of government of a group of 20 or so countries on the Doha Development Round and other crucial topics for achieving the Goals.

Heads of state can agree on the major strategic criteria to shape the multilateral trading system for the future. This grand vision would keep the eyes of negotiators preparing for the Sixth WTO Ministerial Conference, in Hong Kong (China) in December 2005, on the prize of a real development round and the contribution it could make to achieving the Goals.

In this context it is recommended that leaders agree on the following ideals for the future path of the trading system:

- In a conveniently distant long term (2025) the multilateral trading system must deliver the total removal of barriers to all merchandise trade, a substantial and extensive liberalization of trade in services, and the universal enforcement of the principles of reciprocity and nondiscrimination in a way that supports attainment of the Millennium Development Goals. This target is ambitious but not impossible, with political will and appropriate support for adjustment. And there is a base to build on; Asia-Pacific Economic Cooperation (APEC) economies have already committed to free trade by 2010 for developed Members and 2020 for developing Members.
- The most useful WTO would be one focused solely on trade and relieved of other global economic governance tasks, which could be better accomplished by other international instruments or entities.

Consistent with these criteria, more medium-term targets could be adopted. Greatly increased international technical and financial support for reform and adjustment by developing countries will be needed to ensure the achievement

of those targets; in the absence of such assistance, more flexibility would be required. But given the potential benefits, it is in all countries' interests for substantial assistance to be forthcoming to underpin the following targets:

- By 2015, no bound farm tariff should exceed 5 percent for OECD countries, 10 percent for developing countries, and 15 percent for the poorest countries. All nontariff barriers, including tariff-rate quotas, should be removed by 2010.
- As soon as possible and no later than 2010, all export subsidies should be abolished, with comparable disciplines on similar instruments.
- Domestic support (such as price support, direct production subsidies) must be made both less trade-distorting (decoupled from production) and subject to an overall, significantly lower limit. All countries should decouple all support payments to farmers by 2010 and cap all domestic support measures at 10 percent of the value of agricultural production (on a by-product basis) by 2010 and at 5 percent by 2015. The Green Box (of minimally trade-distorting subsidies) should be maintained for the poorest countries—with clarifications or marginal additions such as support for diversification, transportation subsidies for farm products, consumption subsidies for domestic food aid, public assistance for establishing farm cooperatives, or institutions for promoting marketing and quality control.
- Developed countries should bind all tariffs on nonagricultural merchandise at zero by 2015, the target date for achieving the Millennium Development Goals. A mid-term target could be for no tariff higher than 5 percent by 2010. Ideally, developing countries should all be at zero tariffs by 2025. As soon as possible, these countries should bind all their tariffs in coherence with their applied rates. The poorest countries should also aim to bind all tariffs at a uniform and moderate rate.
- Duty-free and quota-free access for all exports from the poorest countries should be extended by all developed countries no later than January 1, 2006.
- The liberalization of mode 4 of the GATS (temporary movement of labor to provide services) should be adopted as a high-priority item on the international agenda, considering its potential benefits for both developing and developed countries as well as the need to manage in a more orderly fashion the mounting migration pressures in the world. Developing countries' liberalization to foreign direct investment must be matched by developed countries' liberalization to foreign labor.
- The traditional approach to special and differential treatment must be revised away from the present, and for the most part counterproductive, system of exemptions from obligations and complex webs of discriminatory preferences. A trading system limited only to agreements that are in the trade and development interests of all Members to implement under

the framework of binding multilateral trade rules should be accompanied by special and differential treatment that affords appropriately long and flexible conditions to adjust to trade liberalization and real and substantial aid for trade. Poor countries must be supported in generating the sources of revenue needed to compensate for losses incurred as a result of lowering import duties, in building the human and physical infrastructure they need to benefit from increased market opportunities, and in adjusting to erosions of existing trade preferences stemming from multilateral negotiations.

- A temporary "aid for trade fund" commensurate with the size of the task, or significantly ramped-up contributions through such existing channels as the Integrated Framework, is needed to support countries in addressing adjustment costs associated with the implementation of a Doha reform agenda. Such funding must be additional to current aid flows (and could be financed out of the tariff revenue that is presently collected by OECD and higher income developing countries on imports that will be subject to Doha reduction commitments). A priority task for the development and trade communities could be the identification of new and existing channels through which this additional funding could most efficiently be made available for relevant, targeted projects in developing countries.

Appendixes

Appendix 1

Countries on the UN official list of LDCs that are WTO Members or observers

Angola	Malawi
Bangladesh	Maldives
Benin	Mali
Bhutan*	Mauritania
Burkina Faso	Mozambique
Burundi	Myanmar
Cambodia*	Nepal
Cape Verde*	Niger
Central African Republic	Rwanda
Chad	Samoa*
Congo, Dem. Rep.	São Tomé and Principe*
Djibouti	Senegal
Equatorial Guinea*	Sierra Leone
Ethiopia*	Solomon Islands
Gambia	Sudan*
Guinea	Tanzania
Guinea-Bissau	Togo
Haiti	Uganda
Lao PDR*	Vanuatu*
Lesotho	Yemen*
Madagascar	Zambia

* WTO observer.

LDCs that are not WTO Members or observers are Afghanistan, Comoros, Eritrea, Kiribati, Liberia, Somalia, Timor-Leste, and Tuvalu.

Appendix 2

G-90 countries (ACP, LDC, or African Union) that are WTO Members or observers

Country	Affiliations	Country	Affiliations
Algeria*	AU	Lao PDR*	LDC
Angola	ACP, AU, LDC	Lesotho	ACP, AU, LDC
Antigua and Barbuda	ACP	Madagascar	ACP, AU, LDC
Bahamas*	ACP	Malawi	ACP, AU, LDC
Bangladesh	LDC	Maldives	LDC
Barbados	ACP	Mali	ACP, AU, LDC
Belize	ACP	Mauritania	ACP, AU, LDC
Benin	ACP, AU, LDC	Mauritius	ACP, AU
Bhutan*	LDC	Mozambique	ACP, AU, LDC
Botswana	ACP, AU	Myanmar	LDC
Burkina Faso	ACP, AU, LDC	Namibia	ACP, AU
Burundi	ACP, AU, LDC	Nepal*	LDC
Cambodia*	LDC	Niger	ACP, AU, LDC
Cameroon	ACP, AU	Papua New Guinea	ACP
Cape Verde*	ACP, AU, LDC	Rwanda	AU, LDC
Central African Republic	ACP, AU, LDC	Samoa*	ACP, LDC
Chad	ACP, AU, LDC	São Tomé and Principe*	ACP, AU, LDC
Congo	ACP, AU	Senegal	ACP, AU, LDC
Côte d'Ivoire	ACP, AU	Seychelles*	ACP, AU
Congo, Dem. Rep.	ACP, AU, LDC	Sierra Leone	ACP, AU, LDC
Djibouti	ACP, AU, LDC	Solomon Islands	ACP, LDC
Dominica	ACP	St Kitts and Nevis	ACP
Dominican Republic	ACP	St Lucia	ACP
Equatorial Guinea*	ACP, AU, LDC	St Vincent and the Grenadines	ACP
Ethiopia*	ACP, AU, LDC	Sudan*	ACP, AU, LDC
Fiji	ACP	Suriname	ACP

Country	Affiliations	Country	Affiliations
Gabon	ACP, AU	Swaziland	ACP, AU
The Gambia	ACP, AU, LDC	Tanzania	ACP, AU, LDC
Ghana	ACP, AU	Togo	ACP, AU, LDC
Grenada	ACP	Tonga*	ACP
Guinea	ACP, LDC	Trinidad and Tobago	ACP
Guinea Bissau	ACP, AU, LDC	Tunisia	AU
Guyana	ACP	Uganda	ACP, AU, LDC
Haiti	ACP, LDC	Vanuatu*	ACP, LDC
Jamaica	ACP	Yemen*	LDC
Kenya	ACP, AU	Zambia	ACP, AU, LDC
		Zimbabwe	ACP, AU

* WTO observer.

Note: Egypt (AU), South Africa (ACP, AU), and Nigeria (ACP, AU) are not included on this list since they were members of the G-20 at Cancún. Other ACP countries that are not WTO Members or observers are Comoros, Cook Islands, Eritrea, Kiribati, Liberia, Marshall Islands, Federated States of Micronesia, Nauru, Niue, Palau, Somalia, and Tuvalu. Other African Union countries that are not WTO Members or observers are Comoros, Eritrea, Guinea Conakry, Liberia, Libya, Saharawi Arab Democratic Republic, and Somalia.

Appendix 3

OECD members

Austria	Korea, Rep.
Australia	Luxembourg
Belgium	Mexico
Canada	Netherlands
Czech Republic	New Zealand
Denmark	Norway
Finland	Poland
France	Portugal
Germany	Slovak Republic
Greece	Spain
Hungary	Sweden
Iceland	Switzerland
Ireland	Turkey
Italy	United Kingdom
Japan	United States

Note: Observers vary according to OECD bodies. Observers to the Trade Committee include Argentina, Brazil, Chile, Hong Kong (China), and Singapore. All OECD members are WTO Members.

Appendix 4

The "poorest developing countries"—some relevant factors

This report uses the term "poorest developing countries" to indicate developing countries that, while not on the UN List of LDCs, still face a wide range of serious development challenges. This appendix does not attempt to define this group in any comprehensive way, but offers some initial thoughts on some of the factors and indicators that might be useful in identifying a group of poorest developing countries.

One basic indicator is gross national income (GNI) per capita, as already used in the WTO Agreement on Subsidies and Countervailing Measures to define the poorest countries as those with a GNI per capita of less than $1,000. There is also the World Bank list (table A4.1) of low-income and lower middle-income countries (these are countries with GNI per capita of $735 or less and $736–$2,935, respectively). Criticisms have been made, however, of GNI per capita as a sufficient means of differentiating countries.

A first issue from a trade point of view is that the threshold of $1,000 GNI per capita includes some countries that are relatively dynamic economies and significant exporters. Proposals have thus been made to supplement the income-based indicator with a measure of trade performance, such as the share of manufactured products in total exports (Oyejide 2002).

Another issue is that the GNI per capita includes very large countries. A possibility would thus be to supplement it with the condition that the total GNI of a poorest country should not be larger than 2 percent of the total GNI of all donor countries (Messerlin 2003). This formula would address the particular problem of countries such as India and China, which have very large numbers of poor people, but which have also experienced high growth rates in the last decades and have achieved considerable reductions in the number of people living in extreme poverty.[1] Further, these countries have much larger levels of negotiating capital and domestic reform capacity than many poorest

countries. There is also a political economy problem; their inclusion in the group of poorest developing countries to which the most extensive special and differential treatment would be granted may reduce the willingness of other countries—mostly developed, but perhaps also some developing—to extend more meaningful special and differential treatment.

Another criticism is that some countries, while having a certain level of GDP per capita, are particularly vulnerable to shocks. These tend to be mini-states, or small island states at particular risk of natural disasters, often geographically remote and highly dependent on a narrow range of products. Considerable work has been done by the Commonwealth Secretariat and the World Bank (2000) to identify these small and poor economies—work that could usefully serve as a guide to discussions in the WTO. While a work program on small economies has been launched as part of the Doha agenda, the self-selected group of small economies goes beyond the scope envisioned by the Commonwealth Secretariat and World Bank and is perhaps too broad to be useful.

Finally, purely economic measurements may not be a reliable indicator of countries' actual levels of development and regulatory capacities. A more sophisticated approach would be to create a composite index capturing the economic and institutional factors that WTO Members would be ready to consider as relevant for defining the poorest countries. For the sake of illustration, table A4.2 provides the UNDP human development index (HDI), a composite index that measures a country's average achievements in a range of aspects of development: longevity, knowledge, and standard of living. Longevity is measured by life expectancy at birth (drawn mainly from UN Population Division data); knowledge, by a combination of the adult literacy rate and the combined primary, secondary, and tertiary gross enrollment ratio (based on UNESCO data); and standard of living, by GDP per capita in terms of purchasing power parity with the U.S. dollar (drawn from World Bank data).

For the sake of information, table A4.3 provides a potential list of the WTO Members and observers (as of December 2003) that would meet one of the criteria mentioned above, along with some additional indicators: GNI per capita of less than $1,000; GNI less than 2 percent of total donor GNI; trade performance; population; farm exports exposure; food security situation; and HDI ranking.

Table A4.1

WTO Members and observers according to World Bank income group classifications, 2003

* WTO observer.
Source: World Bank 2003.

	Sub-Saharan Africa		Asia		Europe and Central Asia		Middle East and North Africa		Americas
Income group	**East and Southern Africa**	**West Africa**	**East Asia and the Pacific**	**South Asia**	**Eastern Europe and Central Asia**	**Rest of Europe**	**Middle East**	**North Africa**	
Low income GNI per capita, $735 or less	Angola Burundi Congo, Dem. Rep. Ethiopia* Kenya Lesotho Madagascar Malawi Mozambique Rwanda Sudan* Tanzania Uganda Zambia Zimbabwe	Benin Burkina Faso Cameroon Central African Republic Chad Congo, Rep. Côte d'Ivoire Equatorial Guinea* Gambia, The Ghana Guinea Guinea-Bissau Mali Mauritania Niger Nigeria São Tomé and Principe* Senegal Sierra Leone Togo	Cambodia* Indonesia* Lao PDR Mongolia Myanmar Papua New Guinea Solomon Islands Viet Nam*	Bangladesh Bhutan* India Nepal* Pakistan	Azerbaijan* Georgia Kyrgyz Republic Moldova Tajikistan* Uzbekistan*		Yemen*		Haiti Nicaragua

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Table A4.1

WTO Members and observers according to World Bank income group classifications, 2003

(continued)

	Sub-Saharan Africa		Asia		Europe and Central Asia		Middle East and North Africa		Americas
Income group	**East and Southern Africa**	**West Africa**	**East Asia and the Pacific**	**South Asia**	**Eastern Europe and Central Asia**	**Rest of Europe**	**Middle East**	**North Africa**	
Lower middle income GNI per capita, $736–$2,935	Namibia South Africa Swaziland	Cape Verde*	China Fiji Philippines Samoa* Thailand Tonga* Vanuatu*	Maldives Sri Lanka	Albania Armenia Belarus* Bosnia and Herzegovina* Bulgaria Kazakhstan* Macedonia FYR Romania Russian Federation* Serbia and Montenegro* Ukraine*	Turkey	Iraq Jordan	Algeria* Djibouti Egypt Morocco Tunisia	Bolivia Brazil Colombia Cuba Dominican Rep. Ecuador El Salvador Guatemala Guyana Honduras Jamaica Paraguay Peru St Vincent and the Grenadines Suriname
Upper middle income GNI per capita, $2,936–$9,075	Botswana Mauritius Seychelles*	Gabon	Malaysia		Croatia Czech Republic Estonia Hungary Latvia Lithuania Poland Slovak Republic		Lebanon* Oman Saudi Arabia*		Argentina Belize Chile Costa Rica Dominica Grenada Mexico Panama St Kitts and Nevis St Lucia Trinidad and Tobago Uruguay Venezuela
Subtotal	*21*	*22*	*16*	*7*	*25*	*1*	*6*	*5*	*30*

	Sub-Saharan Africa		Asia		Europe and Central Asia		Middle East and North Africa		Americas
Income group	**East and Southern Africa**	**West Africa**	**East Asia and the Pacific**	**South Asia**	**Eastern Europe and Central Asia**	**Rest of Europe**	**Middle East**	**North Africa**	
High income OECD GNI per capita, $9,076 or more			Australia Japan Korea, Rep. New Zealand			Austria Belgium Denmark Finland France Germany Greece Iceland Ireland Italy Luxembourg Netherlands Norway Portugal Spain Sweden Switzerland United Kingdom			Canada United States
High income non-OECD			Brunei Hong Kong (China) Macao (China) Singapore Taiwan (China)		Slovenia	Andorra* Cyprus Liechtenstein	Bahrain Israel Kuwait Qatar United Arab Emirates	Malta	Antigua and Barbuda Bahamas* Barbados
Subtotal	*0*		*9*	*0*	*1*	*22*	*5*	*1*	*5*

Table A4.2

GDP per capita and Human Development Indicators, 2004

GDP per capita (purchasing power parity in 2002 dollars)

a. Neither WTO Member nor observer.

b. For purposes of calculating HDI, a value of $40,000 (PPP) was used.

c. Data may refer to another year than that specified.

d. Estimate based on regression.

e. Preliminary World Bank estimate, subject to further revision.

f. No reliable GDP data are available. A rough estimate of GDP was used to build the corresponding HDI.

Source: UNDP 2004a.

HDI rank	Country	GDP per capita (PPP) 2002
High human development		
1	Norway	36,600
2	Sweden	26,050
3	Australia	28,260
4	Canada	29,480
5	Netherlands	29,100
6	Belgium	27,570
7	Iceland	29,750
8	United States	35,750
9	Japan	26,940
10	Ireland	36,360
11	Switzerland	30,010
12	United Kingdom	26,150
13	Finland	26,190
14	Austria	29,220
15	Luxembourg	61,190[b]
16	France	26,920
17	Denmark	30,940
18	New Zealand	21,740
19	Germany	27,100
20	Spain	21,460
21	Italy	26,430
22	Israel	19,530
23	Hong Kong (China)	26,910
24	Greece	18,720
25	Singapore	24,040
Medium human development		
26	Portugal	18,280
27	Slovenia	18,540
28	Korea, Rep.	16,950
29	Barbados	15,290
30	Cyprus	18,360[c]
31	Malta	17,640
32	Czech Republic	15,780
33	Brunei Darussalam	19,210[c]
34	Argentina	10,880
35	Seychelles	18,232[d, e]
36	Estonia	12,260
37	Poland	10,560
38	Hungary	13,400
39	St Kitts and Nevis	12,420

HDI rank	Country	GDP per capita (PPP) 2002
Medium human development		
40	Bahrain	17,170
41	Lithuania	10,320
42	Slovakia	12,840
43	Chile	9,820
44	Kuwait	16,240[d]
45	Costa Rica	8,840[d]
46	Uruguay	7,830
47	Qatar	19,844[c]
48	Croatia	10,240
49	United Arab Emirates	22,420[c, d]
50	Latvia	9,210
51	Bahamas	17,280[c]
52	Cuba	5,259[c]
53	Mexico	8,970
54	Trinidad and Tobago	9,430
55	Antigua and Barbuda	10,920
56	Bulgaria	7,130
57	Russian Federation	8,230
58	Libya	7,570
59	Malaysia	9,120
60	FYR Macedonia	6,470
61	Panama	6 170
62	Belarus	5,520
63	Tonga	6,850[d]
64	Mauritius	10,810
65	Albania	4,830
66	Bosnia and Herzegovina	5,970
67	Suriname	6,590[d, e]
68	Venezuela	5,380
69	Romania	6,560
70	Ukraine	4,870
71	Saint Lucia	5,300
72	Brazil	7,770
73	Colombia	6,370[d]
74	Oman	13,340
75	Samoa (Western)	5,600[d]
76	Thailand	7,010
77	Saudi Arabia	12,650[d]
78	Kazakhstan	5,870
79	Jamaica	3,980

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Table A4.2

GDP per capita and Human Development Indicators, 2004

(continued)

HDI rank	Country	GDP per capita (PPP) 2002
Medium human development		
80	Lebanon	4,360
81	Fiji	5,440
82	Armenia	3,120
83	Philippines	4,170
84	Maldives	4,798[c, d, e]
85	Peru	5,010
86	Turkmenistan	4,300[c]
87	St Vincent and the Grenadines	5,460
88	Turkey	6,390
89	Paraguay	4,610[d]
90	Jordan	4,220
91	Azerbaijan	3,210
92	Tunisia	6,760
93	Grenada	7,280
94	China	4,580
95	Dominica	5,640
96	Sri Lanka	3,570
97	Georgia	2,260
98	Dominican Republic	6,640[d]
99	Belize	6,080
100	Ecuador	3,580
101	Iran	6,690
102	Occupied Palestinan Territories	[f]
103	El Salvador	4,890[d]
104	Guyana	4,260[d]
105	Cape Verde	5,000[d]
106	Syria	3,620
107	Uzbekistan	1,670
108	Algeria	5,760[d]
109	Equatorial Guinea	30,130[c, d]
110	Kyrgyzstan	1,620
111	Indonesia	3,230
112	Viet Nam	2,300
113	Moldova	1,470
114	Bolivia	2,460
115	Honduras	2,600[d]
116	Tajikistan	980
117	Mongolia	1,710
118	Nicaragua	2,470[d]
119	South Africa	10,070[d]

HDI rank	Country	GDP per capita (PPP) 2002
Medium human development		
120	Egypt	3,810
121	Guatemala	4,080[d]
122	Gabon	6,590
123	São Tomé and Principe	1,317[c]
124	Solomon Islands	1,590[d]
125	Morocco	3,810
126	Namibia	6,210[d]
127	India	2,670[d]
128	Botswana	8,170
129	Vanuatu	2,890[d]
130	Cambodia	2,060[d]
131	Ghana	2,130[d]
132	Myanmar	1 027
133	Papua New Guinea	2,270[d]
134	Bhutan	1,969[c]
135	Lao PDR	1,720
136	Comoros	1,690[d]
137	Swaziland	4,550
138	Bangladesh	1,700
139	Sudan	1,820[d]
140	Nepal	1,370
141	Cameroon	2,000
Low human development		
142	Pakistan	1,940
143	Togo	1,480[d]
144	Congo	980
145	Lesotho	2,420[d]
146	Uganda	1,390[d]
147	Zimbabwe	2,400[c]
148	Kenya	1,020
149	Yemen	870
150	Madagascar	740
151	Nigeria	860
152	Mauritania	2,220
153	Haiti	1,610
154	Djibouti	1,990
155	Gambia	1,690
156	Eritrea	890
157	Senegal	1,580
158	Timor-Leste	[f]

(continued on next page)

Table A4.2

GDP per capita and Human Development Indicators, 2004

(continued)

HDI rank	Country	GDP per capita (PPP) 2002
Low human development		
159	Rwanda	1,270
160	Guinea	2,100
161	Benin	1,070
162	Tanzania	580
163	Côte d'Ivoire	1,520
164	Zambia	840
165	Malawi	580
166	Angola	2,130
167	Chad	1,020
168	Congo, Dem. Rep.	650
169	Central African Republic	1,170
170	Ethiopia	780
171	Mozambique	1,050
172	Guinea-Bissau	710
173	Burundi	630
174	Mali	930
175	Burkina Faso	1,100
176	Niger	800
177	Sierra Leone	520
Developing countries		4,054
Least Developed Countries		1,307
Arab States		5,069
East Asia and the Pacific		4,768
Latin America and the Caribbean		7,223
South Asia		2,658
Sub-Saharan Africa		1,790
Central and Eastern Europe and CIS		7,192
OECD		24,904
High-income OECD		29,000
High human development		24,806
Medium human development		4,269
Low human development		1,184
High income		28,741
Middle income		5,908
Low income		2,149
World		7,804

Table A4.3

The poorest developing countries, with GNP per capita less than $1,000 a year

* Net food-importing developing countries defined by the Uruguay Round.

a. AG: African Group; LDC: Least Developed Countries; LMG: Like-Minded Group.

b. GNI: Gross national income; CER: at current exchange rates; PPP: exchange rates at purchasing power parity.

c. Share of exports by the poorest countries of farm products enjoying OECD domestic support.

d. From 1 (the highest security risk) to 12 (the lowest security risk).

e. Excluding China and India.

f. For most OECD countries, tariffs on farm products do not reflect the totality of protection (see text).

Source: World Bank 2003d; WTO 2004f; Hoekman, Mattoo, and English 2002; Hoekman, Ng, and Olarreaga 2002; Diaz-Bonilla, Thomas, and Robinson 2003.

Country	Coalition(s) joined[a]	Population (millions)	GNI per capita[b]		Average tariff rates in 2002 (%)			Farm exports exposure[c]	Food security risk[d]
			CER	PPP	Agriculture	Manufactures	All goods		
Ethiopia	AG,LDC	64.0	100	660			16.3		1
Burundi	AG,LDC	7.0	110	580			7.4	72.8	1
Sierra Leone	AG,LDC	5.0	130	480			21.0	6.6	1
Korea, Dem. Rep.		22.0	150						
Liberia	LDC	3.0	150						1
Eritrea	LDC	4.0	170	960					1
Malawi	AG,LDC	10.0	170	600	15.6	15.7	15.7	75.7	1
Guinea-Bissau	AG,LDC	1.0	180	710				39.8	1
Niger	AG,LDC	11.0	180	740			18.3	17.2	1
Tajikistan		6.0	180	1,090					2
Chad	AG,LDC	8.0	200	870	17.0	15.5	15.8	82.5	1
Burkina Faso	AG,LDC	11.0	210	970	37.0	29.1	31.1	75.5	1
Mozambique	AG,LDC	18.0	210	800	16.9	15.3	16.9	0.0	1
Somalia	LDC	9.0	210				23.2		1
Rwanda	AG,LDC	9.0	230	930	58.0	31.1	34.8	59.0	1
Mali	AG,LDC	11.0	240	780	16.1	10.4	11.2	84.5	1
Nepal	LDC	23.0	240	1,370	12.9	18.9	17.7		1
Madagascar	AG,LDC	16.0	250	820	6.4	6.9	6.8	26.6	1
Cambodia	LDC	12.0	260	1,440			35.0		1

Table A4.3

The poorest developing countries, with GNP per capita less than $1,000 a year

(continued)

Country	Coalition(s) joined[a]	Population (millions)	GNI per capita[b]		Average tariff rates in 2002 (%)			Farm exports exposure[c]	Food security risk[d]
			CER	PPP	Agriculture	Manufactures	All goods		
Congo, Dem. Rep.	AG,LDC	51.0	260	765	18.0	17.5	17.6	10.6	1
Nigeria	AG,LMG	127.0	260	800	23.0	24.0	23.4	1.8	5
Kyrgyz Republic		5.0	270	2,540				24.1	5
Myanmar	LDC	48.0	270	1,027	8.9	5.1	5.7	23.6	6
Tanzania	AG,LDC,LMG	34.0	270	520	17.4	16.2	16.1		1
Central African Rep.	AG,LDC	4.0	280	1,160	7.6	6.8	7.0	24.8	1
Angola	AG,LDC	13.0	290	1,180				0.3	1
Lao PDR	LDC	5.0	290	1,540					3
São Tomé and Principe	AG,LDC	0.1	290	1,792					
Togo	AG,LDC	5.0	290	1,410	13.6	13.3	13.3	42.5	3
Afghanistan	LDC	27.0	300						1
Uganda	AG,LDC,LMG	22.0	300	1,210	23.7	11.6	13.2	63.3	1
Zambia	AG,LDC	10.0	300	750	15.9	13.0	13.6	8.1	3
Sudan	AG,LDC	31.0	310	1,520			24.0	60.1	4
Gambia	AG,LDC	1.0	340	1,620			13.6	11.0	1
Ghana	AG	19.0	340	1,910	20.1	14.1	15.0	32.4	3
Kenya	AG,LMG	30.0	350	1,010	16.7	18.2	18.0	48.7	1*
Uzbekistan		25.0	360	2,360					5
Bangladesh	LDC	131.0	370	1,590	21.4	22.5	22.2	2.2	1
Benin	AG,LDC	6.0	370	980	13.7	12.8	13.1	84.7	4
Mauritania	AG,LDC	3.0	370	1,630			20.3	1.2	4
Yemen	LDC	18.0	370	770			20.0		1

Country	Coalition(s) joined[a]	Population (millions)	GNI per capita[b]		Average tariff rates in 2002 (%)			Farm exports exposure[c]	Food security risk[d]
			CER	PPP	Agriculture	Manufactures	All goods		
Comoros	LDC	0.6	380	1,590				0.1	1
Mongolia		2.0	390	1,760			8.2	12.0	2
Viet Nam		79.0	390	2,000	21.5	14.4	15.1		3
Moldova		4.0	400	2,230	11.2	4.9	6.7		8
Nicaragua		5.0	400	2,080	16.4	10.3	11.0	40.0	2
Pakistan	LMG	138.0	440	1,860	42.7	46.9	46.5	7.0	4*
Guinea	AG,LDC	7.0	450	1,930	16.6	16.3	16.4	7.8	1
India	LMG	1,016.0	450	2,340	30.5	32.4	32.2	8.4	3
Zimbabwe	AG,LMG	13.0	460	2,550	27.0	21.7	22.2	59.3	
Senegal	AG,LDC	10.0	490	1,480	13.5	12.1	12.3	7.6	4
Cuba	LMG	11.0	500		9.7	10.9	10.7	50.7	2
Haiti	LDC	8.0	510	1,470			10.0	12.2	1
Armenia		4.0	520	2,580					2
Congo	AG	3.0	570	570			15.7	1.1	3
Indonesia	LMG	210.0	570	2,830	11.9	10.7	10.9	2.8	6
Cameroon	AG	15.0	580	1,590	24.3	17.8	18.1	24.7	3
Lesotho	AG,LDC	2.0	580	2,590			17.4		
Bhutan	LDC	0.8	590	1,440					
Azerbaijan		8.0	600	2,740					2
Côte d'Ivoire	AG	16.0	600	1,500	21.2	18.8	19.2	48.7	3*
Solomon Islands	LDC	0.4	620	1,710	32.8	22.3	22.7	9.1	3
Georgia		5.0	630	2,680					2

Table A4.3

The poorest developing countries, with GNP per capita less than $1,000 a year

(continued)

Country	Coalition(s) joined[a]	Population (millions)	GNI per capita[b]		Average tariff rates in 2002 (%)			Farm exports exposure[c]	Food security risk[d]
			CER	PPP	Agriculture	Manufactures	All goods		
Papua New Guinea		5.0	700	2,180	24.6	8.0	8.8	15.1	3
Ukraine		50.0	700	3,700	15.7	7.5	10.0		10
Turkmenistan		5.0	750	3,800					
Equatorial Guinea	AG,LDC	0.5	800	5,600					
China		1,262.0	840	3,920	16.5	16.9	16.8	1.9	6
Sri Lanka	LMG	19.0	850	3,460	23.8	19.1	20.0	2.1	3
Guyana		0.8	860	3,670			10.4	33.1	5
Honduras	LMG	6.0	860	2,400	12.2	7.5	8.1	43.9	2*
Djibouti	AG,LDC	0.6	880	2,377				9.5	2
Syria		16.0	940	3,340			21.0		7
Serbia and Montenegro		11.0	940				11.8		
Kiribati	LDC	0.1	950						4
Bolivia		8.0	990	2,360	10.0	8.9	9.7	11.3	3
Poorest developing countries[e]		1,529	396	1,689	19.3	15.6	16.5	29.3	2.5
China and India		2,278	666	3,216	23.5	24.7	24.5	5.2	4.5
Middle income developing countries		1,339	3,257	7,345	16.3	10.8	12.1	15.6	6.4
OECD countries		851	28,335	27,878	7.3[f]	4.0	5.0	4.0	10.5

Appendix 5

A brief explanation of the structure and operation of the GATS

The General Agreement on Trade in Services (GATS) applies to all services supplied on a commercial basis.[1] It excludes most air transport services as well as services supplied in the exercise of governmental authority (defined as services supplied neither on a commercial basis nor in competition with one or more service suppliers).

The agreement includes both rules and a framework for countries to make commitments to open particular service sectors to foreign suppliers. These market-opening commitments are referred to as "specific commitments" and set out the service sectors in which foreign suppliers will be permitted and the conditions under which they will be permitted to supply services.

Accordingly, the GATS is divided in two parts. The first part of the GATS consists of general obligations, as well as some obligations that apply only where commitments for particular sectors are made. An example of a general obligation is the most favored nation or MFN requirement, which requires WTO Members to treat all other WTO Members as well as they treat their most favored nation. That is, treatment offered to one country must be extended to all other Members.

Some transparency requirements are also general obligations, such as the requirement to publish or otherwise make publicly available at the national level all relevant measures of general application that pertain to the agreement. Other transparency requirements apply only where a commitment has been made, such as the requirement to notify other WTO Members through the WTO Council for Trade in Services of any new or changed laws that significantly affect trade in services covered by a commitment.[2] Another example of these types of obligations is the requirement that, in sectors where specific commitments are undertaken, measures of a general application affecting trade in services be administered in a reasonable, objective, and impartial manner (Article VI.1).

The second part of the GATS sets out the framework under which countries decide which service sectors they want to allow foreign suppliers to enter, and under what conditions. The commitments made under this framework are referred to as "specific commitments." The commitments undertaken by each WTO Member are contained in individual schedules of commitments, which are annexed to the GATS.

For the purposes of making commitments, a list of 12 service sectors and around 160 subsectors was developed. The Services Sectoral Classification List (MTN.GNS.W/120, known as "W/120") includes cross-references to the Provisional United Nations Central Product Classification (Provisional CPC). While its use was not obligatory, many WTO Members used W/120 in making their GATS-specific commitments.

What are modes of supply?

As a further tool for making market-opening commitments, the GATS also sets out four possible modes, or ways, in which services can be traded between WTO Members. Mode 1 (cross-border supply) is where the service crosses the border (a Malaysian architect faxes a plan to a client in Thailand). Mode 2 (consumption abroad) is where the service is consumed in the territory of the service supplier (a Thai tourist goes to Malaysia for a holiday). Mode 3 (commercial presence) is where the service supplier establishes a commercial presence in another WTO Member to provide the service (a Malaysian architecture firm opens a branch in Thailand). Mode 4 (presence of natural persons) is where an individual service supplier moves temporarily to another WTO Member for the purposes of supplying a service (a Malaysian architect visits Thailand for six months to supervise construction of the building she designed).

Who is covered by mode 4?

Generally, mode 4 is seen as covering:

- Business visitors.
- Contractual service suppliers, either individuals or employees of foreign companies who have obtained a contract to supply services to clients in the host country.
- Intracorporate transferees: persons employed abroad by foreign companies established in the host country.

There is a difference of view among WTO Members about whether mode 4 covers foreign employees of domestic companies, as opposed to persons providing services to those companies on a contract basis. The wording of the agreement seems to cover only foreign employees of foreign firms established in another Member, and some WTO Members argue that foreigners working for host-country companies would fall under GATS mode 4 if they worked on a contractual basis as independent suppliers for a locally owned firm, but would not necessarily seem to be covered if they were employees of that firm.

However, other Members argue that employees of domestic firms are included and note that a number of GATS commitments actually refer to short-term employment (these commitments also form an integral part of the GATS). This situation is further complicated by the fact that some WTO Members deem almost all types of foreign temporary workers to be employees for the purposes of bringing them under domestic labor law (with implications for their wages, conditions, and social protection).

Mode 4 covers only temporary movement. While temporary is not defined under the GATS, permanent migration is explicitly excluded. In practice, most WTO Members' commitments under mode 4 range from up to 3 months (as for business visitors) to up to 5 years (as for intracorporate transferees, generally limited to 2–5 years).

Mode 4 also applies only to service suppliers. However, it is not always easy to know what constitutes the supply of a service. For example, should fruit pickers be viewed as temporary agricultural laborers (outside the scope of mode 4) or as suppliers of fruit-picking services? Equally, tasks performed on a fee or contract basis, without ownership of the inputs or outputs, are sometimes deemed to be services, even when they would appear to be technically manufacturing in nature. For example, a factory that receives a roll of fabric and a contract to sew 300 shirts is a supplier of tailoring services, whereas a factory that owns the cloth and produces 300 shirts, which it then sells under its own mark, is a textile manufacturer. In a world where production chains are being broken down into a series of outsourced activities, there is some debate over the extent to which activities previously classified as manufacturing can now be broken down into, and classified as, services.

Technically, mode 4 includes service suppliers at all skill levels, but in practice WTO Members' commitments have been generally limited to the higher skilled—managers, executives, specialists—though these terms are generally not further defined.

While there is no single, clear definition of mode 4, a useful approach might be to consider both duration and purpose of stay. That is, mode 4 service suppliers:

- Gain entry for a specific purpose (to fulfill a service contract as self-employed or an employee of a service supplier).
- Are normally confined to one sector (as opposed to workers who enter under general migration or asylum programs who can move between sectors).
- Are temporary (they are neither migrating on a permanent basis nor seeking entry to the labor market).

How does the GATS operate?

The GATS covers the rules and framework for making a commitment to open particular services to foreign suppliers.

Table A5.1
Summary of mode 4 coverage

Included	Excluded	Differences of view exist
Temporary movement (temporary is undefined)	Permanent migration (residence, citizenship, or employment on a permanent basis)	
Related to the supply of services	Persons working in nonservice sectors, such as agriculture or manufacturing	Scope of activities included in "services incidental to agriculture" (such as temporary agricultural workers or suppliers of fruit-picking services) or "services incidental to manufacturing"
All skill levels (but in practice commitments to date are limited to the highly skilled)		
Foreign employees of foreign companies established in the host country	Domestic (nationals of the host country) employees of foreign companies established in the host country	Foreign employees of domestic companies
Business visitors, intracorporate transferees, contractual service suppliers (self-employed or as employee of a foreign service supplier)	Persons seeking to enter the employment market	

What is a commitment?

GATS commitments are guaranteed minimum treatment offered to other WTO Members; countries are always free to offer better treatment if they wish, but they cannot offer worse. Commitments are binding—that is, they cannot be changed without paying compensation to other Members (this takes the form of a commitment for access in another area of equal value to the one being changed or withdrawn). Commitments are also on an MFN basis—that is, the access offered is open to suppliers from all other WTO Members.

Commitments can be made for each sector or subsector and, within this, for each mode of supply. For example, under "legal services," commitments can be made for "foreign legal consultants," with some access granted under mode 3 and mode 4, but not mode 1. Alternatively, commitments can be made "horizontally," covering a single mode of supply across all sectors listed in the schedule. Horizontal commitments apply to all sectors listed in the schedule unless otherwise clearly specified at the sectoral level (for example, a Member's schedule specifies that its horizontal mode 4 commitment does not apply to legal services).[3]

What are market access and national treatment?

For each service sector or subsector, and for each mode of supply within that, countries make commitments to the level of "market access" and "national treatment" they will offer. Read together, market access and national treatment commitments inform a foreign supplier about the access they will have to the

WTO Member's market and any special conditions that will apply to them as foreigners. In making commitments, a WTO Member has three main choices:

- A commitment to provide full market access or national treatment for a particular mode—that is, to maintain no restrictions—indicated in the schedule by "none."
- No commitment to provide anything on national treatment and/or market access for a particular mode, indicated by "unbound" (no bound commitment undertaken).
- Partial commitments for market access or national treatment, with the remaining restrictions listed in the schedule.

There are six types of restrictions on access to their markets for a given service that WTO Members need to list in their commitment if they want to use them. These restrictions can apply to both nationals and foreigners or only to foreigners. These market access restrictions are:

- Restrictions on the number of service suppliers, including in the form of monopolies or exclusive service suppliers.
- Restrictions on the total value of service transactions or assets.
- Restrictions on the total number of service operations or the total quantity of service output.
- Restrictions on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ.
- Restrictions on or requirements for certain types of legal entity or joint venture for the supply of a service.
- Limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

National treatment means that foreign services and service suppliers are granted treatment no less favorable than that accorded to like national services and service suppliers. This can mean formally identical or formally different treatment—the key requirement is that it does not modify the conditions of competition in favor of services or service suppliers who are nationals instead of foreigners. National treatment can also cover both *de jure* and *de facto* discrimination—that is, even if a measure applies to foreigners and nationals it may still be discriminatory if its effect is to discriminate against foreign suppliers. However, national treatment does not require a Member to compensate for any inherent competitive disadvantage that results from the foreign character of the relevant service or service suppliers.

A key consideration in national treatment is whether the services or service suppliers are "like." The GATS, like other WTO agreements, does not define "like," and panels under the WTO dispute settlement system have tended to approach the issue of "likeness" on a case-by-case basis, taking into account, *inter alia*, consumer perceptions of the degree to which a particular good is like, and its substitutability.

WTO Members are free to make no commitment on national treatment or to provide partial national treatment if they list the measures they maintain that discriminate in favor of nationals in their schedule. Unlike market access, there is no specific list of the types of measures that have to be scheduled; Members must judge whether a measure breaches national treatment and therefore should be scheduled. A measure may not be considered discriminatory if it is genuinely open to both nationals and foreigners to fulfill it. For example, a requirement for a degree of proficiency in a certain language need not be discriminatory if it is genuinely possible for foreigners to be able to learn the language and achieve the required level of proficiency. Examples of the types of measures that would need to be listed in the schedule as limitations on national treatment include eligibility for subsidies reserved to nationals and the ability to lease or own land reserved to nationals.

What are the options in making commitments?

Contrary to perception, the GATS does not force privatization of any services. Whether to allow private—or foreign—provision of services remains a purely national decision. The GATS comes into play only once countries have decided to permit foreign private supply in their market and is concerned only with the treatment of foreign providers. The GATS also does not impede countries' ability to regulate the supply of services within their territories. GATS commitments cover only market access and measures that discriminate in favor of nationals. Countries retain flexibility to introduce any new regulatory measures that apply equally to foreigners and nationals, if these are transparent and on an MFN basis.

In making commitments, WTO Members have a number of choices:

- They can exclude an entire sector (health services) or parts of a sector (everything other than general nursing) from their commitments. WTO Members are free to define the sector as they wish—they can refer to a list developed for the GATS negotiations (the Services Sectoral Classification List), or to the United Nations Central Product Classification to which this GATS list refers, or they can use their own definitions.
- They can exclude some modes of supply. For example, a WTO Member may decide to permit its nationals to study abroad (mode 2) but not permit foreign universities to establish in its territory (mode 3).
- They can place limits on the "market access" they offer (for example, they can limit the number and type of foreign computer professionals and the activities in which they can engage).
- They can discriminate against foreign providers in favor of nationals (say, by placing additional conditions or requirements on foreign computer professionals, or restricting some activities or benefits to national computer professionals).
- They can discriminate among foreign suppliers (that is, they can give better treatment to suppliers from some countries) if they have an

MFN exemption for the relevant service. WTO Members had a one-off opportunity to claim exemptions from MFN at the time they joined the GATS.[4] Members that are party to regional trade agreements can also discriminate in favor of other members of those agreements.

- They can commit to providing less access than they currently actually provide (for example, a member may commit in the GATS to allowing 40,000 foreign professionals to provide services temporarily each year, but may in practice under its national law allow 100,000 foreign professionals to enter). Because a commitment is a binding guarantee of minimum treatment, WTO Members often commit to less than they currently offer to leave themselves room to maneuver (say, to change the national law to drop the number from 100,000 to 50,000). Many current GATS commitments represent significantly less openness than actually exists in the member concerned.
- They can commit to liberalize at a chosen future date to give themselves time to ensure that the necessary regulatory frameworks are in place (for example, they can commit to allowing foreign lawyers to work in their territory, but only from 2010). These are known as precommitments.
- Developing countries have added flexibility to liberalize fewer sectors and to attach conditions to access offered. And other members should facilitate their participation in trade, including liberalizing modes and sectors of interest to them, and should establish special contact points to provide information to developing country service suppliers.

The GATS negotiating process

The GATS negotiating process includes general negotiating proposals by WTO Members and request-offer negotiations.

Phase one: general negotiating proposals

In the first phase of the negotiations—roughly between their commencement on January 1, 2000, and the WTO Ministerial in Doha in 2002—a number of members tabled general proposals outlining their interests in the services negotiations. More than 120 proposals were tabled in all, and are available online at www.wto.org.

Phase two: requests and offers

Requests. Under request-offer negotiations, each WTO Member submits requests to its trading partners. These requests can be made to other members individually or to groups of members. While some countries tailor their requests to specific trading partners, others have submitted nearly identical general requests to a number of countries. Requests can take the form of:

- A request for the trading partner to make commitments in a new sector (a sector not already included in its schedule).

- A request to remove an existing restriction or to reduce its level of restrictiveness (for example, if a member has a foreign equity limitation of 49 percent in a given sector, another WTO Member may request that limit to be removed altogether—that 100 percent equity be allowed—or that it be raised to 75 percent).
- A request to remove an existing MFN exemption.
- A request to make an additional commitment in its schedule covering particular regulatory practices aimed at making sure that liberalization is effective. For example, additional commitments were used in the negotiations on telecommunications for countries to commit to providing an independent regulator for the sector.

Requests are communicated directly between the WTO Members concerned, not through the WTO Secretariat, so there is no central collection point for requests. It is thus not possible to know the exact number of requests or to have an overview of their content. Some WTO Members have made their requests—or summaries of their requests—public, but others have chosen not to. It is the decision of individual WTO Members whether to make their initial requests public.

Offers. In the next stage, WTO Members submit offers in response to all the requests they have received. Members usually prepare a single offer in response to all requests received. They may choose not to offer anything in response to some requests, or not to satisfy all points in some requests, and they are free to do so. The choice of what to offer is a decision of each WTO Member. Some members have already indicated that they will not be making requests or offers on particular sectors (notably, health and education) in the current round of negotiations.

For the sake of clarity, WTO Members have submitted their initial offers in the form of a revision to their existing schedule of commitments, with changes indicated in strike-out and bold.

While requests are addressed bilaterally to negotiating partners, offers are traditionally circulated multilaterally (to all WTO Members). This is because, under the MFN rule, access offered to one WTO Member is automatically offered to all WTO Members. Given this, the offer is shown to all WTO Members, and even Members that did not initially make any requests can consult and negotiate with a Member that has submitted an offer. Equally, some Members may choose not to submit their own requests, judging that their interests are covered by others' requests and knowing that whatever those other Members manage to negotiate in terms of access will automatically be extended to them under the MFN rule.

The submission of offers can also trigger further requests, including by countries that had not yet submitted requests, and then the process continues and becomes a succession of requests and offers. As with most types of negotiations, initial requests can be ambitious and initial offers more minimal, with a compromise emerging in the process of negotiation.

The unfinished rules agenda under the GATS

The GATS is an unfinished agreement, with key areas left outstanding at the end of the Uruguay Round. These mainly concern general disciplines, or rules, covering four areas: a possible emergency safeguard (Article X); government procurement (Article XIII); possible disciplines on trade-distorting subsidies (Article XV); and possible disciplines on certain types of domestic regulation (Article VI.4). These negotiations are all due to be concluded prior to the conclusion of the negotiations on specific commitments.

Emergency safeguard negotiations (Article X)

A safeguard is a mechanism that allows WTO Members to temporarily suspend their commitments in the event of unforeseen and negative consequences for domestic suppliers. While such mechanisms exist for goods trade, there is currently no safeguard for services. GATS Article X mandates negotiations on the question of an emergency safeguard. Negotiations have been under way since 1996, but the original deadline has been extended several times.

Progress in the negotiations has been slow because of differences of view among WTO Members on the desirability of a safeguard and because of technical and conceptual difficulties in developing a safeguard for services. The nature and coverage of any safeguard mechanism is still to be determined. A number of developing countries have indicated that the quality of their offers will be influenced by whether or not any commitments they ultimately undertake would have access to an emergency safeguard.

Government procurement (Article XIII)

Government procurement is defined in the GATS as "the procurement by governmental agencies of services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the supply of services

for commercial sale." It is not subject to MFN (WTO Members are not bound to treat all other WTO Members equally), and commitments on market access and national treatment in a sector do not cover government procurement.

GATS Article XIII mandates negotiations on government procurement in services within two years of the entry into force of the WTO Agreement (within two years of January 1, 1995). However, to date there has been relatively limited interest in these negotiations for a number of reasons, including the greater priority placed by a number of WTO Members on concluding the safeguard negotiations and the parallel efforts to develop a multilateral agreement on transparency in government procurement applying to both goods and services.

Subsidies (Article XV)

There are currently no specific disciplines on subsidies under the GATS (although discriminatory subsidies should be scheduled as limitations on national treatment where specific commitments are made), and understanding of the issue is still at an early stage. This is reflected in the language of Article XV, which states that members recognize that, in certain circumstances, subsidies may have distortive effects on trade in services. Article XV mandates members to enter negotiations with a view to developing the necessary multilateral disciplines to avoid such trade-distortive effects of subsidies.

Article XV does not condemn subsidies. Indeed, it notes that the negotiations shall recognize the role of subsidies in relation to the development programs of developing counties and take into account the needs of members, particularly developing countries, for flexibility in this area.

Article XV also mandates that members shall exchange information concerning all subsidies related to trade in services that they provide to their domestic service suppliers. In 1996 a questionnaire asked WTO Members to identify any subsidies they thought were relevant. However, the survey has had relatively few responses, in part because members have experienced difficulty in identifying what might constitute a subsidy, and a subsidy with trade-distortive effects, in services.

Certain types of domestic regulation (Article VI.4)

Article VI.4 mandates the development of any necessary disciplines to ensure that nondiscriminatory measures (which are not restrictions on market access) relating to qualification requirements and procedures, technical standards, and licensing requirements do not constitute unnecessary barriers to trade in services. That is, these measures should be:

- Based on objective and transparent criteria, such as competence and ability to supply the service.
- Not more burdensome than necessary to ensure the quality of the service.
- In the case of licensing procedures, not in themselves a restriction on the supply of a service.

These disciplines do not exist yet. Progress on Article VI.4 has been very slow and there are different views among WTO Members on the sort of disciplines that should be developed. Some Members argue that any disciplines should focus on increasing transparency and that any "necessity test" is itself not necessary. These Members have expressed concern that a necessity test could allow other WTO Members to "second-guess" the decisions of national regulators. However, others argue that other WTO Members should be free to challenge requirements they feel are unnecessarily trade-restrictive and be able to suggest other—equally effective and reasonably available but less trade-restrictive—ways of achieving the same objective.

Appendix 7

Summary of preference margins by country for agricultural products, 2003

Country	Harmonized System chapter	Preference margin (%)	Product descriptions
Australia	05	5	Products of animal origin, not elsewhere specified or included
	07	5	Edible vegetables and certain roots and tubers
	08	5	Edible fruit and nuts; peel of citrus fruit or melons
	11	5	Products of the milling industry; malt; starches; insulin; wheat gluten
	12	5	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal plants; straw and fodder
	13	5	Vegetable plaiting materials; vegetable products not elsewhere specified or included
	17	5	Sugars and sugar confectionery
	19	5	Preparations of cereals, flour, starch, or milk; pastry cooks' products
	20	5	Preparations of vegetables, fruit, nuts or other parts of plants
	22	5	Beverages, spirits and vinegar
Canada	02	11	Meat and edible meat offal
	04	11	Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included
	06	12.5–16	Live trees and other plants; bulbs, roots, and the like; cut flowers and ornamental foliage
	07	11–19.6	Edible vegetables and certain roots and tubers
	08	12.5	Edible fruit and nuts; peel of citrus fruit or melons

Country	Harmonized System chapter	Preference margin (%)	Product descriptions
Canada *(continued)*	15	11	Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes
	16	12.5	Preparations of meat
	17	12.5	Sugars and sugar confectionery
	19	14.5	Preparations of cereals, flour, starch, or milk; pastry cooks' products
	20	11.5–17	Preparations of vegetables, fruit, nuts, or other parts of plants
	21	12.5	Miscellaneous edible preparations
	22	16	Beverages, spirits and vinegar
	24	12.5–13	Tobacco and manufactured tobacco substitutes
European Union	20	24–40	Preparations of vegetables, fruit, nuts, or other parts of plants
	22	32	Beverages, spirits and vinegar
	24	26–74.9	Tobacco and manufactured tobacco. Substitutes
United States	04	19–25.0	Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included
	07	20–24.3	Edible vegetables and certain roots and tubers
	08	28–29.8	Edible fruit and nuts; peel of citrus fruit or melons
	15	18–19.1	Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal or vegetable waxes
	17	18.3	Sugars and sugar confectionery
	20	22.4–29.8	Preparations of vegetables, fruit, nuts, or other parts of plants
	21	20–30.6	Miscellaneous edible preparations
	22	35	Beverages, spirits and vinegar
	24	18.1–46.9	Tobacco and manufactured tobacco substitutes

Source: WTO 2003a.

Appendix 8

WTO disputes with developing country complainants

	WTO dispute number	Disputes title	Year	Complainant	Respondent
1	1	Prohibition of imports of polyethylene and polypropylene	1995	Singapore	Malaysia
2	2	Standards for reformulated and conventional gasoline	1995	Venezuela	U.S.
3	4	Standards for reformulated and conventional gasoline	1995	Brazil	U.S.
4	12	Trade description of scallops	1995	Peru	EC
5	14	Trade description of scallops	1995	Chile	EC
6	16	Importation, sale, and distribution of bananas	1995	Guatemala	EC
7	16	Importation, sale, and distribution of bananas	1995	Honduras	EC
8	16	Importation, sale, and distribution of bananas	1995	Mexico	EC
9	17	Import duties on rice	1995	Thailand	EC
10	19	Import regime for automobiles	1995	India	Poland
11	22	Measures affecting desiccated coconut	1995	Philippines	Brazil
12	23	Antidumping investigation concerning certain oil country tubular goods	1996	Mexico	Venezuela
13	24	Quantitative restrictions on Costa Rican underwear	1996	Costa Rica	U.S.
14	25	Implementation of Uruguay Round commitments concerning rice	1996	Uruguay	EC
15	27	Regime for the importation, sale, and distribution of bananas	1996	Ecuador	EC
16	27	Regime for the importation, sale, and distribution of bananas	1996	Guatemala	EC
17	27	Regime for the importation, sale, and distribution of bananas	1996	Honduras	EC

	WTO dispute number	Disputes title	Year	Complainant	Respondent
18	27	Regime for the importation, sale, and distribution of bananas	1996	Mexico	EC
19	29	Restrictions on imports of textile and clothing products	1996	Hong Kong (China)	Turkey
20	30	Measures affected desiccated coconut and coconut milk powder	1996	Sri Lanka	Brazil
21	32	Measures affecting imports of women's and girls' wool coats	1996	India	U.S.
22	33	Measures affecting imports of woven wool shirts and blouses	1996	India	U.S.
23	34	Restrictions on imports of textile and clothing products	1996	India	Turkey
24	35	Export subsidies in respect of agricultural products	1996	Argentina	Hungary
25	35	Export subsidies in respect of agricultural products	1996	Thailand	Hungary
26	47	Restrictions on imports of textile and clothing products	1996	Thailand	Turkey
27	49	Antidumping investigation on fresh and chilled tomatoes from Mexico	1996	Mexico	U.S.
28	58	Import prohibition of shrimp and shrimp products	1996	India	U.S.
29	58	Import prohibition of shrimp and shrimp products	1996	Malaysia	U.S.
30	58	Import prohibition of shrimp and shrimp products	1996	Pakistan	U.S.
31	58	Import prohibition of shrimp and shrimp products	1996	Thailand	U.S.
32	60	Antidumping investigation on imports of portland cement from Mexico	1996	Mexico	Guatemala
33	61	Import prohibition of certain shrimp and shrimp products	1996	Philippines	U.S.
34	69	Measures affecting importation of certain poultry products	1997	Brazil	EC
35	70	Measures affecting the export of civilian aircraft	1997	Brazil	Canada
36	71	Measures affecting the export of civilian aircraft	1997	Brazil	Canada
37	78	Safeguard measure against imports of broom and corn brooms	1997	Colombia	U.S.
38	89	Imposition of antidumping duties on imports of color television receivers from the Republic of Korea	1997	Korea, Rep.	U.S.
39	96	Quantitative restrictions on imports of agricultural textile and industrial products	1997	EC	India
40	97	Countervailing duty investigation of imports of salmon from Chile	1997	Chile	U.S.
41	99	Antidumping duty on dynamic random access memory semiconductors (DRAMS of one megabyte or above) originating from the Republic of Korea	1997	Korea, Rep.	U.S.

	WTO dispute number	Disputes title	Year	Complainant	Respondent
42	105	Regime for the importation, sale, and distribution of bananas	1997	Panama	EC
43	111	Tariff rate quota for imports of groundnuts	1998	Argentina	U.S.
44	112	Countervailing duty investigation against imports of buses from Brazil	1998	Brazil	Peru
45	122	Antidumping duties on angles, shapes, and sections of iron or nonalloy steel and H-beams	1998	Poland	Thailand
46	123	Safeguard measures on imports of footwear	1998	Indonesia	Argentina
47	134	Measures affecting import duties on rice	1998	India	EC
48	140	Antidumping measures on imports of unbleached cotton fabrics from India	1998	India	EC
49	141	Antidumping measures on imports of cotton-type bed-linen from India	1998	India	EC
50	143	Measure affecting import duty on wheat from Hungary	1998	Hungary	Slovak Rep.
51	148	Measure affecting import duty on wheat from Hungary	1998	Hungary	Czech Rep.
52	154	Measures affecting differential and favorable treatment of coffee	1998	Brazil	EC
53	156	Definitive antidumping measure regarding grey Portland cement from Mexico	1999	Mexico	Guatemala
54	158	Regime for the importation, sale, and distribution of bananas (II)	1999	Guatemala	EC
55	158	Regime for the importation, sale, and distribution of bananas (II)	1999	Mexico	EC
56	158	Regime for the importation, sale, and distribution of bananas (II)	1999	Panama	EC
57	158	Regime for the importation, sale, and distribution of bananas (II)	1999	Honduras	EC
58	158	Regime for the importation, sale, and distribution of bananas (II)	1999	Ecuador	EC
59	159	Safeguard measure on imports of steel products	1999	Czech Rep.	Hungary
60	168	Antidumping duties on import of certain pharmaceutical products from India	1999	India	South Africa
61	179	Antidumping measures on stainless steel plate in coils and stainless steel sheet and strip from the Republic of Korea	1999	Korea, Rep.	U.S.
62	181	Safeguard measure on imports of plain polyester filaments from Thailand	1999	Thailand	Colombia
63	182	Provisional antidumping measure on cement from Mexico	1999	Mexico	Ecuador
64	185	Antidumping measures on pasta from Costa Rica	1999	Costa Rica	Trinidad and Tobago

	WTO dispute number	Disputes title	Year	Complainant	Respondent
65	187	Provisional antidumping measure on imports of macaroni and spaghetti from Costa Rica	2000	Costa Rica	Trinidad and Tobago
66	188	Measures affecting imports from Honduras and Colombia	2000	Colombia	Nicaragua
67	190	Transitional safeguard measures on certain imports of woven fabrics of cotton and cotton mixtures originating in Brazil	2000	Brazil	Argentina
68	191	Definitive antidumping measure on cement from Mexico	2000	Mexico	Ecuador
69	192	Transitional safeguard measure on combed cotton yarn from Pakistan	2000	Pakistan	U.S.
70	201	Measures affecting imports from Honduras and Colombia	2000	Honduras	Nicaragua
71	202	Definitive safeguard measures on imports of circular welded carbon quality pipe from the Republic of Korea	2000	Korea, Rep.	U.S.
72	205	Import prohibition on canned tuna with soybean oil	2000	Thailand	Egypt
73	206	Antidumping and countervailing measures on steel plate from India	2000	India	U.S.
74	207	Price band system and safeguard measures relating to certain agricultural products	2000	Argentina	Chile
75	208	Antidumping duty on steel and iron pipe fittings	2000	Brazil	Turkey
76	209	Measures affecting soluble coffee	2000	Brazil	EC
77	211	Definitive antidumping measures on rebar from Turkey	2000	Turkey	Egypt
78	215	Antidumping measures regarding polypropylene resins from the Republic of Korea	2000	Korea, Rep.	Philippines
79	216	Provisional antidumping measure on electric transformers	2001	Brazil	Mexico
80	217	Continued Dumping andSubsidy Offset Act of 2000	2001	Brazil	U.S.
81	217	Continued Dumping andSubsidy Offset Act of 2000	2001	Chile	U.S.
82	217	Continued Dumping andSubsidy Offset Act of 2000	2001	India	U.S.
83	217	Continued Dumping andSubsidy Offset Act of 2000	2001	Indonesia	U.S.
84	217	Continued Dumping andSubsidy Offset Act of 2000	2001	Korea, Rep.	U.S.
85	217	Continued Dumping andSubsidy Offset Act of 2000	2001	Thailand	U.S.
86	218	Countervailing duties on certain carbon steel products from Brazil	2001	Brazil	U.S.
87	219	Antidumping duties on malleable cast iron tube or pipe fittings from Brazil	2001	Brazil	EC

	WTO dispute number	Disputes title	Year	Complainant	Respondent
88	220	Price band system and safeguard measures relating to certain agricultural products	2001	Guatemala	Chile
89	222	Export credits and loan guarantees for regional aircraft	2001	Brazil	Canada
90	224	U.S. Patents Code	2001	Brazil	U.S.
91	226	Provisional safeguard measure on mixed edible oils	2001	Argentina	Chile
92	227	Taxes on cigarettes	2001	Chile	Peru
93	228	Safeguard measures on sugar	2001	Colombia	Chile
94	229	Antidumping duties on jute bags from India	2001	India	Brazil
95	230	Safeguard measures and modification of schedules for sugar	2001	Colombia	Chile
96	231	Trade description of sardines	2001	Peru	EC
97	232	Measures affecting the import of matches	2001	Chile	Mexico
98	233	Measures affecting the import of pharmaceutical products	2001	India	Argentina
99	234	Continued Dumping andSubsidy Offset Act of 2000	2001	Mexico	U.S.
100	235	Safeguard measure on imports of sugar	2001	Poland	Slovak Rep.
101	237	Certain import procedures for fresh fruit	2001	Ecuador	Turkey
102	238	Definitive safeguard measures on imports of preserved peaches	2001	Chile	Argentina
103	239	Certain measures regarding antidumping methodology	2001	Brazil	U.S.
104	240	Import prohibition on wheat and wheat flour	2001	Hungary	Romania
105	241	Definitive antidumping duties on poultry from Brazil	2001	Brazil	Argentina
106	242	Generalized System of Preferences	2001	Thailand	EC
107	243	Rules of origin for textiles and apparel products	2002	India	U.S.
108	246	Conditions for granting tariff preferences to developing countries	2002	India	EC
109	250	Equalizing excise tax imposed by Florida on processed orange and grapefruit products	2002	Brazil	U.S.
110	251	Definitive safeguard measures on imports of certain steel products	2002	Korea, Rep.	U.S.
111	252	Definitive safeguard measures on imports of certain steel products	2002	China	U.S.
112	255	Tax treatment on certain imported products	2002	Chile	Peru
113	256	Import ban on pet food from Hungary	2002	Hungary	Turkey

	WTO dispute number	Disputes title	Year	Complainant	Respondent
114	259	Definitive safeguard measures on imports of certain steel products	2002	Brazil	U.S.
115	261	Tax treatment on certain products	2002	Chile	Uruguay
116	263	Measures affecting imports of wine	2002	Argentina	EC
117	266	Export subsidies on sugar	2002	Brazil	EC
118	267	Subsidies on upland cotton	2002	Brazil	U.S.
119	268	Sunset review of antidumping measures on oil country tubular goods from Argentina	2002	Argentina	U.S.
120	269	Customs classification of frozen boneless chicken	2002	Brazil	EC
121	270	Certain measures affecting the importation of fresh fruit and vegetables	2002	Philippines	Australia
122	271	Certain measures affecting the importation of fresh pineapple	2002	Philippines	Australia
123	272	Provisional antidumping duties on vegetable oils from Argentina	2002	Argentina	Peru
124	274	Definitive safeguard measures on imports of certain steel products	2002	Taiwan (China)	U.S.

Source: Horn and Mavroidis 2003.

Notes

Chapter 1

1. For a good overview, see Anderson (2004).

2. This estimate is based on the following assumptions: developed country agricultural tariffs of no more than 10 percent and a target average of 5 percent; with tariffs on manufactures to no more than 5 percent and a target average of 1 percent; developing country ceiling of 15 percent and a target average of 10 percent for agriculture, with a ceiling of 10 percent and a target average of 5 percent for manufacturing; complete elimination of export subsidies, specific tariffs, tariff-rate quotas, and antidumping penalties.

3. The concept of nonreciprocity was first established in Part IV of the GATT in 1964, exempting developing country contracting parties from making reciprocal tariff concessions.

4. Both the Uruguay Round Agreement on Agriculture and the GATS mandated the start of further market access negotiations by January 1, 2000.

5. "Modalities" refers to the approach, or methodology, to be followed in negotiations on expanded market access and subsidy reductions. Commonly, WTO Members have used formulas, where, for example, they agree to reduce subsidies on x percent of products by y percent, and to cut tariffs on b percent of products by c percent.

6. For a useful overview of the proposals and discussions at the Cancún Ministerial, see UNCTAD (2003e).

7. The G-20 comprised Argentina, Bolivia, Brazil, Chile, China, Colombia, Costa Rica, Cuba, Ecuador, El Salvador, Guatemala, India, Mexico, Pakistan, Paraguay, Peru, the Philippines, South Africa, Thailand, and Venezuela. El Salvador left the group during the Cancún Ministerial, while Indonesia and Nigeria joined. Egypt and Kenya were not formal members but supported the G-20's position. Some countries later left the grouping—Colombia, Costa Rica, Ecuador, Guatemala, and Peru—while Tanzania and Zimbabwe have joined.

8. Members of the Cairns Group are Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, South Africa, Thailand, and Uruguay.

9. The G-33 comprises Antigua and Barbuda, Barbados, Belize, Botswana, Cuba, Dominican Republic, Grenada, Guyana, Haiti, Honduras, Indonesia, Jamaica, Kenya,

Mauritius, Mongolia, Nicaragua, Nigeria, Pakistan, Panama, Peru, the Philippines, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Tanzania, Trinidad and Tobago, Turkey, Uganda, Venezuela, Zambia, and Zimbabwe.

10. Under these arrangements, products from these countries enter developed country markets at tariffs lower than those applying to all other WTO Members, including many other developing countries. The higher the initial protection (tariff) in the developed country market for a particular product, the greater the practical value of the preference (see chapter 7).

11. A list of members of these groupings that are members or observers of the WTO is in appendix 2.

12. See WTO (2004d). See also UNCTAD (2004d) and the report of the United Nations Secretary-General to the 59th General Assembly on trade and development. The account in this section draws upon ICTSD Bridges July–August 2004. Details of the outcomes on individual issues are discussed in the body of the report and are not repeated at length here.

13. Trade promotion authority (TPA)—or "fast track"—confers upon the U.S. president the authority to negotiate international trade agreements and submit them to Congress under a procedural understanding that the agreements will be voted up or down, without amendment and within a certain time frame. TPA provides countries negotiating agreements with the U.S. with certainty that their carefully negotiated outcomes will not be renegotiated in the U.S. Congress, potentially undermining the balance reached. The current TPA, granted in August 2002, is due to expire on June 1, 2005, unless it is extended until June 1, 2007. An extension will be granted unless either the House of Representatives or the Senate adopts an "extension disapproval resolution."

Chapter 3

1. In fact, decoupling was not completely new. The pre-2003 CAP regime already had a decoupling component in cereals in the (admittedly limited) sense that area-based subsidies were not crop-specific so that farmers could change the production mix between the various kinds of cereals with no consequences in terms of subsidies. This was not the case for the head-based subsidies (specific to beef, cows, suckling cows, sheep, and so on) but these subsidies were constrained by ceilings on the number entitled to receive subsidies.

2. There is a tiny decline (less than 1 percent) of the current intervention price in cereals due to a change in a procedural rule (a 50 percent cut in monthly increments).

3. Only one major livestock (beef) may face a less insignificant price change (6 percent) if all the EU 15 member states use the full possibility of decoupling (minimal decoupling would bring only a roughly 1 percent price change) (FAPRI 2003; OECD 2004b).

4. No other new measure of importance has been taken for the other dairy products. The price of another key dairy product (skimmed milk powder) will be reduced by 15 percent as agreed in the so-called "Agenda 2000." The target price for milk will be abolished, but milk quotas will be maintained until the 2014–15, and increased by 0.5 percent in 2006, 2007, and 2008, as agreed in Agenda 2000.

5. These OECD estimates of the impact of the 2003 reform do not change much when one compares maximum and minimum decoupling.

6. Under this agreement, global trade in clothing was subject to quotas negotiated between countries. The Uruguay Round Agreement on Textiles and Clothing gradually phases out this system of quotas by January 1, 2005. See chapter 5.

7. Compared with the pre-2003 CAP, the 2003 reform is projected to have a substantial positive welfare impact on the new members, but a (very modest) negative impact on the welfare of the rest of world (Jensen and Frandsen 2003).

8. A further issue, liberalization and food safety, is discussed in chapter 6, which looks at the Agreement on Sanitary and Phytosanitary Measures from the perspective of developing countries.

9. The relatively high average level of food security (4.6) for net-food-importing developing countries suggests that the list reflects the negotiating skills of some countries more than the reality. This experience suggests that WTO negotiators should refrain from generating subgroups of loosely defined countries during negotiations.

10. Barbados, Botswana, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Indonesia, Israel, Malaysia, Morocco, Namibia, Nicaragua, Panama, the Philippines, the Republic of Korea, South Africa, Thailand, Tunisia, and Uruguay.

11. Under the UAA special safeguard, additional duties can be triggered automatically if import volumes rise above a certain level, or if prices fall below a certain level, and the importing country does not need to show that import increases have seriously injured its producers.

12. The EU and the U.S. may indeed try to make a good deal for themselves by trading concessions on these subsidies now (which are losing importance because of increasing world prices in any case) for valuable concessions in other topics.

13. Consumption subsidies are already available under the WTO, but providing them through producer subsidies for goods that are barely traded is generally not permitted because developing countries registered no farm subsidies during the Uruguay Round and are bound by a commitment not to increase subsidies above historical levels. The delivery of such subsidies through producers may be desirable for reasons of administrative simplicity.

Chapter 4

1. The WTO Services Sectoral Classification List (MTN.GNS/W120—known as "W/120") used for the GATS negotiations identifies 12 main service sectors and more than 160 subsectors: business services (including a range of professional services), construction services, communication services (including telecommunications and audiovisual services), distribution services, education, environmental services, financial services, health and social services, personal and recreational services, and tourism and transport services (including air, maritime, rail, and road).

2. These figures are derived from the balance of payments, which covers transactions between residents and nonresidents and thus excludes important services flows under GATS commercial presence and, to some extent, mode 4. Balance of payments categories for services also differ from, and are less detailed than, the GATS sectoral classifications.

3. An explanation of the structure and operation of the GATS and GATS negotiations is in appendix 5.

4. Under the GATS, WTO Members can choose which service sectors to open and under what conditions. Commitments are guaranteed minimum treatment—a WTO Member who has made a commitment for a given service is free to offer better treatment at any time, but it cannot offer worse. Commitments need not reflect the level and type of access currently provided—a WTO Member may commit to less liberal access to have room to maneuver. (See appendix 5.)

5. While this is a general pattern, in certain sectors (such as cross-border trade in financial services audiovisual services) developing or least developed countries have undertaken more liberal commitments than developed countries (World Bank 2002).

6. As noted in the introduction, in contrast to the GATT, nondiscrimination is not an absolute obligation under the GATS. WTO Members had a one-off opportunity to list

exemptions from MFN at the time they joined the agreement. They can also limit national treatment (appendix 5).

7. The EU (extra-EU trade) is the number one services exporter and accounts for 27.1 percent of the global market. The U.S. is second, with 21.5 percent, and Japan third, at 5.3 percent. Other developed countries in the top 10 are Canada (number 6 at 3.1 percent) and Switzerland (number 7 at 2.4 percent).

8. There is currently no consensus among WTO Members on whether services delivered over electronic networks are covered by GATS mode 1 (cross-border trade) or mode 2 (consumption abroad). Given that mode 2 commitments tend to be more liberal than mode 1, the distinction is not without significance.

9. While mode 4 is limited to temporary movement by persons supplying services, remittance figures include money sent home from workers in manufacturing and agriculture and by permanent migrants. Further, remittance figures do not include money sent by persons who have been abroad for less than one year, while these people can fall under mode 4. Remittance figures may thus both underestimate and overestimate mode 4 trade. No breakdown between mode 4 and other remittances is currently possible from existing data.

10. Mode 4 often cuts across several existing visa categories, and relevant numbers are hidden within larger aggregates. Definitions of relevant categories in visa schemes vary between countries.

11. Data collection is limited to a few countries. In 2000–01, 5,967 non-EU nurses were admitted to the U.K. Nursing and Midwifery Council. Leading sources were the Philippines (3,396) and South Africa (1,086) (UKCC 2002). In the U.S., 3.9 percent of registered nurses were trained abroad, with the major sources being the Philippines (43 percent), Canada (16.1 percent), the United Kingdom (7.8 percent), and India (9.6 percent). In 2001, 13,536 Philippine nurses left for foreign jobs (OECD 2002d).

12. Germany's Green Card program aimed to recruit 20,000 non-EU ICT specialists, with a university degree in an ICT-related field for a promised annual salary of €51,000, on five-year permits. In January 2003, 60,000 applications had been received and 13,600 cards issued. The program ended in July 2003. ICT professionals have now been removed from the UK Shortage Occupation List, which allows for accelerated recruitment of foreign workers (OECD 2004a).

13. Temporary programs for seasonal workers, primarily in agriculture, have expanded considerably. In the UK, seasonal workers in agriculture numbered 25,000 in 2003; in Germany the figure was 278,000, and in Switzerland 55,000 (2001 figure). However, in the U.S., the numbers of seasonal agricultural workers (H2A visas) fell in 2001 (OECD 2004a).

14. This section draws upon McKinsey Global Institute (2003); "India's plan to beat the off-shoring backlash," *Financial Times,* 27 January 2004; Mattoo and Wunsch (2004).

15. These balance-of-payments figures for business services do not capture the full value of trade in outsourced services and should be treated as an approximation.

16. Privatization here refers to the entry of private sector finance—which may be domestic or foreign—while liberalization refers to the entry of foreign providers. In many developing countries the processes are simultaneous, as foreigners may be the largest available source of private capital.

17. Some important work is already under way. In addition to discussions of assessment of trade in services held as part of the negotiations at the WTO, a number of international organization are also beginning systematic research into developing country experience with services liberalization. See, in particular, UNCTAD 2004a.

18. In 26 American and Asian economies, telecommunications markets with competition were the only ones that consistently increased employment levels, while two-thirds of the countries with monopolies saw considerable declines in their telecommunications workforce (Petrazzini and Lovelock 1996). Competition can also increase employment in the incumbent—the Indian incumbent operator expanded its workforce over 1996–2000 as competition forced it to improve its marketing strategy, expand its network, and open thousands of public call offices all over India (World Bank 2002).

19. In the long run, increased returns to acquiring skills may encourage greater education and training, including through government provision (Winters 2003).

20. For example, it is estimated that about half of those admitted under the temporary high-skilled worker program remain in the U.S. as permanent residents (Lowell 2001). However, only a relatively small proportion of UK work permit holders seem to settle permanently—in 1998, 3,160 work permit holders settled, yet approximately 70,000–80,000 work permits are approved each year (United Kingdom Home Office 2001).

21. These sorts of provisions are included in the agreements between Ecuador and Spain and the Canadian Commonwealth, Caribbean, and Mexican Seasonal Agricultural Worker Programme.

22. A proposed scheme between the Dutch and Polish ministers of health aims to prepare Polish nurses to be employed within the Dutch healthcare system for a maximum period of two years and to facilitate their return and reintegration into the Polish system after their return (OECD, IOM, World Bank 2004).

23. See WTO document S/CSS/W/12, dated 24 November 2000.

24. The GATS already requires establishment of enquiry points at the national level. However, these are single points for all services and, for that reason, have not been very effective in providing timely and specific information.

25. This is a form of the negative-list approach—where all services are deemed to be liberalized unless explicitly specified otherwise—which is increasingly used for services in RTAs. By contrast, the GATS uses a positive-list approach, where only those sectors explicitly included in the commitments are liberalized and no commitments are undertaken for sectors not included.

26. Equally, some OECD countries are not seeking commitments from Least Developed Countries in the current round, while others have simply made a general request that they consider market opening in a range of sectors.

27. It must be acknowledged that the absence of GATS commitments may affect the ability of the poorest developing countries to attract FDI, by reducing the certainty for foreign investors that government policy will not be subject to rapid change. However, this is likely to be only one factor in investment decisions in the poorest developing countries.

28. For example, the U.S., Korea, and Estonia specify that their commitments on sewerage services are limited to services purchased by private industry, while the EU has listed a general carve-out for public utilities.

29. Under these arrangements a private supplier builds and operates the facilities, which are then transferred back to the government after a defined period.

30. This uses three broad categories according to the kind of economic activity undertaken: pollution management group; cleaner technologies and products group; and resources management group (OECD 2001c).

31. This proposes two categories: environmental infrastructure services—such as water supply, wastewater treatment, and solid waste management; and noninfrastructure, commercial environmental services—such as air and water pollution control, including river restoration and remediation and clean-up of soil. The latter also includes services that

are necessary as direct inputs, such as consulting, design and engineering, construction and installation, analysis and monitoring, and certification services (UNCTAD 2003a).

Chapter 5

1. WTO Members bind—that is, they commit to providing—tariffs at a certain level (such as 20 percent) for products identified using the Harmonized System of tariff lines, which classifies products at a range of levels of detail. A tariff binding means that a Member cannot raise the tariff above that level without paying compensation to affected trading partners. WTO Members often give themselves room to maneuver by committing to a bound rate (say, 20 percent) higher than the rate actually applied (say, 10 percent). Bindings can also be phased in, with reductions occurring over a number of years in order to reach the final bound level by a fixed date.

2. Note that these are all MFN tariffs; some middle-income and poorest developing countries may have reduced their tariffs further in the context of preferential trade agreements. However, such access is obviously not available to all other WTO Members, including all other developing countries.

3. These tariffs are zero for LDCs in the EU, U.S., and Canada; however, developing countries pay the MFN tariff.

4. Tariffs on cocoa exports have been eliminated for LDCs under the EU's Everything But Arms initiative, but this does not apply to large exporters such as Ghana and Côte d'Ivoire (UNCTAD 2003c).

5. Other developed countries, such as Australia, had unilaterally renounced the use of textile quotas.

6. Under the ATC, products are referred to as being "integrated," that is, they are brought under GATT rules, under which quotas are prohibited.

7. While this table includes agricultural exports, almost three-quarters of total LDC exports are accounted for by fuels, apparel, precious stones, and fish and fish products (WTO 2003a).

8. Whalley (2002) notes that tariffs, applying only to trade flows (the difference between domestic production and consumption), are narrowly based, compared with taxes applied to production or consumption taxes. Further, the distortions created by trade taxes render them inferior to other fiscal policy instruments.

9. Again, it is important to distinguish among markets for textiles—which include fibers, fabrics, and clothing. Developing countries are important exporters of natural fibers, but much textile production is capital-intensive and located in developed countries. While high-end clothing can be capital-intensive and congregate in clusters in developed countries (Emilia Romagna in Italy), the bulk of clothing remains labor-intensive and located in developed countries.

10. Other winners could be developing country exporters of natural fibers (Pakistan, South Africa) as demand expands. Agricultural subsidy reform could increase their gains (OECD forthcoming).

11. The vertical specialization index reveals the extent of international production networks in the industry by measuring the share of foreign value added in exports.

12. Calls for additional protection need to be seen in light of the fact that several developed countries still numbered among the dominant textiles and clothing exporters in 2002 (Kyvik Nordås 2004).

13. It should be noted that the Dominican Republic and El Salvador receive preferential access into the U.S. market under CAFTA, as does Mauritius into the EU under the

Cotonou Agreement. Pakistan receives preferential access into the EU related to efforts in combating drug trafficking.

14. This agreement was concluded subsequent to the round at the Singapore Ministerial Conference in 1996. There are currently 61 parties to the agreement, accounting for more than 95 percent of world trade in information technology products.

Chapter 6

1. Of the transition economies, Poland has been the major initiator (11 cases), followed by the Czech Republic (3 cases), with Slovenia and Bulgaria initiating 1 case each.

2. It should be noted that "voluntary" export restraints are banned under WTO rules.

3. The International Accreditation Forum (IAF), the International Laboratory Accreditation Cooperation (ILAC), and the ISO Committee on Conformity Assessment (ISO CASCO) are heading up a comprehensive initiative to develop international guidelines and standards to provide a foundation for communicating procedural requirements and for demonstrating competence. The IAF and ILAC are also developing mutual recognition agreements.

4. The examples in the box are drawn from more detailed OECD case studies on the impact of environmental standards on market access that are available at http://webdomino1.oecd.org/comnet/ech/tradeandenv.nsf. Useful UNCTAD case studies are available at http://r0.unctad.org/trade_env/test1/openF1.htm.

5. The problem is not simply entry into developed country markets. Poor information and lack of transparency as to standards and testing also hinder trade between developing countries.

6. Though government regulations relating to both product and process attributes are covered by the SPS and TBT Agreements, some countries have argued that where the process attributes are unrelated to the product attributes (that is, some aspect of the production process that has no impact on the composition of the final product) their coverage would imply a major intrusion by trade rules into domestic regulatory territory.

7. Some developing countries have proposed that a standard only be recognized as "international" under the SPS Agreement if a minimum percentage of countries have participated in its development and it has been adopted by consensus. Some commentators have queried whether this would ultimately be in these countries' interests, given that this additional stringency is likely to result in fewer international standards and thus a proliferation of the differing national standards—which the SPS Agreement was partially designed to address (Jensen 2002).

8. Of the 18 SPS dispute settlement cases, only 4 involve developing countries: 2 as a defendant (EC-India import restrictions 2002–07, U.S.-Mexico restrictions on live swine); 1 as a complainant (India-EC import duties on rice); and 1 as both parties (Thailand-Egypt restrictions on canned tuna).

9. Proposals to increase the effectiveness of the provisions in the TBT and SPS Agreements requiring increased assistance are discussed in chapter 11.

10. This section draws upon Josling (2003), World Bank (2003a), DFID (2002), and Rotherham (2003).

Chapter 7

1. India recently brought a dispute against an EU preference scheme arguing that, while the Enabling Clause permitted discrimination between developed and developing countries for the purposes of providing preferential access to the latter, it did not permit

discrimination among developing countries. The EU countered that the Enabling Clause was an exception to MFN and therefore nondiscrimination obligations did not apply. The Panel agreed with India (WTO 2003e). However, the Appellate Body found that the Enabling Clause is an exception to MFN, and that differentiation is not discrimination to the extent that it is assessed according to an objective standard (see WTO 2004e).

2. In this way preferences also differ from preferential free trade agreements (FTAs) where market access is offered among signatories on a reciprocal basis. Further, FTAs must cover "substantially all trade," while preferences can be limited in their product coverage. FTAs are discussed further in chapter 13. However, as discussed below, the foregoing does not imply there is no "conditionality." In practice preference schemes have often been conditional on "performance standards" by the beneficiary countries.

3. AGOA also seems to have served as a catalyst for the general expansion of other, dutiable textile and apparel exports from Africa (Garay and Cornejo 2002).

4. Cumulation allows inputs from specified countries to be treated as coming from the preference-receiving countries (inputs from other countries in a given grouping can be used without changing the origin of the product).

5. Preferences under the Cotonou (ACP) conventions are an exception, because that is a formal treaty that constrains unilateral actions.

6. Chapter 3 on agriculture notes that the value of preferences can be less than assumed, as developing countries gaining preferential access to the protected market find themselves trying to compete against heavily subsidised domestic producers in a glutted market.

7. For recent proposals for an adjustment facility tied to the implementation of a Doha Round set of reforms, see Commonwealth Secretariat (2004), Hoekman (2004), Page and Kleen (2004), and Winters (2004a).

8. These include, for example, increased funding for multilateral risk insurance agencies to partially cover noncommercial risk in LDCs; standard noncommercial risk insurance policies for LDCs; pooling the capacity of noncommercial risk insurers from developed countries in specific public-private partnerships in developing countries; project-related subsidies to cover noncommercial risks (Mistry and Olesen 2003).

9. See Rodriguez-Clare (2004), Hoekman and Javorcik (2004), and Hoekman, Maskus, and Saggi (2004) for more discussion.

Chapter 8

1. There have been a number of analyses and suggestions developed in the literature on criteria to be used to determine inclusion of subjects on the WTO agenda. Stiglitz and Charlton (2004) argue that issues should be included on the agenda of a development round only if they score highly on three criteria: the relevance of the issue to trade flows; its development friendliness; and the existence of a rationale for collective action. See Finger (2002), Maskus (2002), and Bagwell and Staiger (2003) for additional argument and suggestions.

Chapter 9

1. For example, national enforcement (or nonenforcement) of antitrust laws could impede effective market entry (contestability of the market) by foreign suppliers. That is, private business practices (abuse of dominance) might nullify the expected benefits of negotiated trade liberalization commitments. However, market access concerns were largely abandoned in the course of the WTO discussions—see Hoekman and Saggi (2004) for a fuller discussion.

2. All of the excluded Singapore issues have been the subject of analyses that use these criteria. See World Bank (2003a) on investment; Evenett (2003) on transparency in

government procurement; Hoekman and Saggi (2004) on competition policy; and Maskus (2000), Winters (2003), and Stiglitz and Carleton (2004) on all three.

3. The existing plurilateral Agreement on Government Procurement covers both market access and transparency. The transparency provisions mainly emphasize publication of tenders and notification of regulations to the WTO; ex post norms are relatively weak. This agreement currently has 26 members: Austria, Belgium, Canada, Denmark, EU, Finland, France, Germany, Greece, Hong Kong (China), Ireland, Israel, Italy, Japan, Liechtenstein, Luxembourg, Netherlands, Norway, Portugal, the Republic of Korea, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the U.S. China, Iceland, the Kyrgyz Republic, Latvia, Panama, and Taiwan (China) are negotiating accession, in some cases as part of WTO accession, but the current membership is limited to high-income countries.

4. The WCO's International Convention on the Simplification and Harmonization of Customs Procedures—the Kyoto Convention—comprises a set of principles and 31 annexes that lay out standards and best practices for customs procedures and related arrangements.

5. "Concessions" are something of a misnomer, as what is being exchanged are things that it is in a country's own interest to do in any event.

Chapter 10

1. On the negotiating history of the TRIPS Agreement, see UNCTAD and ITCSD (2003).

2. While TRIPS essentially codified a number of preexisting treaties of the World Intellectual Property Organization (WIPO), there are important differences between the WIPO Paris Convention on Industrial Property and TRIPS. Unlike TRIPS, the WIPO treaty allows countries considerable discretion to exempt a range of subject matter from patent protection, and many countries had excluded inventions relating to public health. The Paris Convention also affords governments greater flexibility in requiring the compulsory license of patents. Not all countries were signatories to the Paris Convention (Lehman 2002).

3. For a more detailed analysis of these provisions, see UNCTAD-ICTSD (2003).

4. This section draws on Brown (2003).

5. This option is not wholly unrealistic, however. The Indian drugmaker Cipla is currently exploring the possibility of investing in Bangladesh, precisely to take advantage of Bangladesh being an LDC and not subject to the 2005 deadline.

6. See Dispute between European Communities and its Member States and Canada: Patent Protection of Pharmaceutical Products, WT/DSB114/R, dated 17 March 2000.

7. The Doha Declaration referred to a very precise problem—the "difficulty in making effective use of compulsory licensing under the TRIPS Agreement."

8. These are Hong Kong (China); Israel; Kuwait; Macao (China); Mexico; Qatar; the Republic of Korea; Singapore; Taiwan (China); Turkey; and United Arab Emirates.

9. Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the U.K., and the U.S.

10. For a detailed analysis of the Canadian and U.S. practice of compulsory licensing, see Reichman and Hasenzahl (2002a, 2002b) and UNCTAD-ICTSD (2003).

11. There is a clear market failure for drugs in developing countries. The hope that IPR protection would provide a financial incentive to drug firms to invest in drugs for tropical diseases has not materialized; during the last decade, research and development for developing country diseases has declined rather than increased. In 1975–99 only 1 percent of 1,191 new drugs approved for marketing were specifically indicated for a tropical disease. Poor countries do not constitute a market capable of inducing patent-driven investment

(Lehman 2002). The global market for pharmaceuticals was estimated at $406 billion in 2002, with the U.S., EU, and Japan accounting for 80 percent of this market and the rest of the world combined for only 20 percent (IMS Health 2001).

12. Escudero (2001) points out that wines have even stronger protection than spirits through protection against homonymous indications (TRIPS Article 23.3).

13. This section draws extensively on Maskus (2003).

14. See Maskus (2000) for evidence in Lebanon and Maskus, Dougherty, and Mertha (1998) for China.

15. Put in more technical terms, firms availing themselves of a GI may have incentives to cheat on its reputation individually, with a joint "prisoner's dilemma" outcome of eroded quality over time. The evident solution to this free-riding is a coordinated strategy within producer coalitions or associations that provides implicit or explicit punishments to defectors. Such associations may themselves be exclusionary, of course.

Chapter 11

1. The ability to provide such subsidies is of course constrained by lack of resources within countries. The need for assistance to help developing countries manage adjustment is discussed in chapter 12.

2. It should be noted, however, that Nepal, in its protocol of accession to the WTO, secured a commitment from Japan to provide technical assistance on the implementation of the TBT Agreement. WTO Members also committed to provide Nepal with technical assistance for the implementation of the SPS, TRIPS, and Customs Valuation Agreements.

3. The absence of requests for assistance under the existing TBT provisions should be analyzed and better understood in this regard. One reason is likely to be that governments know there are very few if any resources available and therefore approach bilateral donors directly.

4. http://www.standardsfacility.org/.

5. See, for example, Stevens (2002, 2003), Prowse (2002), Wang and Winters (1999), Hoekman, Michalopoulos, and Winters (2003), Hoekman (2004), Messerlin (2003), Mattoo and Subramanian (2004), and Page and Kleen (2004).

Chapter 12

1. For example, the International Task Force on Commodity Risk Management seeks to establish market-based price insurance schemes that would reduce the price risk that farmers (especially the poor) have to shoulder in exporting cash crops.

2. See Anderson (2004) for a review of the estimates in the literature.

3. This section draws on Jha (2003).

Chapter 13

1. Many countries have reformed their trade well before they joined FTAs: Mexico, Argentina, Brazil, and Turkey are salient examples (Foroutan 1998). Many African FTA members, and some in Latin America, have not reformed. And plenty of countries have reformed without joining FTAs: Chile (in the 1970s and 1980s), the Republic of Korea, Indonesia, and China (Schiff and Winters 2003).

Appendix 4

1. China's average real GDP growth between 1991 and 2000 is estimated at 10.1 percent, India's at 5.5 percent (World Bank 2003).

Appendix 5

1. This appendix draws on Nielson and Taglioni (2003) and Nielson (forthcoming). Material on the request-offer negotiations is adapted from the WTO website.

2. The Council for Trade in Services includes representatives of all WTO Members. It normally meets around four times a year. The WTO Secretariat serves as the Secretariat to the Council and its subsidiary bodies: the Working Party on Domestic Regulation; the Committee on Financial Services; the Working Party on GATS Rules; and the Committee on Specific Commitments.

3. A WTO Member's mode 4 commitments relate to the acceptance of foreign service suppliers into its territory, not the sending of its own nationals abroad as service suppliers. Similarly, mode 2 commitments relate to the movement of its own nationals abroad to consume services, not the acceptance of foreign consumers into its territory.

4. There are currently about 425 MFN exemptions notified by WTO Members, around half reflecting bilateral or plurilateral agreements among WTO Members.

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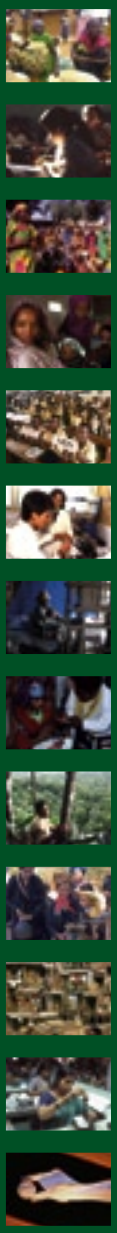
About this report

The Millennium Development Goals, adopted at the UN Millennium Summit in 2000, are the world's targets for dramatically reducing extreme poverty in its many dimensions by 2015—income poverty, hunger, disease, exclusion, lack of infrastructure and shelter—while promoting gender equality, education, health, and environmental sustainability. These bold Goals can be met in all parts of the world if nations follow through on their commitments to work together to meet them. Achieving the Millennium Development Goals offers the prospect of a more secure, just, and prosperous world for all.

The UN Millennium Project was commissioned by United Nations Secretary-General Kofi Annan to develop a practical plan of action to meet the Millennium Development Goals. As an independent advisory body directed by Professor Jeffrey D. Sachs, the UN Millennium Project submitted its recommendations to the UN Secretary-General in January 2005.

The core of the UN Millennium Project's work has been carried out by 10 thematic task forces comprising more than 250 experts from around the world, including scientists, development practitioners, parliamentarians, policymakers, and representatives from civil society, UN agencies, the World Bank, the International Monetary Fund, and the private sector.

The trading system is unbalanced against developing countries. Correcting the imbalance will give developing countries greater economic growth potential and a more effective capacity to defeat poverty. The progressive elimination of remaining trade barriers in goods and services, with rich countries leading by example, coupled with enough support for poor countries to bear adjustment costs and build export capacity, must be part of the international pursuit to overcome poverty.



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