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Comment

Greater Transparency in the World Trading System

An important objective of the GATT and the WTO is to contribute to a transparent world trading system. There should be clear conditions for the servicing of foreign markets and – whenever possible – no discrimination. The Most-Favoured-Nation (MFN) principle, the tariff bindings, the prohibition of quantitative restrictions, and the two special agreements that deal with non-tariff barriers – the Agreement on Technical Barriers to Trade (TBT) and the Agreement on Sanitary and Phytosanitary Measures (SPS) – are indications of the great importance which is attributed to transparency and non-discrimination.

In the last few years, however, several developments have been endangering these goals. These have led and will further lead to a system of highly-differentiated market access conditions that increase information costs, create uncertainty, and ultimately reinforce the segmentation of markets despite the progress achieved in the elimination of tariff barriers.

Preferential trading agreements after Cancún

It has become increasingly obvious that the Doha Round cannot live up to the expectations that had initially been placed in it. From the Cancún Ministerial it is evident that individual WTO members are not ready to seriously consider the requests of the other parties. Not least because of the forthcoming presidential elections in the US, the challenges of the EU-enlargement, and the unwillingness of important developing countries to compromise, a breakthrough on the multilateral level has become more and more unrealistic.

Preferential trading agreements are, on the other hand, flourishing: Already before Cancún, the US had chosen the bilateral track besides the multilateral one with its concept of "competitive liberalisation". The political pressure to conclude bilateral agreements is high, given the lack of progress in the WTO. The EU has created a dense web of free trade agreements in the past and plans to convert the preferential trade agreements with the ACP-countries (77 developing countries in Africa, the Caribbean and the Pacific) into free trade agreements. Plans for more far-reaching regional trade agreements are being made in Asia, too. Most observers expect the negotiation dynamics in the coming years to be marked by bilateralism. Argua-

bly, more liberalisation may be achieved on the bilateral level, but the costs are significant: Depending on membership in a specific regional agreement, market access conditions will differ. The rules of origin are different between integration blocs. Companies that serve a large number of markets face increased administrative costs. Segmentation is further increased when different technical regulations and systems of recognition are in force in the various preference areas.

An intransparent system of preferences for developing countries

With the Enabling Clause, that was introduced in 1979, industrialised countries were allowed (or better: received the political mandate) to grant imports from developing countries preferential market access, even though this represented a deviation from the MFN principle. Although the objective of this Clause is broadly accepted, its implementation has led to a system that is not very transparent: Firstly, preference programs are devised autonomously by the importing countries and differ in important respects (eligible countries and products, preference margins etc.). Secondly, major importing countries, notably the EU and the US, attach political demands to the granting of preferences, which can lead to different preference margins, or even the threat of their withdrawal. Market access conditions are therefore not only intransparent, but also uncertain with respect to their duration.

In the dispute settlement case discussed by Alexander Roitinger (see section on dispute settlement in this issue), the panel strongly restricted the use of conditions for the granting of preferences which discriminate between developing countries. If the Appellate Body were to confirm the argumentation of the panel, the opportunities for imposing political conditions would be restricted, and, thus, the transparency and predictability of the preference system would increase. It is, however, questionable whether the industrialised countries would be willing to renounce their use of preferential agreements for the achievement of political ends – not least with regard to social and environmental requirements. Industrialised countries may then be even more inclined to focus on bilateral free trade agreements, whose creation is weakly controlled multilaterally. But this would only replace one system with little transparency by another with similar effect.

Tariff quotas in agricultural trade

Particularly intransparent is the distribution of tariff quotas in agricultural trade. The Agreement on Agriculture – reached in the Uruguay Round – supported the internal liberalisation of agricultural markets and the reduction of strongly distorting subsidies. However, with regard to market access, the success of the Agreement has been limited. In the process of tariffication, importing countries converted their quantitative restrictions in sensitive areas into tariffs which were substantially more protective than the previous restrictions. In exchange, they had to offer that historical import quantities could be imported at the previously existing, significantly lower, tariff rates. This, however, raises the question according to which criteria and procedures the quantities that have a tariff advantage are distributed. Here, the importing countries can decide relatively freely. The systems that are actually employed provide the administration with considerable discretion and are very intransparent. To make matters worse, free trade agreements and developing country preferences overlap the quota distribution systems and thus create still more extensive regulation. Without doubt, the world market for agricultural goods is not characterised by transparent and predictable entry conditions.

... and more

Bilateral agreements, preferences for developing countries, as well as the implementation of the Agreement on Agriculture are three important causes for trade rules that are hardly transparent – but, unfortunately, they are not the only ones. It proved impossible to implement the MFN Clause in the Agreement on Government Procurement. Government entities included into the procurement commitments, product coverage, as well as the threshold value may differ according to the provider's country of origin. The transparency and predictability of market access conditions in world trade are also negatively affected by the constantly growing number of antidumping and safeguard proceedings. Without going into more detail here, it should be mentioned that the GATS is still far from providing a transparent system of market access.

Tariff reduction on MFN basis

The current market access conditions have a patchwork character. The lack in transparency results to a large extent from the numerous violations of the MFN principle. It would be politically unrealistic to abolish free trade agreements or preferences for developing countries. Therefore, reducing the incentives for preferences becomes the only feasible approach. But this can only be achieved through a substantial reduction of MFN tariffs. Consequently, the Doha Round should concentrate on the core of WTO business, namely tariff reduction on a reciprocal basis. Doing so, both industrial and developing countries could gain a lot. Industrialised countries are called upon to significantly reduce their tariffs on labour-intensive products (such as clothing and leather products) and on agricultural products. It is equally important to severely limit tariff escalation (i. e. tariffs that rise with the degree of processing).

In exchange, developing countries should offer a stronger tariff-binding on their imports. With this, they would not only create a good basis for negotiations with the industrialised countries, but also strengthen trade between developing countries themselves in a sustainable fashion. Specialisation based on the division of labour is still underdeveloped in South-South trade and could become an important source of growth. If it proved possible to lead the Doha Round back to its core business, it might contribute to further liberalisation and, in particular, to increased transparency in world trade. *Heinz Hauser*

WTO-DSB

Dispute Settlement

Equality of special treatment for all developing countries?

In March 2002, India filed for the opening of a dispute settlement procedure (WT/DS246) regarding several aspects of the Generalised System of Preferences (GSP) of the EU. Within the framework of the GSP, industrialised countries open up their product markets voluntarily and independently of each other for exports from the developing world. They do not request reciprocal market access concessions. The aim of this policy is to counteract the dismal economic situation of developing countries.

The core of the conflict between India and the EU is a particularly favourable access for twelve (mostly Latin American) countries to the European single market. Brussels justifies this simplified access by the many difficulties of these countries in their fight against drug production and trafficking. In its report, dated 1 December 2003, the convened panel condemns this inequality of special treatment as a violation of the Most-Favoured-Nation Clause (Article I GATT) that cannot be legitimated by the Enabling Clause of 1979. The Enabling Clause is the legal foundation of all national GSP programs. The EU has announced that it would appeal the panel ruling.

Legal scenarios for the GSP...

According to the panel report, market access concessions within the framework of the GSP must not discriminate among individual developing countries. An exception is the more favourable treatment of the 49 Least Developed Countries (LDCs), which is explicitly provided for in Article 2(d) of the Enabling Clause. Furthermore, industrialised countries may revoke the preferences for those products of individual developing countries where the latter have attained a high degree of competitiveness on international markets.

The EU market access policy towards twelve selected developing countries represents without doubt a blatant disadvantage for the remainder of the European GSP beneficiaries. The latter may have a smaller specific drug problem, but they have to struggle with other adverse conditions (such as natural disasters, unfavourable geographic location, or political instability) that can have a similarly negative impact on development. Despite such considerations, the panel decision came as a surprise to many WTO observers, since there has not been a consensus so far on whether the special treatment of developing countries has to be non-discriminatory. The two-page text of the Enabling Clause does at any rate not give a satisfactory answer, even though the term "non-discriminatory preferences" appears in a footnote. Be that as it may, it is a fact that major industrialised countries (such as the US and the EU) have used the GSP in the past in order to reward those developing countries that complied with special political objectives.

If the reasoning of the panel were endorsed by the Appellate Body, it could have a substantial influence on the future design of the Generalised System of Preferences. The scope of the panel request for non-discrimination is thereby not at all evident. Non-discrimination could mean that industrialised countries are still permitted to make the granting of developmental preferences dependent on certain conditions. However, these conditions would have to be made transparent, and their fulfilment would have to be verified by the help of objective criteria. In particular, the conditions should not result in a situation where some developing countries are excluded a priori from a particular special treatment. The contentious market access policy of the EU did exactly that, since the respective preferences were only available to a predefined number of countries.

Yet the panel seems to promote a still much narrower understanding of the equality of special treatment for all developing countries. In two short paragraphs of the report (No. 7.59 and 7.60), it opens up a Pandora's Box by its interpretation of the term "unconditionally" in the Most-Favoured-Nation Clause of the GATT. Referring to the Oxford English Dictionary, the panel understands "unconditionally" to mean "not limited by or subject to any conditions". Since the Enabling Clause presumably does not invalidate such an interpretation, it is also relevant for the special treatment of developing countries. The interpretation of the panel is, however, not only in opposition to a well-established interpretation of the Most-Favoured-Nations Clause, which understands the term "unconditionally" to stand for "not requiring any kind of compensation". Importantly, it would also mean that the special treatment of developing countries would have to be freed from popular preconditions with respect to the observance of certain social and/or environmental standards. Both the EU and the US would be crucially affected.

... and some economic considerations

From a mere economic perspective, the decision of the panel needs not be criticised. While there is still a deep disagreement on whether social and environmental standards should be integrated in the framework of the world trading order, it is quite obvious that the GSP is not a useful connecting point for such standards. This has primarily two reasons.

Firstly, the effectiveness of established national GSP programmes is already strongly impaired even without any social and environmental standards. The industrialised countries have safeguarded exactly those sectors (such as textiles or agriculture) against an improved market access for developing country exports where the latter would be most competitive due to their comparative advantages. By insisting on short-term safeguard clauses and the possibility to phase out the entire GSP without substitution in the long run, the preference-providing countries have created a climate of uncertainty as regards the future export potential of poor countries. The consequence of this uncertainty is that export-oriented investment in the developing world is slowed down.

Any additional impairment of preferential market access in the form of social and/or environmental requirements further reduces the utilisation rates of the GSP, which often stand at only 50 percent today.

Secondly, the integration of social and environmental standards into the GSP framework runs the risk of causing national GSP programs to potentially diverge in still another dimension. Due to such divergences, developing countries are confronted with different technical and administrative requirements, depending on which export market they choose. This does not only increase the cost of collecting the respective information, but it also contributes to higher complexities (and thereby costs) of the production process in the export sector.

Enormous political impact

A potential prohibition of social and environmental standards within the framework of the GSP could nontheless have a very negative political impact. It has become an open secret over the last few years that social and environmental norms cannot be introduced by means of a multilateral agreement: developing countries would forcefully combat any such intentions. Therefore, the GSP has become the "last resort" of industrialised countries for integrating these standards in the world trading system.

Independently of how the introduction of the standards is justified (be it by ethical and social reasons or by the safeguarding against "unfair trade"), the seemingly inconspicuous panel decision would substantially invalidate the GSP as a political instrument. It could therefore provoke a fierce controversy about the spirit and purpose of the special treatment of developing countries. At the moment, it is extremely questionable whether the political leaders in Brussels and Washington would come to terms with such a massive interference in their trade policy autonomy. The GSP would be seriously at risk. It is imaginable that the special treatment for developing countries could gradually shift to the sphere of bilateral trade agreements, which are anyway enjoying a high degree of popularity at the moment. There, industrialised countries would still have sufficient leeway in order to combine the market opening with individual political goals. However, this would further intensify discrimination in trade relations, and thereby completely undermine the panel's original intention. *Alexander Roitinger*

From the Book Shelf

Robert Z. Lawrence: Crimes and Punishments? Retaliation under the WTO, Washington, DC: Institute for International Economics, 2003; 120 pages, USD 20.00

The WTO dispute settlement system has increasingly come under attack in recent years. The reform of the system is an important item on the agenda of the Doha Round. However, the progress made thus far has been limited (see WTO News No. 9).

In his latest book, Robert Lawrence discusses important questions connected with the dispute settlement system. His emphasis is on one specific aspect of the system: dispute remedies. The present system may lead to a dangerous upward spiral of retaliation and counter-retaliation that might undo much of the trade liberalisation previously achieved. Other criticisms that have been raised against the system are equally grave: For example, it has been claimed that the system is ineffective in enforcing compliance with WTO rules, puts smaller countries at a disadvantage and undermines national sovereignty.

Lawrence evaluates such criticism. Although not all problems are as serious as often depicted, the system is indeed in need of reform. According to the author, all the options advocated in the literature for reforming the responses to violations have serious drawbacks. Therefore, Lawrence puts forward his own innovative reform proposal which would eliminate many of the present system's defects – most importantly the danger that the WTO contributes to increased protection. He advocates the introduction of a system of so-called "Liberalisation Security Deposits" (LSDs) where members would be given the option of offering pre-determined compensation. If a country violates WTO rules, a winning plaintiff would be authorised to select a package of concessions (e. g. tariff reductions in a specific sector) from the defendant's LSDs.

In conclusion, Robert Lawrence has written a book of limited size that provides a good account of major issues related to the WTO dispute settlement system and contains a number of innovative reform proposals. Interesting reading both for the expert and the novice in this area. *Martin Gedult v. Jungenfeld*

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Swiss Institute for International Economics
and Applied Economic Research (SIAW-HSG)
University of St. Gallen
Dufourstrasse 48, CH-9000 St. Gallen, Switzerland
Phone: ++ 41 / (0)71 / 224 23 50
Fax: ++ 41 / (0)71 / 224 22 98
E-Mail: service@wto-news.ch
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