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# THE SINGAPORE ISSUES AND THE WORLD TRADING SYSTEM:

# THE ROAD TO CANCUN AND BEYOND

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# CHAPTER I

# A MULTILATERAL FRAMEWORK FOR INVESTMENT?

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## EXECUTIVE SUMMARY

1. The internationalisation of production and consumption has been the defining feature of the world economy since the mid-1980s. Foreign direct investment (FDI), broadly defined as the creation of enterprises abroad or the acquisition of substantial stakes in existing enterprises, now represents a major form of cross-border capital flow. More firms than ever in more industries and in more countries are expanding abroad through direct investments. Although most FDI originates in and flows to industrialised countries, over the past decade, developing countries' share of global FDI flows has followed an upward trend.

2. Today, most countries let in FDI. This is in part the result of an acceleration of the liberalisation of domestic investment regimes during the 1990s, particularly by developing countries. However, countries tend not to grant unrestricted rights of entry to all investors and to all types of investment. Restrictions on investment typically remain in those sectors considered of national interest, such as telecommunications, health services, and other public utilities. Developing countries, in particular, impose restrictions on entry and on the operation of foreign firms in order to enhance the economic impact of FDI.

3. The economic rationale for regulating FDI, instead of granting unfettered market access to foreign operations, derives mainly from the fact that FDI typically takes place in concentrated industries and that such FDI generates externalities. Host countries, therefore, see a scope for government intervention so as to close the gap between private and social returns from these investments. In the main, national FDI policies are directed to influence the nature and the impact of FDI, particularly with regard to externalities and spillovers in the domestic economy.

4. The principal issue in the debate on the desirability of a multilateral investment framework (MIF) is the trade off between any restrictions on the national policy space that such a framework might imply and the pursuance of efficiency in the allocation of capital. Therefore, the debate between proponents and opponents of an MIF essentially boils down to a long-standing (and unsettled) question as to how far government intervention is necessary to improve investment allocation and economic performance, and to what extent such interventions may lead to further distortions and inefficiencies. In theory, the presence of market failures justifies government intervention and may be necessary to improve economic efficiency. In practice, government intervention frequently exacerbates distortions and hampers static and dynamic economic efficiency. At present, both theoretical and empirical research in the field of FDI is inconclusive, failing to clearly sustain a case in favour of - or against – restrictions on government intervention.

5. The European Commission (EC) is the strongest proponent of a MIF to be negotiated at the WTO. In contrast, India has been leading the opposition to further extending the international regulation of investment in the WTO. The WTO already includes agreements directly regulating FDI or national investment policies that have consequences for international trade. The General Agreement on Trade in Services (GATS) regulates FDI policies of member countries insofar as FDI represents a mode of supply of services. The Agreement on Trade and Investment Measures (TRIMs) prohibits a number of operational measures on investment that, to

some extent, undermine the effects of trade liberalisation under the General Agreement on Tariffs and Trade (GATT).

6. Today's proposals for further WTO obligations on investment would represent a significant expansion on binding multilateral rules on international investment. However, FDI, and investment more generally, are currently influenced at the international level by bilateral investment treaties (BITs) and by regional trade agreements (e.g. EU, NAFTA, ASEAN, etc). These latter agreements are legally binding on signatories, and together cover virtually all global FDI flows.

7. Proponents of a MIF claim that such an agreement would be necessary to overcome the deficiencies of the current patchwork of bilateral, regional, and multilateral rules on investment, so as to provide international investors with a system of transparent, stable, and predictable set of rules to facilitate these transactions. This, it is said, would not only benefit the countries where such investments originate by raising investment possibilities and returns, but also host countries which would benefit from higher international investment flows to their economies resulting from a more favourable business environment. More generally, it is claimed that host countries would gain from MIF-induced positive changes to their institutions and economic systems, becoming more transparent and less prone to state-created distortions and corruption.

8. Opponents to a MIF argue that the current system of international rules on investment and unilateral measures provide all of the necessary legal foundations for international investment to take place, while leaving host countries the necessary flexibility to regulate investment so as to meet national development plans. In their view, a MIF would have the effect of limiting the scope for government intervention to an extent that is considered incompatible with the imperatives of economic growth and development. At the same time, they contest the claim that a MIF would lead to significantly higher investment flows.

9. Some recent economic analysis has focused on the likely global effects from further multilateral disciplines on the regulation of international investment flows. Although most of these studies show that the overall effects from a MIF are likely to be positive, they have not found clear and substantial economic gains for developing countries. Put differently, with the exception of benefits accruing to all countries from multilateral regulation of financial and fiscal incentives for FDI, the welfare gains of other multilateral initiatives on investment tend to principally accrue to Multinational Enterprises (MNEs) and their parent countries. In which case those countries almost exclusively representing the importing side of FDI, which includes most of the developing economies, would need to be compensated in other fields of multilateral negotiations, such as market access in industrial goods.

10. Focusing on the key issues outlined above, this paper summarises the main arguments put forward by the European Commission and the United States in their submissions to the WTO's Working Group on the Relationship between Trade and Investment, together with the critiques offered by India, the main opponent of a MIF, and by some prominent commentators taking a stance on this issue. Rather than trying to resolve the current debate, the aim here is to offer the reader an interpretation of the main arguments raised in the ongoing discussions on this subject inside and outside the WTO. Ultimately, the question as to whether or not a MIF should be negotiated during the next WTO Ministerial Meeting depends on the specific provisions envisaged in a possible negotiating mandate, which have not yet been fully determined, together with a number of other factors, many of which lie far outside any potential investment negotiations. Given the complexity of the issues involved and the inconclusiveness of existing research, there is little faith that a consensus within WTO on a MIF will be reached, and ultimately that the adoption of a MIF would considerably improve the welfare of developing countries.

# INTRODUCTION

After the resounding failure of negotiations on a Multilateral Agreement on Investment (MAI) by OECD members in the mid-1990s, the European Union and a few other industrialised countries have renewed their efforts to put formal negotiations on multilateral investment rules on the WTO agenda. Since 1996, when the WTO established a Working Group with a mandate to study investment issues in more detail, member states have been discussing the desirability of further multilateral disciplines on the national regulation of foreign direct investment (FDI). This chapter assesses the key arguments put forward by those favouring a new so-called multilateral investment framework. Particularly, it addresses the question as to whether a case for a multilateral agreement can be made on economic grounds.

This chapter is organised as follows: the first part summarises the key trends of FDI flows and international investment agreements during recent years. The second part summarises the proposals put forward by the European Commission (EC) and, to a lesser extent, the United States (U.S.), and the concerns voiced by India, the main opponent to new WTO investment disciplines. The third part turns to the pertinent economic analysis, and the fourth part concludes.

# Part I

# CURRENT TRENDS IN FDI FLOWS AND INTERNATIONAL INVESTMENT AGREEMENTS

## I.1 Distribution of FDI flows:[1]

The internationalisation of production and consumption has been the defining feature of the world economy since the mid-1980s. Foreign direct investment (FDI), broadly defined as the creation of enterprises abroad or the acquisition of substantial stakes in existing enterprises, now represents a major form of cross-border capital flows. More firms than ever in more industries and in more countries are expanding abroad through direct investment. It has been estimated that today worldwide some 65,000 trans-national corporations (TNCs), 90 per cent of which are headquartered in OECD countries, have established more than 850,000 foreign affiliates, more than half of which operate in non-OECD countries. Their combined sales of almost $19 trillion is more than twice as high as total world exports in 2001, and the worldwide stock of outward FDI increased from $1.7 trillion to $6.6 trillion from 1990 to 2001. Foreign affiliates now account for about one-third of world exports, and another third of world trade flows are between TNCs. The world's largest TNCs dominate this picture and, mainly as a result of the recent surge in Mergers and Acquisitions (M&As), are consolidating their foreign assets and sales.[2]

UNCTAD (2002) identifies three main long-term factors behind the expansion of international production: policy reforms by an increasing number of countries that facilitate inflows of FDI; rapid technological change reducing communication costs and allowing more risk to be shared among greater markets; and increased competition compelling firms to reach new markets and to locate production where costs are lower. Investment decisions are also influenced by short-term changes in the business cycle. A sharp drop in global FDI flows, particularly of M&As, accompanied the recent slowdown of global economic growth and the increased uncertainty in world financial markets. As a result, the total value of cross-border M&As completed in 2001 ($594 billion) was only half that in 2000 (Appendix Table 1).[3]

The relative weights of different modes of entry of FDI have shifted in recent years. M&As gained importance while greenfield investments steadily lost ground. At a global level, more than 80 per cent of FDI inflows are now mergers or acquisitions. Trends in the mode of entry of firms investing in industrialised countries differ considerably from those of developing countries, where greenfield investment continues to dominate. However, widespread privatisation in developing countries during the 1990s has steadily increased the share of M&As in total FDI. For developing countries as a whole, in 2001 the ratio of M&A sales to FDI inflows was 42 percent, as compared to 13 percent in 1991.[4]

During the last decade the sectoral distribution of cross-border M&As has changed. Whereas in 1990 at the global level 50 percent of M&A took place in the manufacturing sector and 46 percent in services, in 2001 the percentage shares were 33 and 62 respectively.[5] This trend is reflected in overall FDI as well. Finance, business services, transport, storage and communications saw particularly important increases in the number and value of M&A transactions (Appendix Figure 1 – M&A purchases by industry).

FDI remains highly concentrated among industrialised countries (Tables Appendices 2 and 3). In 2001, industrialised countries hosted roughly two-thirds of global FDI stock and accounted for more than 68 percent of FDI inflows. FDI flows to developing countries are very unequally distributed. In absolute terms, Latin America and Asia (mainly East Asia) receive the bulk of FDI, whereas Africa's stock of inward FDI in 2001 amounted to a mere 2.3 percent of total worldwide FDI. Also within regions, FDI flows are highly concentrated (Appendix Figures 6 and 7).[6] The developing economies hosting large amounts of FDI include China, Brazil, Singapore, Hong Kong, South Korea, and Mexico. However, the picture changes when FDI as a

[1] This section heavily draws from UNCTAD(2002) and OECD(2002).
[2] UNCTAD (2002 – Overview: 1).
[3] UNCTAD FDI/TNC database.
[4] ibid.
[5] ibid.
[6] UNCTAD (2002).

share of GDP is considered. On average, FDI stocks relative to domestic GDP in developing countries have exceeded the levels recorded in the industrialised economies (see Appendix Figure 2).[7]

Finally, not only is FDI becoming more important for developing countries in relation to GDP, it is also overshadowing other capital flows such as official development assistance (ODA) and export credits (Appendix Figure 3). FDI in developing countries was 10 times larger than ODA in 2000, in contrast to the latter half of the 1980s, when the two were roughly equal. Also for the least developed countries, where ODA has traditionally been the most important source of external financing, FDI flows are now almost as high (or as low) as bilateral ODA flows.[8]

| **Table I-1**<br>**National regulatory changes, 1991-2001** | **1991** | **1992** | **1993** | **1994** | **1995** | **1996** | **1997** | **1998** | **1999** | **2000** | **2001** |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of countries introducing changes | 35 | 43 | 57 | 49 | 64 | 65 | 76 | 60 | 63 | 69 | 71 |
| Number of regulatory changes | 82 | 79 | 102 | 110 | 112 | 114 | 151 | 145 | 140 | 150 | 208 |
| Of which: | | | | | | | | | | | |
| more favourable to FDI | 80 | 79 | 101 | 108 | 106 | 98 | 135 | 136 | 131 | 147 | 194 |
| less favourable to FDI | 2 | - | 1 | 2 | 6 | 16 | 16 | 9 | 9 | 3 | 14 |

**Source**: UNCTAD (2002: 7 – Box Table I.2.1)

Inflows of FDI accounted for 60 per cent of total resource flows to developing countries in 2000, compared to 6 per cent in 1980 and one quarter in 1990.[9]

In sum, the following stylised facts emerge from recent trends in global FDI flows:

1. Rather than representing the creation of new enterprises, FDI flows to industrialised economies tends to take the form of mergers and acquisitions. This is increasingly true also for FDI to developing countries also.
2. FDI flows increasingly into services sectors, even in developing countries.
3. FDI mostly originates in and flows to industrialised economies. However, the importance of FDI flows to developing countries is increasing both as a share of GDP and fixed capital formation.
4. FDI flows to developing countries are concentrated in certain countries.

## I.2 Domestic liberalisation and international agreements on investment

During the 1990s there has been an uninterrupted trend towards the liberalisation of national FDI regimes. Box I-1 summarises the main types of unilateral FDI liberalisation. UNCTAD (2002) reports 208 changes in FDI laws by 71 countries in 2001 alone, raising the total number of annual changes to its highest level since 1991 (see Table I-1). Of the changes effected in 2001, 194 are said to have created a more favourable investment climate. The Asian and Pacific region introduced the largest number of regulatory changes (43 per cent).[10]

There are two major factors underlying the unilateral liberalisation of FDI. First, the declining trend of official long-term capital flows and the frequent occurrence of international financial crises, particularly since the mid-1990s. Sudden reversals of short-term capital caused many countries' demands for external financing to shift towards private long-term capital. The second factor is the potentially growth-enhancing features widely

[7] OECD (2002).
[8] UNCTAD (2002: 12).
[9] Ibid.
[10] UNCTAD (2002: 7).

ascribed to FDI. Potential spillovers to the domestic economy from FDI have been described in the literature and evidence presented of their importance in a large number of host countries. Given their almost insatiable demand for external finance, few developing countries are willing to forego a relatively stable mode of supply of private funds. However, as described below, many host countries have also found that FDI needs to be regulated in order to correct the market failures associated with it.[11]

### I.3 Bilateral investment treaties

Long-term overseas investment in an alien territory is fraught with risks and costs higher than investment at home. Once invested, the national laws of the host country govern the investor and its operations. Typically, a foreign investors' assessment of expected return to capital is strongly influenced by concerns of expropriation or the imposition of unfavourable rules concerning their operations. In the extreme case, such perceived risks have kept FDI from flowing to countries altogether, or have effectively imposed significantly higher costs on host countries. Typically, investors require guarantees of protection by means of Bilateral Investment Treaties (BITs). To date, BITs constitute the most important instrument for the international protection of foreign investment, providing foreign investors with a clear legal framework. If a BIT is concluded between a capital-exporting industrialised and a developing country, the former typically seeks to secure higher standards of legal protection for the investments of its firms than those offered under the latter's laws. Moreover, since the early 1990s, developing countries have begun to sign BITs among themselves, so as to create a favourable climate for reciprocal investment flows.

**Box I –1 Unilateral liberalisation of FDI policies**

**Definition:**

"FDI liberalisation is a dynamic process that involves the following:

(a) the tempering or removal of those market distortions that result from restrictions applied specifically (and, hence, discriminatorily) to foreign investors (e.g. barriers to entry and operations) and from the granting or withholding of incentives and subsidies that discriminate in their favour or against them;
(b) the strengthening of certain positive standards of treatment for foreign investors (e.g. national treatment, most-favoured-nation treatment, fair and equitable treatment); and
(c) the strengthening of market supervision to ensure the proper functioning of the market (e.g. competition rules, disclosure of information, prudential supervision).

"[…] Certain aspects of the internal normative framework, such as the existence of a comprehensive legal framework for business activities, are essential to give meaning and effect to the liberalisation of FDI. […]

**How far has FDI liberalisation gone?**

"Today, all countries admit FDI in principle. On the other hand, no single country grants unrestricted right of entry to all activities. However, the number of activities in which FDI is barred or restricted has been considerably reduced, especially in the manufacturing sector but also increasingly in natural resources and services, as most countries have gradually moved to open traditionally closed industries, often in the course of their privatisation programmes (e.g. telecommunications, public transport, other public utilities and the construction of public infrastructures, fishing, mining, oil and energy), although some restrictions remain. Ownership requirements and control restrictions (through, for example "golden shares") are limited to certain strategic industries, particularly after privatisation (e.g. broadcasting). Fade-out requirements have virtually disappeared. Most countries have eliminated authorisation requirements for the entry of greenfield FDI, replacing them with registration, although some authorisation requirements and restrictions on the number of foreign firms allowed remain in many countries (both developed and developing) for some 'strategic' industries (e.g. banking and finance, air transport, broadcasting, telecommunications) and often apply to both foreign and domestic firms. There are also indications that certain operational conditions – such

(continues)

[11] UNCTAD (2002), OECD (2002)

**(Box I –1 concluded)**

as performance requirements or those relating to the hiring of foreign managerial personnel – are becoming less significant. Certain types of performance requirements have been reduced or have become more transparent as a result of international commitments and transitional measures under the TRIMs Agreement. […] Others, not covered under the TRIMs Agreement, have become more focussed and tend to discriminate less either in favour of or against foreign investors. […] Exchange restrictions on the repatriation of profits and capital have become exceptional measures reserved for cases of serious balance-of-payments difficulties in most countries. Most restrictions on outward FDI have also disappeared in developed countries and are being gradually reduced in a number of developing countries and transitional economies.

**Strengthening positive standards of treatment**

"The standards of non-discrimination and national treatment of FDI after its entry into the host country are now reflected in the laws and international agreements of many countries (often with certain qualifications and exceptions), as are the principles of due process and fair and equitable treatment. Host countries, including many developing countries, are also granting foreign investors legal protection and guarantees against non-commercial risks. The number of developing countries that have signed bilateral, regional and multilateral agreements dealing with the treatment and protection of FDI after entry has increased dramatically in the 1990s, after most countries in Latin America and in Central and Eastern Europe took to signing them.

**Strengthening market controls**

"An increasing number of countries in all regions have adopted or are strengthening antitrust laws. The number of countries having competition laws has increased from less than 40 in 1980 to over 70 in 1997. Most have also established mechanisms to supervise international mergers and acquisitions, stock exchanges, and financial markets.

"In sum, the trend towards a liberalisation of FDI policies is indeed pervasive and has led to a convergence of FDI regimes, although numerous and at times significant differences remain. To the extent that FDI policy frameworks become similar, specific differences – other things being equal – become more important influences on the locational decisions of investment projects."

Source: UNCTAD (1998: 95-6 - Box IV.2)

UNCTAD has been active in strengthening this pattern by assisting developing countries in the drafting and the signing of BITs. Consequently, the network of BITs is expanding constantly. In 2001 alone, a total of 97 countries have concluded 158 BITs, raising the total number of BITs from 1941 at the end of 2000 to 2099 by the end of 2001. Developing countries have intensified the practice of concluding BITs among themselves, including the least developed countries; the latter signed 51 BITs in 2001, 13 of which were among themselves and 24 with the rest of the developing world (Appendix Figures 4 and 5).[12]

There are a number of similarities between the key provisions enshrined in BITs, as listed in Table I-2. However, some BITs go beyond these basic principles, particularly by granting the right of establishment to foreign investors (typically, the BITs concluded with the United States or Canada), or by prohibiting performance requirements with regard to local content, to exports, and to employment as conditions for the entry by foreign investors.[13]

In general, BITs do not affect the formal right to regulate the admission of foreign investors, but they do provide strong rights for investors and a variety of obligations on host governments once the investment has been made. Nevertheless, typically a host government can continue to exercise its sovereignty to regulate all aspects of the foreign investment in its country, as long as the provisions regulated by the BIT are respected (e.g. non-discrimination, expropriation, transfer rules). For instance, foreign investors have to comply with all national legislation pertaining to environment or labour issues.

[12] UNCTAD 2002: 8.

[13] For a list of performance requirements, see Box III.1.

| Table I-2: Common elements of BITs: | |
|---|---|
| **Definition of investment** | - Usually a broad and open-ended definition of foreign investment is adopted. |
| **Market access (pre-admission)** | - Entry and establishment are subject to national laws and regulations.<br>- BITs usually do not affect the right to regulate the admission of foreign investors. |
| **Post admission** | - Fair and equitable treatment of foreign investors (the "general treatment" clause).<br>- Principle of national treatment of foreign investors, but often subject to qualifications and exceptions, e.g. for taxation, public order, national security.<br>- Most Favoured Nation (MFN) treatment, subject to standardised exceptions. |
| **Investor protection** | - Right of the host country to expropriate foreign investors, subject to the condition that expropriation is non-discriminatory and accompanied by adequate compensation.<br>- Guarantee of free transfer of payments, of capital and returns, related to foreign investment, often qualified by exceptions in case of balance of payments problems. |
| **Dispute settlement** | - State-to-state dispute settlement provisions, and increasingly also investor-to-state dispute settlement, such as BITs signed with the European Union. |
| Source: Pant and Nunnenkamp (2002); UNCTAD (1996, 1998) | |

UNCTAD (1996) has highlighted the particularly development-friendly characteristics of BITs, since they

> "do not disregard the special development needs of individual treaty partners: they emphasise the importance of FDI for economic development; they generally recognise the effect of national law on FDI; and they contain exceptions or qualifications to some general principles (e.g. exceptions for balance-of-payments consideration in relation to the principle of free transfer of funds)".[14]

## I.4 Regional investment agreements

In contrast to bilateral treaties, investment agreements at the regional level tend to have greater ambitions to liberalise entry and establishment of FDI and to eliminate discriminatory policies. Investment protection provisions have also been added more recently. Most of these agreements are legally binding, although the APEC investment principles are a major exception. These investment provisions are usually part of a broader regional trade and integration agreement (RTA). Major examples of RTAs including investment provisions are the ASEAN agreement, MERCOSUR, the EC Treaty, and the NAFTA treaty. Moreover, the proposed Free Trade Agreement of the Americas (FTAA) contains similar provisions. The provisions in these agreements vary considerably with respect to the definition of investment, right of entry and establishment, transparency, protection standards, etc. It is not the aim of this paper to describe and compare the key features of these investment agreements to any great extent. Here, only Chapter 11 of the NAFTA[15] agreement is considered, as it served as the basis for negotiating the proposed MAI at the OECD. Table I-3 below lists the main features of Chapter 11 of NAFTA, and compares it with the key provisions included in the proposed MAI.

A broader comparison between the key provisions included in major existing bilateral, regional, and multilateral investment agreements are presented in Appendix Table 7. It shows that most regional investment agreements are highly intrusive into domestic regulation, including provisions on capital access, standards of treatment, and protection standards. Since virtually all the major home and host countries of FDI are members of at least one regional investment agreement, the regulation of FDI flows by these agreements is likely to be almost universal.

[14] UNCTAD (1996: 29).

[15] The NAFTA treaty between the United States, Canada, and Mexico came into force in 1995 and becomes operational in 2005.

| TABLE I-3: Key provisions in Chapter 11 of NAFTA and the proposed MAI | | |
|---|---|---|
| **Discipline** | **NAFTA Chapter 11** | **Proposed MAI (OECD)** |
| **Scope of application** | - Asset-based definition of investment.<br>- Closed definition: states what is included and what is not.<br>- Only assets having certain characteristics are defined as investment and thus covered. | - Asset-based definition of investment, including every kind of asset owned or controlled, directly or indirectly, by an investor.<br>- Open definition: lists items that are included and implies that non-listed items are also covered. |
| **Investment liberalisation** | - National treatment and most favoured nation treatment granted to both the pre and post-admission phase of the investment process.<br>- Top-down model of liberalisation.<br>- Absolute prohibition of a number of performance requirements. | - Similar to NAFTA Chapter 11.<br>- Absolute prohibition of the use of an even greater number of listed performance requirements than NAFTA. |
| **Investment protection** | - Host states are required to compensate investors in the event of expropriation of their investment.<br>- Includes both direct and indirect expropriation, such as governmental measures having an equivalent effect to a direct expropriation.<br>- Member states are required to provide fair and equitable treatment and full and constant protection and security while ensuring a minimum standard of treatment of that required by international law. | - Similar to NAFTA Chapter 11. |
| **Dispute settlement** | - Contains both state-to-state and investor-to-state dispute settlement procedures. | - Similar to NAFTA Chapter 11. |
| **Investment incentives** | - Largely ignored.<br>- The provisions on performance requirements explicitly condone the use of incentives if linked to certain performance requirements. | - Similar to NAFTA Chapter 11. |
| Source: OECD (1998); Kurtz (2002). | | |

## I.5 Multilateral investment agreements

Despite recurrent pressures from certain industrialised countries - particularly the United States, the Members of the European Union, and Japan - as of today, there is no comprehensive, multilateral investment agreement in existence. The most recent attempt to negotiate an investment agreement among OECD members failed. In 1995 an OECD Council Meeting at the Ministerial Level agreed to commence negotiations along the lines of NAFTA, so as to set "high standards" on investment liberalisation and protection, backed up by an effective process of dispute settlement. The principal features of the proposed Multilateral Agreement on Investment (MAI), shown in Table I-3, were basically the same as those of Chapter 11 of NAFTA, including a broad definition of investment.

The MAI negotiations broke down three years after they had started.[16] There had been several issues of substantial disagreement among OECD members (including the scope of the agreement and cultural exceptions) and fierce opposition by a coordinated group of NGOs concerned about the impact of the proposals for a MAI on labour and environmental standards and, more generally, on the potentially negative effects of economic globalisation. The political climate for the conclusion the MAI turned particularly unfavourable after the July 1997 outbreak of the financial crises in Thailand and its spread to other countries

[16] In 2002, OECD released a comprehensive collection of documents relating to the MAI negotiations, which can be accessed on the organisations' website (www.oecd.org/daf/mai).

in East Asia. Instead of capital flowing in, a sudden reversal of $105 billion[17] of loans and portfolio capital brought the crisis-stricken economies virtually to a standstill or worse. Over-borrowing and a mismatch of maturities are widely blamed as the main culprit of this crisis. FDI, in contrast, was shown to be more stable than portfolio or bank loans. Against this background, and in the presence of concomitant pressures from NGOs and disagreements among OECD Members about some key MAI provisions, the negotiations broke down.

Several lessons from the failure to complete the MAI negotiations are of interest for future initiatives on rule making on investment:

1. Collective action by powerful NGOs and developing countries' growing awareness of the risks accompanying wholesale, as opposed to strategic, financial liberalisation are strong factors influencing the outcome of negotiations, even if the latter take place in fora with the exclusive membership of rich industrialised countries. Arguably, any new international agreement that were to assign more rights to the business community at the cost of restricting sovereignty over national development policies is likely to encounter fierce and organised opposition from civil society.
2. Any agreement that seeks to include financial flows other than long-term FDI is likely to be unacceptable not only to most countries from the developing world, but also to many industrialised countries.
3. The large number of reservations by OECD members on proposed MAI provisions demonstrates that even this relatively homogeneous group of countries found it difficult to agree on an issue as sensitive as the regulation of international investment. In a sense, the MAI proposal may well have been over-ambitious in its scope, and it might have been better to allow for an incremental approach to reform.[18]

### I.6 Existing investment provisions in the WTO framework – GATS and TRIMs

The WTO, which came into being after the conclusion of the Uruguay Round negotiations in 1994, contains two major agreements that directly address investment issues: the Agreement on Trade-Related Investment Measures (TRIMs), and the General Agreement on Trade in Services (GATS). Three further agreements arguably have indirect effects on investment: the Agreement on Subsidies and Countervailing Measures (ASCM), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs), and the Government Procurement Agreement. Since investment is not the primary focus of these agreements, this section addresses only TRIMs and GATS. [19]

#### I.6.1 The TRIMs Agreement

Trade-related investment measures are frequently imposed by governments to either encourage or compel foreign investors to achieve certain national priorities. They relate to trade-distorting restrictions imposed by the host country on multinational enterprises[20] that operate in its territory. The most commonly used TRIMs are requirements on local content, on trade and foreign exchange balancing, on export performance, on joint venture or equity participation, on manufacturing limitations, and on remittance restrictions. The WTO recognises that some TRIMs might cause trade distortions and violate the principles of the General

[17] The essential shock was the large, dramatic, abrupt reversal of capital flows to East Asia. From +$93 billion to the five countries mostly hit in 1996 to -$12 in 1997, equivalent to 11% of their combined GDP (Radelet and Sachs, 1998).

[18] Similar observations have been made by a number of authors, including Kurtz (2002), Nunnenkamp and Pant (2002).

[19] Outside the WTO, a number of agreements and arrangements have been concluded or established that bear on the regulation of investment, including the Multilateral Investment Guarantee Agency (MIGA), which is part of the World Bank Group, offering insurance coverage to foreign investors for political risks in developing countries; the International Centre on Settlement of Investment Disputes (ICSID), another World Bank Group institution, facilitating the settlement of disputes between private investors and host countries; the OECD Guidelines on Multinational Enterprises and UNCTAD's Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, governing the conduct of multinational enterprises; the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy, containing principles on employment, training, conditions of work and life, and industrial relations. See UNCTAD (1996) for further details.

[20] Precisely, the TRIMs agreement is not confined to policies targeted at foreign firms. A panel report on a dispute concerning the Indonesian automotive sector has established that the "TRIMs Agreement is not limited to measures taken specifically in regard to foreign investment", but covers also domestically owned enterprises. See Bora (2002) for further details.

Agreement on Tariff and Trade (GATT). Consequently, the TRIMs Agreement was inserted as an annex to the GATT at the conclusion of the Uruguay Round. It requires countries to phase out TRIMs that have been identified as being inconsistent with GATT rules. More specifically, the TRIMs Agreement, dealing exclusively with investment measures related to trade in goods (not in services), prohibits performance requirements inconsistent with Articles III (National Treatment) and XI (General Elimination of Quantitative Restrictions) of the GATT. The agreement contains an illustrative and potentially non-exhaustive list of TRIMs deemed to be inconsistent with these articles, including local content and trade balancing requirements, and export restrictions.[21] Developing countries were granted a prolonged phase-out period for existing TRIMs that are inconsistent with the agreement. Also, Article 4 of the agreement permits developing countries to temporarily deviate from the agreement for balance of payments purposes.

### I.6.2 The GATS

Foreign investment in the services sector is affected by the General Agreement on Trade in Services (GATS), which covers FDI insofar as it represents a mode of supply of services through "direct commercial presence" in a member state. GATS imposes on all members transparency[22] and MFN treatment, subject to derogations.[23] The so-called "positive-list" approach adopted in GATS allows members to provide for national treatment exclusively in sectors they have decided to open up to international investors, with conditions or qualifications. GATS has thus been widely praised as a development friendly approach to liberalisation. UNCTAD (1996) notes,

> "by covering all factors of production, including the temporary movement of natural persons, the GATS opens opportunities for increased services exports from developing countries, and innovation of considerable importance to these countries. Furthermore, by using a positive list approach […], each country can strategically negotiate the individual service industries or transaction that it is ready to open up […], in pursuance of long-term progressive liberalisation."[24]

### I.6.3 TRIMS and GATS as a departure from BITs

GATS and the TRIMs Agreement have resulted in a certain degree of investment-related liberalisation by WTO Members and of investment protection. Moreover, both agreements impose certain obligations on transparency. The TRIMs Agreement constrains the use of performance requirements by host country governments, departing significantly from the provisions included in BITs, which usually do not.[25] GATS provides investors with MFN treatment, national treatment, movement of personnel and transfer rights in service sectors selected by members. Given the selective nature of the positive-list approach, GATS represents a clear departure from the BITs standard, which usually does not allow specific exceptions to non-discrimination obligations. Another difference is that GATS does not include provisions on investment protection normally included in BITs, other than the right of a foreign service supplier to make international payments and transfers. Moreover, the WTO Dispute Settlement Understanding (DSU) governs disputes arising in GATS, while BITs usually provide also for investor-to-state dispute settlement.

The TRIMs Agreement and the GATS are less invasive of the domestic policies of host countries than most regional trade agreements are. NAFTA, for instance, contains an outright prohibition of performance requirements, and has a sweeping cross-sectional approach to key provisions, including those relating to MFN and national treatment.

Even so, some consider the TRIMs agreement as a failed attempt to enshrine investment issues in the WTO framework, as it merely clarifies the application of existing GATT provisions. Bora (2002), for example, states that

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[21] See Box III.1.

[22] Members are required to publish and notify the Council for Trade in Services all laws, regulations and administrative measures relevant to the agreement in the case of committed service sectors (see also Nunnenkamp and Pant 2002).

[23] Members are allowed to list specific and/or general exceptions. The latter usually relate to reasons of public health or morality, bilateral tax treaties, incompatibility with an economic integration agreement, etc.

[24] UNCTAD (1996: 155).

[25] Notable exceptions being BITs concluded by the United States or by Canada.

> "the agreement is a rather modest attempt to disciplining policies that are targeted at foreign enterprises, and it was the outcome of conflicting positions about the extent to which investment issues should be covered by the WTO".[26]

Other commentators, for example Morrissey (2001), have argued that the TRIMs agreement imposes restrictions on government actions but no reciprocal restrictions on the actions of MNEs, although the latter may be just as trade-distorting as TRIMs. These issues are discussed in more detail in Part III below.

[26] Bora (2002: 171).

# Part II

# A MULTILATERAL FRAMEWORK FOR INVESTMENT: PROPOSALS AND CRITIQUES

After the First Ministerial Meeting in Singapore in 1996, the Working Group on the Relationship between Trade and Investment (WGTI) was set up with the mandate to study the relationship between trade and investment. In November 2001, at the Fourth Ministerial Meeting in Doha, WTO members decided to launch negotiations on a multilateral investment framework after the Fifth Session of the Ministerial Conference, subject to an agreement on the modalities of those negotiations at the latter conference in Cancun. Investment matters have been put on the WTO agenda by a number of industrialised countries, in particular by the European Commission and its member States (EC). A number of developing countries, among them India, Pakistan, Malaysia, and Egypt, have strongly opposed commencing formal negotiations. The following sections give account of the key points of dispute, by summarising the submissions to the WGTI by the European Commission, the main *demandeur*, and India, the main opponent. A further section is dedicated to the United States' proposal for an agreement with even broader coverage than that envisaged by the EC.

## II.1 The Doha mandate on investment

The Doha Declaration specifies that any negotiated commitments considered should be modelled on those made in services (GATS), that is, taking a positive-list approach, rather than making broad commitments and listing exceptions (the so-called negative-list approach). Paragraphs 20-22 of the Declaration the matters for discussion within the Working Group:

> "20. Recognizing the case for a multilateral framework to secure transparent, stable and predictable conditions **for long-term cross-border investment, particularly foreign direct investment**, that will contribute to the expansion of trade, and the need for enhanced technical assistance and capacity-building in this area as referred to in paragraph 21, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations.
>
> 21. We recognize the needs of developing and least developed countries for enhanced support for technical assistance and capacity building in this area, including policy analysis and development so that they may better evaluate the implications of closer multilateral cooperation for their development policies and objectives, and human and institutional development. To this end, we shall work in cooperation with other relevant intergovernmental organisations, including UNCTAD, and through appropriate regional and bilateral channels, to provide strengthened and adequately resourced assistance to respond to these needs.
>
> 22. In the period until the Fifth Session, further work in the Working Group on the Relationship between Trade and Investment will focus on the clarification of: scope and definition; transparency; nondiscrimination; modalities for pre-establishment commitments based on a GATS-type, positive list approach; development provisions; exceptions and balance-of-payments safeguards; consultation and the settlement of disputes between members. **Any framework should reflect in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest. The special development, trade and financial needs of developing and least developed countries should be taken into account as an integral part of any framework, which should enable Members to undertake obligations and commitments commensurate with their individual needs and circumstances.** Due regard should be paid to other relevant WTO provisions. Account should be taken, as appropriate, of existing bilateral and regional arrangements on investment."[27]

[27] (WT/MIN(01)/DEC/1: 5 - emphasis added).

Since the second half of 2002, discussions have intensified among WTO Members within the WGTI. Although some proposals have been advanced in the submissions by a number of countries, a draft agreement or draft modalities for negotiations has yet to be proposed. In the case of the European Commission, a clear stance on this issue has been elaborated, which could represent the basis for future negotiations on a formal MIF.

## II.2 Key elements of European Commission's proposal for a multilateral investment framework

The key elements of EC's proposals can be evinced from its recent submissions to the WGTI on the following matters: transparency, definition of investment, development provisions, pre-establishment rules, balance of payments safeguards, dispute settlement between members, and non-discrimination. These submissions are summarised below (see also Appendix Table 5).

### II.2.1 Transparency (WT/WGTI/W/110)

In EC's conception,

> "transparency means information […] [and] is closely linked to the principle of fairness as well as economic efficiency and legal security. In the international trade and investment area the legal requirement of transparency on host countries means, in general terms, the requirement of making available the relevant 'rules of the game' in force in their territory. The 'rules of the game' cover the relevant laws and regulations as well as the procedural rules and formalities regarding investment."[28]

The EC further claims that there is a case for a multilateral framework to secure transparent, stable, and predictable conditions for long-term investment, as greater transparency is said to encourage higher flows of FDI by reducing investor perceptions of risk. Moreover, it is said that multilateral disciplines on transparency provide an objective benchmark for overcoming this sort of obstacle to FDI. Alternatively put, lack of transparency creates uncertainty about the existing legal regime on investment in a certain country. Potential investors, therefore, tend to have higher estimates of the risks associated with investment in a non-transparent country, leading to distortions (inefficiencies) in the allocation of capital and/or to deterring investing into certain countries or sectors altogether.

Lack of transparency not only concerns the information about rules and regulations as such, but also their application. The EC goes on to explain,

> "the lack of clear rules is often the environment where private, secret and possibly corrupt deals and practices tend to prosper. Even when practices are not corrupt, the lack of transparency produces the inevitable perception that they might be affected by corruption. […] In sum, a non-transparent investment climate in any given host country does not allow foreign investors to take full advantage of the economic opportunities that could be expected from their venture abroad. This, in turn, will impede the positive feedback between FDI and growth in the host economy that would occur in a more transparent environment."[29]

Based on these considerations, the EC argues for a multilateral investment framework "that would at least match what is applicable for investors in services."[30] That is, similar to GATS, transparency provisions for investment should include elements relating to the publication and notification of "all relevant measures which pertain to or affect the operation of the Agreement"[31] within strict deadlines. Also, WTO members should be obliged to respond promptly to other members' inquiries regarding measures of general application, and also ensure procedural transparency, including the establishment of tribunals or procedures "for prompt and impartial review and remedy of administrative decisions affecting FDI."[32]

Developing countries with insufficient domestic capacity should be granted assistance in their efforts to implement the transparency provisions included in a multilateral framework. The EC notes that developing

[28] (WT/WGTI/W/110: 1).
[29] (WT/WGTI/W/110: 2-3).
[30] (WT/WGTI/W/110: 4).
[31] Ibid.
[32] (WT/WGTI/W/110: 5) - see also Appendix Table 5 on this point.

transparency provisions in a multilateral investment framework "[…] would not require WTO members to set up any new administrative machinery or to commit additional budgetary or staffing resources."[33] Moreover, it is emphasised that transparency should not be seen as a set of additional burdens for the host country, as the latter will benefit the most from increased FDI. It would also be possible for developing countries to use transparency rules in a "pro-active" way, for instance as a means to promote their investment regime among the investor community.

### II.2.2 Non-discrimination (WT/WGTI/W/122)

The EC notes that

> "the non-discriminatory treatment of international investment is a necessary condition for the development of a level playing field for FDI worldwide, which would improve the allocation of capital and minimise distortions, releasing additional resources. […] Moreover, all countries have realised that in order to attract foreign investors they need to provide, as a pre-condition, a predictable, transparent and non-discriminatory regulatory framework, beyond macroeconomic and political stability, infrastructure, labour skills, etc."[34]

Hence, the EC proposes to extend the degree of treatment granted to investment in the services sectors by the GATS to the primary and the secondary sectors. A multilateral investment agreement should include a general MFN obligation, pre- and post- establishment and allowing for exceptions; a general, post-establishment national treatment (NT) obligation, including possible exceptions; and a specific market access-related NT obligation for the admission of foreign investments to those sectors listed in each country's schedules of commitments, which would also list each member's derogations to the applicability of the provisions on national treatment. Finally, the EC proposal envisages the possibility of including general, as well as subject- and country-specific, exceptions to MFN and NT.

The EC concludes,

> "[…] while on the one side the above provisions would go a long way towards improving the legal security and coherence of international investment rules on the other side they would not prevent host countries and in particular developing countries from pursuing their domestic policies."[35]

### II.2.3 Pre-establishment (WT/WGTI/W/121)

In this paper the EC emphasises the importance of having clear rules on the admission of foreign investors. Currently, governments have the right to prohibit or restrict the entry of FDI and to impose entry conditions to permitted FDI. Despite the widespread unilateral liberalisation of FDI regimes by host countries, the EC notes, there still exist significant barriers worldwide preventing foreign investors from entering domestic markets. Therefore, the EC paper goes on to note that,

> "[…] admission rules may increase the legal certainty for companies that plan to set up an undertaking in a new host country by confining the wide area of discretion of host countries in a more predictable pattern. Generally speaking, open and transparent admission rules for foreign investment can significantly contribute to a better allocation of capital by creating a level playing filed among potential host countries and among investors. At the same time, host-country governments usually keep a certain control on the entry of foreign investors in order to preserve national development goals, security, public health, the protection of the environment, safety and public morals. These two objectives are not incompatible and can co-exist in a multilateral investment framework, as they do already in most international investment agreements. […] While on the one hand most host countries wishing to attract FDI have liberalised unilaterally the entry conditions for foreign investors, on the

[33] (WT/WGTI/W/110: 4).
[34] (WT/WGTI/W/122: 2).
[35] (WT/WGTI/W/122: 4).

other hand, it is only through international investment agreements that host governments are bound to provide the entry conditions that give investors the predictability and security they seek."[36]

The EC concludes,

" […] the GATS approach provides a useful model for addressing pre-establishment rules in a multilateral investment framework. On the other hand, governments can keep full control of the sectors in which they wish to commit market access and NT to foreign operators and of the sectors in which they do not feel ready to do so. On the other hand, it provides a transparent and predictable picture of the rules affecting the admission and establishment of investors in each host country. This approach has the merit of incorporating enough flexibility to allow a gradual and progressive liberalisation of FDI, fully compatible with any development strategy adopted by WTO members."[37]

Finally, the EC notes that since the GATS already applies to about one half of worldwide FDI stocks and flows, which are in the services sector, and considering that it is in that sector where WTO members impose most market access and discriminatory restrictions, its extension to the secondary sector would not represent a major difficulty for host countries. As far as the primary sector is considered, the EC claims, a positive-list approach would guarantee sufficient flexibility to take into account country-specific circumstances.

### II.2.4 Balance of payments safeguards (WT/WGTI/W/153)

The EC defines a balance of payments (BOP) crisis and related policy responses as follows:

"An unsustainable BOP situation in a given country may arise for a number of reasons and risks becoming a BOP crisis. One example of an unsustainable current account position is when the current account is in deficit, and the net imports of goods and services cannot be financed with a sufficient inflow of foreign capital or a reduction in foreign reserves. This may lead to an unsustainable BOP situation. The policy options available to the affected country include improving the current account, for instance by expanding exports or restricting imports (provided these restrictions are compatible with its international obligations and preferably not counterproductive in terms of future developmental objectives), or improving the capital account by encouraging capital inflows. The latter may be achieved by attracting more FDI or portfolio inflows. Borrowing, if sustainable in terms of future interest and capital repayments, from foreign banks, governments or international institutions is another policy option. Countries may also need to consider adjustments to their monetary and exchange rate policies.

In seeking to avoid serious BOP difficulties governments have sometimes taken restrictive measures on current transfers as well as on capital movements. However, such mechanisms involve costs and can introduce distortions for the country imposing them. Their adoption, or even threats of their adoption, can also provoke capital flight if investors want to 'get out while they can'. A future IDF [Investment for Development Framework] covering FDI would necessarily have to preserve a possibility for safeguards although within well-defined and internationally accepted criteria."[38]

Recognising that developing countries' financial systems are particularly fragile and exposed to instability, the EC proposes the inclusion of a provision allowing members to take safeguard measures in case of a BOP crisis, provided that such measures be taken exclusively

" in exceptional circumstances, in a non-discriminatory manner, in full compliance with the Articles of Agreement of the IMF, for a limited period of time and [do] not go beyond what is necessary to address the BOP crisis. They should also be notified to the WTO, and subject to effective, multilateral review, to be carried out in co-ordination between the WTO and the IMF."[39]

More specifically, according to the EC a future investment agreement should provide:

[36] (WT/WGTI/W/121: 2-3).
[37] (WT/WGTI/W/121: 4).
[38] (WT/WGTI/W/153: 2).
[39] (WT/WGTI/W/153: 1).

" - as a general rule, that members allow: all current and capital transfers related to established investments, and; as far as the making of new investments is concerned, all current and capital transfers related to those investments covered by the countries' sectoral list of commitments.

- as an exception, a safeguard clause to preserve members in case of serious BOP difficulties.

This provision should allow temporary restrictions on the outflows of current and capital transfers related to those investments covered in the IDF.

[…]

A safeguard provision allowing the imposition of investment restrictions for BOP reasons is an example of "escape clause" particularly relevant for developing countries. In any case, a BOP safeguard clause that allows members to take restrictive measures should only be allowed under exceptional circumstances, it should be clearly defined and include strict criteria. For instance, in our view, restrictions should:

- be non-discriminatory;

- be consistent with other relevant international provisions;

- be limited in time and phased out progressively;

- be applied in a way that does not exceed what is necessary to deal with the sudden difficulties;

- avoid unnecessary damages to the interests of other members;

- not be used to justify measures adopted to protect specific industries or sectors."[40]

### II.2.5 Development provisions (WT/WGTI/W/140)

Here the EC focuses particularly on the concept of "flexibility for development", and emphasises that the development dimension is a cross-cutting concern that is pertinent to the specific discussions on scope and definition, transparency, non-discrimination, and pre-establishment commitments contained in its submissions.

More specifically, the EC takes the view,

"[…] while most developing countries recognise the merit of providing an open and transparent investment climate in order to attract FDI, some of them also feel the need to maintain certain investment policies and measures aimed at promoting the development of specific sectors, regions, filling technology gaps or protecting minorities and cultural heritage. Regardless of the effectiveness or appropriateness of any specific policy, it is our firm conviction that any development policy and measures can and should be compatible with a multilateral investment framework.

By saying this, we believe not only that a MIF [multilateral investment framework] can and should be compatible with development objectives and policies, but in fact it could actually support them. Let us not forget that developed countries are both sources and destinations of the greater part of FDI flows worldwide. However, developing countries are those who most need FDI in order to make up for their lack of domestic capital and technology. A MIF would certainly benefit developing countries in particular by improving the legal security, transparency and credibility of their domestic framework.

Thus, should a MIF include meaningful provisions that enhance transparency, predictability and non-discrimination for FDI, those who will mostly benefit from it will be developing countries."[41]

The EC then goes on to explain its conception of flexibility:

" We wish to underline that flexibility for development is an important concept that should be taken into account in the negotiation of a MIF. However, if flexibility is understood as the right of a

[40] (WT/WGTI/W/153: 4-5).
[41] (WT/WGTI/W/140: 7).

government to discriminate among investors, it will not be effective as a means to enhance development. Flexibility instead can be useful if it is seen as a broader concept which combines an appropriate policy space that governments require to pursue their national development objectives with the quest for an appropriate stable, predictable and transparent FDI framework through which firms are encouraged to operate.

Flexibility is to make up for insufficient financial and human resources and, in particular, institutional weaknesses, which put heavy restraints on developing countries. Flexibility may typically involve: lower levels of commitments; asymmetrically phased implementation timetables; exceptions from obligations in certain areas; flexibility in the application of – and adherence to – disciplines. As already discussed in this Working Group, international investment agreements can include each, or a combination of these approaches and instruments."[42]

The European Commission shares the WTO Secretariat's view that

" the GATS is probably one of the most 'development-friendly' agreements in the WTO system because of its structure. […] It addresses the concerns and needs of developing countries through providing appropriate flexibility on an individual basis […], which allows each Member to undertake liberalisation commitments in a manner consistent with its development needs."[43]

These considerations lead the EC to recommend that a flexible, GATS-type structure (based on positive lists of commitments) be adopted for a multilateral investment framework, so as to allow some countries to make phased commitments on market access and NT, and also to attach to the latter conditions related to country-specific development objectives. The right to regulate in order to meet national policy objectives, and to include exceptions for public interest, should be explicitly recognized.

Finally, it is said, the Commission refers to its submission regarding foreign investors' behavior,[44] and cites the OECD Guidelines for multilateral enterprises as

" a useful example of how to ensure that MNEs conduct their activities in a responsible manner and in harmony with the policies of the countries in which they operate."[45]

### II.2.6 Definition of investment (WT/WGTI/W/115)

The Commission submits that the exact definition of investment should depend on the substantive provisions included in the agreement. More specifically, it notes,

"the need to preserve the development objectives of host countries in a multilateral investment framework should not be addressed merely by narrowing the scope and definition but rather by including substantive provisions that allow all countries, and in particular developing countries, to pursue their development policies. […] In any case, WTO Ministers have agreed in Doha that a multilateral investment framework should focus on long-term cross-border investment, particularly foreign direct investment. It is under this understanding that the EC presents its views in this paper."[46]

As a starting point for discussions on the definition of FDI in the Working Group, the EC proposes:

"- Direct investment enterprises: all incorporated (subsidiaries and associates) or unincorporated (branches) enterprises in which a direct investor owns 10 per cent or more of the ordinary shares or voting power or the equivalent.

Should a direct investor control the company with less than 10 per cent of the ordinary shares the following criteria could be taken into account to determine whether a direct investment relationship exists: (a) representation in the Board of Directors; (b) participation in policymaking processes; (c) inter-company transactions; (d) interchange of managerial personnel; (e) provision of technical information; (f) provision of long-term loans at lower than existing market rates.

[42] Ibid.
[43] (WT/WGTI/W/140: 3 – quoting WT/COMTD/W77).
[44] (WT/WGTI/W/81).
[45] (WT/WGTI/W/140: 4).
[46] (WT/WGTI/W115: 2).

- Direct investment capital transactions: as defined by the IMF and the OECD, it comprises both the initial transaction between the direct investor and the direct investment enterprise and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated. This includes all operations that create or liquidate direct investments as well as those that serve to maintain, expand or reduce investments, such as equity capital, long-term loans, reinvested earnings and other capital associated with various inter-company debt transactions.

- Foreign direct investors: this concept could include all natural persons and companies of WTO Members, including public or private incorporated or unincorporated enterprises, which engage in a direct investment enterprise - such as a subsidiary, associate or branch - in a country other than the country or countries of residence of the foreign direct investor or investors."[47]

The EC concludes by noting that it looks favourably at "applying a basic definition for the admission of foreign investment and a wider definition as regards the protection of established investment".[48]

### II.2.7 Settlement of disputes between members (WT/WGTI/W/141)

With respect to dispute resolution, the EC argues as follows:

> "In line with all other WTO agreements, the EC believes that a future Multilateral Investment Framework (MIF) should include the possibility for members to resort to the WTO dispute settlement mechanism where they consider that other members have failed to observe their obligations under the agreement…"[49]

Moreover, the EC notes that

> "The WTO system includes a strong and effective consultation and dispute settlement mechanism which contributes to the fair management of disputes among Members. The GATS, which already addresses around half of world FDI flows (under mode 3) is covered by the WTO DSU. For the sake of consistency, any possible dispute concerning a future multilateral framework on FDI to be negotiated and agreed in the WTO should also be fully covered by the WTO Dispute Settlement mechanism.
>
> We believe that the appropriate forum to address possible disputes arising on the interpretation and application of a future multilateral investment framework to be negotiated and agreed in the WTO context should be the existing WTO Dispute Settlement mechanism. The relationship between the DSU and the State-to-State dispute settlement provisions of bilateral or regional investment Treaties may have to be addressed."[50]

### II.2.8 Key assumptions underlying the EC proposals

It appears that the submissions containing the key elements for a GATS-like MIF are based on a number of assumptions and arguments, which can be summarised in five points:

1. A multilateral agreement would secure transparent, non-discriminatory, stable and predictable conditions for long-term investment. It is only through international investment agreements that host governments are bound to provide the entry conditions that give investors the predictability and security they seek.

2. Besides representing a pre-condition to attract foreign investors, this would reduce investor perception of risk and create the necessary conditions among host countries and investors for a level playing field for FDI worldwide, which in turn would encourage higher FDI inflows, make the allocation of capital more efficient, reduce distortions, undermine actual or perceived corruption, and foster the positive effects of FDI on economic growth in the host country.

[47] (WT/WGTI/W/115: 4).
[48] (WT/WGTI/W/115: 5).
[49] (WT/WGTI/W/115: 1).
[50] (WT/WGTI/W/115: 3).

3. It is the host countries, rather than home countries, that eventually benefit the most from more transparency, as this will not only increase FDI, but also because other negative effects associated with lack of transparency – particularly on productivity, domestic investment and economic growth – will be ameliorated.
4. The GATS represents a development-friendly international agreement, because it guarantees flexibility, i.e. it allows countries to open up their economies to international investment in those sectors at a time, and in a manner, that governments themselves regard as being compatible with national development plans.
5. Therefore, the extension of GATS-type provisions to all economic sectors, beyond the tertiary sector only, would not prevent host countries from pursuing their domestic policies.

Much debate within the WGTI has been about whether or not the assumptions underlying the EC-stance on a MIF are justified on conceptual and empirical grounds. The next section discusses the main critiques of a MIF raised by some WTO members and a number of sceptical outside observers.

## II.3 A survey of the critiques of the EC proposals

Arguments critical of the EC proposals have been developed along two lines. First, they directly address flaws and weaknesses in the logic underlying the EC concept papers. Second, they question the appropriateness of a GATS-style MIF on developmental grounds.

### II.3.1 Some notes on EC's concept papers

The persuasiveness of EC's position on investment is partly undermined by the rather dogmatic approach it appears to have taken in justifying its proposal for a MIF. Rather than building its case on sound conceptual grounds and compelling empirical evidence, the arguments are seemingly based on conjectures. Attempts to provide definitions or explanations of key concepts are often inaccurate, or overly simplistic. For instance, the definition of a BOP crisis quoted above seems to neglect the most basic insights from the vast literature on the causes of - and remedies of - BOP crises.[51] Similar inaccuracies can be found in other parts of the EC submissions.

Section II.2.8 has summarised in five points the implicit logic of EC's submissions. It would appear that the concept of "transparency" is attributed paramount importance in EC's justification for a MIF. It is worth noting, therefore, in its submission on transparency the EC refers to two pieces of empirical research: the TN SOFRES Business Survey, commissioned by the EC itself, and the Opacity Report by PriceWaterhouseCoopers. The EC paper notes that the TN SOFRES Business Survey was

> "conducted for the EC Commission in April 2000 among some of the biggest EU companies, showed that lack of transparency on local legislation and rules was considered the most frequent hindrance to investment by 71 per cent of the companies."[52]

The EC submission in question does not mention perhaps the more interesting results of this survey. First, smaller European businesses tend not to report that they had encountered investment barriers, while big businesses encounter barriers more often. Second, the United States is found to have about as many obstacles to international investment as Malaysia, Poland, and Indonesia. Third, among the 10 most awkward barriers to foreign investment, non-transparent national or local laws and regulations ranked fifth, with less than 20 percent of businesses considering them as awkward enough so as to prevent them from operating abroad. Fourth, only about 10 percent of EU-based multinationals have working knowledge of GATS, less than 10

[51] Without entering into the details of such studies, a critical reader may well be sceptical about the value of EC's list of remedies a financially distressed country would have in order to avert an outright crisis. For example, borrowing fresh private capital is hardly an option for a distressed economy, as in such situations capital tends to leave, rather than entering a country. The small amounts of capital that might enter a financially distressed country is usually highly speculative and is in search of under-priced assets. Boosting exports in the short term, or restricting imports are hardly viable options on the current account side, for obvious reasons of sheer impossibility or economically and/or socially unsustainability (this, at least, the EC seems to have recognised). Furthermore, while most would agree that restrictive measures on current account transfers can introduce distortions, many would also recall from early BOP crisis models that investors may well have a strong enough incentive to flee a country without such measures being imposed.

[52] (WT/WGTI/W/110: 2).

percent of BITs, or the NAFTA Investment Chapter, and less than five percent of the TRIMs Agreement. Less than 10 percent have working knowledge of OECD Guidelines for Multinational Enterprises, and less than five percent of the Tripartite ILO Declaration. If most business people are unaware of the very investment provisions that are said to benefit their companies, it is unlikely that such business people are differentiating between overseas economies on the basis of the investment protection offered. However one may interpret these results, arguably they do not appear to make a particularly strong case for the proposed multilateral disciplines on transparency in investment.

The EC paper also refers to the PriceWaterhouseCooper Report on Opacity,[53] which finds that "opacity", measured as a weighted index of corruption, legal, judicial, economic, accounting and regulatory lack of transparency, can adversely impact the cost and availability of foreign capital. The report concludes that "opacity imposes significant costs on investors – be they individual or corporate- and on countries."[54] This result is not surprising. In fact, there is almost unanimous consensus among scholars and practitioners alike, that transparency, in its broad sense, is a necessary condition for markets to work properly. Also the fact that increased transparency is likely to curb corrupt practices is not much disputed. For example, research in the fields of information economics and the economics of the firm have demonstrated that a higher degree of transparency reduces agency problems and, more generally, is conducive to a more efficient allocation of capital. Furthermore, a substantial body of empirical research has demonstrated that corruption and more generally lack of transparency in the host country can have a significantly negative effect on the amount and form of FDI flows to that country. However, the results from empirical studies on the determinants of FDI, as summarised in Appendix Table 8, also show that it is mainly economic fundamentals – such as national income –that underlies investors' preferences to invest in certain countries rather than in others. This is further sustained by clear anecdotal evidence on huge amounts of FDI flowing to notoriously non-transparent and corruption-ridden countries, such as China and Malaysia.[55] In short, while it is reasonable to assume that international investors prefer countries offering a higher degree of transparency to invest in, and are sometimes deterred from investing at all in countries where transparency falls below a minimum acceptable level, there is no reliable empirical evidence that suggests that transparency is as important as economic fundamentals, such as national income. For instance, it may be argued that even more FDI would have flowed into China over the last decade had it been more transparent and less corrupt. This may be true or not, but it is certain that China would not have received all that FDI if it did not dispose of a huge domestic market, a vast amount of relatively cheap resources and assets, etc.

Similarly questionable is EC's claim that it is the host countries, rather than home countries, that will benefit most from improvements in transparency. This must necessarily be true if a MIF does in fact increase transparency and overall economic efficiency in host countries, and the latter are less transparent, before the introduction of MIF, than home countries. However, this may not hold true if home and host countries have a similar degree of transparency; if a MIF fails to considerably improve transparency; or if investors fail to significantly adjust their risk assessments and keep the cost of capital to perceived non-transparent countries high. None of these possibilities seem to have been addressed in EC's concept papers.

In sum, the evidence on the effects of improving investment-related "transparency" alone does not appear to make a strong case for a MIF. This is not to say that EC's claim[56] that a multilateral investment framework would secure more transparent, non-discriminatory, stable and predictable conditions for long-term investment is incorrect *per se*. What is mainly contested here is largely unfounded assumption that a MIF would have a significant impact on the amounts of FDI inflows to developing countries.

Although a MIF would increase stability and predictability of rules governing FDI, it is not clear why only a multilateral agreement would achieve these results. As further discussed below, a GATS-type investment agreement within the WTO framework would certainly provide investors with a clear indication on market access and conditions set out in each member's schedule, together with more leverage to retaliate against non-complying members. However, bilateral investment agreements are also legally binding, and in some case also include provisions regulating entry conditions for FDI. Moreover, some allow for investor-to-state disputes, while a MIF within WTO would not. Furthermore, even if there were significant benefits from a MIF

[53] PriceWaterhouseCoopers (2003).
[54] PriceWaterhouseCoopers (2003: 10).
[55] A point raised also in Singh (2001).
[56] See point (1), Section II.3.1.

in terms of higher FDI inflows due to increased credibility and stability of rules, then it still has to be demonstrated that such benefits would more than outweigh the costs associated with the loss of flexibility for host countries to choose and condition investment projects on a case-by-case basis.

Related to the "transparency-argument" is EC's claim that a MIF would create a level playing field among host countries and investors, resulting in a more efficient allocation of capital and fostering host country FDI-related growth. This logic seems to be anchored in a crude version of the traditional neo-classical paradigm, where any removal of distortions to the proper working of markets brings about a more efficient outcome. As will be further argued below, the implications of that paradigm certainly fail to apply to those instances where all its assumptions are clearly violated. This is particularly true in the case of FDI, which typically occurs in concentrated markets and is associated with market failures. Hence, a number of commentators have questioned the claim that a MIF would create a level playing field for FDI worldwide. Rather, some argue,[57] it would strengthen the market power of those MNEs that already enjoy strong advantages over host countries' domestic firms.

A crucial assumption underlying EC's proposal for a GATS-type MIF is that the latter, by allowing progressive liberalisation of FDI flows tailored to their national development plans, is necessarily development-friendly.[58] If this were true, the strong opposition to the proposal from a group of developing countries within the WTO would be unjustified. In order to make sense of these strongly opposing positions, it is essential to distinguish between what is defined here, rather loosely, as "absolute flexibility" (or development-friendliness) and "relative flexibility". The former refers to full determination of national policies relating to FDI, both at the pre- and post- establishment phase. In contrast, the concept of "relative flexibility" refers to the maximum flexibility attainable with a multilateral agreement in place. By definition, a multilateral agreement on investment does constrain to some extent the degree of policy flexibility of adhering countries, as it aims at removing policy-related obstacles to what is thought to be the proper functioning of markets. It is doubtful whether a MIF can be designed in a way so as to distinguish between government interventions that are efficiency-enhancing and those which are not. For those having some faith left in the potential benefits from active government intervention in the developmental process, the development-friendliness of a multilateral investment agreement is measured in terms of the degree of flexibility it leaves to host countries in pursuing their development plans and policies. More specifically, UNCTAD (2000b) defines the concept of flexibility as

> "the ability of IIAs [International Investment Agreements] to be adapted to the particular conditions prevailing in developing countries and to the realities of the economic asymmetries between these countries and developed countries."[59]

UNCTAD argues that flexibility of an IIA crucially depends on the combination of:

1. the development objectives set out in the text, usually the preamble, of an investment agreement;
2. the overall structure of an IIA, particularly with regard to special principles and rules, and modes of participation relating to developing countries;
3. the substantive content of an IIA, which needs to reflect development concerns and an overall balance of rights and obligations;
4. the application of an IIA, and particularly the interpretation of its provisions.

Among a number of international trade and investment agreements analysed by UNCTAD on the above criteria, it finds the positive-list approach adopted by GATS as the framework providing the highest degree of flexibility.

Given that proposals any MIF will not take a more concrete and detailed shape until negotiations are concluded, such an MIF cannot be fully assessed against the criteria set out by UNCTAD. Nevertheless, a GATS-type multilateral investment agreement, basically by allowing countries to decide the preferred timing, subjected sectors and the conditions of liberalisation to FDI, would indeed allow for a relatively high degree

[57] Singh (2001), Morrissey (2000), Kumar (2001).
[58] See (4) and (5) in Section II.3.1.
[59] UNCTAD (2000b: 1).

of (relative) flexibility.[60] This is particularly evident when a GATS-MIF is compared to the highly inflexible OECD proposal for a MAI. The EC has made this distinction, as shown in Table II-1.

Most commentators[61] seem to agree that a GATS-type MIF compared to OECD's proposed MAI does indeed represent a significant step forward, in terms of flexibility. Yet, the crucial point in the arguments put forward by the opponents of MIF is that developing countries need to retain a degree of absolute flexibility, which a potential multilateral investment framework would tend to constrain. Therefore, any country unwilling to give up policy flexibility at least to some extent, as it appears to be case with India, will be strictly opposed to any MIF.

In sum, EC's arguments in favour of its proposal for a GATS-type MIF are not compelling, as they are not sustained on analytical and empirical grounds. This has left plenty room for opponents to reject a MIF on fundamental grounds with the key disputed matter being the alleged development-friendliness of a MIF. The views of such opponents will be considered in even greater detail next.

**Table II-1 Why, according to the EC, its proposals are different to the OECD-MAI**

| Provisions | OECD Draft MAI | Potential Multilateral Framework on Investment EC Position |
|---|---|---|
| **Definition of Investment - Scope** | MAI proposed a wide definition of investment, including portfolio investment. | We propose FDI (Foreign Direct Investment) only. It may be difficult to define, but it is imperative to make clear that this is not a capital liberalisation code. It is not full assets based, and would not a priori include short term movements of capitals. |
| **Expropriation** | MAI went beyond customary international law on expropriation, including "indirect expropriation" (NAFTA-style language on "measures tantamount to expropriation"). | We propose, at a maximum, the traditional rules on expropriation (those contained in the BITs of our MS or of countries like India). |
| **Type of liberalisation commitments** | MAI provided for a right of admission (subject to exceptions : the so-called "top-down" "pre-establishment national treatment"). This led to 'negative lists' of limited sectors that could remain unliberalised. | We propose a GATS-style, "bottom-up" approach to admission of investors : the host country chooses whether or not to open a sector. This implies on the contrary a positive list approach of sectors that countries choose to liberalise when they are ready. |
| **Right to regulate for States** | From previous « top-down » provisions, MAI derived only limited right to regulate for States | The bottom-up approach allows States to keep their right to regulate, in a manner consistent with principles of transparency, non-discrimination, predictability and their development needs. |
| **Provisions for development** | MAI was criticised of not paying attention to the flexibility needs of Developing countries when signing up to international rules. | When deliberating a possible Investment Agreement in WTO, taking into account articles of the existing agreements, it should be possible to formulate flexible rules in a manner that respects development policies. |
| **Dispute Settlement** | MAI provided for investor-to-State dispute settlement. | We propose the WTO DSU and nothing else. |
| Source: www.europa.eu.int/comm/trade/miti/invest/index.htm | | |

[60] This is not to say that the overall balance of rights and obligations of a MAI would not ultimately depend on the inclusion of provisions such as binding rules on investor behaviour and on incentives.

[61] Also including the most critical among them, e.g. Singh (2002), Kumar (1999).

### II.3.2 Main arguments for opposing an MIF on developmental grounds, put forward by a group of WTO Members and outside observers

It appears from the submissions to the WGTI that India is the country most strongly opposed to an international investment agreement. Although some developing countries, e.g. Brazil and Malaysia,[62] have expressed their support for a GATS-type approach to investment, India's position can be regarded, by and large, as being representative of the concerns of a broader group of low-income and least developed WTO Members. Appendix Table 6 gives detailed account of the main points raised in India's submissions to the WGTI and these include: concerns regarding the FDI-development nexus, the effects of a MIF on the amount of FDI inflows, the inclusion of development provisions and investor obligations in a MIF, the constraints on imposing performance requirements, and the exclusion of investment incentives. This section now turns to an account of some of the potential costs associated with a multilateral investment agreement, as highlighted by some prominent commentators.[63]

**1. A trade-type regime is not appropriate for investment**

a) The principle of comparative advantage provides the conceptual basis for trade liberalisation. According to the former there exists a wide range of circumstances under which all countries benefit from international trade. According to Kumar (2001),

> "unlike trade, FDI flows emerge because of differences in the levels of development and bundles of created assets. […] From the start, MNE entrants enjoy an edge over local enterprises, if there are any existing at all, because of their monopolistic ownership advantages. […] Therefore, offering national treatment to foreign enterprises would amount to discriminating against the latter. In most developing countries, the little local entrepreneurship that exists runs the risk of vanishing altogether if forced to compete with the mighty global corporations under 'national treatment'."[64]

> In these circumstances, the mechanical application of WTO principles of national treatment and market access would lead to exit by domestic firms, producer concentration, high prices, inefficiency and thereby harm economic development in developing countries. As a remedy, competition authorities in developing countries should be exempted from applying these principles, for instance, by allowing domestic firms to merge but denying mergers involving foreign multinationals. This would ensure more competition, increase efficiency at a global level and also positively influence host country economic development (Singh 2001).

b) FDI is a development and industrialisation issue, rather than a trade issue. With the exception of trade-related investment, already regulated by TRIMS and GATS, there is little justification to include investment in the WTO framework.

c) Moreover, some have argued that the "WTO does also not have the competence to deal with investment and development issues."[65]

**2. Governments need to regulate FDI for it to be beneficial to the process of economic development**

a) Studies examining the developmental impact of FDI have found that those countries pursuing selective policies with respect to FDI have generally had greater success in pursuing their developmental objectives than those that pursued more open policies. Kumar (2001) refers to UNCTAD's conclusions in their literature survey on FDI and development, noting that

> "the impact of FDI on development goes well beyond its linkage with trade […] and […] can be negative. The effect of FDI on development depends on the initial conditions prevailing in the host

[62] Malaysia said that a GATS-type positive list approach would be in favour of developing countries, but also called for permanent exemptions from any obligation regarding admission of FDI.
[63] This part mainly draws from Singh (2001), Kumar (2001), Das (1999), and UNCTAD (various issues of the World Investment Report).
[64] Kumar (2001: 7-8).
[65] Kumar (2001: 8).

countries, on investment strategies of companies and on the host government policies. Governments, therefore, cannot be passive."[66]

b) A large body of literature on the beneficial effects of FDI, in terms of technology transfer and spillovers, has demonstrated that the benefits are highest when FDI is carefully regulated. Furthermore, empirical studies have shown that FDI may fail to have positive effects on a country's capital accumulation and economic development. According to one prominent scholar,

"This is the reason why, other than Hong Kong, most successful Asian countries […] have not allowed unfettered FDI but have extensively regulated it. […] Developing countries need to regulate FDI closely in order for it to promote economic development and not to hinder it."[67]

c) On this view, therefore, a MIF could seriously prejudice economic development if it prevented the careful regulation of inward FDI.

**3. A MIF would increase the volatility of capital flows**

a) FDI has become a predominant source of external capital for developing countries. International liberalisation of trade and capital flows has greatly increased their needs for external finance, while official capital flows have declined. As a result, developing countries have become more balance-of-payments constrained than before, which in turn has resulted in stronger competition to attract FDI. This has shifted the balance of power in the negotiations over FDI projects towards MNEs. Instead of addressing this imbalance, a MIF is likely to make it worse by giving developing countries less instruments to attract and discipline investors (Singh 2001).

b) Although FDI is widely considered as the most stable from of private capital flows, it would be wrong to consider it exclusively as "brick-and-mortar" long-term investment. Singh (2001) notes that unless developing country governments can adequately regulate the timing, quality, and total amount of FDI, FDI can lead to short- and long-term financial fragility, making these countries prone to financial crisis. Moreover, the presumption that FDI flows are more stable than portfolio flows need not be the case. For instance, Singh (2001) argues, a foreign direct investor's assets can be in fact fully offset by locally-acquired liabilities, perhaps by borrowing in the host country's financial markets. In this way, even though any "bricks and mortar" investments cannot easily flee a country, the financial funds associated with FDI can. Furthermore, a large part of some countries' FDI inflows consists of retained profits, which are highly volatile because they depend on the business cycle. Besides, surges of FDI inflows can have disruptive effects by appreciating the exchange rate, thereby reducing a country's competitiveness in the tradable sector. These considerations suggest that to the extent that a MIF would not permit regulation of FDI, at least as far as liberalised sectors are concerned, "it would subject developing economies to much greater financial fragility than would otherwise be the case."[68]

c) A MIF-enforced liberalisation would also make the management and forecasting of balance of payments flows largely dependent on factors that are not under control of the host countries themselves. Particularly in least developed countries, the extreme case of a dominant share of BOP flows being determined by a few MNEs operating on its territory cannot be discounted.

d) A MIF, by giving virtually complete freedom to multinationals, would fail to stimulate higher capital flows to those countries that need them the most to meet their development goals (Singh 2001).

**4. There is an even stronger argument for regulation if FDI takes the form of M&A**

a) Although still predominantly "greenfield", FDI to developing countries increasingly takes the form of mergers and acquisitions.

b) "When FDI takes the form of greenfield investment, it represents a net addition to the host country's capital stock. However, FDI entry via an acquisition may not represent any addition at all to the capital

[66] Kumar (2001: 7 – quoting UNCTAD (1999b).
[67] Singh (2001: 19).
[68] Singh (2001: 18).

**Box II-1: Examples of potential negative effects of FDI on host country development**

Probably the biggest concern about more FDI felt by less developed countries is with regard to the market power. Most of FDI is channeled through multinational firms (MNCs) that are powerful in the global market.

FDI adversely affects domestic entrepreneurship and particularly infant industries. It can do so in two ways: directly through more competition and indirectly through increasing the cost of scarce resources, e.g., domestic source of raw material and finance.

It is argued that FDI into cultural industries (like music, or rice for Japan for that matter) may "pollute" a country's heritage. MNCs have a global perspective in mind and care about their growth in the global market. Hence they may use a particular host country as no more than a location for production or for distribution. In this case, the growth of such a host nation may not be significantly affected by the presence of FDI through MNCs.

There may also be informational problems. Free entrance to foreign markets would help MNCs to recycle their outdated technologies to uninformed and unsuspecting host countries. In other words, there may be *technology dumpin*g. On the other side, MNCs, due to their lack of information, may also make wrong, inefficient locational choices.

Inefficient competition in attracting FDI among potential host countries could also emerge. This would force host countries to offer tax holidays, thereby worsening the budgetary position of developing countries.

International trade and FDI may be substitutes. By inducing international prices to converge, free international trade in goods would narrow down the differences in factor rewards (through product and factor market linkages) and reduce the incentive for capital to move across countries. The reverse argument also holds.

There is also the *pollution haven hypothesi*s. FDI would encourage firms from developed countries to move their outdated, pollutive industries to the "South". This would worsen the environment in the South as well as the global environment.

FDI into skill-intensive sectors in developing countries would increase the relative demand for skilled workers and thereby raise the skilled-unskilled wage gap. Thus, the income distribution in these countries, presumably more unequal than in industrialised countries, would be further 'worsened.'

**Source**: Das (1999: 12-16).

stock, output or employment. In the medium term there may be more investment by the acquiring firm if the acquisition is deemed successful. How beneficial FDI is to developing countries in the long term, if it takes predominantly the form of cross-border take-overs of domestic firms by foreign corporations, is ultimately an empirical question on which there is so far little hard evidence."[69]

c) A MIF providing unfettered market access to certain sectors could result in efficient developing country corporations being acquired by larger, not necessarily more efficient multinational corporations. Also, the strong mergers and acquisitions wave is likely to further accentuate the market power and size of MNEs as compared to most developing country corporations. The fear is that once MNEs get a free foothold into a market, they would wield considerable market power. Furthermore, by driving out domestic firms through predatory practices they can exert monopoly control in the future (Singh 2001, Das 1999).

**5. If there is a rationale for granting free market access and national treatment to capital it should also apply to labour**

a) With freer mobility of capital provided by a MIF, and labour being essentially immobile, the distribution of income would further shift towards the owners of capital, with potentially negative consequences on labour standards and job security in industrialised countries (Singh 2001).

b) If there is a compelling economic argument favouring free movement of capital then, it is said, there is no reason why liberalisation should not include labour. Since the significant liberalisation of the latter is not

[69] Singh (2001: 22).

on the negotiating agenda, the argument goes, where is the incentive for developing countries to negotiate the liberalisation of capital?

These arguments, together with those contained in India's submissions (summarised in Appendix Table 6), provide some insight into why opponents of a MIF do not consider the latter to be development-friendly. Overall, it appears that opponents would not only reject EC's proposal for a GATS-type MIF, but any multilateral investment framework constraining host countries' policy options. A full degree of flexibility in defining and implementing such policies by host governments is seen as a necessary condition for effectively correcting market failures associated with FDI, so as to close the gap between private and social effects from investment. Essentially, these contrasting positions arise from the unsettled debate concerning the optimal degree of government intervention in markets. This discussion on international rule-making, therefore, has to address the fundamental question as to how far governments should be allowed to intervene in their markets, which has no clear-cut answer in economic theory, particularly in the case of markets characterised by imperfect competition and market failures.[70,71]

## II.4 A recent reply by the EC to MIF opponents - Policy space for development (WT/WGTI/W/154)

Recently,[72] the EC has submitted a new concept paper, that

> "[…] addresses some of the concerns expressed in this working group regarding the need of host countries, and in particular of developing countries, to preserve policy space for the purpose of regulating in the public interest and for development purposes."[73]

The EC notes that since

> "[…] some members still fear that any investment framework would prevent developing countries from pursuing particular policies[,] we feel that the time has come to try to clarify and substantiate these statements. In particular, it would be useful to start by giving concrete examples of the policies that have been brought forward as impeded by the possible rules that have been proposed in the WGTI by several members. This paper aims at giving a concrete contribution to this debate."[74]

The EC refers in this submission directly to the position taken by India, as reported in WT/WGTI/W/8[75] and WT/WGTI/W/18,[76] where the latter emphasises its preference for BITs over a MIF, essentially because BITs

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[70] See, for example, Stiglitz (1996), Rodrik (1995), Aoki, Kim, Okuno-Fujiwara (1997), Khan and Jomo (2001), Wade (1990), Amsden (1989), Noland and Pack (2003).

[71] Nor can a conclusive answer be drawn from the existing body of empirical evidence on this fundamental dilemma. However, a rather strong consensus seems to have formed regarding one of the principles of practice of policy, which postulates that "if there is no forceful theoretical support for welfare enhancing effects of a policy intervention, the benefit-of-doubt belongs to the market, not to policy activism" (Das 1999: 17). That is to say, if some developing countries oppose a MIF on grounds of absolute flexibility of policy intervention, then the burden of proving such policies to be indeed welfare-enhancing, rather than distorting, is with the same countries. As a matter of fact, there are a few developing countries, mostly located in the East Asian region, that are usually mentioned as having successfully implemented "market-enhancing" interventions, resulting in high per-capita GDP growth rates and accelerating overall development. India, it must be noted, is usually mentioned among those countries that have largely failed in their attempts to do so since the early 1960s.

[72] The EC submission WT/WGTI/W/154 was issued on 7 April 2003. Although it was published after the cut-off date for WTO documents to be considered in this chapter, and was made available on the WTO web-site only lately, this submission is being considered here because it directly addresses some of the concerns raised by MIF opponents.

[73] (WT/WGTI/W/154: 1).

[74] Ibid.

[75] WT/WGTI/W/8.

Paragraph 47: The representative of India introduced a written contribution (WT/WGTI/W/71) on India's experience with bilateral investment treaties. India had concluded such treaties with 25 countries, had finalized treaties with nine other countries, and was in the process of negotiating treaties with seven countries. The contribution discussed the main features of such treaties, including provisions on the definition of investment, the scope of the agreements, MFN and national treatment, expropriation, compensation and repatriation, dispute settlement and the duration and termination of the agreement. Bilateral investment treaties had found favour with developing countries such as India because they did not restrict the ability of host countries to follow their own FDI policies in light of their unique needs and circumstances. Under these treaties, developing countries had the freedom to grant national treatment only in the post-establishment phase, subject to such qualifications as they deemed necessary.

Paragraph 48: The representative of the European Communities requested an explanation of what kind of qualifications to national treatment India considered useful as a policy tool. He also asked what was the relationship between India's bilateral investment treaties

provide investment protection but do not grant market access, while the proposed MFI is mainly on rules for pre-establishment.[77]

The EC notes that, "[…] according to these members, their policy space would be impeded mainly by pre-establishment rules"[78], and questions whether a MIF would prevent countries from using those policy instruments they consider as necessary to achieving host country development objectives.

The EC position on the alleged flexibility of a GATS-type MIF is then reiterated using the same logic followed in previous submissions:

> "Under the GATS-type approach, members first decide, for each sector, whether to take commitments or not. If a member decides not to take any commitment in a given sector, it remains free to be as open or as closed to foreign investment as it chooses, at any given time. If it decides to take commitments in a given sector, then the member may include in its schedule of commitments limitations to National Treatment (NT) and Market Access (MA). The limitations to the NT principle and MA can also be included as horizontal commitments, which means that they may apply to all sectors of the economy, and not just to one specific sector. Even after taking commitments, a member may still modify or withdraw any commitment in its schedule, provided it follows certain procedures[79]. Indeed, this may not always be straightforward in practice, but WTO members will be able to draw lessons from the GATS experience. Under this system, each member has to strike its own balance between providing certainty (thus, increasing the possibilities of attracting FDI) and retaining flexibility."[80]

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and the MFN principle. Not enough attention had been paid so far to the concrete implications of principles such as national treatment and MFN treatment. In this respect, his delegation welcomed the contribution presented by Costa Rica at the last meeting (WT/WGTI/W/68). An interesting aspect of this contribution was that the investment agreements concluded by Costa Rica provided for national treatment in relation to the pre-and post-establishment phases of investment, but that only established foreign investors could invoke the investor-state arbitration provisions.

Paragraph 49: The representative of India stated that his delegation had consistently taken the position that it was not possible for a country like India to accord a right of establishment or national treatment in the pre-establishment phase and that the entry of foreign investment needed to be regulated. In all India's bilateral investment treaties national treatment and MFN treatment were accorded with respect to the post-establishment phase once investments had been admitted in accordance with the applicable policy framework. Bilateral investment treaties provided protection of foreign investment and did not deal with market access issues. By contrast, the current discussion in this forum centred on the need and desirability of a possible multilateral framework, the main focus of which was market access. Because of this qualitative difference between bilateral investment treaties and the proposed multilateral rules on investment, the argument that multilateral rules were more efficient because they would obviate the need for concluding a large number of bilateral treaties was without merit.

[76] WT/WGTI/M/18.

Paragraph 74: Developing countries also needed policy flexibility to determine the form of investment that would lead to the highest growth. He recalled that his delegation had already highlighted, at the last meeting of the Working Group, the need to focus on those investments that contributed to the expansion of trade, as clearly indicated by Ministers at Doha. The definition of investment would have important implications for the development dimension. Greenfield investments, for example, could be of more significance than mergers and acquisitions as they would have more beneficial multiplier effects on the economy. Likewise, developing countries would need to guard against the crowding out effect of foreign investment, as clearly pointed out in UNCTAD's World Investment Report of 1999. Any movement of capital that caused serious damage to domestic industry, particularly small and medium enterprises, or that had adverse effects on employment, would need to be carefully regulated. Developing countries needed to retain the ability to screen and channel foreign investment in accordance with their domestic interests and priorities. Bilateral investment treaties had been favoured the world over for precisely the flexibility they provided to the host country in this regard.

Paragraph 137: The representative of India responded to observations made by delegations on a number of issues raised by his delegation in its earlier intervention. Regarding the positive impact of FDI on a host country, there was no doubt that FDI could bring into the host country a number of valuable resources for development such as capital, technology, managerial and marketing skills and sometime market access in the case of export-oriented FDI. Export-oriented FDI had evidently helped a number of countries to build rapidly their manufacturing and export capabilities. It would be important to examine the conditions and factors that promoted the export platform or export-oriented FDI. In comparing greenfield investment with mergers and acquisitions, it was the former, as UNCTAD studies had pointed out, that had the more beneficial effects on host economies. India had been liberalizing its foreign investment policies for more than a decade, and had one of the most liberal foreign investment regimes. However, as the UNCTAD presentation had brought out, there could be certain negative effects as well. The point that his delegation wanted to stress was that the positive effects of FDI might not always come about automatically, and that developing countries needed to retain the ability to screen and channel FDI in accordance with their domestic interests and priorities in order to maximize the positive effect and to minimize the negative effects of FDI. His delegation emphasized that, at this point, it had heard no convincing argument that a multilateral framework on investment would achieve this objective.

[77] See footnote 4, paragraph 49.

[78] (WT/WGTI/W/154: 2).

[79] GATS Article XXI.

[80] (WT/WGTI/W/154: 2-3).

The examples of policies aimed at increasing employment, of policies designed to generate and transfer technology, of policies aimed at protecting minorities, and of other host country policies are then listed to "show how certain specific policies can be dealt with under the GATS-type approach." [81]

Although further details can be found in this EC submission, it suffices here to note that the logic of argument appears to be the same as in earlier submissions, specifically:

1. Host country policies designed to generate the desired effects of FDI may or may not be appropriate. A number of well-known studies are cited to corroborate the point of view that they often are not.
2. Notwithstanding the above, if a WTO Member believes its welfare is increased by imposing conditions on FDI, it would still be able to do so under a GATS-type MIF. This is because either such policies could be applied in a non-discriminatory way without restricting market access (and therefore without even the need to list limitations in the country's schedule of commitments), or, if such policies were discriminatory, the imposing country could include them as horizontal, i.e. economy-wide, or sector-specific limitations to their national treatment commitments.
3. Therefore, the EC concludes, countries would have all the flexibility they need under a GATS-type MIF, because "under this system, each member has to strike its own balance between providing certainty (thus, increasing the possibilities of attracting FDI) and retaining flexibility."[82]

The EC then goes on to counter the assumption made by some WTO Members that a MIF would enhance the crowding-out effect on domestic investment,[83] and therefore worsen the negative effects FDI can produce on host countries. Noting that "[…] we have found no evidence in real life that there is any 'crowding-out effect' problem caused by FDI,"[84] the EC offers the following rationale:

> "Even admitting that FDI crowds-out domestic investment, the second question to be asked is: what would be the impact of a multilateral framework on this? There are 2 alternative possibilities. Either: (1) a multilateral framework would enhance FDI flows, thus, allegedly increasing the risk of crowding-out domestic investment; or (2) a multilateral framework would not significantly increase FDI flows, hence with no impact on the "crowding-out" effect. What cannot be said is that, at the same time, a multilateral framework will increase the risk of "crowding out" domestic investment but it will not increase FDI flows for developing countries."[85]

In light of the above, those who might have expected from the EC a more compelling line of argumentation to support its proposal for a GATS-type MIF,[86] may well feel disappointed. In substantive terms, very little has changed compared to the previous submissions summarised above. Much of the critique raised by opponents to the EC proposal is therefore unanswered by the responses given by the EC itself. It should be noted, therefore, that the EC appears to have failed in its acclaimed purpose to

> "[…] try to move this fundamental debate towards a more concrete level, rather than continuing an abstract discussion between those who maintain that any investment rule would undermine their policy space and those who reply that this would not be true."[87]

Rather, the EC appears still be trapped in a given framework of argumentation. In particular, the above claim that it cannot be argued at the same time that a MIF would not significantly increase both FDI flows and the risk of crowding-out, overlooks the crucial point that it is the quality and the type of FDI, rather than its

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[81] (WT/WGTI/W/154: 3).
[82] ibid.
[83] Roughly put, the "crowding-out" effect related to FDI is usually referred to as a situation in which domestic firms are driven out, or discouraged to enter, the market by the new entry or presence of foreign firms they are not able to compete with. Put differently, FDI is said to crowd out investment by domestic firms to the extent it lowers the latter. Some studies find evidence of crowding-out, others point to the evidence of crowding-in domestic investment, particularly in the long-term. Some analysis has found evidence of crowding-in during the 1990s in the case of countries having relatively illiberal FDI regimes (notably, some Asian countries), while crowding-out mainly occurred in those countries that had liberalised their FDI regimes (Latin America) (see, for example, Agosin and Mayer 2000, Agosin 1999).
[84] (WT/WGTI/W/154: 1). One could wonder, then, why a rather broad body of empirical research is emerging on this issue, and a number of theories have been formulated pointing to the channels through which crowding-out of domestic investment may take place?
[85] (WT/WGTI/W/154: 5).
[86] By the EC increasingly and arbitrarily referred to as "Investment for Development Framework" (IDF).
[87] (WT/WGTI/W/154: 6).

quantity, that largely determines whether and for how long FDI is likely to displace or to encourage domestic investment.

Despite the controversies outlined in the preceding sections, there is one fact opponents tend not to dispute: by and large, FDI takes a special place among the various forms of private capital flows, being characterised mainly by its long-term nature and by the potentially positive externalities and spillovers that under certain conditions may benefit host countries' economic development. In particular, given the frequent occurrence of national and international financial crises since 1990, observers tend to clearly distinguish between FDI and more short-term, often highly speculative, types of capital on the one hand, and between FDI and debt-creating financial instruments on the other. Similarly, institutions such as the International Monetary Fund (IMF), which had been advocating wholesale capital account liberalisation over a decade, appear now to be taking a more cautious stance on the issue, recognising the potential dangers associated with the liberalisation of certain types of short-term capital flows. If negotiations on FDI alone appear to be difficult, any discussions involving portfolio capital flows are likely to be even more controversial. It is noteworthy, then, that the United States' proposal for a MIF includes potential provisions on portfolio capital flows as well as FDI.

### II.5 The United States' proposal for a broader definition of investment in MIF

After more than four years without making a formal submission, in September 2002 the United States (U.S.) has contributed to the ongoing discussions in the WGTI with the submission of a paper outlining its views regarding the coverage of investment that a WTO investment agreement should encompass.[88] In contrast to the EC's proposal, which envisages the inclusion of only FDI flows in a possible MIF, the U.S. strongly advocates the inclusion of portfolio flows as well. The U.S. proposal is reproduced in full in Appendix Box 1. Here, only the main points are briefly outlined and discussed.

1. The paper first argues that "portfolio investment is vital for economic growth and development,"[89] listing some of the main functions of financial markets in the process of accumulation of capital and economic growth.[90] Both the crucial distinction between the functions of bank-based financial intermediation and those of stock markets, emphasised by the broad literature in the field, and the important qualifications made on the desirability and pace of stock market development in the developmental context are not discussed in this submission. Such qualifications would shed light on the fact that stock market development may well play a secondary, if not harmful, part in developing countries.[91] Roughly put, the effects of portfolio flows on host economies are highly contested in the literature as they are not associated with potentially beneficial effects of positive externalities and spillovers as in the case with FDI; and also because portfolio flows are characterised by a higher degree of liquidity and therefore, volatility, compared to FDI.

   While omitting any discussion of underlying contrasting theories on financial sector development and its effects on economic growth, the U.S. paper goes on to state the reasons why portfolio investment should be covered by a MIF.

2. The U.S. notes that portfolio investment covers a broad range of financial instruments that are in common use worldwide and question "whether it is worth negotiating an investment treaty that leaves such a wide array of investments without coverage."[92]

3. It is further argued that "offering fewer protections to portfolio investors than direct investors increases the risks associated with portfolio investment, raising the cost of borrowing foreign capital, which is a drag on

[88] (WT/WGTI/W/142). Previous WGTI submissions by the United States all date back to 1998 or earlier, and do not contain elements from which the United States position on the MAI issue could be evinced (see WT/WGTI/W/55, WT/WGTI/W/32, WT/WGTI/W/29, WT/WGTI/W/27, WT/WGTI/W/14).

[89] (WT/WGTI/W/142: 2).

[90] The main functions of the financial system in the economic process include mobilisation of savings, allocation of resources, exertion of corporate control, facilitation of risk management, and the performance of other services facilitating the working of markets. The reader is referred to Levine (1997) and Pagano (1993) for two excellent papers on the main issues concerning the functions of financial systems and the financial development - economic growth nexus.

[91] Particularly in the case of low-income countries. See, for example, Singh (1993 and 1997), Akyuz (1993), Durham (2000 a, b, c), Demirguc-Kunt and Levine (1996).

[92] (WT/WGTI/W/142: 2).

the economy."[93] A recent IMF study[94] of 38 developing economies is cited, finding that in the period 1980-1999 capital account liberalisation led to greater capital inflows (including portfolio flows) to these countries, which, if well-managed, led to more investment and higher economic growth.

Two remarks should be made at this point. First, it is not clear that the IMF paper cited by the U.S. supports the contention made in this submission; that is, higher protection of FDI relative to portfolio finance would result in higher costs of the latter. Moreover, the precise lines of causation needed to support this contention remain unexplained. Second, this IMF paper emphasises that benefits from capital account liberalisation only occur if appropriate and well-developed institutions are in place to ensure the prudent management of capital flows. The growing cautiousness and qualifications by the IMF[95] on the beneficial effects from capital account liberalisation are becoming increasingly evident, and have been even more strongly emphasised in another recent IMF publication,[96] which is summarised in Appendix Box 2. Similar qualifications are expressed by a huge body of literature assessing the economic effects of capital account liberalisation. Indeed, strong concerns have been raised about the inappropriateness of econometric methodologies typically applied in empirical studies on this issue, undermining their reliability.[97]

4. In the US submission it is claimed that "it is not always possible to decide what constitutes a portfolio investment."[98] Therefore, the U.S. notes, if there are instances that are not easily identifiable as either FDI or portfolio investment, a case-by-case analysis would be necessary, complicating matters and potentially leading to disputes among WTO members.

   Here, the U.S. does have a point. Depending on the actual scope and the precise wording of a definition of FDI to be adopted in a MIF, the distinction between FDI and portfolio capital is likely to become a matter of dispute in a number of instances. It may be argued that this should encourage great attention be given to drafting a workable, clearly interpreted definition of FDI. However, this is hardly on the face of it an overwhelming argument justifying the coverage of portfolio capital by a MIF.

5. The U.S. notes that "portfolio investment is a concomitant of direct investment", and therefore "an agreement limited to FDI denies the benefits of the agreement to portfolio investor partners and to the portfolio operations within a direct investment and thus will act to discourage FDI".[99]

   This argument suffers a flaw similar to the preceding one. Essentially, although there are obviously portfolio flows that are part of the operational aspect of FDI and should be accordingly dealt with, this does not change the fact that most portfolio flows are of speculative nature. Therefore, the inclusion of portfolio capital in a MIF should be treated as a separate matter, although the linkages to FDI may well be explored further.[100]

6. It is argued that "restrictions on portfolio capital flows to capital-starved countries is not a long-term solution to financial instability."[101] Taking the view that the Asian financial crisis mainly originated from a lack of prudential financial supervision in many borrowing countries, leading to over-exposure in short-term capital and currency mismatches, the U.S. concludes that this should not speak against capital account liberalisation or short term lending, but rather point to the importance of having efficient supervisory institutions in place.

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[93] (WT/WGTI/W/142: 3).

[94] "International Financial Integration and Developing Countries", World Economic Outlook, IMF, October 2001, pp. 152-159.

[95] The IMF, it should be recalled, can hardly be considered an institution tending towards cautiousness in advocating economic liberalisation if concerns relating to its benefits are not clearly demonstrated.

[96] IMF (2003)

[97] Mainly, the critique points to the inappropriateness of widely applied cross-section and panel analyses in highlighting a reliable causality link between financial openness and economic growth. For example, Demetriades and Hussein (1996: 387) demonstrate that "causality patterns vary across countries and, therefore, highlight the dangers of statistical inference based on cross-section country studies which implicitly treat different economies as homogeneous entities".

[98] (WT/WGTI/W/142: 3)

[99] ibid.

[100] It should be noted that the definition of investment envisaged in the EC proposal for a MAI (Appendix Table 5 - "direct investment capital transactions") does include portfolio flows that are part of the operations of FDI investment.

[101] ibid.

Although this characterises one part of the explanation of the last Asian financial crisis, this argument misses another important matter: the role of investors in the build-up to a financial crisis. Whether due to herding behaviour, fundamental economic reasons, or perhaps a combination of these factors, the fact is that all capital that possibly could leave the crisis-ridden countries tends to do so, causing severe, and in some cases long-lasting, economic and social disruptions. FDI was the only form of capital displaying some stability during those months of severe financial distress, and in its aftermath. Portfolio capital, besides playing a central role in the boom-cycle of the financial euphoria prevailing in that region during the mid-1990s, was quick to leave as soon as the 'feast' was increasingly likely to come to an abrupt end. Therefore, in relation to international financial crises the relevant question as to whether or not to include portfolio capital does not concern the volatility of these flows, but rather the mechanisms that could be built into a MIF to prevent such crises from happening again. The U.S. leaves this question unanswered, and concludes instead that the solution would be "to improve financial supervision, surveillance, and risk analysis, such as through standards developed by the Financial Stability Forum, which was established shortly after the Asian financial crisis to strengthen international financial cooperation and stability."[102] It is not further specified in how far this directly relates to a discussion on a MIF, except for the acclaimed intent for the U.S. to "exploring with our colleagues how best to realize the advantages of portfolio investment coverage while responding to the challenges, for example, through technical assistance and capacity building in the areas of bank supervision and regulation."[103]

7. The U.S. submission concludes with the claim that "excluding portfolio investment defeats the purpose of an international investment agreement."[104] This is because there is said to be little doubt about the positive role of FDI *and* portfolio investment in promoting sustainable growth in developing countries and because a commitment to investment liberalisation and protection must include portfolio capital in order to be fully credible. Both of these latter claims are not compelling as they disregard important qualifications in the relevant literature and the second claim, in particular, lacks in any basis on evidential grounds.

To sum up, the United States is intent to advocating a MIF that includes and protects portfolio flows along the lines of BITs concluded by the U.S. The brief discussion in this section has expressed considerable doubts on the merits of doing so. On both theoretical and empirical grounds, the portfolio capital-growth nexus is controversial, and proponents are certainly aware of the limited impact an argument built on shaky grounds could have. Moreover, other characteristics of this U.S. submission deserve mentioning. First, Paragraph 22 of the Doha Ministerial Declaration[105] clearly emphasises the inclusion of exclusively long-term capital flows in a possible MIF. Second, the EC proposal explicitly excludes portfolio capital, most likely because of the lessons learnt from the failure of OECD negotiations on a MAI and may also reflect in part a large consensus among most high-and low income countries alike about the potential dangers associated with speculative capital. Lately, within the WGTI, Members' submissions have reiterated a widespread reluctance to extending coverage to any form of capital other than FDI, and reinforced the point that differences in view on FDI alone are substantial.

Part III turns now to the main arguments in favour of a multilateral investment agreement as highlighted in a recent scholarly literature. In contrast to Part II, which focussed on the debate between proponents and opponents of a MIF, the remainder of this chapter centres on the more analytical aspects of the debate. The purpose of Part III, then, is to see whether there are different—and perhaps more compelling—rationales for a Multilateral Investment Framework than those advanced in this section.

[102] (WT/WGTI/W/142: 4).
[103] (WT/WGTI/W/142: 4-5).
[104] (WT/WGTI/W/142: 4).
[105] See Section II.1.

# Part III

## A BRIEF REVIEW OF THE MAIN THEORETICAL ARGUMENTS FOR A MULTILATERAL INVESTMENT FRAMEWORK

In the scholarly literature, five principal arguments have been put forward in this regard:

1. The transaction cost argument: firms may confront significant transaction costs and increased uncertainty from differences in national rules governing FDI and the patchwork of existing BITs. A multilateral investment agreement would lower such transaction costs, leading to improved allocation of FDI and higher welfare.
2. The uncertainty argument: investors may avoid a country because it has a history of frequent policy reversals, or whose commitments to reform are not deemed credible. A multilateral investment framework would anchor investors' expectations and lead to increased FDI inflows.
3. The political economy argument: a multilateral investment agreement would serve as a means for governments to overcome the impediments to reform prevented by certain domestic constituencies.
4. The international policy spillovers argument: domestic law and regulation of FDI may have negative effects (spillovers, externalities) at a global level, leading to distortions in the allocation of investment, and/or to coordination failures which result in inefficient outcomes. A multilateral framework could overcome these problems, increasing global welfare.
5. The "grand-bargain" argument: suppose as FDI importers, developing countries are unlikely to gain much from a MIF. The latter could consider offering concessions on investment policies and at the same time demand reciprocal concessions in other fields of WTO negotiations where they can gain substantial benefits.

The following sections assess these arguments in turn, with the exception of the transparency argument, which was already analysed in Section II.3.

### III.1 The uncertainty argument

Some commentators have argued that a MIF, besides making national policies more transparent, could help raise investor confidence in a country's policy reform programmes, thereby stimulating higher FDI inflows. Hoekman and Saggi (1999) note,

> "governments seeking to attract FDI may be pursuing all the 'right' policies without generating a significant 'supply response' because of a history of policy reversals. If investors are risk averse, they may avoid the country altogether, impose large risk premia, not transfer 'sensitive' technologies, etc. International agreements may then serve as a mechanism through which governments make irrevocable commitments and 'guarantees' against policy reversals, thereby anchoring expectations of investors".[106]

Clearly, investor confidence is a necessary condition for FDI particularly in the case of greenfield investments which usually involve significant amounts of sunk investment. Once an investment is made, the host country may have incentives to renege the agreement with the investor *ex-post*, and directly or indirectly expropriate rents from the investor. Given the sunk costs involved, the MNE would not have much choice but to accept the new conditions imposed by the host, as long as the former continues to accrue some positive benefit.[107] For investment to take place, therefore, it is essential that a commitment mechanism be in place, so that the host country can credibly bind itself not to expropriate, or more generally degrade investments, *ex post*.[108]

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[106] Hoekman and Saggi (1999: 2).

[107] Such a situation is usually referred to as the "hold-up risk" in game theory.

[108] It is a standard result of game theory that by binding itself not to defect on an agreement, which appears to make the agent worse off by sacrificing flexibility, may turn out to be in fact welfare improving for the same agent. However, studies in the field of incomplete contract theory have also shown that under certain circumstances it can be welfare improving to renegotiate the original contract, rather than to comply.

There is reason to believe that an international agreement would create a strong incentive for signatories to comply, particularly by providing for trade sanctions to punish non-compliance. However, there are a number of alternative ways that a country has to credibly commit to obligations, including bilateral investment treaties. Further investment protection is usually guaranteed in these treaties by provisions on international arbitration. Moreover, there is a strong case for arguing that a country will try to keep intact or increase its reputation in international financial markets and so will have a sufficiently strong incentive not to behave in any way that could undermine the flow of future investment.[109] If a country values its reputation, and many do, then the expectations-anchoring argument for a MIF would largely be undermined.

In sum, the arguments in favour of a MIF on credibility grounds have certainly some appeal, but are ultimately not compelling. Moreover, there is no hard evidence to support the hypothesis that a MIF would significantly increase FDI flows to countries that have already entered binding bilateral investment agreements, which overall seem to provide an adequate degree of investment protection. As far as host country commitments are concerned, the literature does not explain why existing multilateral commitments, particularly of progressive trade liberalisation within the WTO framework, are not considered by international investors to be a sufficient signal for long-term commitment and credibility.

### III.2 The political economy argument

Some have argued that an international agreement on investment could represent a necessary means for governments to overcome otherwise insuperable political impediments to removing costly restrictions on FDI flows. Indeed, it is frequently observed that developing countries' governments are unable to overcome opposition by certain local groups that are powerful enough to protect so-called unproductive rents. Such rents may be associated with distortions to the efficient allocation of capital, with deleterious consequences to host economies. Moreover, these rents are frequently accompanied by rent-seeking activities, including bribery and corruption. In such a context, the argument goes, with governments lacking power to impose a change on the *status quo*, an international agreement can in principle be helpful to overcome such resistance mainly for three reasons. First, once signed international agreements may offer the necessary political scapegoat when reformers face powerful local constituencies. Second, if an investment agreement is embodied within the WTO framework, it could be part of a larger package that offers significant benefits that can help "pay off" or compensate current beneficiaries of investment protection. Alternatively, those benefits can help galvanise other economic interests in favour of a comprehensive WTO package, where investment liberalisation is seen as the "price" of reforms abroad. Third, it is argued, that a MIF could have stronger binding effects on current and future governments as compared to a bilateral agreement. This last point is related to the credibility argument mentioned above.

The validity of the political-economy argument largely depends on one's assessment of the role of rents and rent-seeking processes in the development process. Broadly speaking, in the standard neo-classical framework,[110] the presence of rents typically signals inefficiency, and the best policy is to remove them altogether. Rent-seeking activities, on the other hand, are associated with a waste of potentially productive resources, adding to costs associated with the presence of rents. Some strands of economic theory distinguish between rents that are productivity-enhancing from those that are not. Accordingly, governments may do well by allocating super-profits to certain capitalists, as long as the latter have an incentive, or are forced, to use those rents productively.[111] Logically, if rents can be growth-enhancing, so can rent-seeking activities, provided that the latter make sure rents are being allocated to those firms or industries that positively contribute to long-term growth, and are withdrawn from those that do not. It should be noted that only a few

[109] A point raised by Singh (2001). This argument is weakened if reputation is specific to local managers rather than directly to the country (Markusen 1998). Hoekman and Saggi (1999) have questioned the relative importance of multilateral binding rules as compared to the use of a variety of existing institutions devoted to the arbitration of disputes, such as the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID), the International Chamber of Commerce (ICC), and the UN Committee on International Trade Law (UNCITRAL).

[110] "Standard" in the sense of basic, without, for instance, considering the insights from new institutional and information economics, which are fields that have developed within the neoclassical framework, but distancing themselves quite radically from some of the assumptions of the latter. More sophisticated analysis in the neo-classical framework does in fact recognise the potentially positive effects played by economic rents in the development process. See, for example, Hellmann, Murdock, and Stiglitz (1999).

[111] Khan and Jomo (2001).

states,[112] and then only in the presence of a combination of specific circumstances, have managed to control this complex process in a welfare-enhancing way. Hence, the reluctance by many authors to view rents as growth-enhancing, except in well-defined circumstances,[113] and the reluctance by many others, scholars and policy-makers alike, to view rents indiscriminately as welfare-reducing.

Notwithstanding these considerations, it may still be argued that a MIF may be necessary for governments otherwise unable to overcome domestic pressures from rent-earners that are in fact retarding growth and development. This may well be the case, but it remains difficult to envisage how this argument would be played out in the context of the WTO. Would those countries opposing a MIF be seen as unable to overcome powerful domestic lobbies? Conversely, could this line of argument be extended to implying that those countries demanding a MIF are not able to overcome pressures from their domestic business-community in search of rents that may come at a cost of host countries' welfare? As a matter of fact, even within advanced 'democracies', power and interest usually prevails over social objectives.

In sum, the political economy argument is a sensitive one. The assessment of the role of rents played in the economy is highly controversial, even at a country-specific level. Notwithstanding theoretical and empirical controversy, it remains difficult to imagine a multilateral framework that helps reducing unproductive rents while simultaneously maintaining those that are growth-enhancing. Rather, all rents would gradually be wiped out, to the satisfaction of those who view them as purely distortionary. It appears, from the submissions of low-income countries like India, that it is precisely on these grounds that a MIF is being strongly opposed.

### III.3 The international spillovers argument

The arguments discussed so far all relate to the potential of a MIF to lead to higher degrees of transparency, credibility, and commitment, as compared to the standards already prevailing in bilateral and regional agreements. Sanna-Randaccio (2000) rightly notes that such arguments call for rules negotiated within WTO and that are primarily meant to "*lock in* the results of unilateral liberalisation of national FDI policy or to adopt standards prevailing in bilateral agreements."[114] Arguably, such rules would mainly reflect the interests of the international business community, so as to have guaranteed market access and investment protection at a multilateral level. As shown above, transparency, credibility, and commitment are also EC's key arguments in favour of a MIF. However, it has just been argued that none of these arguments is ultimately compelling, as they do not make a clear case for cooperative action, at a multilateral level.

Some recent papers[115] have thus pointed towards an alternative set of arguments in favour of a MIF. More specifically, they have questioned whether a MIF would represent a means to overcome international policy spillovers, i.e. the effect of host country policies on other countries, particularly the home countries of FDI, and *vice-versa*. In other words, according to these authors, the crucial question in addressing the desirability of a MIF is whether or not its provisions are directed at eliminating market distortions and international policy spillovers caused by host countries on the one hand, and to eliminate market distortions created by foreign investors and home countries on the other hand. The logic of argument in these papers evolves mainly within the Walrasian neoclassical framework underlying the first welfare theorem,[116] some features of which are briefly outlined next.[117]

Economic theory establishes that cooperative action is called for if individual actions taken by rational agents—including governments—result in sub-optimal collective outcomes. An outcome is said to be pareto-inefficient if it is possible to propose some form of action (including an external credible commitment device, such as an international agreement) that raises the welfare of at least one agent or group of agents without making anybody else worse off. Conventional economic theory establishes that a Pareto-inefficient situation may arise in the following instances:

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[112] Most notably, a number of East-Asian countries. See, for instance, Wade (1992), Amsden (2001), and Khan and Jomo (2001).

[113] Typically, in the case of scarce natural resources.

[114] Sanna-Randaccio (2000: 9).

[115] Hoekman and Saggi (1999 and 2002), World Bank (2003, Ch.4), Sanna-Randaccio (2000).

[116] Essentially, it states that a Walrasian general equilibrium always yields a Pareto efficient allocation of the social endowment.

[117] This section, rather than simply summarising the main findings of the papers surveyed, lays out the logic followed in the latter, without necessarily arriving at the same conclusions.

1. the presence of market failures or exogenous distortions, such as policy interventions offsetting the efficient working of markets;
2. a coordination problem, even in the absence of other market failures.

On this perspective, therefore, the desirability of a multilateral agreement on foreign direct investment depends on whether it represents the appropriate remedy to these causes of inefficiency, so leading to a gain in overall welfare without making some countries worse off.[118] Both sources of inefficiency are considered in turn.

### III.3.1 Market failures and/or domestic policy distortions

In theory, if markets were working properly, the so-called first best policy would be not to intervene at either the national or the international level. Here *laissez faire* ensures a Pareto efficient, welfare maximising outcome. In reality, market failures are the rule, rather than the exception. Production by multinational enterprises (MNEs) typically takes place in concentrated industries and may involve a variety of externalities[119] and spillovers. In the presence of such market failures, there is a clear economic rationale to intervene in the market, so as to improve on an inefficient market outcome.

Intervention may take a variety of forms. Abstracting from other than investment-related industrial policies, interventions may, for example, relate to bargaining between the host and the investor over the economic surplus from the MNE's operations in the domestic territory. Such economic super-profits (or rents) can be the result of market power accruing, for instance, from market concentration. FDI will only take place if the MNE perceives a gain and these firms attempt to use their market power to appropriate most of the rents themselves. However, the host nation wants to ensure that it derives benefits from the investment. Hosts respond by using TRIMs and other Host Country Operational Measures (HCOMs, see Box III-1) to capture rents for their economy or, more generally, to ensure that the domestic benefits from FDI are maximised. HCOMs can be justified as attempts to fill the gap between social and private rates of return for foreign investments that create positive spillovers, such as knowledge transfers, or to deal with other market failures. From an economic theory point of view, such interventions can be welfare enhancing, but ultimately the outcome from intervention is indeterminate, depending on country-specific circumstances.

Empirical evidence, however, tends to demonstrate that only certain HCOMs have benefited host countries implementing them. Moran (1998), for example, has argued that frequently HCOMs do not stimulate host country growth, and can even hinder it, particularly if they are targeted at protecting inefficient industries. However, Moran and other prominent commentators, such as Rodrik (1987), recognise that certain HCOMs, particularly export performance requirements, can increase host country welfare by shifting rents from the foreign investor to the domestic economy. Similarly, Bhagwati (1998), well known for his market-friendly views, has concluded that FDI policy, such as performance requirements, is an area where "host countries should be free to make their own choices, based on their own (even if oft harmful) assumption about externalities and spillover effects on their national economies."[120] As a general rule however, mainstream consensus on best policy practice requires that interventions, if necessary, should target market failures as directly as possible. For example, the introduction of strict competition policy is seen as a more appropriate measure to regulate market concentration than the use of restrictive investment policies.[121]

It should be emphasised that there is no consensus on this matter in the economics literature. Notwithstanding such inconclusiveness, it can be argued that in those instances investment policies do in fact raise host country welfare, a multilateral agreement imposing restrictions on the use of such measures could possibly raise the welfare of capital exporting countries by increasing MNE's return, but would not achieve a Pareto efficiency improvement, since the host countries' welfare would be reduced. This argument applies to all HCOMs including those prohibited by the TRIMS agreement.

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[118] For the time being, this analysis abstracts from distributional effects within countries.

[119] An externality exists where the utility of a consumer or the production possibility of a producer is directly affected by the actions of another agent in the economy.

[120] Bhagwati (1998), Kumar (2001).

[121] Also emphasised in Hoekman and Saggi (1999), Das (1999).

At the global level, even when HCOMs do benefit the domestic economy, they have the potential of adversely affecting trade and investment flows with neighbours. If all countries were to effectively restrict FDI inflows, there could in theory be scope for cooperation. Yet, the benefits of such cooperation would accrue exclusively to those countries that are large net exporters of capital and those net importers with welfare-reducing policies in place. Taken to the extreme of a zero-sum game, where all benefits accrue to capital exporters and are mirrored by welfare losses to capital importing countries, no cooperative solution could exist.

Besides market failures, the efficient working of markets may be impeded by domestic distortions such as protective trade measures. In this case, an application of the theory of the second best leads to the conclusion that government intervention does not necessarily lower welfare and may well be welfare-improving instead. In this case, there is no clear-cut case for government intervention or for non-intervention.[122] In sum, whether market failures or distortions, the preconditions for an international agreement curtailing the use of HCOMs to be welfare improving globally are not necessarily present.

Even in the absence of a coordination problem that can be directly remedied by an international agreement, there is one other set of circumstances where an agreement to curtain the use of HCOMs that raise developing countries' welfare can in fact beneficial be beneficial to all. Hoekman and Saggi (1999) describe the situation as follows:

> "developing countries squarely represent only the host country view of FDI. Consequently, it will be very difficult to devise an international agreement on investment that is welfare enhancing for developing countries that successfully employ policy strategically. In this case a cooperative solution would require that the negotiating agenda be expanded to include issues of interest to developing countries".[123]

In other words, developing countries could enter a "grand-bargain" and link the investment-related issues with other issues that offer them substantial benefits. The merits of such an argument are discussed in section III.4 below.

**Box III-1: Host country operational measures prohibited by international agreements**

Host country operational measures (HCOMs) are those concerning the operation of foreign affiliates in the home country's territory. They cover all aspects of investment and usually take the form of either restrictions or performance requirements. They are usually adopted to influence the location and character of FDI and, in particular, to increase its benefits in the light of national objectives.

**1. HCOMs explicitly prohibited at the multilateral level, i.e. by the TRIMs Agreement:**

- Local content requirements
- Trade-balancing requirements
- Foreign exchange restrictions related to foreign exchange inflows attributable to an enterprise
- Export controls

**2. HCOMs that are prohibited, conditioned or discouraged by interregional, regional or bilateral agreements, but not at a multilateral level:**

- Requirements to establish a joint venture with domestic participation
- Requirements for minimum level of domestic equity participation
- Requirements to locate headquarters for a specific region or the world market
- Employment performance requirements
- Export performance requirements
- Restrictions on sales of goods or services in the territory where they are produced or provided
- Requirements to supply goods produced or services provided to a specific region or the world market exclusively from a given territory
- Requirements to act as the exclusive supplier of goods produced or services provided
- Requirements to transfer technology, production processes or other proprietary knowledge
- Research-and-development requirements
- Measures contrary to the principle of fair and equitable treatment

**(continues)**

[122] See Lipsey and Lancaster (1956) for the original formalisation of the theory of the second best.
[123] Hoekman and Saggi (1999: 9).

**(Box III-1 concluded)**

**3. HCOMs that are not prohibited (illustrative list):**

- Restrictions on employment of key foreign professional or technical personnel, including restrictions associated with the granting of visas and permits
- Requirements to establish a joint venture with domestic participation
- Public procurement restrictions (e.g. foreign affiliates are excluded as Government suppliers or subject to providing special guarantees)
- Restrictions on imports of capital goods, spare parts, manufacturing inputs
- Restrictions/conditions on access to local raw materials, spare parts and inputs
- Restrictions on long-term leases of land and real property
- Restrictions to relocate operations within a country
- Restrictions to diversify operations
- Restrictions on access to telecommunications networks
- Restrictions on the free flow of data
- Restrictions relating to monopolies or participation in public companies (e.g. an obligation to provide a public service at a certain price)
- Restrictions on access to local credit facilities
- Restrictions on repatriation of capital and profits (e.g. case-by-case approval, additional taxation or remittances, phase out of transfers over a number of years)
- "Cultural" restrictions, mainly in relation to educational or media services
- Disclosure of information requirements (e.g. on the foreign operations of TNCs)
- Special requirements on foreign firms in certain sectors/activities (e.g. on branches of foreign banks)
- Operational permits and licences (e.g. to transfer funds)
- Special requirements on professional qualifications, technical standards
- Advertising restrictions for foreign firms
- Ceilings on royalties and technical assistance fees or special taxes
- Limits on the use of certain technologies (e.g. territorial restrictions), brand names, etc., or case-by-case approval and conditions
- Rules of origin, tracing requirements
- Linking local production to access or establishment of distribution facilities
- Restrictions related to national security, public order, public morals, etc.
- Training requirements
- Import restrictions, local sales requirements
- Linking export quotas to domestic sales

**Source**: UNCTAD (2001b)

### III.3.2 Inefficiency as the result of a coordination problem

A strong argument in favour of a multilateral agreement on investment derives from the fact that incentives aimed at attracting FDI impose negative spillovers on the rest of the world. The extant literature typically examines this matter as a prisoner's dilemma problem, with the finding that only with binding commitments will governments maximise collective welfare. If a nation's government enters a bidding war to attract FDI, principally because it rationally expects other governments do to so, then it is quite possible for governments to pay a higher price for having FDI allocated to their countries than would have been the case. In this situation, investment incentives represent a transfer of resources from the host countries to MNEs and indirectly to their parent countries, as well as a distortion in the worldwide allocation of capital. Enforcing rules on subsidies to foreign investors by means of an international agreement could avert this socially sub-optimal outcome.

**Box III-2: Investment incentives**

**Definition:**

"Incentives are any measurable economic advantage afforded to specific enterprises or categories of enterprises by (or at the direction of) a government, in order to encourage them to behave in a certain manner. They include measures either to increase the rate of return of a particular FDI undertaking, or to reduce (or redistribute) its costs of risks. They do not include broader non-discriminatory policies, relating to the availability of physical and business infrastructures, the general legal regime for FDI, the general regulatory and fiscal regime of business operations, free repatriation of profits or the granting of national treatment. While these policies certainly bear on the location decision of TNCs, they are not FDI incentives per se. The main types of incentives used are fiscal incentives (e.g. reduction of the standard corporate income-tax rate, investment and reinvestment allowances, tax holidays, accelerated depreciation, exemptions from import duties), financial incentives (e.g. government grants, subsidized credits, government equity participation, government insurance at preferential rates) and market preferences (e.g. granting of monopoly rights, protection from import competition, closing the market for further entry, preferential government contracts). Other types of incentives frequently used include preferential treatment of foreign exchange and subsidised dedicated infrastructure and services."

**Economic rationale for incentives:**

UNCTAD points out that incentives are mainly used to correct market failures to reflect the wider benefits arising from externalities in production, and to reflect the gains that can accrue over time from declining unit costs and learning by doing. However, they also have the potential to introduce economic distortions that are analogous to subsidies on trade, and they involve financial and administrative costs.

**Source:** UNCTAD (1998: 102 - Box IV.4)

Although this is perhaps the most convincing argument in favour of multilateral rules, there are a few caveats that Hoekman and Saggi (1999) have identified. First, a case for international coordination exists only if incentives are actually effective in altering the distribution of FDI flows. If not, countries have no incentive to offer such inducements, and there is no case for international collective action. Second, if there are potentially important externalities and spillovers to the domestic economy from FDI, and investors lack information about country-specific investment possibilities, incentives may act as an important signalling device as to where the return to investment is highest. In this case, incentives may raise locational efficiency of FDI and raise world welfare, though still with the distributional effects related to the transfer of rents from host countries to investors. Here, the analysis of investment incentives ceases to be a prisoner's dilemma. Third, investment incentives may take a number of forms, and are often delivered by using a combination of fiscal, financial, and other instruments. Therefore, an international agreement disciplining the use of incentives would necessarily need to be very intrusive by regulating, for example, domestic tax policies, competition policies, etc.

Besides the concerns raised above, there are a few considerations that have not yet been clearly addressed. One refers to considering the bidding war as a prisoner's dilemma problem. It seems that some commentators are increasingly applying the prisoner's dilemma in a metaphorical sense, rather than considering its precise implications. For example, it should be noted that there exist alternative means to bring about the socially optimal outcome than a collective agreement not to offer subsidies. In fact, if a prisoner's dilemma game is repeated over time, there may be an incentive by the players to cooperate as long as the expected long run gains from cooperation (offering no investment incentives) more than offset the short run gains from not cooperating (offering incentives). Therefore, from a purely game-theoretical point of view, an explicit agreement with its enforcement machinery—which is what the WTO provides in the international trade context—is not necessary to achieve the optimal outcome[124]. At a practical level, however, so long as investors are attracted by incentives and potential host countries believe they are, then there appears to be indeed a

[124] Whether or not cooperation emerges spontaneously depends also on the relative size of the payoffs and how much policymakers value the future compared to the present. Yet another non-coercive solution is the "morality solution", where reciprocal trust is a sufficient condition for cooperation to emerge. Arguably, the latter is a rather unlikely solution to emerge, especially if one takes a dim view of the motives of short-term oriented policymakers.

strong case for international coordination. The case for coordination would be even stronger in the case of investment diversion from developing to industrialised countries caused by uneven competition in the "incentives war" between these two groups of countries. [125]

In sum, so far it seems that the restriction on the use of investment incentives is the single strongest rationale for international collective action. Given the economic interests at stake perhaps it is unsurprising that there has never been much momentum for international rule-making on this matter. The OECD's MAI largely ignored the incentives issue, and today's proponents of an investment agreement at the WTO seem not to have given it much consideration. Arguably, MIF proponents are likely to gain on two fronts from investment incentives. First, they have the financial muscle to successfully compete for those FDI projects where incentives do count. Second, government outlays on incentives are partly compensated by the rents accruing to domestic MNE's profiting from the incentives paid to their subsidiaries abroad.

### III.4 The "grand-bargain" argument

According to Hoekman and Saggi (1999),

> "the 'grand bargain' argument is one of the *raisons d'entré* of the WTO. In a nutshell, what the WTO process does is to allow countries to define a negotiating set that allows a variety of potential tradeoffs and deals to be crafted that are superior to the status quo ante. Because countries are restricted to the equivalent of barter trade in multilateral trade negotiations to achieve Pareto superior (cooperative) outcome, issues must be linked." [126]

Moran (1998) suggests developing countries could make concessions on the investment issue, as a *quid pro quo* for concessions by industrialised economies in other areas of interest to them, such as market access in agriculture or industrial products. Hoekman and Saggi (1999) note that policies other than investment, particularly in terms of further concessions under the existing GATT and GATS agreements, are likely to be more valuable negotiating chips for developing countries.

Implicit in the grand-bargain argument is that developing countries have little to gain from multilateral rules on investment. Although this may be the case, if investment policy is one of the main pillars of national industrial policy, then matters differ. From the development perspective, if developing countries' growth-prospects were to be negatively effected by multilateral rules on investment, many possible grand bargains are unlikely to be viewed favourably. This is not to say, however, that in a context of what some have termed the *Realpolitik* of the WTO, the grand-bargain argument may well be stronger than any other mentioned in this paper.

### III.5 An overview of the likely welfare effects of a MIF

Table III-3 summarises the main welfare effects of a MIF, by focusing on the likely signs of the payoffs from multilateral rules on investment to a FDI-importing developing host country and an industrialised home country. For the sake of the following argument it is assumed here that industrialised countries represent the host country view of FDI, and developing countries the home country view. Following a similar classification as adopted in Sanna-Randaccio (2000), multilateral rules on investment are grouped into three categories, as shown in Table III-3.

#### 1. Multilateral rules that lock in minimum standards already prevailing internationally

The case for these rules broadly coincides with the transparency, credibility, and political economy argument discussed above. The main assumption here is that MNEs and their parent countries would strongly benefit from a MIF locking in the results of unilateral host country policy reforms and standards contained in bilateral agreements, particularly regarding market access and investment protection standards. Developing countries are assumed to benefit from the welfare-enhancing results of irrevocable policy reform itself, which

[125] Although it should be noted that competition for FDI is mainly at a regional level, and among countries offering similar fundamental conditions, mainly relating to traditional gravity factors.
[126] Hoekman and Saggi (1999: 18).

| Table III-3: Welfare effects of MIF | Likely welfare effect | | | |
|---|---|---|---|---|
| **(1) Multilateral rules that lock in minimum standards already prevailing internationally:** | **Developing host country** | **Industrialised home country** | **Global effect** | **Comments** |
| Resulting in: | | | | |
| (a) Increased credibility, commitment of national policies | **++/-** | **++** | **+** | (1) |
| (b) Lower transaction costs | **+** | **++** | **+** | (2) |
| (c) Stronger enforcement rules | **+** | **++** | **+** | |
| (d) More transparency | **+** | **++** | **+** | |
| **(2) Multilateral rules addressing market distortions created by host countries' policies, constraining the use of:** | **Developing host country** | **Industrialised home country** | **Global effect** | **Comments** |
| **Host country operational measures** | | | | |
| (a) Efficient measures | **-** | **+** | **0** | Zero-sum[3] |
| (b) Inefficient measures | **+** | **+** | **+** | |
| **Investment incentives** | | | | |
| Reducing: | | | | |
| (a) Investment diversion | **+** | **-** | **0** | Zero-sum[4] |
| (b) Transfer of rents from Host to MNE | **+** | **-** | **0** | Zero-sum[5] |
| (c) Lack of transparency | **+** | **+** | **+** | |
| (d) "Incentive wars" (pure coordination problem) | **+** | **+** | **+** | Prisoner's dilemma (positive sum) |
| **(3) Multilateral rules addressing market distortions created by foreign investors:** | | | | |
| **Competition policies** | **MNEs' surplus/rents** | **Global consumer surplus** | **Global production efficiency** | |
| (a) International co-operation by national competition authorities | **-** | **+** | **+** | |
| **Investor behaviour** | **Developing host country** | **MNEs/Industrialised home countries** | **Global Effect** | |
| (b) Binding rules on investor behaviour | **+** | **-** | **0** | (6) |

**Notes:**
(+) and (++) denotes a positive welfare effect, (-) a negative effect
(0) denotes zero effect, as seen by the players (developing and industrialised countries) according to their payoff structure (the welfare effects). This does not imply the global welfare effect would actually be zero.
(1) From a developing country perspective, higher commitment and credibility can have strong positive effects in terms of stabilisation of long-term development plans, particularly in the face of obstruction by powerful local constituencies. Besides the overall benefits at the domestic level, the international investor community is likely to respond to decreased uncertainty/risk with more and higher-quality FDI inflows to the country. On the other hand, more commitment comes at the price of less flexibility, to some extent, which some developing countries may view as a potential danger to long-term economic development.
(2) Positive, insofar developing countries are also FDI exporters.
(3) The global effect depends on the positive effects at the national level, in terms of long-term welfare effects and economic growth prospects, and the negative effects, both from a home country and global prospective, from the conditions on FDI. Obviously, from a pure development perspective, the prohibition of beneficial host country operational measures has negative global effects. Therefore, "zero-sum" refers here to the payoff structure as perceived by the two players only.
(4) The global effect may well be positive or negative, depending on whether or not investment incentives act as signals increasing the efficient allocation of capital, or are simply distorting measures.
(5) Similarly to (1), the global welfare effect of a transfer of rents from a developing to industrialised country could be negative, particularly if the potential long-term implications for economic growth are considered (e.g. those arising from differences in return to capital).
(6) Likely to have strong positive effects on global welfare in terms of "long-term sustainability". Yet, the negative effects of binding rules on investor behaviour may strongly reflect on their overall incentive to invest and the cost of foreign capital.

Source: Sanna-Randaccio (2000 – Annex Table), adapted and expanded by the author

in turn would result in a more favourable environment for FDI, and therefore increased inflows. Global welfare effects are assumed to be positive, but the intensity of effects is an unsettled empirical question.

**2. Multilateral rules addressing market distortions created by host country policies**

This argument broadly coincides with the international spillovers argument outlined above. More specifically, the likely welfare effects of Host Country Operational Measures (HCOMs) and investment agreements are considered.

If a HCOM enhances the welfare of the host country, the effects of a MIF constraining its use is negative for host countries and is likely to be positive for home countries as their overseas investments are freed from the burdens of conditionality. The global effect, in the sense of the overall effect resulting from the interaction of host and home country governments represents in this case a zero-sum game. In contrast, if HCOMs are inefficient, their removal is obviously welfare-enhancing. Here, there is no case for cooperation, as development countries should have incentive enough to unilaterally remove welfare-reducing performance requirements. (Nevertheless, the political-economy argument might rationalise international collective action if clientist states retain inefficient measures.)

The effects of a MIF constraining the use of investment incentives crucially depends on a number of assumptions: that investment incentives tends to divert FDI towards the highest bidders; that industrialised countries have an advantage in the incentives race by having "deeper pockets"; and that developing countries are only hosts to FDI. Such simplifying assumptions allow to make the point that a MIF constraining the use of investment incentives would probably reduce investment diversion towards industrialised countries, and reduce the transfer of rents from host countries to MNEs and their parent countries.

With the exception of 'wars' over investment incentives, it appears from the above analysis that there is little case for international collective action on investment. However, Sanna-Randaccio (2000) and Moran (1998) have a point in noting that such a case may well arise if a number of issues are linked within the investment framework.[127] For instance, host country operational measures could be linked to investment incentives, so creating an incentive for cooperation where there is none on either issue taken singularly (since they are zero-sum). This insight is not reflected within the debate at the WGTI. In fact, developing countries are traditionally opposed to giving up HCOMs, while industrialised countries have shown to be strongly reluctant to forego the use of incentives. Could both groups be persuaded to forgo their preferred measures under the auspices of a multilateral investment framework?

**3. Multilateral rules addressing market distortions created by foreign investors**

MNEs can have strongly distorting effects on host countries. Such distortions mainly result from anti-competitive behaviour on the part of MNEs, including Restrictive Business Practices (RBP) such as transfer pricing, price fixing, market allocation agreements, and tied-selling. Morrissey (2001) and Kumar (2001) have shown that RBPs are frequently as market- (including trade-) distorting as TRIMs and other HCOMs are, and therefore the rationale for outlawing the use of RBPs would be at least as strong as it is the case of TRIMs. Nevertheless, binding rules on RBPs do not exist at a multilateral level. Recently, China, Cuba, India, Kenya, Pakistan, and Zimbabwe have co-sponsored a submission to the WGTI (see Appendix Table 6) demanding binding rules on RBPs to be put on the negotiation agenda, and reinforcing so developing countries' long-standing demand for constraints on MNE's actions as a *quid pro quo* for further liberalisation on their part. Industrialised countries, on the other hand, do not seem particularly inclined to consider such a proposal, in accordance with MNE's desire to face as few restrictions on investment as possible. As shown in Table III-3, this is yet another case where no cooperative international arrangement would be preferred by all parties, except in a context of issue-linkage with other provisions of a potential MIF.

In parallel to the WGTI, the Ministerial Declaration at Singapore has established a Working Group on the Interaction between Trade and Competition Policy (WGTCP) with a mandate to study the relationship between trade and competition policies. As it is beyond the scope of this chapter to deal with this issue in any detail, the interested reader is referred to Evenett (2003) for an analysis of the issues relating to the possible

[127] Which is not the same as the cross-issue linkage as envisaged in the "grand-bargain" argument.

adoption of a multilateral framework on competition policy. It will be sufficient here to note that FDI and competition are highly inter-related issues, as FDI takes typically place in concentrated industries. Host countries are particularly concerned with the market power of MNEs, since they usually lack effective national competition authorities and policies to deal with anti-competitive practices. Moreover, international cooperation on competition policy, particularly on enforcement matters, is often necessary to deal with anti-competitive behaviour in the global market place. Table III-3 shows that international competition rules would result in a transfer of surplus from MNEs to consumers. Also, increased competition would raise efficiency in production. Overall, the effect from increased competition is positive. Yet, governments in industrialised and developing countries alike may well face opposition to cooperation on competition policy matters if their firms are able to apply strong enough pressure (Sanna-Randaccio 2000).

# Part IV

# CONCLUSION: IS THERE A CASE FOR NEGOTIATING A MULTILATERAL FRAMEWORK FOR INVESTMENT?

## IV.1 Summary: why the case for a Multilateral Investment Framework is not convincing

Parts II and III of this paper have shown that most arguments in favour of a Multilateral Investment Framework (MIF) are not compelling. The papers submitted to the Working Group on Trade and Investment (WGTI) by the European Commission (EC) and the United States (U.S.) are largely based on conjectures, rather than being founded on compelling theoretical and empirical analysis. From the more conceptual approaches taken in recent papers by scholars assessing the likely welfare effects of a MIF, it appears that there is little case for further international accords on economic grounds, with the important exception of the regulation of incentives to attract foreign investment. The latter are largely considered as beneficial by industrialised countries and their multinationals, and fall outside current proposals for an MIF. Moreover, although a MIF may raise total global welfare, it does not necessarily represent a desirable option for all countries as it would largely undermine developing countries' flexibility to regulate foreign investment in the domestic economy.

An assessment of whether or not the benefits from multilateral rules on FDI are likely to outweigh the costs associated with the partial loss of scope and flexibility of government intervention in regulating FDI will crucially depend on country-specific instances and, ultimately, on contrasting perspectives on the efficacy of such measures. However, as long as some countries continue to view Host Country Operational Measures (HCOMs) as a necessary instrument to ensure that FDI positively contributes to host country economic growth and welfare, and in the absence of compelling evidence against such measures, a MIF along the lines advocated by the EC would not necessarily represent a pareto-improvement over the current system of international rules governing FDI.

It is worth recalling that Paragraph 22 of the Doha Declaration requires that "any framework should reflect in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest." If Paragraph 22 is to be understood as requiring that a multilateral investment framework be as development-friendly *as possible* then this may be reconcilable with *some* constraint on policy flexibility, as implied by the basic features of the EC proposal's proposals for a MIF. Having said that, if a MIF constrains the national policy space of host countries, then it should also include binding provisions regulating multinational enterprises' practices.

If, in contrast, Paragraph 22 is read as requiring a framework on investment to be of benefit to all WTO members, then a MIF would have to be designed in a way so as to distinguish between HCOMs that are growth-enhancing from those that are not. Particular account of country-specific circumstances would be essential. It is not enough to have GATS-type country commitments and exceptions, as circumstances change and the policies that optimise the speed of development may change too. Arguably, such a high degree of flexibility is practically impossible to be achieved by an MIF, and would partly undermine the very aim of the latter, i.e. to provide a set of stable and transparent rules on FDI. Indeed, given the lack of any intellectual consensus on what policies maximize the benefits from FDI, then a MIF may lock developing countries into a sub-optimal set of policy choices. Lack of predictability of the rules facing foreign investors may well be the price of maintaining sufficient flexibility to optimally respond to evolving national circumstances.

## IV.2 If a MIF, then why in the WTO?

It has been argued that WTO has almost global membership and therefore presents itself as the ideal forum for negotiations on sensitive issues such as investment. It is noted sometimes that the failure of OECD's MAI negotiations was due, in part, to the fact that they were conducted by a group of industrialised countries, while the developing countries were expected to stand-by during negotiations and ratify the agreement upon its conclusion. The WTO, in contrast, as a member-driven and consensus-based organisation is said to offer the ideal forum where low-income members could raise their concerns and shape the outcome of negotiations

in their favour. Not everyone shares this view. A number of influential NGOs have expressed their concerns about the decision-making processes in the WTO, which they consider flawed because of the limits upon effective participation on the part of the smaller and poorer developing countries. Such concerns are echoed by an influential group of academic commentators. For instance, Helleiner (2000) claims that 'consensus' was achieved at Doha, as ever before, "through bilateral, behind-the-scenes pressures, dealing and bullying."[128] He concludes that "the WTO simply must find a more credible and effective decision-making system then the possibly awkward, and abuse-prone, 140-country 'consensus'-based system it now employs."[129] Whether or not such concerns are fully justified,[130] as a matter of fact developing countries do have the opportunity to collectively oppose an agreement on MIF in WTO negotiations. However, developing countries are a largely heterogeneous group, and a compact coalition along the lines of India's opposition is unlikely to be formed. Indeed, a look at the submissions to the WGTI shows that most low-income and least developed countries have not reacted to India's comments. This may be because of a more accommodating stance taken by some developing countries, the outcome of effective persuasion by industrialised economies, but it is also likely to be the result of a lack of capacity to reply to complex matters by some.

### IV.3 Conclusion

Two brief considerations should suffice at this point. First, from a broad field of studies on the effects of FDI and economic development a strong consensus has emerged that FDI requires active government regulation to maximise the benefits (and limit the negative effects) for host countries. Transferring away control over FDI from host countries to MNEs is therefore hardly a sustainable policy option, as long as corporate behaviour and responsibilities are not subjected to binding multilateral rules while host country actions are. Second, it appears that many of the positions taken by WTO Members are based on a number of unsupported assertions rather than on serious analyses of the likely effects of multilateral disciplines on investment on WTO members. Instead of talking past each other, it would be desirable if further discussions in the WTO's Working Group on the Relationship between Trade and Investment involved a dialogue on the most equitable ways of creating and expanding those multilateral rules that an increasingly worldwide system of production and distribution is going to require.

[128] Helleiner (2000: 3).

[129] Ibid.

[130] It should be noted, however, that some observers take a more optimistic view on the capacity of developing countries to influence outcomes from multilateral negotiations. Page (2003: 4), for example, notes that particularly in the last WTO Ministerial Meetings (Seattle 1999, Doha 2001) "developing countries have proved first that they can modify the outcome, then that they can block a settlement, and finally that they can initiate their own issues."

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## APPENDICES

**Appendix Table 1 – Mergers and acquisitions (million US$)**

| M&A Sales | 1991 | 1995 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| TOTAL WORLD | 80,713 | 186,593 | 766,044 | 1,143,816 | 593,960 |
| Developed countries | 74,048 | 163,950 | 679,481 | 1,056,059 | 496,159 |
| Western Europe | 38,520 | 79,114 | 370,718 | 610,647 | 228,995 |
| European Union | 36,676 | 75,143 | 357,311 | 586,521 | 212,960 |
| Other Western Europe | 1,844 | 3,971 | 13,407 | 24,126 | 16,035 |
| North America | 31,884 | 64,804 | 275,884 | 401,429 | 226,798 |
| Other developed countries | 3,644 | 20,032 | 32,879 | 43,983 | 40,365 |
| Developing countries | 5,786 | 16,493 | 74,003 | 70,610 | 85,813 |
| Africa | 47 | 840 | 3,090 | 3,199 | 15,524 |
| Latin America and the Caribbean | 3,529 | 8,636 | 41,964 | 45,224 | 35,837 |
| Asia and the Pacific | 2,210 | 7,017 | 28,949 | 22,187 | 34,452 |
| Asia | 2,182 | 6,950 | 28,839 | 22,182 | 34,452 |
| West Asia | 131 | 222 | 335 | 970 | 1,323 |
| Central Asia | - | 450 | 73 | 107 | 15 |
| South, East and South-East Asia | 2,051 | 6,278 | 28,431 | 21,105 | 33,114 |
| The Pacific | 28 | 67 | 110 | 5 | - |
| Central and Eastern Europe | 880 | 6,032 | 10,357 | 17,147 | 11,607 |

| M&A Purchases | 1991 | 1995 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| TOTAL WORLD | 80,713 | 186,593 | 766,044 | 1,143,816 | 593,960 |
| Developed countries | 77,435 | 173,139 | 700,808 | 1,087,638 | 534,151 |
| Western Europe | 42,473 | 92,539 | 539,246 | 852,735 | 348,738 |
| European Union | 39,676 | 81,417 | 517,155 | 801,746 | 327,252 |
| Other Western Europe | 2,797 | 11,122 | 22,091 | 50,989 | 21,486 |
| North America | 20,702 | 69,833 | 138,881 | 198,915 | 135,019 |
| Other developed countries | 14,260 | 10,767 | 22,681 | 35,988 | 50,395 |
| Developing countries | 3,258 | 13,372 | 63,406 | 48,496 | 55,719 |
| Africa | 430 | 645 | 5,762 | 6,659 | 3,041 |
| Latin America and the Caribbean | 387 | 3,951 | 44,767 | 18,614 | 27,380 |
| Asia and the Pacific | 2,441 | 8,776 | 12,877 | 23,223 | 25,298 |
| Asia | 2,441 | 8,755 | 12,873 | 22,895 | 25,298 |
| West Asia | 113 | 1,697 | 1,538 | 1,750 | 454 |
| Central Asia | - | 450 | - | 6 | - |
| South, East and South-East Asia | 2,329 | 6,608 | 11,335 | 21,139 | 24,844 |
| The Pacific | - | 22 | 4 | 328 | - |
| Central and Eastern Europe | 14 | 59 | 1,549 | 1,694 | 2,225 |

**Source**: UNCTAD FDI/TNC database

| **Appendix Table 2**<br>**FDI inflows (million US$)** | **1980** | **1985** | **1990** | **1995** | **2000** | **2001** |
|---|---|---|---|---|---|---|
| TOTAL WORLD | 54'945 | 57'596 | 202'782 | 330'516 | 1'491'934 | 735'146 |
| (percentage share) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Developed countries | 46'530 | 42'693 | 164'575 | 203'311 | 1'227'476 | 503'144 |
| (percentage share) | 84.7 | 74.1 | 81.2 | 61.5 | 82.3 | 68.4 |
| Western Europe | 21'427 | 16'762 | 96'803 | 118'265 | 832'067 | 336'210 |
| (percentage share) | 39.0 | 29.1 | 47.7 | 35.8 | 55.8 | 45.7 |
| European Union | 21'317 | 15'879 | 90'213 | 114'439 | 808'519 | 322'954 |
| (percentage share) | 38.8 | 27.6 | 44.5 | 34.6 | 54.2 | 43.9 |
| Other Western Europe | 111 | 883 | 6'591 | 3'827 | 23'549 | 13'256 |
| (percentage share) | 0.2 | 1.5 | 3.3 | 1.2 | 1.6 | 1.8 |
| North America | 22'725 | 21'862 | 56'004 | 68'027 | 367'529 | 151'900 |
| (percentage share) | 41.4 | 38.0 | 27.6 | 20.6 | 24.6 | 20.7 |
| Other developed countries | 2'377 | 4'069 | 11'767 | 17'019 | 27'880 | 15'034 |
| (percentage share) | 4.3 | 7.1 | 5.8 | 5.1 | 1.9 | 2.0 |
| Developing countries | 8'380 | 14'873 | 37'567 | 112'537 | 237'894 | 204'801 |
| (percentage share) | 15.3 | 25.8 | 18.5 | 34.0 | 15.9 | 27.9 |
| Africa | 380 | 2'407 | 2'483 | 5'743 | 8'694 | 17'165 |
| (percentage share) | 0.7 | 4.2 | 1.2 | 1.7 | 0.6 | 2.3 |
| Latin America and the Caribbean | 7'485 | 7'278 | 10'282 | 30'866 | 95'405 | 85'373 |
| (percentage share) | 13.6 | 12.6 | 5.1 | 9.3 | 6.4 | 11.6 |
| Asia and the Pacific | 516 | 5'187 | 24'803 | 75'928 | 133'795 | 102'264 |
| (percentage share) | 0.9 | 9.0 | 12.2 | 23.0 | 9.0 | 13.9 |
| Asia | 396 | 5'110 | 24'251 | 75'217 | 133'707 | 102'066 |
| (percentage share) | 0.7 | 8.9 | 12.0 | 22.8 | 9.0 | 13.9 |
| West Asia | -3'162 | 740 | 2'141 | 3 | 688 | 4'133 |
| (percentage share) | -5.8 | 1.3 | 1.1 | 0.0 | 0.0 | 0.6 |
| Central Asia | - | - | 4 | 1'484 | 1'895 | 3'569 |
| (percentage share) | - | - | 0.0 | 0.4 | 0.1 | 0.5 |
| South East and South-East Asia | 3'558 | 4'371 | 22'106 | 73'729 | 131'123 | 94'365 |
| (percentage share) | 6.5 | 7.6 | 10.9 | 22.3 | 8.8 | 12.8 |
| The Pacific | 119 | 77 | 552 | 711 | 88 | 198 |
| (percentage share) | 0.2 | 0.1 | 0.3 | 0.2 | 0.0 | 0.0 |
| Central and Eastern Europe | 35 | 30 | 639 | 14'668 | 26'563 | 27'200 |
| (percentage share) | 0.1 | 0.1 | 0.3 | 4.4 | 1.8 | 3.7 |

**Continues…**

| **Appendix Table 2 (continued)**<br>**FDI outflows (million US$)** | **1980** | **1985** | **1990** | **1995** | **2000** | **2001** |
|---|---|---|---|---|---|---|
| TOTAL WORLD | 53674 | 62163 | 233315 | 356404 | 1379493 | 620713 |
| (percentage share) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Developed countries | 50343 | 57907 | 216562 | 304151 | 1271273 | 580624 |
| | 93.8 | 93.2 | 92.8 | 85.3 | 92.2 | 93.5 |
| Western Europe | 24065 | 31961 | 129531 | 174305 | 1018392 | 380434 |
| (percentage share) | 44.8 | 51.4 | 55.5 | 48.9 | 73.8 | 61.3 |
| European Union | 23812 | 26084 | 121344 | 159713 | 968019 | 365182 |
| (percentage share) | 44.4 | 42.0 | 52.0 | 44.8 | 70.2 | 58.8 |
| Other Western Europe | 253 | 5877 | 8188 | 14593 | 50373 | 15252 |
| (percentage share) | 0.5 | 9.5 | 3.5 | 4.1 | 3.7 | 2.5 |
| North America | 23328 | 17250 | 36219 | 103536 | 212468 | 149449 |
| (percentage share) | 43.5 | 27.7 | 15.5 | 29.1 | 15.4 | 24.1 |
| Other developed countries | 2950 | 8696 | 50812 | 26310 | 40414 | 50741 |
| (percentage share) | 5.5 | 14.0 | 21.8 | 7.4 | 2.9 | 8.2 |
| Developing countries | 3310 | 4255 | 16700 | 51547 | 104207 | 36571 |
| (percentage share) | 6.2 | 6.8 | 7.2 | 14.5 | 7.6 | 5.9 |
| Africa | 1119 | 346 | 2103 | 3051 | 1481 | -2544 |
| (percentage share) | 2.1 | 0.6 | 0.9 | 0.9 | 0.1 | -0.4 |
| Latin America and the Caribbean | 1129 | 1048 | 3163 | 7493 | 21748 | 7217 |
| (percentage share) | 2.1 | 1.7 | 1.4 | 2.1 | 1.6 | 1.2 |
| Asia and the Pacific | 1062 | 2861 | 11434 | 41003 | 80978 | 31897 |
| (percentage share) | 2.0 | 4.6 | 4.9 | 11.5 | 5.9 | 5.1 |
| Asia | 1044 | 2847 | 11413 | 41005 | 80942 | 31836 |
| (percentage share) | 1.9 | 4.6 | 4.9 | 11.5 | 5.9 | 5.1 |
| West Asia | 586 | 80 | -496 | -916 | 1262 | 1090 |
| (percentage share) | 1.1 | 0.1 | -0.2 | -0.3 | 0.1 | 0.2 |
| Central Asia | - | - | - | 0 | 23 | 152 |
| (percentage share) | - | - | - | 0.0 | 0.0 | 0.0 |
| South East and South-East Asia | 458 | 2767 | 11909 | 41921 | 79657 | 30593 |
| (percentage share) | 0.9 | 4.5 | 5.1 | 11.8 | 5.8 | 4.9 |
| The Pacific | 18 | 14 | 21 | -2 | 36 | 62 |
| (percentage share) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Central and Eastern Europe | 21 | 1 | 54 | 706 | 4012 | 3518 |
| (percentage share) | 0.0 | 0.0 | 0.0 | 0.2 | 0.3 | 0.6 |

**Continues….**

| **Appendix Table 2 (continued)**<br>**Net FDI Inflows**<br>**(million US$)** | **1980** | **1985** | **1990** | **1995** | **2000** | **2001** |
|---|---|---|---|---|---|---|
| TOTAL WORLD | 1'271 | -4'567 | -30'533 | -25'888 | 112'441 | 114'433 |
| Developed countries | -3'813 | -15'214 | -51'987 | -100'840 | -43'797 | -77'480 |
| Western Europe | -2'638 | -15'199 | -32'728 | -56'040 | -186'325 | -44'224 |
| European Union | -2'495 | -10'205 | -31'131 | -45'274 | -159'500 | -42'228 |
| Other Western Europe | -142 | -4'994 | -1'597 | -10'766 | -26'824 | -1'996 |
| North America | -603 | 4'612 | 19'785 | -35'509 | 155'061 | 2'451 |
| Other developed countries | -573 | -4'627 | -39'045 | -9'291 | -12'534 | -35'707 |
| Developing countries | 5'070 | 10'618 | 20'867 | 60'990 | 133'687 | 168'230 |
| Africa | -739 | 2'061 | 380 | 2'692 | 7'213 | 19'709 |
| Latin America and the Caribbean | 6'356 | 6'230 | 7'119 | 23'373 | 73'657 | 78'156 |
| Asia and the Pacific | -546 | 2'326 | 13'369 | 34'925 | 52'817 | 70'367 |
| Asia | -648 | 2'263 | 12'838 | 34'212 | 52'765 | 70'230 |
| West Asia | -3'748 | 660 | 2'637 | 919 | -574 | 3'043 |
| Central Asia | - | - | - | 1'484 | 1'872 | 3'417 |
| South East and South-East Asia | 3'100 | 1'604 | 10'197 | 31'808 | 51'466 | 63'772 |
| The Pacific | 101 | 63 | 531 | 713 | 52 | 136 |
| Central and Eastern Europe | 14 | 29 | 585 | 13'962 | 22'551 | 23'682 |

**Source**: UNCTAD (2002: 303-9); UNCTAD FDI/TNC database; net figures own calculations

| Appendix Table 3<br>Inward Stock | 1980 | 1985 | 1990 | 1995 | 2000 | 2001 |
|---|---|---|---|---|---|---|
| TOTAL WORLD | 635'534 | 913'182 | 1'871'594 | 2'911'725 | 6'258'263 | 6'845'723 |
| (percentage share) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Developed countries | 389'715 | 568'670 | 1'382'978 | 2'021'303 | 4'124'261 | 4'504'122 |
| (percentage share) | 61.3 | 62.3 | 73.9 | 69.4 | 65.9 | 65.8 |
| Western Europe | 232'081 | 285'544 | 780'813 | 1'192'427 | 2'498'247 | 2'776'627 |
| (percentage share) | 36.5 | 31.3 | 41.7 | 41.0 | 39.9 | 40.6 |
| European Union | 216'840 | 267'618 | 733'303 | 1'115'081 | 2'381'954 | 2'648'651 |
| (percentage share) | 34.1 | 29.3 | 39.2 | 38.3 | 38.1 | 38.7 |
| Other Western Europe | 15'241 | 17'926 | 47'511 | 77'346 | 116'292 | 127'976 |
| (percentage share) | 2.4 | 2.0 | 2.5 | 2.7 | 1.9 | 1.9 |
| North America | 137'209 | 249'272 | 507'793 | 658'843 | 1'415'854 | 1'522'552 |
| (percentage share) | 21.6 | 27.3 | 27.1 | 22.6 | 22.6 | 22.2 |
| Other developed countries | 20'425 | 33'855 | 94'372 | 170'033 | 210'161 | 204'943 |
| (percentage share) | 3.2 | 3.7 | 5.0 | 5.8 | 3.4 | 3.0 |
| Developing countries | 245'819 | 344'463 | 484'954 | 849'915 | 2'002'173 | 2'181'249 |
| (percentage share) | 38.7 | 37.7 | 25.9 | 29.2 | 32.0 | 31.9 |
| Africa | 34'326 | 35'473 | 50'291 | 77'863 | 142'379 | 158'840 |
| (percentage share) | 5.4 | 3.9 | 2.7 | 2.7 | 2.3 | 2.3 |
| Latin America and the Caribbean | 50'297 | 80'019 | 117'001 | 201'426 | 613'094 | 692'978 |
| (percentage share) | 7.9 | 8.8 | 6.3 | 6.9 | 9.8 | 10.1 |
| Asia and the Pacific | 161'196 | 228'970 | 317'663 | 570'625 | 1'246'700 | 1'329'431 |
| (percentage share) | 25.4 | 25.1 | 17.0 | 19.6 | 19.9 | 19.4 |
| Asia | 160'000 | 227'764 | 315'412 | 567'631 | 1'243'202 | 1'325'735 |
| (percentage share) | 25.2 | 24.9 | 16.9 | 19.5 | 19.9 | 19.4 |
| West Asia | -1'170 | 28'764 | 31'322 | 41'757 | 57'835 | 61'968 |
| (percentage share) | -0.2 | 3.1 | 1.7 | 1.4 | 0.9 | 0.9 |
| Central Asia | - | - | - | 3'864 | 16'898 | 20'362 |
| (percentage share) | - | - | - | 0.1 | 0.3 | 0.3 |
| South East and South-East Asia | 161'170 | 199'000 | 284'090 | 522'011 | 1'168'470 | 1'243'405 |
| (percentage share) | 25.4 | 21.8 | 15.2 | 17.9 | 18.7 | 18.2 |
| The Pacific | 1'196 | 1'207 | 2'250 | 2'994 | 3'498 | 3'696 |
| (percentage share) | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Central and Eastern Europe | - | 49 | 3'661 | 40'508 | 131'829 | 160'352 |
| (percentage share) | - | 0.0 | 0.2 | 1.4 | 2.1 | 2.3 |

**Continued…**

| Appendix Table 3 (Continued)<br>Outward Stock | 1980 | 1985 | 1990 | 1995 | 2000 | 2001 |
|---|---|---|---|---|---|---|
| TOTAL WORLD | 521486 | 691745 | 1721462 | 2854853 | 6086428 | 6552011 |
| (percentage share) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Developed countries | 499428 | 656276 | 1630443 | 2577550 | 5316292 | 5751947 |
| (percentage share) | 95.8 | 94.9 | 94.7 | 90.3 | 87.3 | 87.8 |
| Western Europe | 237694 | 321972 | 875571 | 1457253 | 3421542 | 3721228 |
| (percentage share) | 45.6 | 46.5 | 50.9 | 51.0 | 56.2 | 56.8 |
| European Union | 215582 | 295727 | 798525 | 1292043 | 3148830 | 3440890 |
| (percentage share) | 41.3 | 42.8 | 46.4 | 45.3 | 51.7 | 52.5 |
| Other Western Europe | 22112 | 26245 | 77047 | 165210 | 272712 | 280338 |
| (percentage share) | 4.2 | 3.8 | 4.5 | 5.8 | 4.5 | 4.3 |
| North America | 239158 | 281512 | 515358 | 817224 | 1520417 | 1626165 |
| (percentage share) | 45.9 | 40.7 | 29.9 | 28.6 | 25.0 | 24.8 |
| Other developed countries | 22577 | 52792 | 239514 | 303073 | 374333 | 404553 |
| (percentage share) | 4.3 | 7.6 | 13.9 | 10.6 | 6.2 | 6.2 |
| Developing countries | 22058 | 35469 | 90404 | 270925 | 751632 | 776065 |
| (percentage share) | 4.2 | 5.1 | 5.3 | 9.5 | 12.3 | 11.8 |
| Africa | 6878 | 10961 | 23202 | 35606 | 47249 | 44583 |
| (percentage share) | 1.3 | 1.6 | 1.3 | 1.2 | 0.8 | 0.7 |
| Latin America and the Caribbean | 8974 | 12809 | 19389 | 49388 | 120859 | 128191 |
| (percentage share) | 1.7 | 1.9 | 1.1 | 1.7 | 2.0 | 2.0 |
| Asia and the Pacific | 6206 | 11699 | 47813 | 185931 | 583524 | 603290 |
| (percentage share) | 1.2 | 1.7 | 2.8 | 6.5 | 9.6 | 9.2 |
| Asia | 6193 | 11662 | 47711 | 185417 | 582681 | 602385 |
| (percentage share) | 1.2 | 1.7 | 2.8 | 6.5 | 9.6 | 9.2 |
| West Asia | 1447 | 2143 | 6452 | 5955 | 10172 | 11467 |
| (percentage share) | 0.3 | 0.3 | 0.4 | 0.2 | 0.2 | 0.2 |
| Central Asia | - | - | - | 0 | 553 | 705 |
| (percentage share) | - | - | - | 0.0 | 0.0 | 0.0 |
| South East and South-East Asia | 4746 | 9519 | 41259 | 179462 | 571956 | 590213 |
| (percentage share) | 0.9 | 1.4 | 2.4 | 6.3 | 9.4 | 9.0 |
| The Pacific | 13 | 37 | 101 | 514 | 843 | 905 |
| (percentage share) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Central and Eastern Europe | - | - | 616 | 6378 | 18505 | 23999 |
| (percentage share) | - | - | 0.0 | 0.2 | 0.3 | 0.4 |

**Continued…**

| **Appendix Table 3 Net FDI Stock (million US$)** | **1980** | **1985** | **1990** | **1995** | **2000** | **2001** |
|---|---|---|---|---|---|---|
| TOTAL WORLD | 114'048 | 221'437 | 150'132 | 56'872 | 171'835 | 293'712 |
| Developed countries | -109'713 | -87'606 | -247'465 | -556'247 | -1'192'031 | -1'247'825 |
| Western Europe | -5'613 | -36'428 | -94'758 | -264'826 | -923'295 | -944'601 |
| European Union | 1'258 | -28'109 | -65'222 | -176'962 | -766'876 | -792'239 |
| Other Western Europe | -6'871 | -8'319 | -29'536 | -87'864 | -156'420 | -152'362 |
| North America | -101'949 | -32'240 | -7'565 | -158'381 | -104'563 | -103'613 |
| Other developed countries | -2'152 | -18'937 | -145'142 | -133'040 | -164'172 | -199'610 |
| Developing countries | 223'761 | 308'994 | 394'550 | 578'990 | 1'250'541 | 1'405'184 |
| Africa | 27'448 | 24'512 | 27'089 | 42'257 | 95'130 | 114'257 |
| Latin America and the Caribbean | 41'323 | 67'210 | 97'612 | 152'038 | 492'235 | 564'787 |
| Asia and the Pacific | 154'990 | 217'271 | 269'850 | 384'694 | 663'176 | 726'141 |
| Asia | 153'807 | 216'102 | 267'701 | 382'214 | 660'521 | 723'350 |
| West Asia | -2'617 | 26'621 | 24'870 | 35'802 | 47'663 | 50'501 |
| Central Asia | - | - | - | 3'864 | 16'345 | 19'657 |
| South East and South-East Asia | 156'424 | 189'481 | 242'831 | 342'549 | 596'514 | 653'192 |
| The Pacific | 1'183 | 1'170 | 2'149 | 2'480 | 2'655 | 2'791 |
| Central and Eastern Europe | - | - | 3'045 | 34'130 | 113'324 | 136'353 |

**Source**: UNCTAD (2002:310-17); UNCTAD FDI/TNC database

**Appendix Table 4 - Inward and Outward FDI Stocks as a percentage of GDP**

| | | 1980 | 1985 | 1990 | 1995 | 2000 |
|---|---|---|---|---|---|---|
| **TOTAL WORLD** | Inward | 6.1 | 7.8 | 8.9 | 10.0 | 20.0 |
| | Outward | 5.4 | 6.2 | 8.4 | 9.9 | 19.6 |
| **Developed countries** | Inward | 4.8 | 6.2 | 8.1 | 8.9 | 17.1 |
| | Outward | 6.2 | 7.2 | 9.6 | 11.3 | 22.1 |
| **Western Europe** | Inward | 6.2 | 9.3 | 10.8 | 13.1 | 30.2 |
| | Outward | 6.4 | 10.5 | 12.1 | 16.1 | 41.4 |
| **European Union** | Inward | 6.1 | 9.2 | 10.6 | 12.9 | 30.3 |
| | Outward | 6.1 | 10.2 | 11.6 | 15.0 | 40.1 |
| **Other Western Europe** | Inward | 8.7 | 10.9 | 13.4 | 16.6 | 28.1 |
| | Outward | 12.7 | 16.1 | 22.0 | 35.6 | 66.0 |
| **North America** | Inward | 4.5 | 5.5 | 8.0 | 8.3 | 13.5 |
| | Outward | 7.9 | 6.2 | 8.1 | 10.3 | 14.5 |
| **Other developed countries** | Inward | 1.6 | 2.1 | 2.7 | 2.9 | 4.0 |
| | Outward | 1.8 | 3.3 | 6.9 | 5.2 | 7.5 |
| **Developing countries** | Inward | 10.2 | 13.9 | 13.0 | 15.3 | 30.9 |
| | Outward | 1.3 | 1.7 | 2.8 | 5.1 | 11.9 |
| **Africa** | Inward | 8.8 | 10.3 | 10.7 | 15.6 | 25.5 |
| | Outward | 2.2 | 4.1 | 5.9 | 7.9 | 9.2 |
| **North Africa** | Inward | 4.3 | 6.0 | 8.5 | 13.0 | 15.1 |
| | Outward | 0.4 | 0.6 | 0.9 | 0.9 | 1.3 |
| **Other Africa** | Inward | 11.2 | 13.8 | 12.2 | 17.2 | 33.8 |
| | Outward | 3.6 | 8.2 | 9.7 | 12.8 | 15.9 |
| **Latin America and the Caribbean** | Inward | 6.5 | 11.0 | 10.4 | 11.8 | 30.9 |
| | Outward | 1.2 | 1.9 | 1.8 | 3.0 | 6.2 |
| **Asia and the Pacific** | Inward | 13.0 | 16.3 | 14.8 | 17.0 | 31.6 |
| | Outward | 0.9 | 1.0 | 2.7 | 5.7 | 15.2 |
| **Central and Eastern Europe** | Inward | n.a. | 0.2 | 1.7 | 5.4 | 18.9 |
| | Outward | n.a. | n.a. | 0.4 | 0.9 | 2.7 |

**Source:** UNCTAD (2002:328-36); UNCTAD FDI/TNC database

| **Appendix Table 5 – EU proposal for a multilateral investment agreement, evinced from concept papers recently submitted to the WGTI** | |
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| **Issue discussed** (WTO document) | **Proposal** |
| **Definition of investment**<br><br>(WT/WGTI/W/115) | **Narrow definition**, including FDI and related transfers and payments only.<br><br>⊙⊙**Direct investment enterprise**s: all incorporated (subsidiaries and associates) or unincorporated (branches) enterprises in which a direct investor owns 10 per cent or more of the ordinary shares or voting power or the equivalent.<br>Should a direct investor control the company with less than 10 per cent of the ordinary shares the following criteria could be taken into account to determine whether a direct investment relationship exists: (a) representation in the Board of Directors; (b) participation in policy-making processes; (c) inter-company transactions; (d) interchange of managerial personnel;(e) provision of technical information; (f) provision of long-term loans at lower than existing market rates.<br><br>⊙⊙**Direct investment capital transaction**s: as defined by the IMF and the OECD, it comprises both the initial transaction between the direct investor and the direct investment enterprise and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated. This includes all operations that create or liquidate direct investments as well as those that serve to maintain, expand or reduce investments, such as equity capital, long-term loans, reinvested earnings and other capital associated with various inter-company debt transactions.<br><br>⊙⊙**Foreign direct investor**s: this concept could include all natural persons and companies of WTO Members, including public or private incorporated or unincorporated enterprises, which engage in a direct investment enterprise - such as a subsidiary, associate or branch - in a country other than the country or countries of residence of the foreign direct investor or investors. |
| **Non-discrimination**<br><br>(WT/WGTI/W/122) | **GATS-like provisions extended to the primary and secondary sectors,** but allowing for general, as well as subject- and country-specific exceptions:<br><br>⊙⊙a general MFN obligation (including possible exceptions) for foreign investments across the board and on all sectors;<br>⊙⊙a general NT obligation (including possible exceptions) for all foreign investments established in accordance with the laws and regulations of the host country (as provided for in most existing BITs);<br>⊙⊙specific NT obligations for the establishment (i.e. admission) of foreign investments in those sectors listed in each country's schedule of commitments. The schedule of commitments would also enumerate each member's limitations to NT. |
| **Transparency**<br><br>(WT/WGTI/W/110) | **GATS-like provisions extended to the primary and secondary sectors, including:**<br><br>**Publication:** Each member should publish, or otherwise make publicly available, all relevant measures of general application which pertain to or affect the operation of the Agreement. Thi sshould include measures affecting the establishment, expansion, withdrawal, operation of investment and international agreements pertaining to FDI.<br>**Notification:** a notification procedure should apply for any new or changes to, existing laws, regulations, judicial decisions, and administrative procedures which significantly and directly affect FDI. A standard proforma could be created to ensure consistency in the notifications, as in the TBT Agreement. This would make sure that all notifications cover the same important areas such as scope of measure, rationale, timing, contact for further details, etc.<br>**Deadline:** publication should be made promptly, and at the latest by the time of the entry into force of the relevant measures. Generally speaking transparency increases if the measures are made public earlier. Better regulation, as well as better transparency is achieved by early public awareness of a prospective measure. Transparency also implies the need to tackle the problem of uncertainty caused by policy changes. Thus, making available information on possible reforms affecting investment will increase predictability of rules.<br>**Enquiry:** Members should be required to respond promptly to all reasonable requests by other Members for specific information on any of its measures of general application.<br>**Procedural transparency:** Members shall ensure that all measures affecting FDI are administered in a reasonable, objective and impartial manner. Each member shall maintain or establish judicial, arbitral or administrative tribunals or procedures for prompt and impartial review and remedy of administrative decisions affecting FDI. |

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| | **Exemptions** may be needed in certain cases, in order to preserve confidential information and public interest. However, the potential of abusing certain exemption provisions should be taken into account and it has to be defined under which circumstances and on what grounds should exemptions be granted. |
| **Balance of payments Safeguards**<br><br>(WT/WGTI/W/153) | - as a **general rule**, members should allow: all current and capital transfers related to established investments, and, as far as the making of new investments is concerned, all current and capital transfers related to those investments covered by the countries' sectoral list of commitments.<br><br>- as an **exception**, a safeguard clause to preserve members in case of serious BOP difficulties. This provision should allow temporary restrictions on the outflows of current and capital transfers related to those investments covered in the IDF.<br>In any case, a BOP safeguard clause, which allows members to take restrictive measures should only be allowed under exceptional circumstances, it should be clearly defined and include strict criteria.<br><br>**Restrictions should be**:<br>- non-discriminatory;<br>- consistent with other relevant international provisions;<br>- limited in time and phased out progressively;<br>- applied in a way that does not exceed what is necessary to deal with the sudden difficulties;<br>- avoid unnecessary damages to the interests of other members;<br>- not be used to justify measures adopted to protect specific industries or sectors.<br><br>As in the GATT and in the GATS, specific procedures should be included concerning notification, review and consultations within the WTO and with other fora as appropriate. |
| **Development provisions**<br><br>(WT/WGTI/W/140) | **The agreement should allow "flexibility" for development.**<br><br>**Definition of flexibility**: flexibility is to make up for insufficient financial and human resources and, in particular, institutional weaknesses, which put heavy restraints on developing countries. Flexibility may typically involve: lower levels of commitments; asymmetrically phased implementation timetables; exceptions from obligations in certain areas; flexibility in the application of – and adherence to – disciplines.<br><br>A flexible, **GATS-type structure based on positive commitments** could be used for market access and NT provisions at the pre-establishment stage. This mechanism would allow some countries to take phased commitments on market access and NT which would be adapted to their level of development. The level of commitments of developing countries would be commensurate to their level of development and there would be no obligation for them to liberalise sectors. Moreover, each developing country would be able to attach to its market access and NT commitments possible conditions related to its development objectives.<br><br>**Technical assistance** should be foreseen for developing countries for all the stages, i.e. the pre-negotiation phase, the negotiation as well as for the implementation of provisions that required specific additional resources.<br><br>The **right of members to regulate** 'in order to meet national policy objectives' should be explicitly recognised, as well as possible exceptions for public interest (for example: security protection of public moral, public order and consumers, exercise of governmental authorities) and restrictions to safeguard the Balance of Payments in accordance with IMF rules.<br><br>The question of **investors' behaviour and their responsibility** vis-à-vis host countries could also be addressed. The OECD Guidelines for multinational enterprises provide a useful example of how to ensure that MNEs conduct their activities in a responsible manner and in harmony with the policies of the countries in which they operate. |
| **Dispute Settlement**<br><br>(WT/WGTI/W/141) | **DSU as in GATS**<br><br>For the sake of consistency, any possible dispute concerning a future multilateral framework on FDI to be negotiated and agreed in the WTO should also be fully covered by the WTO Dispute Settlement mechanism. |
| **Pre-establishment**<br><br>(WT/WGTI/W/122) | **GATS-like positive-list approach** extended to the primary and secondary sectors. |

| Appendix Table 6 - India's submissions to the WGTI | |
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| **Issues discussed** | **Key comments/proposals** |
| **General concerns**<br><br>(WT/WGTI/W/86) | - The relationship between trade and investment is a complex one and is not susceptible to easy analysis, much less, any definitive conclusions;<br><br>- The developmental dimension is at the heart of this educational process and in the end, for developing countries this is what counts most;<br><br>- Flexibility for pursuing various developmental options is key to the future of any developing country; anything that reduces the flexibility currently available to countries should not be an advisable course to pursue;<br><br>- Evidence of the putative benefits from FDI is not conclusive and what we get is a very mixed picture of the advantages and disadvantages of FDI; as with many other things, a lot depends upon the specificities of the country concerned;<br><br>- The present regime of bilateral agreements gives flexibility to a lot of countries enabling them to channel FDI into areas of priority determined by them;<br><br>- There is no evidence that the pattern and flow of investment will change in any significant way with multilateral rules on investment. On the other hand, the bilateral investment treaties appear quite successful in protecting existing investments;<br><br>- On the other hand, there is evidence that should there be multilateral agreement on investment it would definitely limit flexibility currently available for developing countries;<br><br>- FDI appears to be dependent on a host of other factors than the investment regimes *per se*; for example, the size of the market, skilled labour, political stability, sound legal regime and good infrastructure are some of the factors that have been mentioned by Members themselves in their various submissions.<br><br>- If the issues subject to discussion in the WGTI are not addressed from the viewpoint of the entire WTO membership, including low-income and least developed countries, then it is possible that any premature move in this regard would only widen the developmental disparities to which today's globalisation paradigm have provided no clear solutions yet. |
| **FDI and development**<br><br>(WT/WGTI/W/86) | - The WGTI needs to examine how trade and FDI impact upon and are also in turn impacted upon by the stage of development of the country concerned and its trading profile. This should start from an analysis of the experience of industrial and newly industrialised countries, at various stages of their development, also with regard to how far regulation of FDI is necessary for developing countries. (Note of the author: virtually all today's developed countries have heavily regulated FDI and trade flows during their various stages of development).<br><br>- If it true that only certain types of FDI, notably greenfield investment, have potentially high positive welfare effects in the host country, why should the latter not be allowed to discriminate in favour of such FDI that promotes technology transfer, capacity building and employment? In that case, BITs would be the optimal instrument, as it allows for a great deal of flexibility, rather than a multilateral investment agreement which, by definition, ca not take into account the specificities and peculiarities of each and every country. |
| **Mobility of labour**<br><br>(WT/WGTI/W/86)<br>(WT/WGTI/W/148) | - From a purely economics viewpoint, the arguments for free movement of labour are no weaker that those for free movement of capital. Any discussion on the mobility of capital remains incomplete without appropriate investigation into the scope for the mobility of labour.<br><br>- Capital is a factor of production and, as such, is not more or less significant than any other factor of production. If disciplines aimed at freer movement of capital are being considered then in the interests of the development needs of developing countries, the need to simultaneously build in disciplines facilitating movement of labour, particularly professionals and skilled personnel, could be a compelling argument.<br>- |
| **Multilateral investment** | - BITs have proven to be a means assuring investors sufficient protection and hosts an adequate degree of policy flexibility. Indeed, FDI flows to developing countries has risen manifold over |

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| **agreement and quantity of FDI flows** (WT/WGTI/W/86) | the last decade or so. It is far from clear that a multilateral agreement on investment will either provide the same degree of flexibility and comfort that the bilateral instruments currently provide to developing countries or it will necessarily lead to significant increase in inward flows of investment. |
| **Multilateral investment agreement and efficiency** (WT/WGTI/W/86) | - The argument that multilateral rules will lead to efficiency gains, lower costs and prices which are in the interest of both home and host countries does not take into account the costs for host countries in terms of costs of adjustment and impact on social gains that could otherwise have accrued in many cases? Global welfare gains do not necessarily translate into national welfare gains for the host country. What is therefore the benefit for the host country in becoming a party to such a multilateral agreement? |
| **Performance requirements** (WT/WGTI/W/148) | - Host countries may find it necessary to impose performance requirements on FDI so as to assure certain domestic industries are adequately protected against the overwhelming power of MNEs. The study process within the WGTI needs to examine the positive role played by such policy instruments before arriving at any conclusion.<br><br>- There is a need to have a fresh look at performance requirements. Empirical studies have shown that affiliates of certain trans-national corporations buy the bulk of their inputs from parent companies and other affiliated companies leaving only a small proportion for unaffiliated suppliers within the host country or in third countries. UNCTAD's Trade and Development Report 2002 has highlighted the poor record of generation of value added and linkages by trans-national corporations. It is also an undeniable fact that until recently performance requirements were an integral part of the growth strategy of all developed countries. It is important, therefore, that performance requirements on employment generation, transfer of technology, export performance requirements, manufacturing requirements, training and research and development requirements etc., remain available to developing countries to ensure that foreign investment contributes to the achievement of development policy goals.<br><br>- Another point to which attention needs to be drawn is the possible damaging effect of capital outflows on balance-of-payments. There are many recent cases of such damage to the economies of developing countries. While this calls for further policy flexibility to maintain restrictions on outflows, there is also a strong case for performance requirements such as export obligations and foreign exchange neutrality to moderate the adverse effects of capital outflows. |

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| **Investment incentives** (WT/WGTI/W/86) | - This is an important issue, to be reflected upon carefully by all WTO members. (Note by the author: the issue of investment incentives is usually neglected in international investment agreements, mainly because of industrialised countries' reluctance to give in on this issue) |
| **Non-discrimination**<br><br>(WT/WGTI/W/149) | - Non-discrimination in the context of trade includes national treatment (NT) and most-favoured-nation (MFN) treatment. The question of including the MFN and NT standard in any international investment agreements tends to raise more complex issues than including them in trade agreements, for the following reasons:<br><br>- Investment essentially involves movement of capital, which tends to move in various ways from home country to third countries and then to host countries. There may be many channels of such movement and the ultimate investor may not be the original lender or investor. Hence the question of non-discrimination in capital flows becomes more complex. There is no clear buyer-seller linkage, as is the case of goods and services, and no certainty regarding the source of funds. There is also no certainty regarding the manner in which funds will be retained in the host country and at what point in time, in what manner, and to what extent funds will flow out. Unlike domestic investment, where funds remain within the country, foreign investment can flow in and out, depending on speculative factors and short-term changes in different investment destinations. Many developing countries have, in the recent past, faced economic crises on account of heavy outflow of funds occurring within a short period of time. A certain degree of discrimination between different kinds of investment is unavoidable. The effect of different kinds of foreign capital on the economies of developing countries would obviously vary. The source of funds is also of significance from the economic as well as political point of view. There are, therefore, severe limitations to the extension of the concept of non-discrimination to capital flows.<br><br>- The important issue to be clarified is whether non-discrimination is an absolute principle. While it is universally accepted and endorsed that the principle of non-discrimination underlies the multilateral trading system, issues have been raised by developmental economists (author's note: e.g. Singh, 2002) whether such non-discrimination provisions have to be treated in an absolute sense. Given the various channels of capital flows, characteristics of capital and their different socio-economic impact on the host country, is it not essential that developing countries preserve fully their discretionary authority with regard to investment inflows?<br><br>- Another issue is the relevance of the WTO principles of non-discrimination to international investment agreements. When it come to "investment" per se as distinct from "trade" per se, the relevance of fundamental WTO principles - e.g. non-discrimination, freer trade, predictability, promotion of freer competition, encouraging development and economic reform – is neither direct or evident. Money flows are essentially different in character from flows of services and goods. The money market is considerably more opaque, less predicable, far more subject to purely speculative movements. The principles of free trade in goods and services cannot be applied to the movement of capital.<br><br>- It is not appropriate to compare "investment" as defined and dealt with under GATS <u>with</u> "investment" as proposed for negotiation by some members under the aegis of WTO. GATS follows an "enterprise-based" definition of investment and the definition is closely linked to the mode 3 of service delivery vis-à-vis "commercial presence" which in the context of GATS has no other purpose than to facilitate service supply. One of the basic characteristics of service delivery in respect of certain categories of services is the need for the "supplier" and the "receiver" of the service to be in contact. "Commercial presence", therefore, is the only mode of service delivery in the case of certain types of services, e.g. banking and insurance. GATS deals with trade in services by its nature, not investment per se. Therefore, the "commercial presence" in a host country, even though it includes direct investment, or the establishment of a foreign company, mainly focuses on the supply of services.<br><br>- Commercial presence is covered under GATS only to the extent that it facilitates the delivery of services – and that too is subject to various conditions and exemptions. What is of importance is the commitment for market access for specific service sectors undertaken by a Member. Mistaking it as a commitment to "commercial presence" is mistaking the "medium" for the "message". Therefore, inclusion of commercial presence under GATS in the WTO does not, in any way, justify the inclusion of "investment" under "goods" in the WTO.<br><br>- It was to bring services under the umbrella of the WTO that it was found necessary to devise a specific architecture involving, *inter alia*, mode based definitions. It would be erroneous logic to now reapply the GATS architecture to the goods sector. GATS is a complex Agreement. Safeguard measures in respect of services have eluded evolution. Protection in respect of goods is possible through tariff and other border measures, while certain modes of services are not amenable to such measures. Given the complex nature of capital flows/investments, application of non-discrimination principle as it exists in goods and services to investment cannot be |

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| | automatic. Developing countries need to retain the ability to screen and channel foreign direct investment consistent with their domestic interests and priorities. This is the reason why bilateral investment treaties are preferred the world over. |
| **Pre-establishment in a GATS-type positive list approach**<br><br>(WT/WGTI/W/150) | - The concept of pre-establishment national treatment as such does not exist under the GATS. National treatment is available only to the extent that commitments have been taken by Members.<br>- With the exception of regional trading agreements, BITs involving the United States or Canada, and a recently negotiated between Japan and Korea, all international investment agreements provide for national treatment only at the post-establishment stage. BITs leave host countries the right to make or modify their rules and regulations on foreign investment. Availability of this policy space is the most important development dimension.<br>- Other factors, such as size of host-country market, macro-economic conditions, availability of skilled personnel and inputs, have attracted substantial investment flows to certain countries without national treatment being guaranteed to investment or investors.<br>- Most BITs grant national treatment to investment, while investors are accorded MFN treatment only. When certain international instruments envisage national treatment at the pre-establishment stage, such instruments are non-binding and cover only investments and investors. Binding national treatment and MFN provisions are available in some regional trading arrangements, such as NAFTA, covering advanced stages of integration. However, it is not clear for why this should be emulated by an investment agreement in WTO, where the membership is predominantly low-income developing countries and LDCs, with diverse economic backgrounds and at different stages of development.<br>- National treatment at the sub-central level: it is not clear what should be the modalities for treatment of sub-national authorities with constitutional powers to make rules and regulations related to foreign investment.<br>- Unlike goods and services, investment essentially involves movement of capital, which tends to move in various ways from home country to third countries and then to host countries. Given the complex nature of capital flows/investments, binding rules on "pre-establishment commitments" will neither be feasible nor necessary. Developing countries need to retain the ability to screen and channel FDI in tune with their domestic interests and priorities. Bilateral investment treaties have been favoured the world over for precisely the flexibility they provide to the host country while at the same time extending necessary protection to foreign investors. |
| **Development provisions**<br><br>(WT/WGTI/W/148) | - Development is a complex process, and no single formula can fit into every economic situation in such a manner that it inevitably leads to growth. Developing countries, therefore, need policy space so that they can determine for themselves how the process of economic development can be speeded up and the welfare of their citizens enhanced. This also includes the policy space to determine the manner in which investment shall be regulated and channelled. Any multilateral discipline that seeks to limit this policy space, by its very definition, would reduce the policy options available to developing countries to use foreign investment for promoting development.<br>- The basic assumption underlying the proposal for multilateral disciplines on investment is that the principle of free trade, which permeates WTO rules in respect of goods and services, would apply equally to movement of capital. If conditions of a perfect market prevail, then freedom of international capital movement could possibly lead to benefits both for home and host countries and for investors. This is not a realistic situation, as the efficient markets paradigm is fundamentally misleading when applied to capital flows. In the case of domestic distortions and/or market failures, which are endemic particularly in developing economies, then there is no reason to assume that financial liberalisation will be welfare improving. Several studies have highlighted cases where foreign investment may have lowered host-country welfare.<br><br>- Developing countries need policy flexibility to determine the form of investment leading to highest growth. The definition of investment would have important implications for the development dimension. Greenfield investment is generally preferable to mergers and acquisitions. Any movement of capital that could cause serious damage to the host economy would need to be carefully regulated. Existing BITs provide such necessary flexibility.<br><br>- Money falls in the category of neither goods nor services. WTO is a trade-negotiating forum: it is neither a forum of bankers, nor of monetary economists. The less-developed countries in the WTO do not have the skills and the expertise that the richer countries have. Perhaps the best contribution that can be made to the cause of development is to understand the limitations of developing countries and focus only on trade issues within the WTO. |
| **Investor obligations** | - While foreign investment could generate positive changes in the economy through the |

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| (WT/WGTI/W/148)<br>(WT/WGTI/W/152)<br><br>Note: submission no.152 on investors' obligations is co-sponsored by China, Cuba, India, Kenya, Pakistan and Zimbabwe | induction of capital, technology, managerial and marketing skills, it could also have various negative effects. It need not necessarily bring in any significant new technology as empirical evidence presently indicates, generate little value added for employment or develop linkages with domestic industry in the host country. The objective of global profit maximisation by trans-national corporations rather than by each new subsidiary may sometimes result in conflict of interests with the developing host country being the loser in many cases. It is important, therefore, that the Working Group discusses also a binding code of conduct on investors with a further stipulation that it shall be enforced by home countries through a set of precise domestic laws that can be activated by any host country.<br><br>- Some possible general principles that would need to be kept in view while drawing up any investor obligations could be as follows.<br><br>a) General principles, to cover the following broad principles:<br><br>• foreign investors would respect the national sovereignty of host member and the right of each member government to regulate and monitor their activities;<br>• non-interference in internal affairs of the host member and in its determination of its economic and other priorities;<br>• adherence to economic goals and development objectives, policies and priorities of host members, and working seriously towards making a positive contribution to the achievement of the host members' economic goals, developmental policies and objectives;<br>• adherence to socio-cultural objectives and values, and avoiding practices, products or services that may have detrimental effects.<br><br>b) Restrictive business practices (RBP):<br><br>The provisions of the UNCTAD's Set of Multilaterally Agreed Principles on RBPs could be incorporated, making them legally binding and thus enforceable.<br><br>c) Obligations of technology transfer should include:<br><br>• Contribution to technical and managerial training of citizens of host members<br>• Prohibition to impose restrictive clauses in technology transfer contracts with their affiliates and licensees that prevent absorption and assimilation of technology transferred.<br>• Providing information on various aspects of the technologies to be transferred.<br><br>d) Balance of payments<br><br>Foreign investors should be obliged to follow and contribute towards the goal of host countries' policies implemented to counter adverse, or to improve positive BOP effects from FDI. Such obligations should include:<br><br>• adhere to policies and measures instituted by the host member governments aimed at safeguarding the balance-of-payments and at strengthening the balance-of-payments position;<br>• contribute to promotion and diversification of exports and to increased utilization of goods, services and other resources available locally;<br>• cooperate with the host governments in periods of balance-of-payments crisis by delaying remittances of profits and by phasing out divestment proceeds;<br>• desist from engaging in short-term financial operations or intra-corporate transfers in a manner that would increase currency instability and balance-of-payments difficulties<br>• apply fair pricing policies in intra-corporate trade and curb transfer pricing manipulations.<br><br>e) Ownership and control:<br><br>MNE's should be required to:<br><br>• delegate as much as possible the power of decision making to their entities, so that the latter can contribute positively to the economic and social development of the host members;<br>• should work together with the governments and citizens of host members to realize the national objectives of local equity participation and effective exercise of control by local partners in accordance with contractual terms of equity or non-equity arrangements or with the terms of control as established by the laws of those members concerned;<br>• exercise their personnel policies in light of host member national polices, laws and regulations to the effect that priority is given to local nationals in recruitment, training and promotion to posts of managerial and leading nature so as to enhance the effective participation of local citizens in the process of decision-making. |

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| | f) Consumer protection and environmental protection<br><br>MNEs should be required to:<br><br>• respect the rights of consumers in host members and pay due regard to effective consumer protection and ensure the safety and quality of the goods and services they provide and not to produce, market or advertise potentially harmful products;<br>• adhere to environmental and safety practices and requirements to ensure that the health, safety and environment of people in the host members are properly protected;<br>• take steps to protect the environment and to rehabilitate the environment when there is damage caused by the investor;<br>• respect the right of the host member population to know the names and types of dangerous chemicals used in the production process and size of their inventory, the undesirable effects resulting from their use and their accidental consumption and possible remedial measures to be taken in the event of an accident.<br><br>g) Disclosure and accounting<br><br>• acceptance to provide a disclosure on the financial as well as non-financial information on the structure, policies and activities of MNE as a whole, as well as that of the local affiliate;<br>• providing details of transactions with the affiliated parties such as parent or other group companies outside or inside the host member;<br>• transparency with regard to transactions in financial markets that have a speculative effect on the currency or financial markets of the host member. |
| **Source**: Indicated submissions to the WGTI | |

**Appendix Table 7 : A comparison between bilateral , regional, and multilateral investment agreements in terms of provisions affecting the entry and operations of foreign investors**

| | Bilateral Investment Treaties | Regional and Interregional Agreements | | | | | | | | | | Multilateral Agreements | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | **ASEAN** | **MERCOSUR** | **APEC (non-binding investment principles)** | **Islamic Conf.: Agreement on Investment** | **Arab League: Unified Agreement for Investment of Arab Capital among Arab States** | **CoMESA** | **Energy Charter Treaty** | **OECD Codes of Liberalisation of Capital Movements and Current Invisible Transactions** | **OECD Declaration on International Investment and Multinational Enterprises and related Decisions** | **NAFTA** | **GATS** | **TRIMS** | **World Bank (*)** | **United Nations (+)** |
| **1. Restrictions** | | | | | | | | | | | | | | | |
| (a) Entry and establishment | Y (some) | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | | GUIDE | |
| (b) Ownership and control | | | | | | | | | | | | | | GUIDE | |
| (c) Operational conditions | Y | Y | | Y | | Y | | Y | | Y | Y | | Y | GUIDE | |
| (d) Authorisation and reporting | Y (some) | Y | Y | | Y | | Y | | | | | | | GUIDE, MIGA | |
| **2. Incentives** | | | | Y | Y | Y | Y | Y | | Y | Y (partly) | | Y | GUIDE | |
| **3. Standards of treatment** | | | | | | | | | | | | | | | |
| (a) National Treatment | Y | | Y | Y | Y (in part) | Y | | Y | | Y | Y | Y | Y | GUIDE | |
| (b) MFN Treatment | Y | Y | Y | Y | Y | Y | | Y | | | Y | Y | | GUIDE | |
| (c) Fair and Equitable Treatment | Y | Y | Y | | | Y | Y | Y | | Y | Y | | | GUIDE | |
| **4. Transfer of funds** | Y | Y | Y | Y | Y | Y | Y | Y | | Y | Y | | | GUIDE | |
| **5. Protection Standards** | | | | | | | | | | | | | | | |
| (a) Minimum international standard of protection | Y | Y | Y | | Y | | | Y | | Y | Y | | | GUIDE, MIGA | |
| (b) Expropriation | Y | Y | Y | Y | Y | Y | Y | Y | | | Y | | | GUIDE, MIGA | |
| (c) Recourse to international means for settlement of investment disputes | Y | Y | Y | Y | Y | Y | Y | Y | | | Y | | | GUIDE, ICSID | |
| **6. Transparency** | | | | Y | | | | Y | Y | Y | Y | Y | Y | GUIDE, MIGA | |
| **7. Measures dealing with broader concerns** | | | | | | | | | | | | | | | |
| (a) Restrictive business practices | | | | | Y | | | Y | | Y | Y | | | Y | RBP, GCP |
| (b) Consumer protection and health safety standards | | | | | | | | | | Y | | | | | RBP, GCP |
| (c) Labour standards | | | | | | | | | | Y | | | | | ILÖ |
| (d) Corporate behaviour | | | | Y | | | | | | Y | | | | GUIDE | |

**Notes:**
(*) Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID); Convention establishing the Multilateral Investment Guarantee Agency (MIGA); Guidelines on the Treatment of Foreign Direct Investment (GL).
(+) ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (ILO); UNCTAD Multilaterally Agreed Set of Principles and Rules for the Control of Restrictive Business Practices (RBP); Guidelines for Consumer Protection (GCP)
**Source**: UNCTAD (1996: 140-3, Table V.3)

**Table Appendix 8: Main findings by empirical studies on the determinants of FDI**

| Determinants of FDI | Positive effect on FDI | Negative effect on FDI | Insignificant/inconclusive effect on FDI |
|---|---|---|---|
| Market size<br><br>**(Real GDP, GDP per capita, GDP growth, population)** | Schneider and Frey (1985)<br>Wheeler and Mody (1992)<br>Tsai (1994)<br>Lipsey (1999)<br>Taylor (2000)<br>Chakrabarti (2001)<br>Nunnenkamp (2002)<br>Morisset (2000)<br>Gastanaga et al. (1998) | Edwards (1990)*<br>Jaspersen, Aylward, and Knox (2000)* | Loree and Guisinger (1995)<br>Wei (2000)<br>Hausmann and Fernandez-Arias (2000) |
| **Infrastructure quality**<br>(Resource seeking FDI) | Wheeler and Mody (1992)<br>Kumar (1994)<br>Loree and Guisinger (1995)<br>Asiedu (2002) | Schneider and Frey (1985) | Tsai (1994)<br>Loree and Guisinger (1995)<br>Lipsey (1999) |
| **Labour cost**<br>(efficiency seeking) | Wheeler and Mody (1992)<br>Lucas (1993)<br>Schneider and Frey (1985)<br>(2001)Chakrabati (2001) | | Lipsey (1999) |
| **Labour quality/ Human capital** | Noorbakhsh, Paloni, Youssef (2001)<br>Nunnenkamp (2002) | | |
| **Openness/Export orientation/Trade liberalisation** | Edwards (1990)<br>Gastanaga et al. (1998)<br>Hausmann and Fernandez-Arias (2000)<br>Singh and Jun (1995)<br>Gastanaga, Nugent , Pashamova (1998)<br>Chakrabarti (2001)<br>Asiedu(2002) | | Tsai (1994)<br>Lucas (1993)<br>Taylor (2000) results depend on proxy used |
| **Taxes, tariffs, NTBs** | | Loree and Guisinger (1995)<br>Gastanaga et al. (1998)<br>Wei (1997, 2000) | Wheeler and Mody (1992)<br>Lipsey (1999) |
| **Country risk/ Political instability** | | Schneider and Frey (1985)<br>Edwards (1990) | Loree and Guisinger (1995)<br>Jaspersen, Aylward, and Knox (2000)<br>Hausmann and Fernandez-Arias (2000) |
| **Corruption/lack of transparency** | | Hines (1995)<br>Gelos and Wei (2002)<br>Wei and Wu (2001)<br>Wei (1997, 2000)<br>Smarzynska and Wei (2000)<br>Drabek and Payne (1999) | Wheeler and Mody (1992) |

Notes: (*) Find that real GDP per capita is inversely related to FDI/GDP.
Almost all empirical work on FDI is seriously flawed: relevant variables are either difficult to measure or to proxy (e.g. transparency, infrastructure, etc.), and trade-related variables (e.g openness) are notoriously biased. Results from cross-section studies are likely to be biased by non-measured, country-specific variables. Time-series analyses are usually limited by the insufficient length and variation on the relevant policy variables. Panel data analyses lead to contrasting results, depending on specification and proxies used. Outcomes generally lack robustness.

**Appendix Box 1**

**WT/WGTI/W/142 – 16 September 2002**

**COMMUNICATION FROM THE UNITED STATES**

The following communication, dated 12 September 2002, has been received from the Permanent Mission of the United States.

## Covering FDI and Portfolio Investment in a WTO Investment Agreement

### INTRODUCTION

For a number of reasons, investment agreements must have a broad, open-ended definition that includes all types of investment, including portfolio investment. Long-standing U.S. practice is to have the broadest definition of investment, covering both direct and portfolio investment. European bilateral investment treaties also cover all types of investment.

In UNCTAD's recent study of investment treaties, the number of bilateral investment treaties grew fivefold during the 1990's, from 385 to 1,857, with 173 countries concluding these instruments. Moreover, the number of treaties signed by developing and emerging market countries increased dramatically, rising from 63 at the end of the 1980s to 833 at the end of the 1990s.[131] Many of these treaties were with the US and Europe, and the preponderance cover both direct and portfolio investment. This growth indicates increasing acceptance by developing and emerging market countries of the need to cover both direct and portfolio investment in order to maximize the gains from investment liberalization and protection.

### A. WHAT IS PORTFOLIO INVESTMENT?

The principal difference between FDI and portfolio investment is the extent of control. A direct investment is one in which the investor obtains a lasting influence in, and a degree of influence over the management of, a business enterprise. Portfolio investment is all other investment, including investments in financial assets without the expectation of significant management control of the real assets on which the financial assets are based. Other examples of portfolio investment include, interests in concessions agreements, contractual rights, (such as rights embodied in intellectual property interests), debt interests in business enterprise, and ownership interests in tangible and intangible property, such as leases, mortgages, and liens.

For statistical purposes, governments and international organizations may require a minimum level of ownership for an investment to be treated as FDI. The OECD and IMF, in compiling FDI statistics, consider a direct investment to be one in which ownership is at least ten per cent of the voting securities of an incorporated business enterprise, or the equivalent interest in an unincorporated business enterprise.

While useful for statistical categorization, the "ten per cent" rule may be too rigid for practical use in a legal agreement. For example, an investor might own only nine per cent of an investment but still exercise effective control over the investment because other shareholders have extremely limited holdings. The extent to which an investment confers control is the most reliable indicator of whether it represents direct or portfolio investment.

### B. WHY INVESTMENT AGREEMENTS SHOULD COVER PORTFOLIO INVESTMENT AS WELL AS FDI

**Portfolio investment is vital for economic growth and development.**

1. Developing and emerging market countries benefit from portfolio capital inflows. Portfolio investment adds to national savings, helps broaden and deepen financial markets in developing countries to mobilize capital more efficiently, broadens the array of lending available to domestic businesses, promotes large-scale investments that capture economies of scale, and stabilizes the local economy by spreading credit risk. The investment and financial

[131] UNCTAD, Bilateral Investment Treaties, 1959-1999 (2000).

development impact of capital account liberalization, which reflects increased FDI and portfolio investment, has been shown to increase economic growth in developing countries by 0.5 per cent annually.[132] Excluding portfolio investment from the definition of investment would be counter productive for countries that hope to use foreign investment to bolster their own growth.

**Portfolio investment is key to financial market deepening. Relegating portfolio investment to second-class status discourages the creation of sound financial markets.**

2. A well-developed financial market is able to match willing sellers of capital with willing buyers in such a way that both parties can expect to benefit from the transaction. To meet the various needs of its customers, the financial market ideally has a range of instruments on offer, including equity, debt, and the many variations on these concepts that are found in modern financial centers. Granting fewer rights to the holders of portfolio capital than to direct investors would only create a bias against portfolio investment and stall the development of an efficient, diversified capital market.

**The definition of "portfolio investment" covers a broad range of investments that are in common use worldwide.**

3. Denying the benefits of an investment treaty to portfolio investments means leaving out such standard types of investments as minority equity holdings, such as of shares and stocks; bonds, debentures, and other forms of debt interests in a company; contractual rights, such as under turnkey contracts, production or revenue-sharing contracts, and concessions; rights conferred pursuant to law, such as licenses and permits; and other investments such as leases, mortgages, liens, and pledges.
4. One could ask whether it is worth negotiating an investment treaty that leaves such a wide array of investments without coverage. Certainly such a treaty could not be called "comprehensive."

**Offering fewer protections to portfolio investors than direct investors increases the risks associated with portfolio investment, raising the cost of borrowing foreign capital, which is a drag on the economy.**

5. Developing countries, already contending with scarce economic resources, can little afford to worsen the terms facing domestic borrowers who wish to raise capital abroad. Recent research shows that increased openness to portfolio investment benefits the liberalizing country by decreasing the cost of capital in that country and giving domestic investors access to global financial markets, which enables them to share risk with other investors.[133] An IMF study of 38 developing countries over the period 1980–1999 found that capital account liberalization generally leads to greater capital inflows and, with good management of these inflows, more domestic investment and higher growth. The growth effects of liberalization on developing countries came from both FDI and portfolio investment.[134]

**It is not always possible to decide what constitutes a portfolio investment.**

There is no easy way to distinguish between direct and portfolio investment in many cases. For example, a venture capitalist might loan a foreign start-up company a large amount of money, underlying a large share of the start-up's assets. The venture capitalist may not hold any evidence of ownership B because no shares have been issued, only debt B or have measurable control over the start-up. This type of start-up capital is critical to many successful businesses.
Because portfolio and direct investment are not always easily distinguished, removing portfolio investment from the definition of investment would require case-by-case analysis to determine which kind of investment a given investor had made, or intended to make, and whether it was covered by the investment agreement. At best, this would complicate the investment process considerably; at worst, it could lead to disputes between treaty partners and

[132] "International Financial Integration and Developing Countries," World Economic Outlook, IMF, October 2001, p. 143.
[133] "International Portfolio Flows and Security Markets", Rene M. Stulz, in International Capital Flows, edited by Martin Feldstein, University Chicago Press, 1999, pp. 257-293. Pre-publication working paper.
[134] "International Financial Integration and Developing Countries", World Economic Outlook, IMF, October 2001, pp. 152-159.

weaken the treaty's ability to promote overseas investment in general.

**Portfolio investment is a concomitant of direct investment.**

It is not possible to isolate foreign direct investment from portfolio flows, because direct investors will be engaged in portfolio investment as they manage their cash flows. For example, the treasurer of Ford's operations in Europe will be in and out of the "portfolio" markets as he manages the cash and other financial assets involved in the business. Any classic direct investment of any size and autonomy will have a similar treasurer's function, and be an active portfolio investor. Portfolio investment characteristically accompanies direct investment across borders. An agreement limited to FDI denies the benefit of the agreement to portfolio investor partners and to the portfolio operations within a direct investment and thus will act to discourage FDI.

**Restrictions on portfolio capital flows to capital-starved countries is not a long-term solution to financial instability.**

In the aftermath of the financial crises of the 1990's, there has been criticism of capital market liberalization for promoting short term capital inflows – sometimes referred to as "speculative capital" – into emerging market economies. The problem is not with capital market liberalization, or with short term capital flows per se. Empirical research by the World Bank demonstrates that in the long run, volatility tends to *decrease* following liberalization and integration with world financial markets. One study, which examined a sample of 103 countries from 1980 to 1996, found that portfolio investment was only slightly more volatile than FDI. Among 85 emerging market countries over the same interval, the levels of volatility of FDI and portfolio investment were actually equal.[135] However, the *process* of capital account opening has been shown to raise, temporarily, the danger of volatility.[136] This argues for a careful approach to financial liberalization itself, mostly through the establishment of supportive macroeconomic and structural policies, in particular, improved bank regulation, prudential standards, and other safeguards.
In the Asian financial crisis, certain countries were vulnerable to sudden capital outflows in part because their domestic banks had too much exposure in short-term foreign currency-denominated borrowing. In some cases, bank customers were permitted to borrow short-term in hard currency even though proper credit analysis would have shown they were not good risks for such lending. The solution is not to restrict portfolio investment *per se*, but to improve financial supervision, surveillance, and risk analysis, such as through standards developed by the Financial Stability Forum, which was established shortly after the Asian financial crisis to strengthen international financial cooperation and stability.

**Excluding portfolio investment defeats the purpose of an international investment agreement.**

6. Governments should be as open to portfolio investment as they are to direct investment. There is general agreement on the positive role of investment in promoting sustainable growth in developing economies. This is true of both direct and portfolio investment flows. Potential investors would have to question the commitment to liberalization and investment protection of a country that would not agree to extend treaty rights to portfolio investment.
7. Including portfolio investment in the definition of investment does not mean that host governments will not be able to treat portfolio investment differently from direct investment. Most regulations of the financial markets need not violate the agreement, as they need not discriminate between foreign and domestic investors. In a U.S. Bilateral Investment Treaty (BIT), for example, the transfers provision permits financial market regulators to prevent or delay a transfer if necessary for the proper functioning of the market, and allows for the mandatory reporting of transactions that may be required by financial regulations.

[135] "Negative Alchemy? Corruption, Composition of Capital Flows, and Currency Crises", Shang-Jin Wei and Yi Wu, Working Paper 8187, National Bureau of Economic Research, March 2001.
[136] "Globalization, Growth, and Poverty: Building an Inclusive World Economy", World Bank, 2001.

**CONCLUSION**

The United States favours a broad definition of investment that includes both direct and portfolio investment. Our experience, based on negotiation of more than forty BITs, the NAFTA, and the ongoing FTAA and bilateral FTAs with Chile and Singapore, is that a broad, open-ended definition is necessary to maximize the benefits of investment liberalization and protection. We believe that covering portfolio investment can contribute to the development agenda of this round by making developing and emerging market countries more attractive hosts to foreign capital, deepening local financial markets, and furthering global economic integration. We would be interested in exploring with our colleagues how best to realize the advantages of portfolio investment coverage while responding to the challenges, for example, through technical assistance and capacity building in the areas of bank supervision and regulation. The task ahead is to build on our shared experience of covering portfolio investment in our bilateral treaties, and to internationalize it in a high-standards investment agreement from which all WTO members may benefit.

**Source:** WTO (http://docsonline.wto.org)

**Appendix Box 2**

Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose
**Effects of Financial Globalization on Developing Countries: Some Empirical Evidence**
International Monetary Fund - (March 17, 2003)

**"** **SUMMARY**

"This paper provides a review of recent empirical evidence, including some new research, on the effects of financial globalization for developing economies. The paper focuses on three questions:

(i) Does financial globalization promote economic growth in developing countries?
(ii) What is its impact on macroeconomic volatility in these countries?
(iii) What factors can help to harness the benefits of financial globalization?

"Developing economies' financial linkages with the global economy have risen significantly in recent decades. However, a relatively small group of these countries has garnered a lion's share of private capital flows from industrial to developing countries, which surged in the 1990s. Despite the recent sharp reversals in such "North-South" capital flows, various structural forces are likely to lead to a revival of these flows, and to continued financial globalization, over the medium and long term.

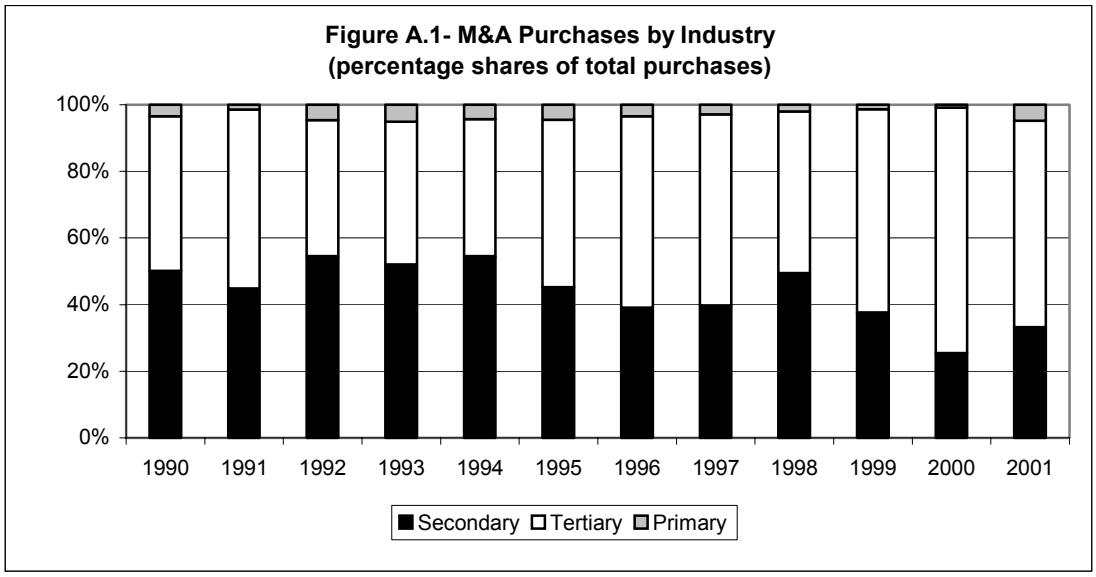
"Theoretical models have identified a number of channels through which international financial integration can promote economic growth in developing countries. However, a systematic examination of the evidence suggests that it is difficult to establish a strong causal relationship. In other words, if financial integration has a positive effect on growth, there is as yet no clear and robust empirical proof that the effect is quantitatively significant.

"There is some evidence of a "threshold effect" in the relationship between financial globalization and economic growth. The beneficial effects of financial globalization are more likely to be detected when the developing countries have a certain amount of absorptive capacity. Preliminary evidence also supports the view that, in addition to sound macroeconomic policies, improved governance and institutions have an important impact on a country's ability to attract less volatile capital inflows, and on its vulnerability to crises.

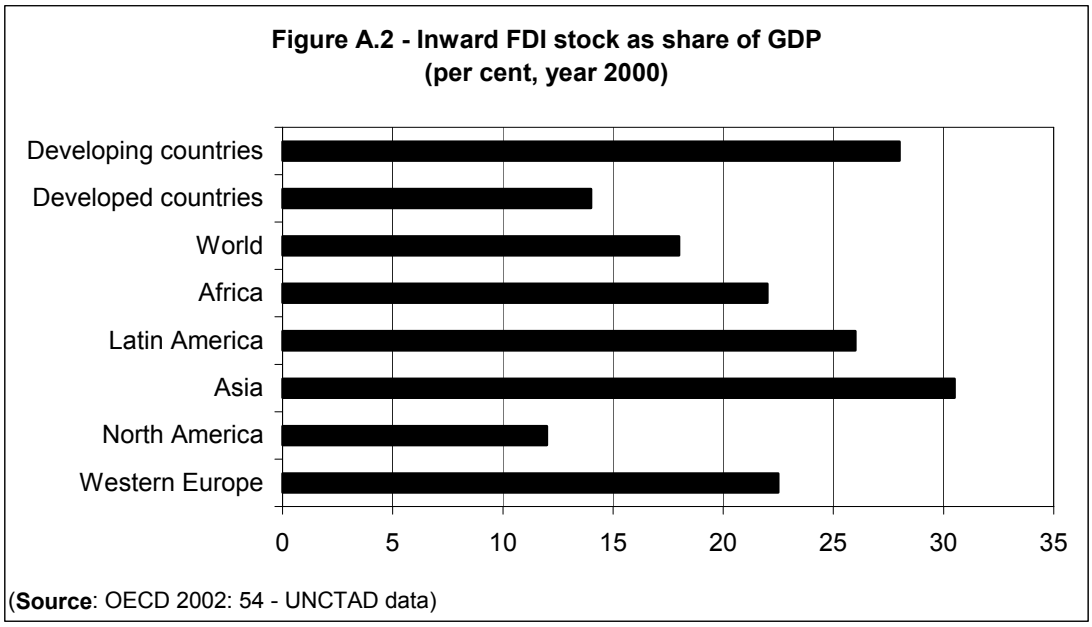
"International financial integration should, in principle, also help countries to reduce macroeconomic volatility. The available evidence suggests that developing countries have not fully attained this potential benefit. Indeed, the process of capital account liberalization appears to have been accompanied in some cases by increased vulnerability to crises.
Globalization has heightened these risks since cross-country financial linkages amplify the effects of various shocks and transmit them more quickly across national borders. A type of threshold effect appears here as well—reductions in volatility are observed only after countries have attained a particular level of financial integration.

"The evidence presented in this paper suggests that financial integration should be approached cautiously, with good institutions and macroeconomic frameworks viewed as important. The review of the available evidence does not, however, provide a clear road map for the optimal pace and sequencing of integration. For instance, there is an unresolved tension between having good institutions in place before undertaking capital market liberalization and the notion that such liberalization can itself help import best practices and provide an impetus to improve domestic institutions. Such questions can best be addressed only in the context of country-specific circumstances and institutional features."

**Source**: IMF website (http://www.imf.org/external/np/res/docs/2003/031703.pdf)

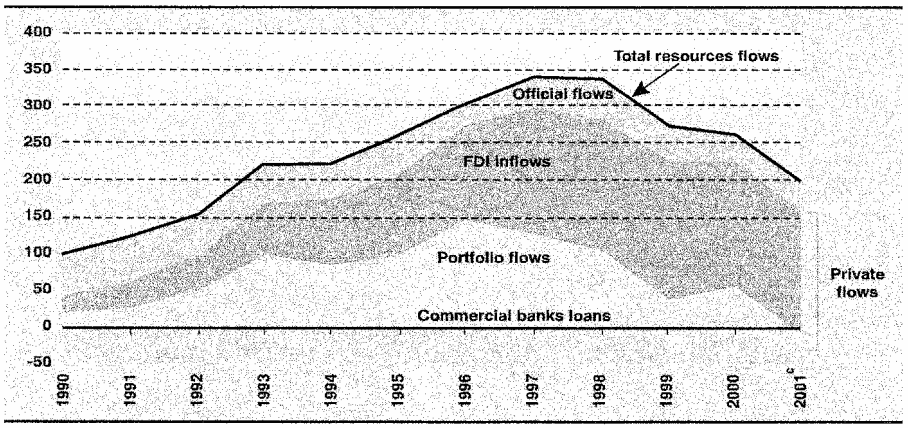



**Source**: UNCTAD FDI/TNC database



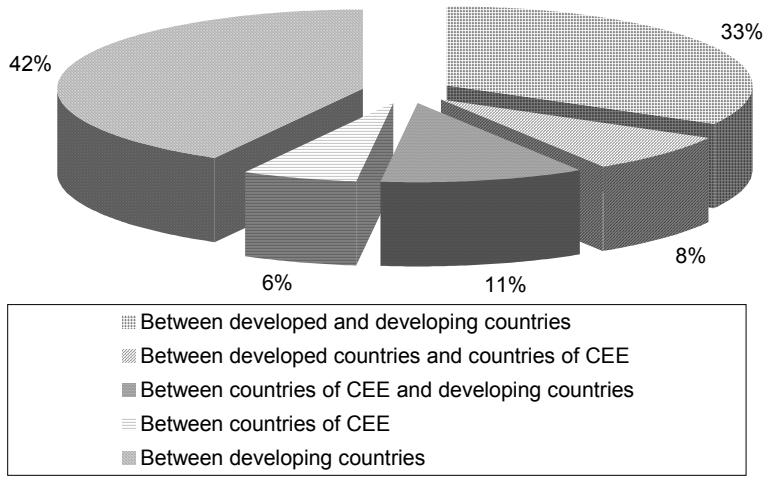

(**Source**: OECD 2002: 54 - UNCTAD data)

**Appendix Figure 3 - Total resource flows to developing countries, by type of flow, 1990-2001 (billion US$)**

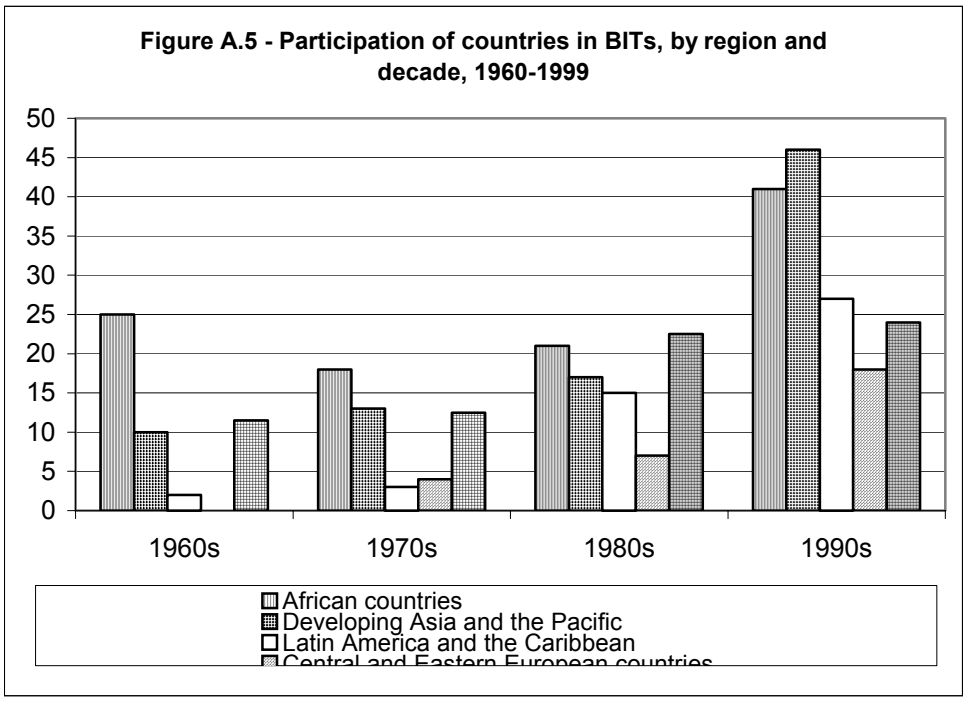



**Source**: UNCTAD (2002: 12 – Figure I.7)

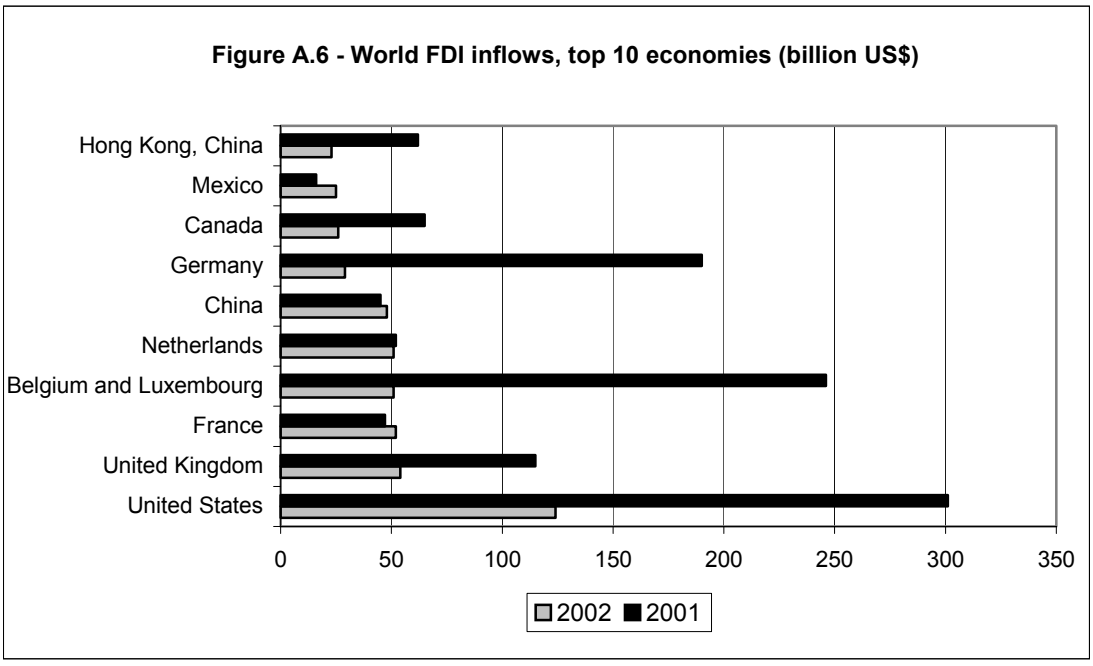
**Figure A.4 - BITs concluded in 2001, by country group**




**Source**: UNCTAD (2002: 8 – Box Figure I.3.1)

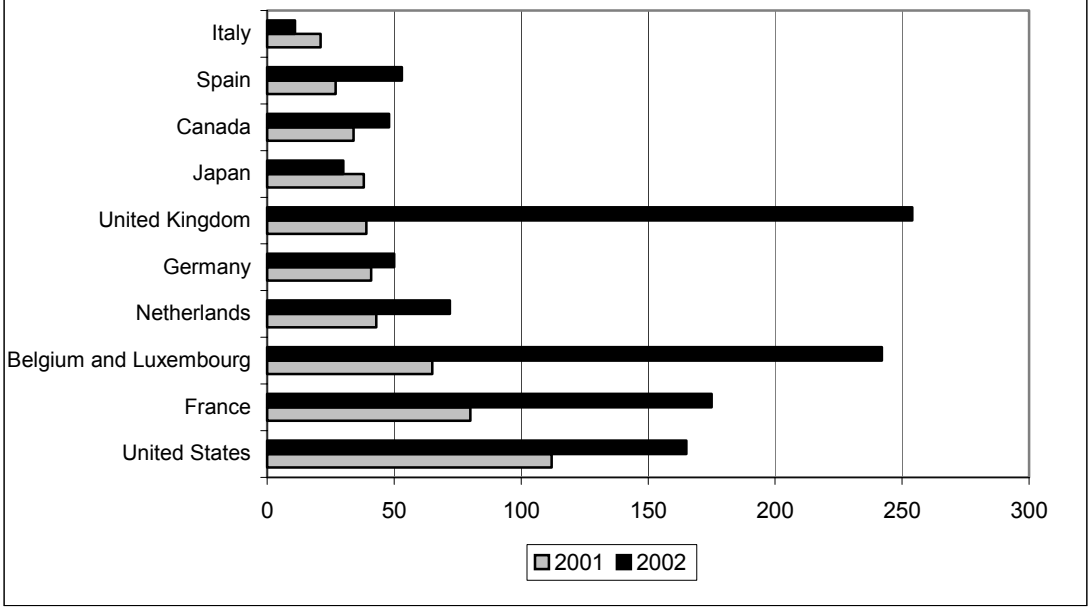



**Source**: UNCTAD (2000: 15 - Figure 4)




**Source**: UNCTAD (2002 – Overview, p.6 – Figure 2)

**Figure A.7 - World FDI outflows, top 10 economies (billion US$)**




**Source**: UNCTAD (2002 – Overview, p.7 – Figure 3)

# CHAPTER II

# A MULTILATERAL FRAMEWORK FOR COMPETITION POLICY?

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## EXECUTIVE SUMMARY

1. The 1990s saw a considerable increase in the number of jurisdictions adopting competition laws. Many of these jurisdictions joined others and began enforcing competition laws, targeting the anti-competitive practices of domestic and foreign firms. A surge in international cartel enforcement has also taken place since 1993, after changes in the enforcement practices of certain industrialised countries. At the World Trade Organization's (WTO) Ministerial in Cancun, Ministers are supposed to decide whether, and upon what terms, negotiations on a potential multilateral framework on competition policy should take place; negotiations that could lead to new multilateral disciplines that, in turn, might reinforce the impetus for reform described above.

2. The goal of this chapter is to describe and assess the proposals for a multilateral framework on competition policy. To put this policy-related discussion in its appropriate context, the central economic issues are identified before the analysis of the proposals. Moreover, the proposals for such a framework—and critiques of them—are stated in considerable detail. In addition, wherever possible, empirical evidence is brought to bear on the discussion. This is not to suggest that the legal matters arising from the negotiation of a multilateral framework are unimportant, rather that they are only part of the relevant analysis. The chapter concludes with recommendations for policymakers.

3. When assessing the consequences of adopting a possible multilateral framework on competition policy, it is worth bearing the following economic issues in mind: the beneficial role, if any, that the enforcement of competition law can play in improving national economic performance in general and economic development, in particular; the extent to which national reform programmes can be shaped by so-called competition advocacy (that is, by having a government agency that is prepared to comment on and monitor proposals for reform); the extent to which the benefits of lower trade barriers and open borders are undermined by private anti-competitive corporate practices, and the measures that states can take against them; and the extent to which the enforcement, under-enforcement, or non-enactment of national competition laws creates economic knock-on effects (or spillovers) in other jurisdictions. The first part of this chapter presents some empirical evidence on these matters, so setting the scene for subsequent discussion.

4. National and international competition enforcement matters have received far more attention from policymakers in the 1990s than in previous decades. The second part of this chapter describes the developments that have taken place outside of the WTO. A number of non-binding initiatives have been pursued in the Organisation for Economic Cooperation and Development (OECD) and in the International Competition Network

(ICN), joining a long-standing initiative by the United Nations Conference on Trade and Development (UNCTAD); and these are described here. An important question is whether these non-binding approaches—in their current form or once reformed—can substitute for new measures at the WTO. The finding here is that in one case (the ICN and its emphasis on merger reviews) the non-binding initiative focuses on matters that are not being discussed at the WTO and that in other cases (such as the UN Set and the OECD's Recommendation on Hard Core Cartels) beneficial improvements have only occurred in piecemeal and incomplete manner. Moreover, in either case there is not any compelling evidence to suggest that these trajectories will change in the future. The chapter then turns to an assessment of the proposals advanced at the WTO for a multilateral framework on competition policy.

5. Part III of this study describes the key submissions made by WTO members on the desirability and content of a potential multilateral framework on competition policy. These submissions address the following matters: transparency, non-discrimination, and procedural fairness of national competition laws; potential provisions on hard core cartels; modalities for voluntary cooperation; and Special and Differential Treatment for developing countries. The discussion in this part attempts to clarify what potential disciplines are being proposed and what matters are left to one side.

6. Turning now to economic analysis and political-economy matters, part IV of this chapter assesses different conceptual arguments for international collective action on competition policy; focusing on the case for collective action against hard core cartels. Here it is argued that the non-enforcement or under-enforcement of laws against cartels can create safe havens for international cartels, whose adverse effects are often felt by trading partners. In other words, a nation's decision not to enact or properly enforce an anti-cartel law has adverse consequences that spill over national borders. This argument provides a conceptual argument for a binding minimum standards agreement on the effective enforcement of cartel laws; a central component of the proposals for a multilateral framework on competition policy.

7. The fifth part of this chapter identifies several lines of causation through which the adoption of a multilateral framework on competition policy can affect key economic and social indicators. Empirical evidence is then marshalled to assess the strength of each link. Interestingly, the evidence that developing countries are likely to gain from the adoption of such a framework is stronger than for the least developed countries; suggesting that special attention may have to be given to the latter's interests if, and when, any multilateral disciplines are drafted.

8. The final part of the study offers recommendations for policymakers as well as some notes of caution. It is argued that, on the basis of the available evidence, there is a strong case for starting negotiations on a multilateral framework on competition policy along the lines currently advocated—especially if any future disciplines force the repeal of export cartel exemptions in national laws and, more importantly, sectoral exemptions on cartels and cartel-like arrangements in domestic and international transportation sectors. Another important consideration arises out the experience with implementing competition laws in transition and developing countries and that is that many factors determine the nature and magnitude of the benefits that can accrue to societies from effective enforcement of competition laws. Likewise, the effect of implementing a multilateral framework on competition policy will vary considerably across nations and will be a function of certain nation-specific characteristics (such as availability of expertise and the capacity to train such expertise; and the presence of supportive groups in civil society) and other matters where assistance from industrialised countries can be very beneficial (such as the technical assistance provided by long-term advisers in a nascent competition enforcement agency.)

# INTRODUCTION

One of the questions at the centre of the debate over the future course of the world trading system is the whether greater market access alone can sustain the momentum for multilateral trade reform, or whether new "rules" should be added to the negotiating agenda. The Singapore meeting of WTO Ministers identified four such rules that might be well suited for the development of multilateral disciplines: investment policies, competition policies, transparency in government procurement, and trade facilitation. Since that Ministerial meeting, working groups and other bodies in the WTO have been deliberating on the scope, if any, for further multilateral commitments in these areas. Meeting in Doha in 2001, Ministers provided further clarification on the mandate for these deliberations and the following three paragraphs of the so-called Doha Declaration are devoted to the interaction between trade and competition policies:

> "23. Recognizing the case for a multilateral framework to enhance the contribution of competition policy to international trade and development, and the need for enhanced technical assistance and capacity-building in this area as referred to in paragraph 24, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations.
>
> 24. We recognize the needs of developing and least-developed countries for enhanced support for technical assistance and capacity building in this area, including policy analysis and development so that they may better evaluate the implications of closer multilateral cooperation for their development policies and objectives, and human and institutional development. To this end, we shall work in cooperation with other relevant intergovernmental organisations, including UNCTAD, and through appropriate regional and bilateral channels, to provide strengthened and adequately resourced assistance to respond to these needs.
>
> 25. In the period until the Fifth Session, further work in the Working Group on the Interaction between Trade and Competition Policy will focus on the clarification of: core principles, including transparency, non-discrimination and procedural fairness, and provisions on hardcore cartels; modalities for voluntary cooperation; and support for progressive reinforcement of competition institutions in developing countries through capacity building. Full account shall be taken of the needs of developing and least-developed country participants and appropriate flexibility provided to address them." (WTO 2001)

Of particular note is the text in paragraph 24 which states that, although WTO Members recognise the case for a multilateral framework on competition policy, a decision on whether to proceed with negotiations on such a framework will be made in Cancun on the basis of "explicit consensus"; with the latter term having no widely accepted definition. Some have interpreted this paragraph as saying that negotiations will commence after the Cancun WTO Ministerial, and that all that needs to be agreed is the scope and other terms of the negotiation. Others have argued that no decision has been taken yet on the more fundamental question of whether negotiations will take place after Cancun. Whichever interpretation is correct, an analysis of current proposals for a multilateral framework would appear to be pertinent to the decisions to be taken in Cancun.

Another important point about the Doha Declaration is that paragraph 25 indicates that the WTO's Working Group on the Interaction Between Trade and Competition Policy should focus on matters that do not directly address the market access consequences of the multilateral rules on national competition law. This marks a substantial shift in emphasis on discussions on competition policy in international trade circles. Discussions from the mid-1980s to the mid-1990s tended to be couched in terms of the consequences for market access of various inter-firm agreements—principally vertical restraints—and of government measures that could influence these agreements. Now, the only substantive area of competition law being discussed is hard core cartels; a point which is of note as many developing countries have long been concerned about the detrimental effects of so-called restrictive business practices.

The principal objective of this chapter is to assess the proposals for a multilateral framework on competition policy which have been advanced in the WTO's Working Group on the Interaction Between Trade and Competition Policy (WGTCP). This assessment departs from others by providing a comprehensive overview of those proposals and the concerns raised about them in the Working Group; by assessing these proposals in the light of recent developments in national and international fora (such as the ICN, OECD, and UNCTAD), and by drawing upon empirical analyses that shed light on the magnitudes involved. In doing so, this chapter also examines the strengths and weaknesses of various arguments for international collective action on competiton-policy related matters.

This chapter is organised as follows: part I describes the principal economic issues concerning the operation of national competition policies in a world of integrating markets and summarises the major changes in competition policy in the 1990s. Part II discusses developments in competition policy-related maters in fora outside of the WTO. The leading submissions on the content and efficacy of a multilateral framework on competition policy are summarised in part III, and part IV analyses the different conceptual arguments for international collective action on competition policy. An empirical assessment of the proposals for a multilateral framework is presented in part V. Policy recommendations are given in the final part of the chapter.

# Part I

# THE ENFORCEMENT OF NATIONAL COMPETITION LAWS: KEY ISSUES AND STATE OF PLAY

Although discussions on WTO-related matters tend to focus on negotiating matters, proposed or actual legal provisions, enforcement concerns and the like, it is important not to lose sight of the important economic issues at hand. In the context of competition law and policy (terms which are defined in section I.1 below), the following economic issues are germane:

1. What role, if any, can the enforcement of competition law play in improving national economic performance and, in the context of non-industrialised economies, in promoting economic development?
2. To what extent can certain competition policy instruments—such as competition advocacy (again defined below)—shape government reform programmes?
3. To what extent are the benefits of lower trade barriers and open borders undermined by the operation of anti-competitive corporate practices? And to what extent is the effectiveness and deterrent value of national measures against such practices attenuated by the fact that often the persons and evidence needed to secure prosecutions can be located abroad in another jurisdiction?
4. To what extent does the enforcement, under-enforcement, or outright non-enactment of competition law in one jurisdiction have consequences for prices, consumers' welfare, and producers in other jurisdictions?

These questions might be borne in mind when assessing the potential implications of current proposals for a multilateral framework on competition policy. Arguably, the importance attached to each question may differ across policymakers and experts; with the first question likely to be of paramount importance to those concerned with policymaking in developing economies. The fact that these questions can be stated in no way implies that the evidence available allows for a comprehensive and unanimous answer to them; or for a particularly extensive assessment of the effects of a potential multilateral framework on competition policy on the outcomes (economic performance, prices, etc) of interest. As will become clear later in this part and elsewhere in this chapter, the body of available evidence is growing significantly but it has certainly not reached a size comparable to that relating to long-standing trade policy instruments, such as tariffs.

This part begins with a description of the various objectives and instruments of competition policy, and clarifies the distinction between competition law and competition policy. Then certain important elements of the enforcement record in those jurisdictions that enforced competition laws in the 1990s are summarised. Two developments of particular importance are the increased enforcement actions against hard core cartels and the growth of bilateral and regional agreements between official agencies on competition policy matters.

## I.1 Objectives and instruments of competition policy

There has been an evolution in the importance given to different objectives of competition or antitrust policy over the past 100 years. Initially, protecting market processes and rights to engage in commerce were accorded a high priority, as the following quotation from a joint World Bank and OECD study points out:

> "While many objectives have been ascribed to competition policy during the past hundred years, certain major themes stand out. The most common of these objectives cited is the maintenance of the competitive process or of free competition, or the protection or promotion of effective competition. These are seen as synonymous with striking down or preventing unreasonable restraints on competition. Associated objectives are freedom to trade, freedom of choice, and access to markets. In some countries, such as Germany, freedom of individual action is viewed as the economic equivalent of a more democratic

constitutional system. In France emphasis is placed on competition policy as a means of securing economic freedom, that is, freedom of competition" (World Bank-OECD 1997, page 2).

This quotation suggests that protecting economic freedom and competitive processes as well as fairness have historically been seen as objectives of competition policy in many countries. In a similar vein, the new competition law of India refers, in its preamble, to the objectives of preventing practices having adverse effects on competition, promoting and sustaining competition in markets, protecting the interests of consumers and ensuring freedom of trade carried on by other participants in markets in India.

Only after competition laws were enacted did a school of thought develop that justified certain competition laws on the grounds that they resulted in improvements in economic efficiency. In fact, the logic of static analyses of efficiency in markets and the rhetoric of "protecting the competitive process" as well as a focus on consumer welfare often went hand in hand. Posner (1976), for example, was to argue in his seminal treatise on US antitrust law that its "fundamental objective" is "the protection of competition and efficiency" (Posner 1976, page 226). This perspective gained considerable currency and accounts for the role that static economic efficiency still plays in the implementation of competition policy.

More recently, a wide range of opinion has stressed the importance of dynamic efficiency as an objective of competition policy. For example, Singh (2002) argues that competition policy in developing economies should support the overall development path of an economy. He points to:

"the need to emphasise dynamic rather than static efficiency as the main purpose of competition policy" (Singh 2002, page 22).

Audretsch *et al*. (2001), Baker (1999), Baumol (2001), and Posner (2001) argue that the nature of technologies or consumer preferences in certain industries, or the fast pace of innovation in some industries, call for a reassessment of the weight given to static efficiency as an objective of competition policy. Indeed, in many jurisdictions with active competition regimes the promotion of innovation or dynamic efficiency gains has become an important goal of competition policy, and the application of competition law explicitly takes account of this objective.

A distinct and important matter is that many states have explicitly introduced other objectives into their national competition laws. For example, the Competition Act of 1998 in South Africa states that:

"The purpose of this Act is to promote and maintain competition in the Republic in order-

(a) to promote the efficiency, adaptability and development of the economy;

(b) to provide consumers with competitive prices and product choices;

(c) to promote employment and advance the social and economic welfare of South Africans;

(d) to expand opportunities for South African participation in world markets and recognise the role of foreign competition in the Republic;

(e) to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and

(f) to promote a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons" (Chapter 1, article 2).

This multiplicity of goals reflects the fact that:

"A fundamental principle of competition policy and law in South Africa thus is the need to balance economic efficiency with socio-economic equity and development" (Introduction, web page of the South African Competition Commission,

http://www.compcom.co.za/aboutus/aboutus_intro.asp?level=1&desc=7).

This example demonstrates that competition law need not be directed towards a single objective.

Turning now to the instruments of competition policy, it is important to recognise that such policy is concerned both with private anti-competitive practices and with government measures or instruments that affect the state of competition in markets. For example, trade barriers, barriers to foreign direct investment, and licensing requirements (amongst others) can influence the extent of competitive pressures in markets.

In many jurisdictions, the anti-competitive effects of government measures are addressed through an instrument known as competition advocacy. In a report to the International Competition Network, its Advocacy Working Group defined this instrument as follows:

> "Competition advocacy refers to those activities conducted by the competition authority related to the promotion of a competitive environment for economic activities by means of non-enforcement mechanisms, mainly through its relationship with other governmental agencies and by increasing public awareness of the benefits of competition" (ICN 2002, page i).

The potential contribution of competition advocacy activities to national economic performance has been discussed extensively in international fora. An overview of the different types of competition advocacy and some claims about its effectiveness is provided in Box 1.

**Box 1: Competition advocacy**

The growing importance attached to competition advocacy is described by Anderson and Jenny (2002).

"Apart from the potential benefits for developing countries of appropriate competition law enforcement activities, discussions in the WTO Working Group on the Interaction between Trade and Competition Policy and other fora such as the OECD Global Forum on Competition Policy have called attention to the importance of so-called competition advocacy activities. These may include public education activities, studies and research undertaken to document the need for market-opening measures, formal appearances before legislative committees or other government bodies in public proceedings, or "behind-the-scenes" lobbying within government. These, it has been suggested in the Working Group, may be among the most useful and high payoff activities undertaken by agency staff" (page 7).

Anderson and Jenny (2002) go onto to discuss the particularly strong link between competition advocacy and regulation:

"The importance of competition advocacy activities arises partly in relation to regulation. Of course, in both developed and developing economies, regulation can and often does serve valid public purposes. For example, it is well-established that regulation can be an efficient response to market failures such as imperfect information, the existence of a natural monopoly (a situation in which a market is most efficiently supplied by a single firm) and other such problems. Nonetheless, it is important to recognize that, notwithstanding its avowed aims, regulation often thwarts rather than promotes efficiency and economic welfare. This is likely to be the case, for example, where it imposes restrictions on entry, exit and/or pricing in non-natural monopoly industries. In fact, experience in both developed and developing countries shows that, in many cases, rather than having regulation imposed on them for the public benefit, incumbent firms have often sought regulation for their own benefit, for the purpose of limiting entry into the industry and helping them to enjoy higher prices for their products. Recognition of the significance of such conduct as a formidable barrier to economic development dates back at least to Krueger (1974), and is affirmed in recent analyses by the World Bank and other development-related agencies. In the light of this, efforts to remove inefficient regulatory restrictions and related interventions can be central to the establishment of healthy market economies in developing and transition economies" (page 7).

Notwithstanding the importance attached to competition advocacy in both national competition regimes and the work on competition policy in international organisations, another instrument—namely competition law—is at the centre of competition policy in many countries. Audretsch *et al*. (2001) describe competition law as follows:

> "Competition (or antitrust) law lays down the rules for competitive rivalry. It comprises a set of directives that constrain the strategies available to firms" (page 614).

Hoekman and Holmes (1999) add more specificity by defining national competition law:

> "as the set of rules and disciplines maintained by governments relating either to agreements between firms that restrict competition or to the abuse of a dominant position (including attempts to create a dominant position through mergers)" (page 877).

UNCTAD (2002) provides a list of firms' actions that can fall within the purview of competition law. Although there is no agreed list of the elements of competition law, The following five figure prominently in most accounts of such laws:

1. Measures relating to agreements between firms in the same market to restrain competition. These measures can include provisions banning cartels as well as provisions allowing cartels under certain circumstances.
2. Measures relating to attempts by a large incumbent firm to independently exercise market power (sometimes referred to as an abuse of a dominant position).
3. Measures relating to firms that, acting collectively but in the absence of an explicit agreement between them, attempt to exercise market power. These measures are sometimes referred to as measures against collective dominance.
4. Measures relating to attempts by a firm or firms to drive one or more of their rivals out of a market. Laws prohibiting predatory pricing are an example of such measures.
5. Measures relating to collaboration between firms for the purposes of research, development, testing, marketing, and distribution of products.

This list of five instruments is not supposed to be exhaustive, nor is it meant to suggest that each element is given the same weight or referred to in the same terms in each country that has enacted a competition law.

An important point is that there are many types of competition law and that there are many types of government laws and policy that fall outside the domain of competition law but within the definition of competition policy. This point will become even more significant later because, as will be discussed in section III.8 below, many of measures that are traditionally regarded as competition policies will fall beyond the reach of the disciplines of a multilateral framework on competition policy, as currently articulated by proponents of such a framework.

## I.2 Selected recent experience in jurisdictions with competition laws

The decade of the 1990s saw considerable changes in the priority given to competition law in many jurisdictions. Perhaps the single biggest change is in the number of countries that have enacted such laws. Although counts vary, all point to the fact than many countries have adopted competition laws for the first time (Palim 1998, ICPAC 2000, and White & Case 2001). Table 1 presents data on the number of jurisdictions that adopted some form of competition law in the 1990s and is based on an cross-country survey by a well-regarded international law firm (White & Case 2001). The principal finding is that 38 jurisdictions adopted some type of competition law since 1990 taking, according to this source, the total number of jurisdictions with such laws to above 80. Also of interest is that 27 of the 38 jurisdictions were developing countries and that no least developed country appears to have adopted a competition law from 1990 to 2001, when this survey was published.

Two other points are noteworthy in this regard. First, as there are at present 145 members of the WTO, the factual record (Table 1 and the above paragraph) suggests that dozens of WTO members have not enacted any form of competition law. Second, one of the first competition laws that jurisdictions tend to enact are those that include provisions against the cartelisation of markets; which is important as discussions at the WTO on competition law and policy have given a prominent role to hard core cartels.

**Table 1: Just under forty countries enacted competition laws in the 1990s**

| Countries adopting their first competition law after 1990 | | | | |
|---|---|---|---|---|
| Total | of which ... are EU Member States | of which ... are non-EU developed countries | of which ... are developing countries | of which ... are Least Developed Countries |
| 38 | 8 | 3 | 27 | 0 |

Source: White & Case, *Worldwide Antitrust Merger Notification Requirements*, 2001 Edition.

## I.3 Enforcement actions against cartels[137]

[137] To fix ideas, the definitions of different types of cartels are presented. This will serve to clarify the distinction between international cartels and some other forms of cross-border anti-competitive conduct. It is worth noting that the definition of a private cartel stated below is one typically employed in economic analysis and need not be the same as the definition of such cartels found in existing international accords.

A *private cartel* is said to exist when two or more firms, that are not *de facto* or *de jure* controlled by a government, enter into an explicit agreement to fix prices, to allocate market shares or sales quotas, or to engage in bid-rigging in one or more markets.

It is worth noting that the objective of a private cartel is to raise prices above competitive levels, so harming the customers—who can be consumers, other firms (whose competitiveness is thereby harmed), or governments.

A *private international cartel* is said to exist when not all of the firms in a private cartel are headquartered in the same economy or when the private cartel's agreement affects the markets of more than one national jurisdiction.

This definition, therefore, *rules out* cartels that involve *state enterprises* (as in the case of OPEC). Furthermore, the definition requires an *explicit* agreement between firms, which distinguishes cartelisation from collusion. Another aspect of this definition is that it includes governments and the private sector as victims of private international cartels, as recent cases involving bid-rigging in American aid projects in Egypt can attest.

It is also worth distinguishing between *private international cartels* and *export cartels*. The latter are a special type of private international cartel in which the conspiracy does not involve commerce in the economies where the cartel members are headquartered. Often discussions of export cartels implicitly assume that such a cartel is made up of firms from one nation and that the agreement is to cartelise markets abroad. (This interpretation is not surprising as many nation's laws give specific exemptions from national antitrust laws to those cartels that only affect commerce abroad.) However, in principle, an export cartel could include firms headquartered in more than one economy.

As noted in the body text another term is prominent in the discussions on private cartels, namely, *hard core cartels*. This term has acquired a special significance since the Organisation for Economic Cooperation and Development (OECD) members agreed in 1998 to a non-binding "Recommendation" on such cartels. According to the OECD, a hard core cartel is

> "an anticompetitive agreement, anticompetitive concerted practice, or anticompetitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markers by allocating consumers, suppliers, territories, or lines of commerce."

Perhaps the most important distinction between the definition of "private cartels" and that of "hard core cartels" is the repeated reference to the phrase "anticompetitive" in relation to "hard core cartels". This raises the issue as to whether a cartel could be pro-competitive, that is, whether a cartel's formation could result in lower prices for purchasers. As some Chicago-school scholars have pointed out, as a theoretical matter it is possible for a cartel—under certain specific circumstances—to result in large enough cost reductions that prices paid by purchasers actually fall. The relevance of this theoretical observation for policy discourse has not been established in the available empirical evidence on recently prosecuted private international cartels.

The definitions outlined above also serve to clarify the distinctions between private international cartels and other forms of anti-competitive corporate practices. First, cartels do not necessarily involve mergers, acquisitions, and other forms of inter-firm combination; which may or may not result in anti-competitive outcomes. Second, cartels can involve firms that in principle could compete for the same customers. Therefore, cartels *can* differ from vertical restraints between firms; although some cartels have been found to have a vertical component too. Third cartels, by definition, involve more than one firm, and so are different from attempts by a single firm to dominate a market. Finally, attempts by firms to collectively dominate a market are to distinguished from cartels in that the former do not involve a formal agreement between the firms concerned.

An important aspect of the enforcement of competition laws in the 1990s has been the actions taken against cartels.[138] Policy discourse tends to focus on so-called hard core cartels, which the OECD has defined as follows:

> "an anticompetitive agreement, anticompetitive concerted practice, or anticompetitive arrangement by competitors to fix prices, make rigged bids (collusive tenders), establish output restrictions or quotas, or share or divide markets by allocating consumers, suppliers, territories, or lines of commerce.[139]"

Table 2 summarises several of the prominent enforcement actions against cartels in industrial and developing economies. This table was assembled by the OECD and interestingly, Mexico, Korea, and the Slovak Republic have joined higher-income OECD members in initiating enforcement actions against hard core cartels. The evidence presented in table 2 is noteworthy in two other respects. First, it appears that cartels are not confined to a small number of sectors; which tends to favour an economy-wide approach to cartel enforcement rather than a sector-specific approach. Second, the fines levied by many jurisdictions are only a fraction of the estimated harm done by these cartels, which raises the question whether previous—and perhaps even current—enforcement practices had sufficiently strong deterrents to cartelisation.

**Table 2: Selected cartels prosecuted in the 1990s: affected commerce, estimated harm, and sanctions applied**

| Country or enforcement agency | Good | Affected commerce (national currency or euros in eurozone countries) | Estimated harm (value in local currency or percentage price increase) | Sanctions (including damages to private parties where applicable) | Fines as % of affected commerce | Fines as % of estimated harm |
|---|---|---|---|---|---|---|
| *EU Member States* | | | | | | |
| Denmark | Electric wiring services | NA (many billions over "several decades") | 20-30% | Some cases pending; largest find to date DKK 3.2 million | NA | NA |
| European Commission | Graphite electrodes | More than 2 billion | Up to 50% | 218.8 million | 11% | 22% |
| European Commission | Lysine | NA | NA | 110 million | NA | NA |
| European Commission | British sugar | NA | NA | 50.2 million | NA | NA |
| European Commission | Pre-insulated pipe | More than 2 billion | NA | 92.210 million | 5% | NA |
| Finland | Purchases of raw wood | NA | NA | 1.5 million | NA | NA |

[138] Another significant form of competition law enforcement in the 1990s was merger review and reflects the scale of domestic and cross-border mergers and acquisitions wave of 1995-2000. As proposals for a multilateral framework on competition policy have not concerned policies towards mergers directly, then the scope, nature, and operation of this important policy instrument are not discussed here. See Evenett (2003a) for an overview of the cross-border mergers and acquisitions wave of the late 1990s.

[139] Organisation for Economic Cooperation and Development (2002). This definition was proposed when the members of the OECD reached an accord—technically a Recommendation—on hard core cartels in 1998.

| | | | | | | |
|---|---|---|---|---|---|---|
| Germany | Ready-mix concrete | 2.5 billion | 220 million (9% of affected commerce) | 300 million | 12% | 136% |
| Germany | Road markings | More than 750 million | "Hundreds of millions" (more than 13% of affected commerce) | 25.6 million | 3% | NA |
| Germany | Power cables | Many billions | As much as 50% | 249.5 million | NA | NA |
| Spain | Hotel association | 1 billion | 30 million (3% of affected commerce) | 1.1 million | Less than 1% | 3.30% |
| The Netherlands | Veterinary products | 58.5 million | NA | 10.5 million | 18% | NA |
| *Non-EU Industrialised Countries* | | | | | | |
| Australia | Distribution Transformers | 320'505'000 | NA | 1.5 million (incomplete at time of response) | NA | NA |
| Australia | Frozen foods, Tasmania | NA | 10 – 12% price increase | 1.245 million | NA | NA |
| Australia | Installation of fire protection devices | More than 500 million | 5-15% price increase | 15.386 million | 3% | 31% |
| Canada | Lysine | 89 million | NA | 17.57 million | 19.74% | NA |
| Canada | Citric acid | 104.6 million | NA | 11.575 million | 11% | NA |
| Canada | Sorbates | 37 million | NA | 7.39 million | 19.97% | NA |
| Canada | Vitamins | Up to 750 million | NA | 91.475 million | 12.70% | NA |
| Canada | Graphite electrodes | 440 million | 90% price increase | 24 million (incomplete at time of response) | NA | NA |
| Japan | Ductile iron pipe | NA | NA | 230 million | NA | NA |
| Norway | Hydro-electric power equipment | 1.6 billion | 140 million (9% of affected commerce) | 75 million | 5% | 54% |

| | | | | | | |
|---|---|---|---|---|---|---|
| *Developing Countries* | | | | | | |
| Korea | Military fuel | USD 548.3 million | NA | USD 14.6 million | 3% | NA |
| Korea | Graphite electrodes | USD 553 million | USD 139 million | USD 8.5 million | 2% | 6% |
| Mexico | Lysine | NA | NA | 1.699 million | NA | NA |
| Slovak Republic | Flour | NA | 200-300/ton | 2.24 million | NA | NA |
| Slovak Republic | Beer | 4 billion | NA | .1 million | Less than 1% | NA |

Source: OECD (2003).

In addition to national enforcement actions against national cartels, since 1990 officials in the United States and the European Commission (EC) have taken over 40 enforcement actions against international cartels made up of private firms. Twenty four (sixty percent) of these cartels lasted four or more years, suggesting that this latest set of private international cartels did not tend to collapse quickly under the weight of the own incentive problems or in response to increased shipments or imports by firms outside of these cartels (Evenett, Levenstein, and Suslow, 2001).

Table 3 lists the countries whose firms were found to be members of these international cartels; again the impression is given that such anti-competitive acts are not a localised or insignificant phenomenon. In fact, private international cartels are found to have raised prices between 15 and 40 percent (Levenstein and Suslow 2001) and are estimated to have inflicted billions of dollars of overcharges per year on customers in developing economies (Evenett and Ferrarini 2002). A single international cartel, which lasted ten years in the vitamins industry, was estimated to have inflicted nearly two and three quarter billion dollars of overcharges on vitamins imports by to 90 countries (Clarke and Evenett 2003). Moreover, the same study found that jurisdictions in Asia, Latin America, and Western Europe with active cartel enforcement regimes tended to suffer much smaller overcharges than those jurisdictions that do not (Clarke and Evenett 2003). This finding is evidence of the deterrent value of active cartel enforcement regimes; not just deterring the formation of cartels in the first place but reducing the damage done by those cartels that do have the audacity to form. Finally, it is worth bearing in mind that these international cartels take advantage of the very open borders that the multilateral trading system has sought for decades to achieve. This speaks to the important matter of whether private anti-competitive practices have eroded the benefits of prior trade reforms.

**Table 3: Economies whose firms were found to be engaging in cartelisation by the US and the EC during the 1990s**

| Economy | Cartel |
|---|---|
| *EU member states* | |
| Austria | Cartonboard, citric acid, newsprint, steel heating pipes |
| Belgium | Ship construction, stainless steel, steel beams |
| Denmark | Shipping, steel heating pipes, sugar |
| Finland | Cartonboard, newsprint, steel heating pipes |
| France | *Aircraft*, cable-stayed bridges, cartonboard, citric acid, ferry operators, *methionine*, newsprint, *plasterboard*, shipping, sodium gluconate, stainless steel, steel beams, seamless steel tubes |
| Germany | *Aircraft*, graphite electrodes onboard, citric acid, aluminum phosphide, lysine, *methionine*, newsprint, pigments, *plasterboard*, steel heating pipes, |

| Economy | Cartel |
|---|---|
| | seamless steel tubes, vitamins |
| Greece | Ferry operators |
| Ireland | Shipping, sugar |
| Italy | Cartonboard, ferry operators, newsprint, stainless steel, steel heating pipes, seamless steel tubes |
| Luxembourg | Steel beams |
| Netherlands | Cartonboard, citric acid, ferry operators, Ship construction, sodium gluconate, Tampico fiber |
| Spain | *Aircraft*, Cartonboard, stainless steel, steel beams |
| Sweden | Cartonboard, ferry operators, newsprint, stainless steel |
| UK | *Aircraft*, cartonboard, explosives, ferry operators, newsprint, pigments, *plasterboard*, shipping, stainless steel, seamless steel tubes, steel beams, sugar |
| *Non-EU industrialised countries* | |
| Canada | Cartonboard, pigments, plastic dinnerware, vitamins |
| Japan | Graphite electrodes, lysine, *methionine*, ship transportation, shipping, sodium gluconate, sorbates, seamless steel tubes, thermal fax paper, vitamins |
| Norway | Cartonboard, explosives, ferrosilicon |
| Switzerland | Citric acid, laminated plastic tubes, steel heating pipes, vitamins |
| US | *Aircraft*, aluminum phosphide, bromine, cable-stayed bridges, cartonboard, , citric acid, diamonds, ferrosilicon, Graphite electrodes, isostatic graphite, laminated plastic tubes, lysine, maltol, *methionine*, pigments, plastic dinnerware, Ship construction, ship transportation, sorbates, Tampico fiber, thermal fax paper, vitamins |
| *Developing countries* | |
| Brazil | Aluminum phosphide |
| India | Aluminum phosphide |
| Malaysia | Shipping |
| Mexico | Tampico fiber |
| Singapore | Shipping |
| South Africa | Diamonds, newsprint |
| South Korea | Lysine, *methionine*, ship transportation, shipping |
| *Least Developed Countries* | |
| Angola | Shipping |
| *Unclassified* | |
| Israel | Bromine |
| Taiwan | Shipping |
| Zaire | Shipping |

Source: Adapted from Evenett, Levenstein, and Suslow (2001).

Note: Products in italics were under investigation at time of publication of Evenett, Levenstein, and Suslow (2001).

Yet more evidence on cartel enforcement is available. Table 4 summarises the information presented to the OECD by 11 developing economies and one least developed country on 28 recent enforcement actions against cartels. These twelve economies differ markedly in their stages of development and yet they were all affected by the detrimental effects of cartels. Furthermore, the number of big rigging cases reported (six) suggest that the private sector is not the only victim of cartelisation—governments (and by extension taxpayers) are too. In fact, the three cartel cases described by the Chinese authorities were all bid rigging examples.

**Table 4: Cartel enforcement cases in 11 developing economies and one least developed country**

| Economy engaging in enforcement action | Cartelised market | Duration of cartel | Summary of conspiracy and any fines imposed |
|---|---|---|---|
| *Developing countries* | | | |
| Bulgaria | Transportation on variable routes (intermediate transportation) | 2000 | Conspirators agreed on a price increase of approximately EUR 0.1 on transportation services. The companies were fined a total of EUR 47,000. |
| | Phone cards sales | One year (year not specified) | A common shareholder acted at as intermediary in price co-coordination between two conspiring companies. Both were fined of EUR 9,000. |
| | Gasification | 2002 | Two companies agreed on a five-years contract with non-compete clauses. A fine of EUR 25,500 was imposed on both companies. |
| China | Brickyard | 1999 | Bid rigging conspiracy involving five groups of companies affecting the operation of a brickyard plant in Zhejiang Province. They were fined EUR 6,500 each. |
| | School building | 1998 | Bid rigging involving ten construction companies. The bid was declared invalid and illegal gains confiscated. |
| | Engineering construction | 1998 | Bid rigging involving two construction companies. |
| Estonia | Milk products | 2000 | Price-fixing attempt by four leading milk processors and ten wholesalers. A prohibiting order was issued before an agreement came in place. |
| | Taxi services | 1999 | Three taxi companies (over 40% of the taxi market) convicted of price fixing, and fined EUR 639 each. |
| | Road transport | 1999 | The Association of Estonian International Road Carriers was prosecuted for participating in price fixing involving the provision of international transport services. The Competition Board issued a proscriptive order. No sanctions were applied. |
| Indonesia | Pipe and pipe processing services | Formed in May 2000 | Bid rigging involving four companies. The ensuing contract was dissolved. No fines were imposed. |
| Latvia | Aviation | 1998-1999 | International cartel involving one Latvian and one Russian company agreeing to co-cooperate in the organisation of passenger flights between Riga and Moscow. The Latvian company was fined 0.7% of its total turnover of 1998. |
| | Courier post | 1999 | Agreement between a Latvian state-owned courier post services and an international courier services operator. No sanctions were |

| Economy engaging in enforcement action | Cartelised market | Duration of cartel | Summary of conspiracy and any fines imposed |
|---|---|---|---|
| | | | applied, as no practical effect on competition was ascertained. |
| Peru | Building and construction | 1997 | Three companied involved in bid rigging. Fines of nearly EUR 1,800 were imposed on each of the respondents. |
| | Taxi Tours | 1999 | Price fixing agreement between a number of local companies. Only one company, which did not express their commitment to cease the restrictive practices, was fined EUR 900. |
| | Poultry market | 1995-1996 | Several associations and 19 firms investigated and subsequently prosecuted for price-fixing, volume control, restrain of trade, for a conspiracy to establish entry barriers and for the development of anti-competitive mechanisms to suppress and eliminate competitors, in the market of live chicken in Metropolitan Lima and Callao. |
| Romania | Mineral water | 1997 | Price fixing conspiracy relating to the bottling of mineral water. Fines not specified. |
| | Drugs | 1997-2000 | Members of the Pharmacists Association were found to be participating in a conspiracy relating to market sharing in pharmaceutical distribution (approx. EUR 430 million per year) and to be deterring entry by other competitors. Fines were calculated as a percentage of profit of the Pharmacists Association (amount not specified). |
| Slovenia | Electric energy | 2000 (year of enforcement decision) | Price fixing conspiracy relating to the provision of electric energy in Slovenia. The cartel was prohibited. |
| | Organisation of cultural events | 2000 | Two companies agreed to co-operate and prevent entry in the market. The amount of fines imposed is not specified. |
| South Africa | Citrus fruits | 1999 | Conspiracy relating to the purchase, packaging, and sale of citrus fruits. Fines not specified. |
| Ukraine | Electronic cash machines | 1999 | Price fixing conspiracy involving two companies. As an effect of the agreement, prices rose by EUR 1.0–2.0. The sanctions applied, if any, were not specified. |
| | Kaolin | 2000 | Two competing distributors concluded a contract specifying amounts of sales of the product. The sanctions applied, if any, were not specified. |
| *Least Developed Countries* | | | |
| Zambia | Poultry | Not specified | Two companies, the dominant producer and the largest buyer in the poultry market, made |

| Economy engaging in enforcement action | Cartelised market | Duration of cartel | Summary of conspiracy and any fines imposed |
|---|---|---|---|
| | | | agreements foreclosing competition. The agreement was declared invalid. |
| | Oil | 1997 – not specified | Nine oil-marketing companies convicted of price fixing. The cartel leaders also forced other companies to comply with standard behaviour on prices. The sanctions applied, if any, were not specified. |
| *Unclassified* | | | |
| Taiwan | Wheat | 1997-1998 | The Flour Association was convicted of organising a buyers' cartel, instituting quantity control and quota system among 32 flour producers. The association was imposed a fine of EUR 620,000. |
| | Mobile cranes | 1998 | Six companies convicted of bid rigging. No fines specified. |
| | Liquefied Petroleum Gas (LPG) | Not specified | Twenty seven companies, controlling most of the market share, convicted of participating in a price fixing conspiracy relating to delivery of LPG in southern Taiwan. Total fines amounted to EUR 4,123,000. |
| Source: Assembled from national submissions to the First and Second OECD Global Fora on Competition. | | | |

## I.4 Other types of competition law enforcement in developing economies

As the number of developing economies adopting competition laws rises over time, more evidence of anti-competitive practices is emerging from the enforcement records of national competition authorities. Many such authorities have their own websites, where annual reports and press releases are posted. In addition, numerous developing economies have reported on significant enforcement actions in submissions or notifications to the OECD, to UNCTAD, and to the WTO. The evidence reported in this section was assembled from such sources.

Developing economies' enforcement actions are not confined solely to cartels. Firms with sizeable market shares may individually or collectively raise prices and take other measures to distort market outcomes. Such corporate acts are said to be abuses of a dominant position and are regularly the target of developing economy competition policy enforcement. In their last annual reports to the OECD on competition enforcement, Hungary, Korea, Mexico, Russia, and Turkey took steps against abuses of dominant positions (see Table 5).

**Table 5: Findings of anti-competitive conduct in selected developing economies**

| Economy | Year | Findings of horizontal agreements, cartels, and concerted agreements | Findings of abuse of a dominant position |
|---|---|---|---|
| Hungary | 1997 | 0 | 8 |
| | 1998 | 2 | 5 |
| | 1999 | 7 | 7 |
| | 2000 | 11 | 19 |
| Korea | 2000 | 38 | 0 |
| Mexico | 1999 | 41 | |
| | 2000 | 63 | |
| Russia | 2000 | 9 | 438 |
| Turkey | 2000 | 12 | - |

Source: Named countries' annual reports to the OECD on the enforcement of their national competition laws.

The factual record on competition policy enforcement in Eastern Europe is particularly well developed (see Kovacic 2001 and Neven and Mavroidis 2000). This reflects the fact that many of these economies have been preparing to accede to the European Union and that the European Commission has in recent years published annual reports on (amongst other matters) the status of each applicant's competition policy enforcement regime. The latest reports published in 2002 refer to the enforcement record in 2001 and perusing these reports reveals that many of these Eastern European nations have active competition authorities and that they are increasingly targeting anti-competitive practices. It would appear that the fact that these economies' competition enforcement agencies have been established only recently has not prevented some of them from taking a relatively aggressive stance against private anti-competitive practices; suggesting that nations need not wait long before investments in competition enforcement begin to bear fruit. This is not to say that all of these economies' competition authorities are up to full strength as the European Commission's adverse commentary on the resources and personnel available to the Latvian and Slovenian competition authorities demonstrates. Similar quantitative and qualitative evidence for these and other developing countries can be found in Evenett (2003b, part III).

## I.5 International agreements and cooperation on competition matters

The 1990s saw a number of jurisdictions sign bilateral agreements on competition law and policy matters with other nations. These agreements differ markedly in their content and legal status; ranging from Mutual Legal Assistance Treaties (such as the one treaty between Canada and the United States) to more informal arrangements between enforcement agencies.

The extent of cooperation between enforcement agencies varies across different types of competition law, with cooperation on merger reviews tending to be greater than cooperation on cartel enforcement cases (Jenny 2002). Moreover, cooperation between enforcement agencies is predominantly between industrialised countries, and only recently has evidence of cooperation between industrialised countries and counterparts in developing countries come to light (see, for example, Brazil 2002). Of course, this may well change in the future as expertise and experience on competition enforcement matters deepens in developing countries. Finally, there are many different types of cooperation including notifications to other countries when their interests are affected, discussions about specific industries or about the so-called theory of a case, close collaboration on the analysis of a case (where permitted by national law) and joint enforcement actions, such as dawn raids.

While precise measures of the extent of bilateral cooperation on competition law-related matters are hard to come by, the public record does include those international agreements between national enforcement agencies. Figure 1 portrays graphically which nations have signed bilateral or trilateral agreements; and it is immediately evident that many pairs of nations do not have any formal cooperative machinery in place. This is important as bilateral

cooperation is much less likely to occur without a formal agreement to structure the nature and content of such cooperation.

**Figure 1: Bilateral and trilateral cooperation agreements on competition law enforcement**

| - | USA | EC | Ger. | Aus. | Fra. | NZ | Can. | Chi. | Rus. | Taiwan | Isra. | Jap. | Kaz. | Bra. | PNG | Mx. | Ice. | Nor. | Den. | Chil. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| USA | - | 1991 and 1998 | 1976 | 1982 and 1997 | | | 1995 | | | | 1999 | 1999 and 1999 | | 1999 | | 2000 | | | | |
| EC | 1991 and 1998 | - | | | | | 1999 and 2000 | | | | | | | | | | | | | |
| Germany | 1976 | | - | | 1984 | | | | | | | | | | | | | | | |
| Australia | 1982 and 1997 | | | - | | 1994 and 2000 ** | 2000 ** | | | 1996 | | | | | 1999 | | | | | |
| France | | | 1984 | | - | | | | | | | | | | | | | | | |
| New Zealand | | | | 1994 and 2000 ** | | - | 2000 ** | | | 1997 | | | | | | | | | | |
| Canada | 1995 | 1999 and 2000 | | 2000 ** | | 2000 ** | - | | | | | | | | | 2001 | | | | 2001 |
| China | | | | | | | | - | 1996 | | | | 1999 | | | | | | | |
| Russia | | | | | | | | 1996 | - | | | | | | | | | | | |
| Taiwan | | | | 1996 | | 1997 | | | | - | | | | | | | | | | |
| Israel | 1999 | | | | | | | | | | - | | | | | | | | | |
| Japan | 1999 and 1999 | | | | | | | | | | | - | | | | | | | | |
| Kazakhstan | | | | | | | | 1999 | | | | | - | | | | | | | |
| Brazil | 1999 | | | | | | | | | | | | | - | | | | | | |
| Papua New Guinea | | | | 1999 | | | | | | | | | | | - | | | | | |
| Mexico | 2000 | | | | | | 2001 | | | | | | | | | - | | | | |
| Iceland | | | | | | | | | | | | | | | | | - | 2001 ** | 2001 ** | |
| Norway | | | | | | | | | | | | | | | | | 2001 ** | - | 2001 ** | |
| Denmark | | | | | | | | | | | | | | | | | 2001 ** | 2001 ** | - | |
| Chile | | | | | | | 2001 | | | | | | | | | | | | | - |

Shaded boxes/entries implies no cooperation agreement. White entries indicate a cooperation agreement exists. Date that the agreement was signed is also indicated. Key: ** indicates a tripartite agreement. Source: UNCTAD (2002).

# Part II

# DEVELOPMENTS IN INTERNATIONAL FORA AND ELSEWHERE

> "It can be said that competition law is national, while markets are increasingly global. Yet there is no international antitrust code. The key question is how to deal with transnational competition issues in a global economy. How can competition authorities manage marketplace conduct that takes place in one nation, but has a harmful effect in another?" Konrad von Finckenstein (2001)

The quotation above, made by Canada's top competition law enforcer, highlights the tension between the desire to maintain national enforcement of competition laws and the need to prosecute cross-border anti-competitive practices such as international hard core cartels. A distinct but related matter arises in merger reviews, where many jurisdictions can exercise their rights to evaluate a proposed merger involving firms located abroad. Competition enforcement officials increasingly recognised that the effects of their actions and foreign counterparts' actions spilled over national borders. Enforcement may well be national, but their effects need not be. The realisation of this fact lead to a number of initiatives by policymakers in the 1980s and 1990s, only some of which strengthened the link between trade policies and competition policies.

## II.1 Unilateralism

In recent years, the first of a series of initiatives that linked trade and competition policies arose out of concerns that anticompetitive vertical restraints were blocking foreigners' market access, in particular in Japan (ICPAC 2000, Lawrence 1993, Saxonhouse 1993). Here it is asserted that the non-enforcement of Japan's law had implications for market access and some went so far as to advocate reducing the access of Japanese goods to foreign markets in retaliation (see Tyson 1992 for an overview of arguments on both sides). The United States became increasingly critical in the late 1980s and early-to-mid 1990s of what it perceived as Japanese unwillingness to enforce its own competition laws. Moreover, bilateral consultations rarely produced the results the US was looking for and eventually the US government brought a high-profile dispute settlement case to the WTO. The Consumer Photographic Film and Paper case, colloquially referred to as the "Kodak-Fuji case", concerned complaints that Fuji's close relationship with its distributors in the Japanese market had adversely affected Kodak's ability to sell film and other consumer products in Japan. The United States cited Articles III, (national treatment), X (transparency), and XXIII (nullification and impairment) in its argument that Japan had breached its GATT obligations. A Panel of the WTO's Dispute Settlement Body found in favour of Japan in this case, which has led some to argue that new multilateral practices are needed to tackle private anti-competitive practices. Moreover, this ruling took the wind out of the sails of those who wanted to use trade sanctions to strengthen national incentives to enforce their competition laws; admittedly much to the relief of many practitioners of competition law (and others) who felt that this was an unwise course of action. Indeed, the reasons advanced at the time for taking the Kodak-Fuji case to the WTO go a long way to explain the long-standing and still prevalent hostility of many competition lawyers to linking trade policy and competition law enforcement.

## II.2 Bilateralism

Since the Kodak-Fuji decision, in the US the unilateralist approach has given way to what might be termed bilateralism. In 1994, the US Congress granted the USDOJ explicit authority to negotiate bilateral agreements with foreign competition enforcement agencies under the International Antitrust Enforcement Assistance Act (the "IAEAA"). Bilateralism was thought to be a means of allowing for custom-tailored solutions to specific cross-

border antitrust issues while permitting differences in markets, legal traditions and other aspects to be tolerated (Klein, 1996).

Bilateralism was borne in part out of the frustration faced by antitrust officials in their attempts to prosecute foreign companies for anticompetitive behaviour. The so-called GE/De Beers case was a good example of the problems faced by US antitrust authorities in the absence of international accords on competition. Joel Klein, former Assistant Attorney General for Antitrust at the USDOJ, summed up the dilemma of US prosecutors in a speech he gave at Chatham House in 1996:

> "Unfortunately, we have directly run up against this problem. For example, a couple of years back in the GE/DeBeers case, we filed criminal antitrust charges against a U.S. company, General Electric, a Swiss affiliate of DeBeers, and two foreign nationals, for conspiring to raise the price of industrial diamonds. Much of the alleged conduct relating to the cartel took place in Europe, and much of the evidence was located overseas and consequently beyond the Justice Department's reach, although we did seek and received some assistance from the government of Belgium. The case proceeded to trial, but in December 1994, the court entered a judgment of acquittal, observing that much of the "missing" evidence presumably was located outside the U.S., beyond the reach of U.S. prosecutors.
>
> In addition to the problem of not being able to obtain the necessary evidence located abroad, our efforts to cooperate effectively with other antitrust authorities can be stymied by the absence of arrangements that allow the sharing of our own evidence with those authorities. In criminal investigations, for example, our rules of criminal procedure are very strict in protecting the secrecy of grand jury proceedings." (Klein 1996, page 4)

And later,

> "…our ability under current law to share such information with countries who are not parties to cooperation agreements is very limited." (page 5)

In the same speech, he outlined his enthusiasm for the bilateralist approach. "We believe," he said,

> "that bilateral, or what are generally referred to as "positive comity" agreements are the best way to ensure effective enforcement. Under such agreements, the antitrust agency of the country that believes its companies are being closed out of another country as a result of private restraints makes a preliminary determination that there are reasonable grounds for an investigation of the matter, perhaps under its own law but, in any event, under the law of the country in which the restraint operates. It then refers the matter, along with its preliminary analysis, to the competition authority in the country whose home market is directly affected and that authority conducts the investigation and then reports back to, and consults with, the initial country as to the nature of its investigation, its findings, and any remedy it is considering. The referring country can accept these conclusions, or seek to modify them, or it can subsequently conduct its own investigation and take actions that it thinks are appropriate." (Klein, 1996)

The first such Antitrust Enforcement Assistance Act (IAEAA), for example, was signed with Australia in 1997; a jurisdiction with an advanced antitrust infrastructure. The IAEAA with Australia, though being heralded as a "critical contribution to antitrust enforcement" was, in reality, limited to providing only non-public information and the reciprocation of investigatory assistance (United States Federal Trade Commission, Press Release, April 17 1997). Even this agreement pales compared to the Canada-United States Mutual Legal Assistance Treaty (MLAT) which covers competition matters and has been used with considerable effect in prosecuting cross-broder cartels (Waller 2000).

It is worth noting that the US Congress placed a number of provisos on the bilateral agreements that the USDOJ could sign with foreign governments. Agreements between the US and other nations were subject to the condition that the reciprocating nations have comparable authority to provide assistance. Moreover, concerns about the need to protect confidential business and investigative information led Congress to require that foreign parties to such agreements have laws adequate to protect materials provided in confidence from unauthorized public disclosure. This may well account for the fact that few such bilateral agreements have been signed by the

US and developing nations; with obvious implications for the degree of bilateral cooperation and the capacity of firms with international operations to evade the reach of US enforcement authorities.

## II.3 International initiatives for policy convergence

With bilateralism not delivering as much as perhaps was originally hoped, in the late 1990s the United States and other jurisdictions began to press for international initiatives for convergence of enforcement practices. It is worth stating that convergence in practices is quite distinct from harmonisation, although the former may well—when carried to the limit—result in the latter. Moreover, at present no government appears to be advocating harmonisation of competition laws in *any* international fora.[140] Initiatives to promote convergence in laws and enforcement practices are, however, quite another matter.

In 2000, an advisory committee to the US government recommended that bilateral initiatives be coupled with a Global Competition Initiative to foster best practices and to encourage dialogue between enforcement officials. This advisory committee envisaged policy convergence as one of the goals of this Initiative:

> "Indeed, the Advisory Committee recommends that the United States explore the scope for collaborations among interested governments and international organizations to create a *new* venue where government officials, as well as private firms, nongovernmental organizations (NGOs), and others can exchange ideas and work toward common solutions of competition law and policy problems. The Advisory Committee calls this the "Global Competition Initiative."
>
> "A Global Competition Initiative should be inclusive and foster dialogue directed toward greater convergence of competition law and analysis, common understandings, and common culture. Such a gathering also could serve as an information center, offer technical expertise to transition economies, and perhaps offer mediation and other dispute resolution capabilities." (ICPAC 2000)

After considerable deliberation by the leading competition enforcement bodies, this initiative led to the creation of the International Competition Network (ICN). Currently the ICN has approximately sixty competition enforcement bodies as members. The philosophy of the ICN stresses dialogue, cooperation, and discussion, rather than binding commitments, enforcement, and linkages to other policy domains (Janow 2002). Interestingly, trade policy officials—indeed trade-related thinking—appears to play no role in the deliberations of the ICN. As such, the ICN can be seen as an attempt to further separate trade and competition policy matters.

The inaugural ICN conference in 2002 covered a number of competition enforcement-related issues. Statements were received from senior officials dealing with competition policy in their member countries and some resolutions were adopted. For example,

> "There was consensus on the proposed Guiding Principles for Merger Notification and Review, and members officially adopted them. The eight principles are: sovereignty, transparency, non-discrimination on the basis of nationality, procedural fairness; efficient, timely and effective review; coordination; convergence; and confidentiality."

And, in addition to four existing working groups on mergers, competition advocacy, funding, and membership, at the inaugural conference

> "The members established a new working group on Capacity Building and Competition Policy Implementation…"(Fox, 2002 page 10)

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[140] Indeed, the Secretary and Chairman of the WTO's Working Group have noted that:

> "…the Working Group has shown little or no interest in the international "harmonization" of competition law, if by harmonization is meant an insistence on uniform approaches to competition law and policy at the national level. Indeed, the observation that "one size does not fit all" in the field of competition law and policy has become a staple of the dialogue in the Working Group" (Anderson and Jenny 2003, page 560).

which is obliged to report back to the ICN membership at its next conference.

Given this chapter's focus on the proposals for a multilateral framework on competition policy, it is perhaps worth noting that international cartels are not a topic that the ICN appears to be devoting much attention to. Moreover, it is unclear what role, if any, nations without competition laws—many of whom hail from the developing world—can play in an organisation that requires such laws a pre-requisite for membership. This is not to say that the ICN offers no promise, just that the limitations in its scope and membership should be appreciated.

The emphasis on a number of international tracks for addressing competition policy-related matters remains US policy. The current Acting Assistant Attorney General, R. Hewitt Pate, speaking before the American Bar Association in 2003, outlined the following policy towards international competition policy matters:

> "As valuable and productive as our relationships with the EU and other foreign governments are, we cannot accomplish everything that we should in international antitrust through bilateral relationships." (Pate 2003)

Moreover, he argues:

> "…if we are to achieve true global convergence and cooperation, multilateral efforts must supplement existing bilateral ties. " (Pate 2003)

In addition,

> "By focusing here on ICN, I do not mean to dismiss the extremely important work going on in the OECD, WTO and UNCTAD." (Pate 2003)

Indeed, like the ICN, UNCTAD and the OECD have developed non-binding initiatives on competition enforcement related matters; however, the focus of the latter has been less on mergers and more on anti-competitive corporate practices such as hard core cartels. The contributions of UNCTAD and of the OECD are discussed below.

### II.3.1 The UNCTAD Set

In 1980, the United Nations General Assembly adopted The Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices (UNCTAD, 1980). Like the OECD recommendation of 1967, this contribution from UNCTAD recognised that restrictive business practices could adversely affect international trade. This initiative, which has become popularly referred to as the 'UN Set', was propagated in the hope that by doing so the United Nations could contribute to "the establishment of a new economic order to eliminate restrictive business practices." (UNCTAD, 1980 page 7)

The United Nations General Assembly's adoption on 5 December 1980 of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, the so-called UNCTAD Set.[141] The latter contains an explicit injunction to firms to refrain from many of the measures taken by private international cartels, as the following statement makes clear:

> "Enterprises…should refrain from practices such as the following when, through formal, informal, written or unwritten agreements or arrangements, they limit access to markets or otherwise unduly restrict competition, having or being likely to have adverse effects on international trade, particularly that of developing countries, and on the economic development of these countries:

[141] This Set has been reviewed by UN members in 1985, 1990, 1995, and 2000. The Fourth Review Conference, held on 25-29 September 2000, adopted a resolution which: "Reaffirms the validity of the UN Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, recommends to the General Assembly to subtitle this set for reference as the "UN Set of Principles and Rules on Competition", and calls upon all member States to implement the provisions of the Set." This resolution is contained in UN document TD/RBP/CONF.5/15.

(a) Agreements fixing prices, including as to exports and imports;

(b) Collusive tendering;

(c) Market or consumer allocation arrangements;

(d) Allocation by quota as to sales and production;

(e) Collective action to enforce arrangements, e.g. by concerted refusals to deal;

(f) Concerted refusal of suppliers to potential importers;

(g) Collective denial of access to an arrangement, or association, which is crucial to competition." (UNCTAD, 2000. Section IV. D.3. page 13).

Furthermore, the Set calls upon signatories to act individually or collectively to tackle restrictive business practices, of which international cartelisation is a leading example. In the preamble to Section IV, the Set states that signatories are

"Convinced of the need for action to be taken by countries in a mutually reinforcing manner at the national, regional and international levels to eliminate or to effectively deal with restrictive business practices…"

Having said this, the UNCTAD remains a non-binding statement of principles; like the OECD Recommendation on Hard Core Cartels which was to follow.

### II.3.2 OECD Recommendations

The OECD was the first international organisation to formally adopt an accord (technically a "Recommendation" of the OECD's Council) in regard to cooperation on competition policy enforcement through a Council Recommendation in 1967. More recently, the OECD has undertaken a sustained programme of research, policy dialogue, and dissemination of best practices on the matter of hard core cartels; amongst other issues. A more recent and oft-cited contribution is the 1998 Recommendation of the Council Concerning Effective Action Against Hard Core Cartels. In this Recommendation hard core cartels are said to be the "most egregious violations of competition law" and recommended that the governments of OECD member countries ensure that their competition laws effectively halted and deterred hard core cartels (OECD, 1998 page 58).

This Recommendation notes that

"Member countries should ensure that their competition laws effectively halt and deter hardcore cartels. In particular, their laws should provide for:

(a) effective sanctions, of a kind and at a level adequate to deter firms and individuals from participating in such cartels; and

(b) enforcement procedures and institutions with powers adequate to detect and remedy hardcore cartels, including powers to obtain documents and information and to impose penalties for non-compliance" (OECD 1998, article I.A.1).

Moreover, the Recommendation speaks to the issue of cooperation in the fight against hard core cartels:

"Member countries have a common interest in preventing hardcore cartels and should co-operate with each other in enforcing their laws against such cartels. In this connection, they should seek ways in which cooperation might be improved by positive comity principles applicable to requests that another country remedy anticompetitive conduct that adversely affects both countries, and should conduct their own enforcement activities in accordance with principles of comity when they affect other countries' important interests" (OECD 1998, article B.1).

Like the UN Set, this OECD Recommendation makes use of hortatory language and is non-binding. Moreover, although the OECD encourages non-members to adhere to the Recommendation, there is nothing to compel non-

members to do so. That is not to say that the increased attention given to hard core cartels, and to the other competition policy matters raised by the OECD and by UNCTAD, have had no positive effects; in fact, these non-binding agreements have probably increased the spread and tempo of enforcement of competition law around the globe. Rather, these non-binding agreements have not assured minimum standards of competition law enforcement around the globe; nor has any compelling evidence been presented that suggests they might do so in the near to medium term.

# Part III

## NATIONAL SUBMISSIONS TO THE WTO'S WORKING GROUP ON THE INTERACTION BETWEEN TRADE AND COMPETITION POLICY

Since the Doha Ministerial meeting, many WTO members have made submissions to this Working Group on the following subjects: core principles (including transparency, non-discrimination, procedural fairness), hard core cartels, modalities for voluntary cooperation, capacity building, and Special and Differential Treatment. The purpose of this part is to describe in detail the principal submissions on each of these matters. However, before doing so, the Chairman and the Secretary of the Working Group provide some context for the following sections. These gentlemen have remarked that:

> "First, the Working Group, in its work over the past five years, has eschewed a narrow approach to the "trade and competition interface", concerning itself not only with practices that can disrupt the *flow* of trade (e.g., vertical market restraints) but also, very much, with practices that undermine the benefits that are intended to flow from trade liberalization (e.g., international cartels). In addition to the role of competition law enforcement, attention has been given to the benefits of effective competition advocacy work. Second, the Group has had a major focus in its work on the importance of and the challenges involved in implementing competition policies in developing countries. Indeed, in our view a major contribution of this work has been to raise awareness of the harm caused to developing countries by international cartels and other anti-competitive arrangements, thereby promoting interest in modern approaches to competition policy among developing country Members and reinforcing related consciousness-raising efforts in other fora such as the OECD, UNCTAD and the ICN.
>
> "Third, and perhaps contrary to the expectations of some, the Working Group has shown little or no interest in the international "harmonization" of competition law, if by harmonization is meant an insistence on uniform approaches to competition law and policy at the national level. Indeed, the observation that "one size does not fit all" in the field of competition law and policy has become a staple of the dialogue in the Working Group. On the other hand, central to the dialogue in the Group have been two more basic concerns: (i) a recognition that, for political-economic reasons, developing countries often suffer from an under-investment in competition policy institutions relative to the harm caused to them by anti-competitive practices; and (ii) a belief that sound application of competition law and policy in ways that promote trade, investment and development - particularly in countries where such law is only recently established or that lack an entrenched "competition culture" - could be facilitated by explicit commitments in the WTO regarding application of the fundamental principles of non-discrimination, transparency and procedural fairness in this area" (Anderson and Jenny 2003, pages 3 and 4).

### III.1 Transparency

The Annual Report of the Working Group in 2002 describes the potential elements of a provision on transparency as follows:

> "In the field of competition policy, a transparency commitment would apply to laws, regulations, and guidelines of general application. There would be an obligation upon WTO Members to ensure the publication of such laws, regulations and guidelines in a comprehensive and timely manner. This might be done either in print in an official gazette, journal or the like, or possibly on a publicly accessible website" (WTO 2002, page 6).

Transparency has other facets as Janow (2002) notes:

> "Transparency in the competition context would also require notification of exemptions and exclusions from competition laws. But transparency could not reasonably be an unbounded obligation—the reasons why a competition agency may decide to pursue an individual enforcement action or decide against such an action could rely on confidential information that cannot be disclosed." (Janow 2002)

The country submissions on the merits of potential provisions on transparency fall into three main groups. The first group is supportive of transparency provisions and advocates means by which it could be realised in a future multilateral framework on competition policy. A second group of submissions are characterised by caution about the extent and nature of any transparency provisions and a third group argue for flexibility in the design of any transparency provisions.

Submissions to the Working Group from Australia, Switzerland, the European Community and Canada fall into the first group; that is, those submissions that are broadly supportive of transparency provisions.

The European Community states that

> "…a transparency commitment would obviously apply to laws, regulations, and guidelines of general application. The obligation would be for WTO members to ensure public availability in a comprehensive and timely manner – be it in print or on a publicly accessible web site – of all laws, regulations and guidelines of general application." (EC WT/WGTCP/W/222 2002)[142]

Canada and Switzerland broadly support these provisions stating, respectively, that

> "The EC has identified the need for transparency commitments in terms of laws, regulations and guidelines of general application. We agree that it is clearly important for these items to be transparent, through publication and notification." (Canada WT/WGTCP/W/226 2003)

and,

> "We would find it appropriate for WTO Members to make publicly available, in a timely manner and subject to protection of confidential information, the following: relevant laws including exceptions and exemptions, and including procedural rights and obligations, as well as procedures for investigations, and important case decisions including reasoning and facts." (Switzerland WT/WGTCP/W/214 2002)

Consequently, these countries go beyond mere expressions of support for the provisions on the core principle of transparency to suggest practical steps toward their implementation.

Support for flexibility in the implementation of transparency provisions seems to be uncontroversial. The European Community, for instance, notes that developing countries have the right to progressive and flexible implementation criteria; arguing that

> "… certain elements may need to be introduced progressively and be identified as a priority for technical assistance programmes." (EC WT/WGTCP/W/222 2002)

Canada makes similar remarks as do the Swiss, which support a progressive and flexible approach,

> "…adaptation to the circumstances will be necessary; and the principles should be applied in a flexible, different manner, comparable to the way the principles are applied across the WTO agreements being tailored to the respective agreement and adapted to the context to which the agreement applies." (Switzerland WT/WGTCP/W/214 2002)

The second group of submissions to the Working Group on transparency provisions can be best described as cautious, and include contributions from the USA and Hong Kong, China. The latter's submission demands that the scope of the transparency requirement be identified so that developing countries can better determine their stance towards it, arguing that

[142] In this part of the chapter the references to a WTO Member's submissions to the Working Group on the Interaction Between Trade and Competition Policy are of the form (X Y Z), where X refers to the WTO Member, Y to the WTO document number associated with the submission, and Z to the year of the submission.

> "…the problems of developing a "competition culture", weak enforcement capabilities and court systems as well as markets that may be characterised by high degrees of concentration and histories of state intervention." (Hong Kong, China WT/WGTCP/W/224 2003)

These characteristics are inimical to the requirements set down by the more ambitious proposals from the EC and others. Hong Kong, China argues that the scope of the transparency obligation will have very different implications for different members and implies that its final opinion on the transparency requirement will be made only upon the receipt of further information.

The US adopts a more neutral position to potential transparency provisions and voices some scepticism. Rather than making any specific proposals, it uses its submission to question the legality of several aspects of the transparency requirement under GATT law and draws the attention of WTO Members to the possible ramifications of a binding commitment on transparency.

> "Transparency is important to the sound application of antitrust law and maintaining the effectiveness, impartiality and credibility of such law. However, a number of questions remain concerning the application of transparency principles in a potential WTO Competition agreement. As in the non-discrimination context, these concerns generally arise at the point at which WTO rules and fundamental principles are discussed as applying to individual enforcement actions." (USA WT/WGTCP/W/218 2002)

The third broad theme to emerge from the submissions, represented most forcefully by the Chinese, Thai, and Indian contributions, is the insistence that flexibility be integral to any transparency provision. It should be noted that none of these countries specifically opposes the inclusion of transparency commitments in a future multilateral framework; rather, they make the case for a more gradual phase-in of these requirements. The Indian submission states, in opening, that

> "Both transparency and procedural fairness are no doubt desirable qualities that any administrative or judicial process must ensure." (India WT/WGTCP/W/215 2002)

And goes on to say,

> "Developing countries cannot be expected to adhere to the same standards as more developed ones in terms of transparency and procedural fairness." (India WT/WGTCP/W/215 2002)

While the Chinese take a less strident approach,

> "China stands for the inclusion of the principle of transparency in a future multilateral framework on competition policy, provided Members could reach explicit consensus on modalities before the Cancún Ministerial Conference for the negotiations on such a framework." (China WT/WGTCP/W/227 2003)

Before proceeding to argue that developing countries require a longer phase-in period before a transparency obligation would come into effect.

> "China therefore strongly supports the point made by Thailand in its submission (WT/WGTCP/W/213) that developing countries should be given enough time to build up their transparency and procedural fairness mechanisms progressively." (China WT/WGTCP/W/227 2003)

### III.2 Non-discrimination

Before describing the submissions on non-discrimination, a few introductory observations may help clarify matters. First, the objectives of a policy are to be further distinguished from the *instruments* that a government has at its disposal to secure those objectives. These instruments include measures that a state, court, or their delegated representatives are empowered to take.

Second, such instruments are said to be *discriminatory* if they result in foreign entities being treated differently from otherwise identical domestic entities. The discrimination may be incorporated into the relevant legal provisions empowering a government to act or in to the stated means of implementing those provisions, in which

case the discrimination is said to be *de jure*. An example of de jure discrimination in competition policy might be a requirement to evaluate foreign take-overs of domestic newspapers more strictly than domestic take-overs. Discrimination that results from uncodified practices or uncodified norms of implementation is called *de facto discrimination.*

Third, generally, in international trade law the term non-discrimination has two facets: most-favoured nation treatment (MFN) and national treatment (NT). The two concepts are broadly similar in the sense that aim to equate the treatment of different suppliers of the same good or service. MFN treatment is enshrined in Article I of the GATT and sets out the principle that all foreign trading partners should be accorded equal treatment in the application of laws and regulations. National treatment in found in Article III of the GATT and requires that regulations are not imposed in a manner that treats imports from overseas producers worse than comparable products sold by domestic firms.

Furthermore, Janow (2002) notes

> "The tendency now in some WTO Article III:2 national treatment/nondiscrimination cases to consider whether products are directly competitive or substitutable also borrows a conceptual leaf from economics and its influence on competition policy analysis. The WTO jurisprudence of national treatment/nondiscrimination has clarified that equality of competitive opportunity (not outcome) underpins this concept, a perspective that is also congenial with competition policy norms."

Turning now to the submissions, a number of issues are identified. Few submissions are as strongly supportive of disciplines on non-discrimination as Korea,

> "… in principle, there should be no problem in applying National Treatment and Most-Favoured Nation Treatment in a straightforward way to competition policy." (Korea WT/WGTCP/W/212 2002)

Korea's submission, however, emphasises that non-discrimination can only practicably be applied to de jure treatment:

> "Korea believes that a possible multilateral framework on competition policy should focus on *de jure* discrimination: discrimination that is written into the law and is based solely on nationality." (Korea WT/WGTCP/W/212 2002)

The EC also raises the issue of the application of any disciplines to de jure and de facto discrimination. On this matter, the EC has taken perhaps the most explicit stance:

> "…we are *only* suggesting a binding core principle as regards *de jure* discrimination in the domestic competition law framework, i.e. the treatment accorded to firms according to the wording of the laws, regulations and guidelines of general application. The main reason for limiting WTO provisions to *de jure* discrimination is that, when transposed to a competition context, the concept of *de facto* discrimination could raise complex questions about the enforcement policies, priorities and prosecutorial discretion of competition authorities, including how competition law is being applied to individual cases.
>
> Moreover, we propose to define *de jure* discrimination *exclusively* in relation to the domestic competition law regime. We are <u>not</u> proposing that a competition agreement should seek to introduce an absolute standard of national treatment to be applied to *any form* of government law or regulation." (EC WT/WGTCP/W/222 2002)

The USA adopts a neutral tone. Its submission is initially characterised by broadly supportive language,

> "The US experience has been that antitrust rules and their application are supportive of and consistent with the WTO's basic non-discrimination principles… discrimination on the basis of nationality, in favor of an individual competitor or group of competitors, is inconsistent with the purpose of antitrust rules." (USA WT/WGTCP/W/218 2002)

However, this neutrality is later tempered by questions about the application of disciplines on non-discrimination to bilateral cooperation agreements and to sectoral exemptions.

Australia's submission refers to its own domestic programme of exemptions and seems to indicate a willingness to tolerate similar exemptions in a multilateral framework. Australia notes:

> "Australia's competition law also allows for legislated exemptions from provisions of the TPA. However, where an exemption may have the effect of restricting competition, it must be demonstrated that this restriction is in the public interest." (Australia WT/WGTCP/W/211 2002)

Some have called into question the appropriateness of disciplines on non-discrimination for developing countries, as evidenced by the following quotation from a Thai submission:

> "In Thailand's view on non-discrimination, a competition law should not *discriminate between export and non-export firms…* We believe that the use of export cartels as a strategic trade policy to extract "rents" from foreign countries is unacceptable." (Thailand WT/WGTCP/W/213 2002)

Simultaneously Thailand makes the case that some flexibility should be maintained for developing nations which may otherwise be victimised by large multinational corporations from the industrialised world.

> "…developing countries should be allowed to: … exempt national and international export cartels. This is because most developing countries' exporters or importers are mainly small scale and may need to bind together to counter the bargaining power of larger buyers or sellers from industrialized countries..."( Thailand WT/WGTCP/W/213 2002)

India's submission amplifies the point made by Thailand and argues vigorously for special and differential treatment for developing countries on the matter of national treatment:

> "It is important in this regard to point out that a competition policy that ostensibly applies to all members equally is likely in practice to discriminate against firms in developing countries… domestic producers will in practice bear the brunt of a competition law that enshrines the NT principle, while allowing foreign producers to get away with similar infractions…In the context of meeting the needs of developing countries, it is more appropriate to adopt the concept of non-discrimination in terms of the need to treat different countries with different capacities in a differential manner, and of the need and responsibility to provide assistance, positive measures and affirmative action to local firms and institutions in developing countries to ensure their viability and development so that they can become increasingly efficient and competitive." (India WT/WGTCP/W/216 2002)

By far the most popular concern expressed in the submissions to the Working Group relate to exceptions and exclusions from an obligation on non-discrimination in so far as it relates to bilateral cooperation arrangements between nations. Japan and the EC both argue that such arrangements should be allowed to maintain their preferential status under a multilateral framework on competition policy:

> "…if the same definition of non-discrimination as that stipulated in the existing WTO Agreement is also used in the multilateral framework on competition policy, there could arise some misunderstanding whereby such bilateral agreement is contrary to the principle of non-discrimination. To avoid any misinterpretation, the bilateral agreement should thus be indicated as an exception to the non-discrimination." (Japan WT/WGTCP/W/217 2002)

> "…It is in the light of this that the EC has been proposing flexible modalities for international cooperation as explained in detail in previous submissions, most notably WT/WGTCP/W/184." (EC WT/WGTCP/W/222 2002)

### III.3 Procedural fairness

The relevance of procedural fairness and the potential components of a provision on this subject are described in the Annual Report of the Working Group in 2002 in the following terms:

> "With regard to the principle of procedural fairness, the view was expressed that a common feature of all effective competition policy regimes was that they included guarantees that the rights of parties facing

adverse decisions and sanctions would be recognized and respected. Such guarantees could vary both in content and in form, because they reflected the tools of the legal system and the traditions that had generated the competition regime. Four broad categories of guarantees were relevant. First, there should be guarantees relating to access to the system. For example, this could involve the right of firms to have notice that a formal investigation by the competition authority was pending against them, and what the authority's objections to their conduct were. A second basic guarantee related to the defence of the firms involved. Firms should have the opportunity and the time to make their views known to the authority in writing or by participating in hearings, by submitting evidentiary proof or documents, and by having an opportunity to introduce testimony from witnesses who might corroborate their views on the facts. These types of guarantees would typically include some right of access to the authority's file. A third guarantee was the right of firms involved in competition proceedings to have decisions affecting them reviewed by an independent judicial body. Finally, the protection of confidential information, including business secrets, should also be guaranteed. (WT/WGTCP/6, 9 December 2002)

The submissions of WTO members reflect these points. The submissions from Australia and Canada, for example, are very supportive of the concept of due process. Australia suggests that the list of factors developed by the OECD Joint Group on Trade and Competition is essential in ensuring procedural fairness in the final multilateral framework (Australia WT/WGTCP/W/211 2002). This approach has also been taken by the EC:

"Such "rights of defence" in favour of firms involved in administrative proceedings before a competition authority could include for instance:

(i) the right for parties to proceedings under the domestic competition law to have access to the agency or court applying the law and to be informed of the objections of the authority to their conduct.

(ii) the right for such parties to express their views within a fair and equitable procedure in advance of an adverse decision addressed to them.

(iii) the right to be notified of a reasoned final decision detailing the grounds on which such a decision is based.

(iv) the right to appeal such administrative decisions by competition authorities and to have them reviewed by a judicial body." (EC WT/WGTCP/W/222 2002)

Korea takes the TRIPS agreement as a model for procedural fairness in a future multilateral competition framework and notes that:

"Korea believes that the TRIPS Agreement provides a good reference for demonstrating procedural fairness in competition enforcement because the TRIPS Agreement includes the minimum provisions necessary for procedural fairness, such as the following:

(a) All processes pertaining to competition law enforcement should apply equally to foreign and domestic persons (natural and legal) in a fair and transparent manner.

(b) All parties have the right to appeal against an unfavourable decision made by a competition authority or court.

(c) Both domestic and foreign individuals or firms should be guaranteed the right to appeal to and to request remedy measures from competition authorities or courts against anti-competitive practices.

(d) The proceedings must proceed in a timely fashion in order to ensure prompt measures to protect rights and prevent uncertainty or excess costs resulting from undue delays."(Korea WT/WGTCP/W/212 2002)

Canada is also broadly supportive, though less ambitious than Australia and the EC, and argues that less stringent characteristics could be sufficient:

"We would concur with other delegations that a notice of charges, fair and equitable administrative proceedings, and an appeal process, could provide the required checks and balances to the claims of

relevant parties. Clearly, we recognize that Members will differ in the implementation of these elements to reflect their different legal traditions." (Canada WT/WGTCP/W/201 2003)

The European Community has raised the following concerns about the exchange of confidential information.

"What is important to a competition authority is to provide adequate protection for the business secrets and other confidential information provided by companies, physical persons and public authorities involved or co-operating in proceedings under domestic competition rules. Failing to provide adequate protection would seriously impair the effectiveness and credibility of a competition regime, may make firms in that jurisdiction hesitant to provide it with the information it needs to carry out its tasks and could even expose a competition authority – in certain legal systems – to claims for damages." (EC WT/WGTCP/W/222 2002)

This sentiment is echoed by Thailand,

"…we agree that rights to appeal and to have private confidential information protected are crucial. However, each country should design its own appeal process and confidential information protection schemes that are consistent with the local legal, political and institutional environment." (Thailand WT/WGTCP/W/213/Rev.1 2002)

Korea's approach to confidential information is less concerned with the needs of the business community and focuses instead on the need for government to acquire information for prosecutions. It argues that,

"While these procedures should be made available to protect the rights of the involved parties, they should also ensure that governments will be able to obtain the necessary information and documentation for a competition investigation." (Korea WT/WGTCP/W/212 2002)

Thailand, China and Hong Kong, China are all concerned that they be allowed to tailor the concept of due process to suit the local needs of their different judicial systems. China's submission puts the issue directly,

"As far as the position of China is concerned, we hold that each and every Member of the WTO is entitled to design, establish and maintain its own procedural system that is suitable to its specific national conditions and in accordance with its level of development." (China WT/WGTCP/W/227 2003)

The US also signals some support for an approach which would allow countries to tailor the obligations of any future agreement with the exigencies of each Member's existing law.

"…devising detailed provisions on procedural fairness that would not lead to interminable arguments on the comparable merits of various legal systems would be a difficult exercise because notions of fundamental fairness differ greatly from legal system to legal system. What may be considered a sound and fair policy in one jurisdiction may not be transferable or even necessary in another. On the other hand, a bare-bones framework on procedural fairness may not provide enough guidance to WTO Members or the general public on what meets minimum standards, and any Member's system could become subject to challenge with unpredictable results." (USA WT/WGTCP/W/219 2002)

At the same time, Thailand is concerned about progressivity issues in the sense that it desires a longer time period for the phase in of the due process requirement:

"…gradually introduce greater transparency and due process in the administration and enforcement of competition law." (Thailand WT/WGTCP/W/213/Rev.1 2002)

### III.4 Hard core cartels

A number of submissions to this Working Group have noted the harm done to developing countries by international cartels. The following remark by Thailand in representative in this regard:

"Thailand recognizes the potential damage associated with an international cartel and the urgent need to eradicate these cross-border collusive practices. We also recognize that these cartels tend to operate in

countries with weak enforcement of competition laws and thus support multilateral assistance in providing mutual assistance in fighting these cartels" (Thailand WT/WGTCP/W/205 2002 paragraph 1).

Korea, for one, has also stated that:

"…regulations on cartels should be included in the multilateral framework on competition policy, for their negative impacts are clear and also significantly affect international trade" (Korea WT/WGTCP/W/225 2002 paragraph 4).

This Korean contribution goes on to usefully describe a number of the key components of potential multilateral disciplines on hardcore cartels; namely, the definition and scope of hardcore cartels, obligations on WTO members to take effective enforcement action against such cartels, provisions for flexibility, and modalities for voluntary co-operation.[143]

With respect to non-discrimination and exemptions, Thailand has proposed that export cartels should be prohibited (Thailand WT/WGTCP/W/213 2002 paragraph 2.1). Moreover, India has argued for a ban on exemptions from national competition laws for export cartels, although it is envisaged that this ban would only apply to industrialised countries (India WT/WGTCP/W/216 2002 paragraph 3). With respect to international co-operation in the enforcement of anti-cartel laws, Thailand has made an ambitious proposal (see Thailand WT/WGTCP/W/205 2002). Specifically, Thailand has argued

"that the *initial commitment* in multilateral cooperation in fighting *hard-core cartels* should consist of the following elements:

-Notification, which requires authorities that are in the process of investigating and prosecuting international hard-core cartel cases to promptly alert concerned authorities in countries that the cartels may be operating. The notification should include, at a minimum, the background and preliminary analysis of the particular case. Authorities should be kept up-to-date on a regular basis with regard to the progress.

-Mandatory consultation, which requires governments that are investigating an alleged cartel to engage in discussions with other Member countries whose interests may be affected.

-Assistance, which requires competition authorities to co-operate in terms of providing analytical assistance, sharing of experience, suggestions concerning enforcement techniques, etc. Requests for information gathering should also be facilitated." (Thailand WT/WGTCP/W/205 2002, paragraph 5.)

This submission goes onto make clear that many of the above obligations would be mandatory and not voluntary. Thailand has also argued that—due to financial constraints in developing countries—that competition agencies in developing economies be

"financially compensated for delivering requested services and be allowed to cooperate to the extent possible subject to technical and financial constraints" (Thailand WT/WGTCP/W/205 2002, paragraph 6).

The European Community and its Member States have put forward perhaps the most comprehensive proposal for binding WTO disciplines on private international cartels in a submission on 1 July 2002 (submission number WT/WGTCP/W/193). This submission characterises hardcore cartels as:

'…cases where would-be competitors conspire to engage in collusive practices, notably bid-rigging, price-fixing, market and consumer allocation schemes, and output restrictions. These practices can appear in a number of shapes and combinations' (EC WT/WGTCP/W/193 2002, page 1).

The submission goes on to describe EC enforcement actions against private international cartels as well as reviews the recent research findings on the effects of such cartels on the world economy, noting in particular research undertaken at the OECD and for the World Bank.

[143] It should be noted that this submission does not include specific proposals from Korea on each of these matters. Nevertheless, this submission is a particularly helpful contribution as it lays out a number of important issues that would probably have to be addressed if negotiations began on multilateral disciplines on hard core cartels.

On the basis of this submission, the Commission envisages that a potential WTO agreement on hardcore cartels could include the following provisions:

1. 'a clear statement that [hardcore cartels] are prohibited' (EC WT/WGTCP/W/193 2002, page 5). This presumably includes domestic hardcore cartels as well as private international cartels.

2. 'a definition of "what types of anti-competitive practices could be qualified as "hardcore cartels" and would be covered by the multilateral ban' (EC WT/WGTCP/W/193 2002, page 5). The EC notes, in this respect, that such a definition might include a description of the permitted exceptions and exemptions to such a multilateral ban, although in this submission the EC did not take a stand on what those exemptions and exceptions might be (EC WT/WGTCP/W/193 2002, page 6). It would appear that, at the time of making the proposal, the EC was not prepared to take a position on whether export cartels are a type of hardcore cartel.

3. a commitment by WTO members 'to provide for deterrent sanctions in their domestic regimes' (EC WT/WGTCP/W/193 2002, page 6); while noting that a variety of sanctions are available.

4. on 'appropriate procedures in the field of voluntary cooperation and exchange of information. Indeed, transparency is an essential element of a framework of competition. Provisions have therefore to be developed on notification, information exchange and cooperation between competition authorities. These would include provisions regarding the exchange of information and more generally, cooperation procedures, e.g. when authorities are launching parallel investigations into the same practice. Negative and positive comity instruments could also be addressed' (EC WT/WGTCP/W/193 2002, page 7).

It would appear, therefore, that the Commission envisages a cartel enforcement architecture that includes strong national pillars (enforcement authorities) and a chapeau that links the pillars (information exchange and notification.) Although the EC's submission leaves the reader in no doubt that there are many subtle parameters to be negotiated, the construction of such an architectural edifice would, in their view, constitute:

'a major step towards effectively curbing such cartel activity and eliminating their adverse impact' (EC WT/WGTCP/W/193 2002, page 7).

### III.5 Modalities for voluntary cooperation

The proponents of a provision on voluntary co-operation in a multilateral framework on competition policy have argued that it should contain four "tools," which are described in the passage below.

"The point was made that the tools for voluntary co-operation that, according to this proposal, would be included in a multilateral framework were practical instruments which had come from experience with co-operation at the bilateral level. A first essential tool was notification, whereby one country would inform another of certain cases which affected the other country's important interests. Second, there was the exchange of information other than notifications to facilitate enforcement activities on either side. A third tool involved the provision of mutual assistance in the enforcement process. Finally, the proposed agreement would provide for: (i) traditional or negative comity, meaning that one country would take into consideration the important interests of other affected countries when taking a decision on a case; and (ii) positive comity, which would involve a country taking enforcement action upon a request from another country which suffered from anti-competitive practices originating in the territory of the requested country. All these tools were already found in the bilateral agreements to which some Members were party; regrettably, however, for the most part, developing countries were excluded from the benefit of such agreements" (WT/WGTCP/6 2002 page 24).

The submissions of WTO members in regard to voluntary cooperation are broadly supportive of a multilateral initiative in this area. Differences between the submissions hinge upon a few particulars regarding the possible future framework. The EC, Canadians and the Koreans, for example, are advocates of a Competition Policy

Committee which would be structured in a way that enabled it to monitor all notifications and transactions between separate Member states.

> "Canada takes the view that a WTO Competition Policy Committee should be established. Such a Committee could play a significant role in enhancing exchanges between Members and serve as a forum for Members to learn about each other's practices and policies. This type of dialogue would be distinct from the case-specific cooperation, such as exchange of notifications or coordination of investigations, that occurs under bilateral arrangements." (CanadaWT/WGTCP/W/202 2002)

> "If a multilateral framework on competition policy comes into being under the WTO, it would be desirable to set up a Competition Policy Committee that will enhance exchanges between Member countries and assist efficient implementation of the framework."(Korea WT/WGTCP/W/225 2003)

The EC's detailed outline of the functions of such a committee includes: contact points, experience exchanges, peer reviews and periodic reports on competition developments (EC WT/WGTCP/W/184 2002). Moreover, the EC has raised the following concern:

> "…bilateral cooperation agreements are the result of a long-standing, continuously evolving relationship between competition authorities with regard to the application and enforcement of their respective competition law regimes. Extending the provisions of such agreements to countries not originally parties to such agreements would not only defeat the underlying foundation for such agreements, i.e. the evolving relationship, but could also place considerable burdens on developing countries in administrative and financial terms. " (EC WT/WGTCP/W/222 2002)

Australia echoes the sentiment of the EC in so far as it would like to see a more formal system, especially in regards to the transfer of confidential information between nations (Australia WT/WGTCP/W/199 2002).

Thailand, the only developing nation to submit an extensive proposal on voluntary cooperation, believes that voluntary cooperation is one way of ensuring that developing countries are not targeted by the industries of industrialised countries for anticompetitive practices.

> "Thailand believes that the bilateral co-operative arrangements that are currently in place are helpful in enhancing capacity, but are not sufficient to protect developing countries from international cartels because countries with more advanced competition regimes would see no benefit from cooperating with countries whose enforcement of competition law is considered inadequate." (Thailand WT/WGTCP/W/205 2002)

Thailand takes the additional step of suggesting that members be *required* to cooperate in sharing of certain information and in investigations. As noted earlier, in the context of investigations into hard core cartels, Thailand calls for:

> "Mandatory consultation, which requires governments that are investigating an alleged cartel to engage in discussions with other Member countries whose interests may be affected." (Thailand WT/WGTCP/W/205 2002)

Hong Kong, China however, remains wary of voluntary cooperation and asserts that members need more information on this requirement before committing to it. Also, Hong Kong, China is concerned that voluntary cooperation commitments may place 'terrible burdens' on developing nations.

> "Voluntary cooperation, while voluntary in nature, nonetheless causes resources and capacity concerns to developing Members…There are also worries that certain developing Members are frequently required or targeted to provide cooperation assistance to developed Members, thus creating tremendous burden to the former." (Hong Kong, China WT/WGTCP/W/224 2003)

### III.6 Capacity building

Capacity building typically involves an industrialised nation assisting in the creation and strengthening of the so-called competition policy infrastructure in developing countries. Capacity building may take the form of funds or

expertise. Moreover, capacity building is generally taken to mean a long-term commitment on the part of the donor.

The submissions below are supportive of technical assistance and capacity building. The EC sees a role of international organisation in the provision of technical assistance.

> "The European Communities remains convinced that the WTO can make an important contribution towards the development of a reinforced and better co-ordinated approach to technical assistance in the competition field (as in other areas). As regards competition, it is clear that such a role should be undertaken in close cooperation with other relevant international organisations such as UNCTAD, the World Bank and bilateral donors and could only complement the primary role of the WTO, namely that of establishing binding rules and multilateral cooperation modalities." (EC WT/WGTCP/W/184 2002)

The US emphasises that differences between member states should be respected.

> "Our experience suggests, and much of the literature on the topic agrees, that technical assistance programs must take into account the country and culture, local concerns and conditions, and the body of domestic law." (USA WT/WGTCP/W/185 2002)

Japan makes similar remarks (see Japan WT/WGTCP/W/186 2002). Egypt and Thailand are also concerned that capacity building should take place within the framework of a country's specific needs, and preferably in the local language.

The USA is of the view that political and social considerations in the member state are also important. However, the most important aspect of capacity building is to ensure that the competition infrastructure is resistant to shocks, independent of government influence, supported by other independent institutions and long-lived. In relation to technical assistance for merger reviews, for instance, the US states:

> "…most new competition agencies do review mergers, so in those cases we suggest sensitivity to whether competition concerns rather than political and social concerns inform the analysis. All too often, a proposed acquisition is seen as a threat to incumbent firms or employment, rather than something that might enhance efficiency, increase consumer welfare, and expand output in the long run. Concerns about employment or the closing of antiquated facilities may be a political reality, but sound competitive analysis is essential in all merger reviews." (USA WT/WGTCP/W/185 2002)

### III.7 Special and Differential Treatment

In the context of trade and competition policy, special and differential treatment generally refers to longer (delayed) phase-in times, opt-out provisions, specially-tailored safeguard clauses, and reduced obligations for developing countries (Fox 2002, Nottage 2003).

The submissions on special and differential treatment typically describe the particular challenges faced by developing countries. Hong Kong, China, notes

> "…developing countries face special challenges in establishing effective competition laws and policies. This is often attributable to the problems of developing a "competition culture", weak enforcement capabilities and court systems as well as markets that may be characterised by high degrees of concentration and histories of state intervention." (WT/WGTCP/W/224 2003 page 2)

China, in a similar vein, asserts

> "…adequate and effective special and differential treatment should be accorded in *all related aspects* to developing countries including the least developed countries. In this regard, we fully share the concerns shown by Thailand in its submission (WT/WGTCP/W/213) and similar concerns expressed by other developing Members." [emphasis mine] (WT/WGTCP/W/227 2003 page 3)

India declares that the special challenge it faces is a bias in favour of foreign suppliers, which works against developing countries. This bias, asserts India, justifies its claims for special and differential treatment.

> "In the context of meeting the needs of developing countries, it is more appropriate to adopt the concept of non-discrimination in terms of the need to treat different countries with different capacities in a differential manner" (WT/WGTCP/W/216 2002 page 3)

The perceived scope of special and differential treatment varies across the submissions. India's proposal is concerned with the application of special and differential treatment to transparency and procedural fairness only. China, on the other hand, takes a much broader approach, insisting that special consideration should be given to developing members across all aspects of a potential multilateral framework on competition policy. Thailand, like China, goes so far as to argue that special and differential treatment should be a distinct core principle of a multilateral framework on competition policy; arguing as follows:

> "…in compliance with the spirit of the Doha Declaration, various needs and constraints faced by developing countries will have to be taken into account. We, therefore, propose that "special and differential treatment" constitutes the fourth element of the core principles for competition policy." (WT/WGTCP/W/213/Rev.1 2002 page 1)

### III.8 Further commentary on and summary of proposals for a multilateral framework for competition policy

Before offering any comments on the above submissions, it may be useful to summarise what appears to be the major elements of the proposals for a multilateral framework on competition policy, to be implemented under the auspices of the WTO. For purposes of this section, the authors have relied on the various elements that are set out in paragraph 25 of the Doha Ministerial Declaration and on related proposals by the proponents of a multilateral framework and clarifications that have been offered in the WTO's Working Group on the Interaction Between Trade and Competition Policy. These sources suggest that a multilateral framework might have the following elements:

1. A commitment by WTO Members to a set of core principles relating to the application of competition law and policy, including transparency, non-discrimination, and procedural fairness in the application of competition law and policy.
2. A parallel commitment to the taking of measures against hardcore cartels.
3. The development of modalities for cooperation between WTO members on competition policy issues. These would be of a voluntary nature, and could encompass cooperation on national legislation, the exchange of national experience by competition authorities, and aspects of enforcement.
4. A commitment to support the introduction and strengthening of competition laws and related institutions in developing countries, in a framework agreed at the WTO but in cooperation with other interested organisations and national governments.[144]

It should be appreciated that, to the extent that the eventual contents of any framework differ from the foregoing elements, the conclusions below might have to be qualified or revised.

Further analysis of these proposals provides answers to a number of potentially important questions. First, would a multilateral framework on competition policy be directed at government measures that restrain competition, or would it focus on anti-competitive acts of enterprises and their treatment under national competition laws? A related question is: would a possible framework apply only to competition law and its enforcement as such, or to other policy instruments, such as industrial policies?

[144] For a similar compilation of the possible contents of a multilateral framework, see Anderson and Jenny (2001) or Anderson and Holmes (2002), page 35.

The proposals of proponents of a multilateral framework on competition policy indicate that the focus is on private anti-competitive practices, in particular on hardcore cartels. Furthermore, the proponents have argued that intergovernmental or state-to-state arrangements would not likely be covered by a WTO agreement on competition policy. The observation could be taken to mean that arrangements such as OPEC would not be affected by a multilateral framework.

Specifically, the adoption of such a framework would—the proponents note—require the enactment of one type of competition law; namely, an anti-cartel law. Moreover, the proponents have argued that WTO members need not create a separate state body to enforce this law (WTO 2002, page 39).

With regard to the second question above, the EC's contribution on core principles focuses on the implications of potential provisions for competition law and not for other policies—such as industrial policy. In the case of the proposed provision on non-discrimination, the EC states that:

> "In other words, what would be at issue would be the *treatment accorded to firms pursuant to the terms of domestic competition laws* as such, and not the treatment accorded to firms under a range of other policies" (EC WT/WGTCP/W/222 2002, page 4).

Moreover, in the specific context of national treatment, the EC has stated that:

> "We are not proposing that a competition agreement should seek to introduce an absolute standard of national treatment to be applied to *any form* of government law or regulation" (EC WT/WGTCP/W/222 2002, page 4).

With regard to the ability to define freely the objectives of national competition laws, at this point in time no proposal has been put forward to constrain the objectives that would be incorporated in relevant national laws. The following excerpt from the Annual Report of the Working Group for 2002 is also germane to this point:

> "the proponents also affirmed their belief that the proposed multilateral framework could and should preserve adequate "policy space" for developing countries to pursue economic and social policies they deemed necessary for their own development. It is perfectly legitimate for a government to decide that there were policy goals which overrode the need to protect competition" (WTO 2002, page 15).

With regard to the ability to tailor the application of competition law so as explicitly to take into consideration possible implications for innovation and other determinants of long-run economic performance, it is worthwhile to ask what implications, if any, would potential provisions on core principles have for the factors that a nation can take into account when it enforces its competition law? Two related questions are: would these provisions prevent a nation from taking into account non-economic factors and evidence when implementing its competition law? And would these provisions prevent a nation from taking into account long term or dynamic factors and evidence when implementing its competition law?

In answer to these questions, nothing in the proposals would seem to rule out tailoring the application of competition law to promote innovation or long run economic performance. Indeed, as already noted, the current proposals do not seek to limit the criteria to be employed in the application of national competition law. Moreover, in principle, nothing prevents the potential provisions on core principles from being drafted in such a way that non-economic factors, short-term factors, and long-term factors are stated as permissible considerations during the enforcement of competition law.

One aspect of the proposals that could have implications for certain application of competition law for industrial policy-related purposes is the proposed obligation concerning national treatment. If a nation has a merger review law and the proposed provisions on non-discrimination apply, then without some kind of sectoral exemption, it would be obliged to evaluate any proposed merger involving one or more foreign firms in the same way that it evaluates a merger between two domestic firms, for example.

However, a nation that wants to discriminate in this manner *without violating the proposed provisions on non-discrimination* in a multilateral framework on competition policy might be able to do so through the application of its laws on foreign investments. This possibility is stated without endorsement or criticism, and highlights the fact

that there exist mechanisms other than competition law through which discrimination can be conducted. Therefore, with careful choice of policy instruments, it would seem that the goal of creating so-called national champions need not fall foul of a multilateral framework on competition policy.

With regard to the ability to implement relevant exceptions, exemptions and exclusions in national competition law, the following excerpt from the Annual Report of the WTO's Working Group on the Interaction Between Trade and Competition Policy for 2002 is pertinent:

> "With regard to the relevance of exceptions and/or exemptions from national competition laws and/or from a multilateral framework as a tool for managing any conflicts with national industrial policies, the view was expressed that given the diversity in stages and patterns of economic development among Members, sufficient flexibility had to be incorporated in any possible framework to make it workable among all WTO Members. A multilateral framework on competition had to provide for the possibility of appropriate exemptions or exclusions in two respects. First, many Members – including LDCs and other developing countries, but also some industrialized countries – wished to provide greater flexibility for small and medium-sized enterprises than for other firms under their competition laws. The proposed framework should permit this kind of flexibility. Second, as mentioned above, national interests might be safeguarded simply by providing for exclusion of sensitive economic sectors altogether from the substantive provisions of a multilateral framework, or from some of the core principles. Provisions for exemptions and exceptions would provide greater flexibility for WTO Members to achieve other national objectives such as industrial and economic development. Exceptions and exemptions must, however, be subject to appropriate transparency procedures, in order that firms trading with a Member or investing in a Member's economy would know where they stood. The suggestion was also made that the ability to implement exemptions should not be phased out over time, or be subject to periodic review" (WTO 2002, page 15).

Moreover, one leading proponent of a multilateral framework has recognised the importance of this issue and proposed that a flexible approach be taken to it. Specifically, the delegation of the European Community and its member States argues:

> "The issue of sectoral exclusions and exemptions from the scope and application of competition law is of great importance from both a competition and a trade perspective. At the same time it must be acknowledged that it constitutes a question of great sensitivity and complexity both among developing countries as well as several OECD members, including the EC. Some countries have made the point that, in order to gather consensus for the introduction of competition legislation, it has proved necessary to introduce certain sectoral exclusions and exemptions, but that these have then been limited over time. When analysing the recent developments, the trend has clearly been to eliminate such exclusions or to define them in increasingly narrow terms. We suggest that a flexible approach would be to focus - at this stage - on the essential question of transparency and its application to sectoral exclusions and exemptions, as well as their review over time. For instance, the Working Group could also usefully examine the experience of WTO Members who have phased out exemptions and exclusions (including the reasons for and the timing of such phasing out), as well as the domestic processes employed to enact such exemptions and exclusions" (EC WT/WGTCP/W/222 2002, page 7).

On the basis of the foregoing remarks, the principal elements of a multilateral framework on competition policy are taken to be:

1. A commitment to enact and enforce a national cartel law.
2. A commitment to apply a set of core principles (including non-discrimination) to whatever competition laws a nation already has on the statute books.
3. The development of a set of modalities on voluntary cooperation between competition agencies and such cooperation need not be limited to cartel enforcement actions.
4. A framework of measures that support the introduction and strengthening of competition policy-related institutions.

Given the earlier analysis of the current statements by proponent of their proposals, it might be useful to state that a multilateral framework on competition policy need *not*:

1. Require the creation of a new enforcement agency.
2. Require the enactment of any competition law other than a cartel law.
3. Require the abandonment of pro-development objectives for competition law.
4. Require the abandonment of existing exclusions, exemptions, and exceptions to national competition law.
5. Prevent the creation of so-called national champions, so long as those champions were nurtured using measures outside of a nation's competition law regime.

It should be stressed the foregoing remark in no way commends or condemns any of the five policy options listed directly above. These five points are important, however, as they reduce the number of factors that need to be considered in evaluating the impact of a multilateral framework on competition policy. (In the absence of the fourth point, for example, an analysis of current proposals for a multilateral framework would have to include the impact of eliminating exclusions, exemptions, and exceptions to national competition laws; a sizeable undertaking as these clauses differ markedly across nations.)

## Part IV

# WHAT IS THE CASE FOR INTERNATIONAL COLLECTIVE ACTION ON MATTERS RELATING TO NATIONAL COMPETITION ENFORCEMENT?

The case for binding international collective action in the area of competition policy differs from that in traditional reform, such as cutting tariffs and reducing quotas. For a long time, multilateral initiatives on the latter have been seen as necessary to overcome domestic opposition to reform. Specifically, simultaneous liberalisation at the international level offers the promise of greater access to foreign markets. This galvanises domestic export interests that now are prepared to support multilateral trade reform to a greater extent than they were prepared to support unilateral trade reform. In other words, domestic import-competing interests are no longer the only producers that have a strong interest in the outcome of trade reforms. (On this view, domestic consumers are thought to be too numerous and have too little at stake to bear the costs of organising collective action in the domestic political arena.) And so, multilateral trade reform is said to be more politically feasible than unilateral trade reform.

When the above arguments are applied to reforms to competition policy they tend to break down. As far as unilateral measures to strengthen competition enforcement are concerned, and assuming again that personal consumers are—by and large—too small to effectively organise, then it must be recognised that firms are *both* buyers of materials, energy, labour, and services as well as sellers of goods or services. This can produce conflicting interests for individual firms as the desired intensity of competition law enforcement, because a firm may well be engaged in anti-competitive conduct as a buyer or as a seller. The result is a fragmentation of producer interests on the desirability of strengthening competition laws, preventing the creation of wide-ranging and united producer lobbies in favour of (and for that matter, against) strengthening competition law and enforcement.

The arguments in the last paragraph apply to the unilateral strengthening of competition law enforcement as well as to international initiatives to simultaneously raise the tempo of such enforcement[145] or to introduce a minimum standard for competition law enforcement. Firms, for sure, have an interest in the manner in which competition laws are enforced abroad. That is not to say, however, that a nation's exporters have a common interest in how intensely those laws are enforced, in contrast to the case of tariff reductions where exporters' interests are aligned. Therefore, international initiatives on competition policy are unlikely to break any bottlenecks to domestic or unilateral reform, as is the case of multilateral initiatives on tariff reductions.

Although political-economy considerations do not provide a case for international collective action on competition policy matters, other arguments hold more promise—especially when they relate to hard core cartels. Findings such as those reported in part I may provide a rationale for robust national cartel enforcement regimes—but do they also provide a rationale for international initiatives on cartel enforcement? In the terminology used by economists, for this question to be answered in the affirmative it is enough to show that national cartel enforcement efforts—or the absence of such efforts—create 'spillovers' or knock-on effects in other jurisdictions. An international agreement, then, may be able to strengthen the positive spillovers and reduce the harm done by negative spillovers. Two arguments, borne out in the enforcement experience of the 1990s, imply there is a case from an international accord that specifies minimum standards of cartel enforcement.[146]

The first spillover arises from public announcements in one nation about cartel enforcement actions tend to trigger investigations by trading partners. For example, Korea began investigating the graphite electrodes cartel

[145] Note also, that in contrast to cutting tariffs and reducing quotes, there is no general presumption that every increase in the tempo of competition law enforcement will improve the allocation of resources.

[146] Other arguments for international collective action against private international cartels can be found in Evenett, Levenstein, and Suslow (2001).

after reading about American enforcement actions against this cartel. Likewise, Brazil initiated investigations into the lysine and vitamins cartels after US investigations were concluded (see Box 7).[147] Trading partners therefore benefit from active enforcement abroad—and these benefits are likely to be reinforced over time as formal and informal cooperation between competition authorities deepens.

The second argument is based on the fact that prosecuting an international cartel almost always requires securing testimony and documentation about the nature and organisation of the conspiracy. To the extent that an international cartel hides such documentation in a jurisdiction that cannot or will not cooperate with foreign investigations into the cartel's activities, this jurisdiction's actions have adverse effects on their trading partners' interests. The key point is that when a nation does not rigorously enforce its cartel laws the damage done is rarely confined to its own borders. An international accord on the enactment and enforcement of cartel laws can go some way to eliminating *safe havens* for domestic as well as international cartels. Moreover, such an accord would have to be binding to prevent a national government—for whatever reason—from failing to enact such a law.

The reader may well respond to the above arguments by noting that they only provide a case for binding minimum standards for national anti-cartel enforcement—rather than a case for a multilateral framework on competition policy that includes other elements such as core principles (transparency, non-discrimination, and procedural fairness) and voluntary cooperation. However, as the discussions in part II and the submissions in part III made clear, effective hard core cartel enforcement is likely to depend on the adoption of provisions on voluntary cooperation and on core principles. Thailand and the United States, amongst others, forcefully made the case that cooperation between enforcement agencies is essential if evidence is to be secured from abroad to prosecute cross-border cartels. Moreover, the adoption of core principles will ensure that foreign firms are aware of their legal obligations, of their procedural rights, and that they will be treated on a comparable basis as domestic firms. Indeed, without the latter assurances, a firm may well be more reluctant to supply a nation's markets if it feels that there is now a greater chance of being unfairly targeted in a cartel-related enforcement action. In sum, for minimum binding standards on cartel enforcement to be *effective* other multilateral disciplines on voluntary cooperation and core principles are required. The disciplines in the proposed multilateral framework on competition policy are an inter-related package.

Much has been made by the critics of a potential WTO agreement on competition policy of the need to identify spillovers as the rationale for international collective action (see, for example, Hoekman and Mavroidis 2002). The purpose of this discussion has been to show the difficulties in obtaining evidence and cartel-related information underlie two such spillovers.

[147] This is not to suggest that, at present, there is much inter-agency cooperation on cartel enforcement, with the potential exception of cooperation between US and Canadian agencies (see Waller 2000 for an account of the latter.) This dearth of cooperation is probably a reflection of the fact that confidential information on cartel cases typically cannot be shared with foreign enforcement agencies and that, until recently, few agencies beyond Brussels, Ottawa, and Washington, D.C., were enforcing their jurisdiction's cartel laws in the first place.

# Part V

# AN ECONOMIC ASSESSMENT OF THE PROPOSALS FOR A MULTILATERAL FRAMEWORK ON COMPETITION POLICY

## V.1 Identifying the key lines of causation

Unlike many trade policy reforms—which involve the reduction of a continuous variable, such as a tariff—the reforms considered here involves a number of discrete—and in many cases, binary—changes. For example, the decision to enact a cartel law is a binary choice. The discrete nature of the components of a multilateral framework on competition policy do not lend themselves to the traditional tools used to evaluate trade policy changes. However, a number of causal links can be traced out that, in some cases, lend themselves to quantification.

The principal lines of causation are as follows:

1. The effect of more vigorous cartel enforcement on the prices paid by consumers, including, but not limited to,

a. the poor and

b. governments.

2. The effect of more vigorous cartel enforcement on the intensity of competition in markets more generally, and its knock-on effects for dynamic economic performance.

3. The effect of more voluntary cooperation on the effectiveness of national competition law, including the strength of any deterrents contained in those laws.

4. The effect of more vigorous cartel enforcement on the environment.

5. The effect of greater technical assistance and capacity building on the effectiveness of national competition law and enforcement and on government budgets in developing economies and in the least developed economies.

With respect to the first line of causation, box 2 provides a detailed overview of the incentives supplied by effective anti-cartel laws to firms that are members of, or are contemplating being members of, a cartel. Effective enforcement creates two types of deterrents: deterrents to the formation of cartels in the first place and strong disincentives to raise prices in cartels that do form. Customers—who may be the poor, other firms, or the government—are the principal beneficiaries of stronger deterrents to cartelisation. In the case of imported goods, in the presence of strong deterrents import prices will be lower than otherwise; which, in turn, improves the terms of trade. In the important case of the poor, the prices of necessities will tend to be lower in jurisdictions where the disincentives to cartelisation are stronger, holding all else equal.

**Box 2: The economics of cartel enforcement**

The purpose of this box is to describe—from a traditional "law and economics" perspective—the incentives supplied to firms by national anti-cartel enforcement regimes.[148]

From a law and economics perspective, the objective of anti-cartel laws should be to deter, and where necessary punish, firms who engage in cartelisation.[149] Three characteristics of cartels are germane to understanding the incentives supplied by anti-cartel enforcement. First, cartels typically involve secret agreements between firms. Second, the objective of these agreements is to secure pecuniary gains for cartel members. Third, sustaining the cartel requires careful attention to crafting incentive compatible agreements between firms that discourage cartel members from cheating by selling more than the agreed amount or by selling below agreed prices.[150]

A group of firms will be *collectively* deterred from cartelising a nation's markets if that country's enforcers of competition law are expected to fine them *more than* the gains from participating in the cartel. Assuming that the firms are risk neutral; there are no costs to the firms in defending themselves before a fine is imposed; the pecuniary gain from cartelisation equals *G*; and the probability of the enforcement authority detecting and punishing the cartel equals *p*, then a fine *f that equals or exceeds (G/p)* will provide the necessary collective deterrent. An important insight is that even though cartel agreements are typically secret—and even though the probability of detection and punishment *p* is typically low—so long as *p* is positive there exists a fine that will collectively deter cartelisation.[151] Secrecy may impede investigations but deterrence is still, in principle, feasible. These arguments may also provide a rationale for why some nations, such as the United States and Germany, have made the maximum fines for cartel members a function of the pecuniary gain from their illicit activity.[152]

*Interpreting existing enforcement practices in the light of the above conceptual considerations*

Anti-cartel enforcement officials have exploited the "incentive compatibility" problems faced by cartels through the introduction of corporate leniency programs. These programs—which offer reduced penalties to firms that come forward with evidence of cartel conduct—induce members to "defect" from cartel agreements. These programs have also been motivated by the observation that the successful prosecution of cartels typically requires evidence supplied by at least one co-conspirator.[153]

The US corporate leniency program, last revised in 1993, can be rationalised in these terms. Currently only the *first* firm to come forward with evidence about a currently uninvestigated cartel is *automatically* granted an amnesty from all US criminal penalties. This encourages a "winner takes all" dynamic, where members of an otherwise successful cartel each have an incentive to be the first to provide evidence to US authorities.[154] A

[148] For a recent exhaustive survey of the law and economics literature, see Kaplow and Shavell (1998). The discussion in Box 2 focuses on the incentives supplied by public enforcement practices. Private suits—brought for damages by cartel victims—that are permitted in some jurisdictions, may reinforce these incentives.

[149] As a testament to the influence of this perspective it is worth noting that the Ministry of Commerce in New Zealand recently published a report on the effectiveness of the deterrence provided by that nation's enforcement practices and courts which was explicitly built on the lines of reasoning discussed in this box. See Ministry of Commerce, Government of New Zealand (1998).

[150] These forms of cheating are sometimes referred to as chiseling.

[151] This simple calculation can be extended in a number of ways, see Government of New Zealand (1998). Perhaps the most important extension is to include enforcement costs, which leads to the finding that the optimal enforcement of cartels may result in some less distortionary cartels not being prosecuted.

[152] Although this box focuses on the deterrent effect of state antitrust enforcement, it should be borne in mind that some jurisdictions permit private suits by those entities whose interests are hurt by a cartel. In principle, the expectation of damages won by those interests can act as a deterrent to cartelisation too.

[153] At the core of such leniency programs lies the incentive to give evidence in return for reduced (or even no) punishment for criminal acts. Some members of the Bar have pointed out that this incentive may well distort the information offered to enforcement authorities and the statements that former conspirators are willing to make in court. See "The World Gets Tough on Price Fixers," *New York Times*, June 3, 2001, section 3, pages 1ff.

[154] The German Bundeskartellant (Federal Cartel Office) revised their corporate leniency program in April 2000 to include such a provision. Dr. Ulf Boge, President of the Bundeskartellant, argued in explicitly economic terms as follows: "By granting a total exemption from fines to the first firm that approaches us, we want to induce the cartel members to compete with each other to defect from the cartel." See Bundeskartellant (2000).

second feature is that even if a firm is not the first to approach the US authorities, such a firm can gain a substantial reduction in penalties by admitting to cartel practices in *other* markets that are (at the time of the application for leniency) uninvestigated. This provision has set off a "domino" effect in which one cartel investigation can result in evidence for subsequent investigations.

Jurisdictions differ considerably in whether they impose criminal penalties in cartel cases. In particular, few jurisdictions allow the incarceration of business executives responsible for cartelisation.[155] However, US officials strongly believe that criminal penalties including the threat of incarceration are essential deterrents to cartelisation.[156] How does a law and economics approach assess this claim? First, incarceration involves costly losses of and re-allocation of output: managers' productivity is, by definition, less during their period of incarceration, and resources must be devoted to the construction and operation of prisons. If these were the sole considerations, then incarceration would be for sure be a less desirable alternative to fines. However, given the low probability of punishing a cartel and the sizeable gains from engaging in such behaviour, the minimum fine that would deter a cartel may in fact bankrupt a firm or its senior executives. Bankrupting a firm that has been engaged in cartel behaviour could actually reduce the number of suppliers to a market resulting, perversely, in less competition and higher prices. Furthermore, personal bankruptcy laws put a limit on what corporate executives can lose from anti-cartel enforcement. Incarceration may provide—through the loss of freedom, reputation, social standing, and earnings—the only remaining means to alter the incentives of corporate executives. This argument is particularly important in industrialised economies because in recent years the use of stock options in executive compensation packages provides very strong incentives to senior managers to maximise firm earnings and stock market value.

The second law and economics argument is that incarceration is needed to reduce or eliminate the expected harm caused by repeat offences. There may be legitimate concern that executives who have successfully arranged explicit agreements to carve up a market will, after the cartel is broken up, attempt some other form of anti-competitive practice. The imposition of fines alone may not induce a firm's shareholders to replace the offending executives, especially if the latter can convince shareholders that the fine was a "cost of doing business" and that the benefits from implicit collusion (which they expect to secure in a market that is well known to them) will soon flow. In these circumstances, the incarceration of executives may serve two purposes: first, to create a clean break with the past and second to act as a threat to incoming senior executives not to attempt re-cartelisation. When considering the merits of incarcerating executives, the advantages of stronger deterrents might be weighed against the higher levels of evidence that are required to secure criminal convictions. The threat of incarceration exacerbates the difficulties that officials face in securing evidence and testimony from cartel participants, which in terms of the framework outlined above effectively lowers the probability of detection and punishment, $p$.

*The effectiveness of national anti-cartel laws against international cartels*

The law and economics perspective explains why national enforcement efforts may be particularly ineffective in deterring international cartels. First, the ability of executives to organise cartels (including attending meetings and the writing and storing of agreements) in locations outside the direct jurisdiction of the national competition authority, where the cartel's effects are felt, can effectively reduce the probability of punishment $p$ to zero. For example, in 1994 the US case against General Electric, which along with De Beers and several European firms were thought to be cartelising the market for industrial diamonds, collapsed with the trial judge citing the inability of US enforcement authorities to secure the necessary evidence from abroad.[157] Second, constraints on the

[155] Although the criminality of cartel behaviour has considerable implications for international cooperation and evidence sharing, the role of these sanctions as a deterrent is issue here.

[156] See, for example, Hammond (2000) who argues: "based on our experience, there is no greater deterrent to the commission of cartel activity than the risk of imprisonment for corporate officials. Corporate fines are simply not sufficient to deter would-be offenders. For example, in some cartels, such as the graphic electrodes cartel, individuals personally pocketed millions of dollars as a result of their criminal activity. A corporate fine, no matter how punitive, is unlikely to deter such individuals." Mr. Scott Hammond is the Director of Criminal Enforcement at the US Department of Justice. In interpreting his remarks it is worth bearing in mind that the maximum fine under US law for individuals convicted in engaging in cartel behaviour is $350,000 which given recent trends in executive compensation is likely to be much less than the potential stock-option and other gains paid to an executive whose firm's profits have increased due to participating in a cartel.

[157] See Waller (2000).

ability to collect evidence and to interview witnesses abroad imply that the probability of punishment $p$ is lower than it might otherwise be. Increasing the fines $f$ imposed may not, given the substantial reduction in $p$ and the limits imposed by bankruptcy, be sufficient to deter cartelisation. In sum, supplying the right deterrent is more difficult when conspirators can hatch and execute their plans abroad. Both of these arguments imply that a nation which under-enforces its anti-cartel laws can effectively become a "safe haven" for international cartels, so creating adverse knock-on effects that harm its trading partners. **Indeed, the case for an international agreement that includes minimum standards for national cartel laws and enforcement is that it will help eradicate safe havens for private international cartels.**

Finally, the effectiveness of national leniency programs is compromised by firms' participation in cartel activities in many nations. A firm may be reluctant (to say the least) to apply for leniency in a single jurisdiction if that leaves it potentially exposed to penalties in other jurisdictions. Furthermore, even though a firm may be willing to offer evidence on cartel activities in many nations, a national competition authority will only value information on activities within its jurisdiction. Both factors reduce the benefits of seeking leniency.

Source: Substantially adapted from Evenett, Levenstein, and Suslow (2001).

The effect on the government budget of enacting and enforcing a cartel law *for the first time* is ambiguous. The stronger deterrents will reduce the propensity of bidders for government contracts to rig bids and the like. The associated reduction in the prices paid by the government will enable government outlays to fall or will permit greater quantities to be purchased. (To the extent that any price reductions free up funds that enable a government to spend more on social safety nets, education, and health services, then improvements in social well-being are likely to result.) The potential reduction in the levels of government spending are to be weighed against the cost of effectively enforcing a cartel law. As far as the latter is concerned, holding all else equal, these costs are likely to be lower in those jurisdictions with stronger deterrents to cartelisation because the case load of the enforcement authority will be smaller in the first place. Consequently, it is misleading to state that implementing a cartel law must be a net burden to the national treasury (see Evenett 2003b for a further elaboration of this and associated remarks.)

With respect to the second line of causation, it should be noted that many experts have pointed out four ways in which greater rivalry between firms enhances dynamic economic performance. And to the extent that cartel enforcement promotes such rivalry—by deterring firms from engaging in price-fixing and the like—then the enactment and effective enforcement of cartel law will further promote economic development. The four channels identified by experts (and described and analysed at greater length in Evenett 2003b, part I) are as follows:

1. Greater inter-firm rivalry is said to focus managers' attention on raising productivity, so as to reduce the probability of bankruptcy or to increase current or expected future profits.
2. Greater inter-firm rivalry helps to ensure that the dynamic benefits of trade and investment reforms are not reduced or eliminated by private anti-competitive practices.
3. The enforcement of competition law improves the business climate in a nation and enhances its attractiveness as a destination for foreign direct investment.
4. Greater inter-firm rivalry in product markets sharpens firms' incentives to innovate.

If these causal links are valid, then one would expect to see in the data the enforcement of competition law positively contribute—along with many other factors—to measures of dynamic economic performance, such as economic growth.

With respect to the third line of causation, greater voluntary cooperation between enforcement agencies can result in stronger deterrents to anti-competitive acts by firms. In the case of cartels, the disincentive to price fix will be stronger if potential conspirators know that a nation's competition enforcement agency may receive assistance from another enforcement body in searching for evidence, interviewing witnesses, and conducting dawn raids.

Furthermore, with more extensive provisions on voluntary cooperation, a nation may be willing to launch investigations into a cartel that has been prosecuted abroad, if the former anticipates receiving considerable assistance from the agencies that have already prosecuted the cartel. As a result, greater voluntary cooperation is likely to have the same *eventual* consequence as the first line of causation discussed above; namely, lowering prices paid by customers. These gains are to be set against any increase in enforcement costs that come from requests for cooperation from abroad. Having said that, requests for cooperation from abroad can also reduce domestic enforcement costs (as resources spent on evidence collection may, for example, be less); so the net effect of cooperation on total enforcement costs is ambiguous.

With respect to the fourth line of causation, there are likely to be a number of distinct effects of greater cartel enforcement actions on the environment. First, to the extent that cartelisation is deterred and firms no longer curb output so as to keep prices high, then increased production levels may result in greater resource use, environmental pollution, and the like. In the opposite direction, to the extent that cartels take steps to impede the introduction of more environmentally-friendly products by new entrants, or to slow the introduction of such products by cartel members, then more vigorous enforcement actions against cartels will improve environmental outcomes. (For accounts of the means by which cartels block the entry of new firms and slow innovation, see Levenstein and Suslow 2001). Moreover, to the extent that enforcement of competition policy leads to price reductions of environmental services, this could encourage the use of such services, to the benefit of the environment.[158] In sum, then, the respective strength of these three lines of argument will determine whether or not greater cartel enforcement improves the environment.

With respect to the fifth line of causation, greater technical assistance and capacity building are likely to improve the enforcement of competition law in developing economies and in the least developed economies, but probably not immediately after signing a multilateral framework on competition policy. To the extent that such improvements increase the deterrent effects of national cartel law, then the benefits identified earlier—namely, lower prices for consumers—can be expected to follow.

To summarise, these lines of causation suggest that the likely effects of adopting a multilateral framework on competition policy are to:

1. Strengthen the deterrent to cartelisation, which reduces the prices paid by customers, including the poor, importers, other firms, and the government.
2. Reduce bid rigging for government contracts, freeing up funds for other government purchases including expanded social programmes.
3. Potentially necessitate additional expenditures on cartel enforcement, the magnitude of which will depend in large part on the case load of the enforcement agency, and therefore on the strengths of the deterrents of cartelisation.
4. Foster inter-firm rivalry more generally, which improves dynamic economic performance.
5. Expand production which can lead to greater resource use and pollution; but also to lower prices and larger sales of environmentally-friendly products.

## V.2 Empirical assessment of the above lines of causation

Drawing upon publicly available data sources and existing studies, this section presents evidence that may be pertinent to an assessing the adoption of a multilateral framework on competition policy. This section is broken down into five substantive parts, each considering a separate line of causation identified above and the related empirical evidence.

[158] For a recent example of how environmental factors have been taken into account in the enforcement of competition law within Europe, see http://europa.eu.int/rapid/start/cgi/guesten.ksh?p_action.gettxt=gt&doc=IP/01/850|0|AGED&lg=EN&display=

### V.2.1 Effects on macroeconomic performance

A growing body of research supports the proposition that competition laws enhance macroeconomic performance in industrial and developing economies. Such research has drawn upon recent collections of large cross-country datasets of the factors which impede or facilitate competition in national markets, including measures of the strength of national competition or antitrust policy. The Global Competitiveness Report 2001-2002[159], for example, reports the average responses of business leaders in over 70 economies to two important competition-related questions. Each business leader was asked to grade on a seven point scale their responses to the following statements:

> "Anti-monopoly policy in your country is (1=lax and not effective at promoting competition, 7=effectively promotes competition)."
>
> "In most industries, competition in local markets is (1=limited and price cutting is rare, 7=intense and market leadership changes over time)."

The first statement refers to the effectiveness of one form of competition policy and the second to the extent of competition in a nation's market. Figure 2 plots the values of these two measures for all of the countries together. Table 6 presents summary statistics on these two measures in three of the four country groupings considered in this chapter. It is clear that both measures are substantially higher in the industrialised countries than in the developing economies, suggesting that the degree of intensity of competition and the vigour of anti-monopoly policy is weaker in the latter. However, in all three groupings the measure of the strength of anti-monopoly policy is strongly and positively correlated with the intensity of competition in national markets and is suggestive of—but does not prove—a causal link between the former and the latter.[160] If there is such a link, then to the extent that implementing a multilateral framework on competition policy strengthens national anti-monopoly policies, then the benefits of greater inter-firm rivalry should follow in the three country groupings found in table 6.

[159] This report is published annually by the World Economic Forum and is listed in the references as World Economic Forum (2002).

[160] In principle, there could be some (as yet unidentified) third variable that determines both of the measures reported in the text.

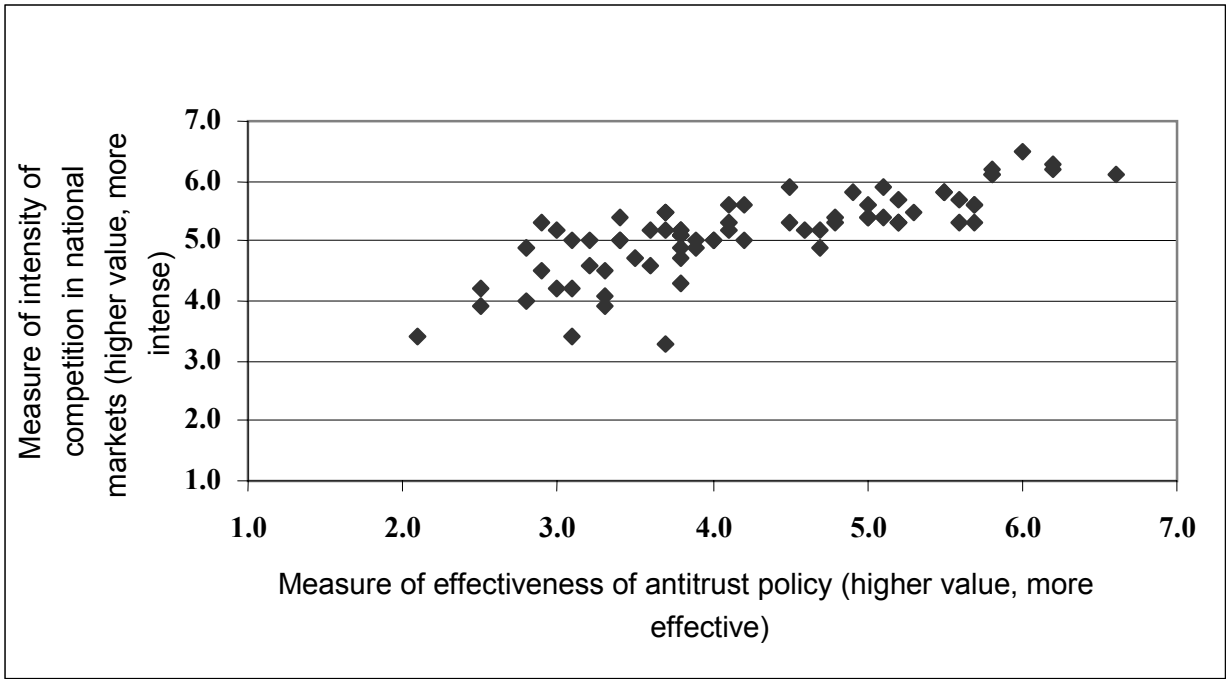
**Table 6: Summary indicators of the rigour of competition in national markets and of competition policy, by country groupings**

| Grouping of countries | Intensity of Local Competition<br>In most industries, competition in the local market is (1=limited and price-cutting is rare, 7=intense and market leadership changes over time) | Effectiveness of Anti-Trust Policy<br>Anti-monopoly policy in your country (1=is lax and not effective at promoting competition, 7=effectively promotes competition) | Correlation coefficient | Number of countries |
|---|---|---|---|---|
| EU member states | 5.79 | 5.46 | 0.79 | 14 |
| Non-EU developed countries | 5.65 | 5.46 | 0.72 | 8 |
| Developing countries | 4.87 | 3.68 | 0.63 | 50 |

Source: *Global Competitiveness Report 2001-2.*

Note: Data for only one least developed nation (Bangladesh) is reported in the *Global Competitiveness Report 2001-2*. For Bangladesh the reported value of the "intensity of local competition" measure is 4.5 and the reported value of the measure of "effectiveness of anti-trust policy" is 2.9.

**Figure 2: Intensity of competition and antitrust policy**



Other studies have examined the impact of competition law and policy on different measures of national economic performance. These studies invariably employ econometric techniques to strip out—or to "control for" in language of researchers—the variation caused by other pertinent factors, so enabling the analyst to isolate the impact of competition law and policy on the measure of economic performance being studied. Dutz and Hayri (1999) found that, after controlling for the many determinants of economic growth, national output grew faster in economies that took more strenuous steps to promote competition and to attack market power.

More ambiguous results on the effectiveness of competition law can be found in Hoekman and Lee (2003). Using data from 28 industries in 42 countries for the years 1981 to 1998, they first estimate the price-cost mark up in each industry in each country. They then show that these estimated mark ups tend to be smaller in economies with greater import penetration and lower domestic barriers to entry. They further show, using a dichotomous indicator of whether a country has a competition law or not, that such laws have no direct independent and statistically significant impact on the estimated price-cost margins. However, once they take account of the fact that nations choose whether to enact a competition law, they find that:

> "…industries that operate under a competition law tend to have a larger number of domestic firms, suggesting that in the long run, competition laws may have an indirect effect on domestic industry markups by promoting entry" (Hoekman and Lee 2003, page 4).

Although these authors would prefer to stress the importance of barriers to entry, this latter finding is also consistent with the view that the enforcement of competition law discourages incumbent firms from taking steps to frustrate the entry of new firms.

On the basis of these findings Hoekman and Lee (2003) conclude:

> "While competition law is potentially an important component of a pro-active competition policy, the analysis in this paper suggests that dealing with trade barriers and government regulations that restrict domestic competition by impeding entry and exit by firms may generate a higher rate of return" (page 23).

This carefully crafted conclusion should be interpreted with caution. Hoekman and Lee (2003) do not calculate the rates of return on trade reform, investment liberalisation, and measures to reduce barriers to entry, as one might expect given the strength of their conclusion. The costs of relevant reforms—which in the case of tariff reductions would include the potential loss of tariff revenues—are not considered in their paper, even though they ought to be part of any cost-benefit analysis of this issue. Although tariff reductions would normally be considered welfare-enhancing, in developing or least developed countries it may be difficult to make up any resulting revenue loss. At best, this paper has illuminated one set of factors that are central to any such analysis (the effects of different policy instruments on price-cost margins).

The effects of competitive policies have also been traced through to firm behaviour. In a study of Eastern European and other transitional economies, Dutz and Vagliasindi (2000) found that enhanced enforcement (not merely enactment) of competition policies facilitates the growth of higher productivity firms in an industry—that is, inefficient firms cannot be cushioned by the profits acquired through the exercise of market power.[161]

Carlin *et al.* (2001) used survey data on 3,300 firms in 25 countries to examine whether the degree of competition that a firm's manager perceives he or she is up against has a positive effect on a number of dimensions of performance. They found that the more rivals a firm perceives itself as having and the more sensitive to price a manager perceives the demand for its products to be, the better was the firm's record at improving productivity, cutting costs, and the greater the rate at which it developed new products and improved existing products.

Given the positive correlation between the intensity of competition in national markets and the strength of anti-trust policy discussed earlier (recall figure 2) and the findings of the Carlin *et al.* (2001) survey, the evidence suggests that by attacking anti-competitive practices, stronger antitrust policies stimulate competition in domestic

[161] This paper was also circulated at the OECD's Global Forum on Competition in February 2002.

markets. Moreover, as was reported earlier, greater inter-firm rivalry triggers a number of improvements in firm performance over time—such as innovation and increases in productivity—some of which may get passed on to their customers. These firm-level effects are in addition to the effects on economic growth identified earlier by Dutz and Hayri (1999).

To summarise, there is a nascent but growing empirical literature which has identified positive effects on macroeconomic performance of stronger enforcement of national competition laws in developing economies. This research complements the large body of evidence on the beneficial impact on the long term performance of firms and customers of greater rivalry, which can be enhanced by the appropriate enforcement of competition law.

### V.2.2 Effects on government budgets

As discussed in section V.1, the effect of enforcing a cartel law on a government's budget is, in principle, ambiguous. However, in many developing countries the size of government purchases are now so large that only small reductions in the amount of bid rigging on state contracts would more than cover the likely costs of cartel enforcement.

**Table 7: Estimated savings to governments through a reduction in bid rigging on just one percent of government contracts**

| Country | Conservative estimate of reduction in government spending in 2000, millions of US dollars | | Budget of competition authority in 2000, millions of US dollars | Ratio of estimated savings to cost of competition agency | |
|---|---|---|---|---|---|
| | 15 percent price reduction | 20 percent price reduction | | 15 percent price reduction | 20 percent price reduction |
| India | 121.96 | 162.61 | 0.72 | 169.39 | 225.85 |
| Kenya | 4.85 | 6.46 | 0.24 | 20.19 | 26.92 |
| Pakistan | 20.34 | 27.12 | 0.33 | 61.64 | 82.18 |
| South Africa | 34.91 | 46.54 | 7.74 | 4.51 | 6.01 |
| Sri Lanka | 5.09 | 6.79 | 0.10 | 50.93 | 67.90 |
| Tanzania | 1.52 | 2.02 | 0.16 | 9.47 | 12.63 |
| Zambia | 0.51 | 0.68 | 0.19 | 2.68 | 3.58 |

Source: Data on central government spending and on the budget of the competition enforcement agency taken from CUTS (2003).

Table 7 provides some evidence of the magnitudes involved. The table reports data for seven developing economies that have competition enforcement agencies. Assuming either a 15 or 20 percent price increase caused by bid rigging, the table reports the savings to each respective national government if stronger cartel enforcement deterred bid rigging in just one percent of the value of state contracts. Those savings (reported in the second and third columns of table 7) are compared to the current outlays on the national competition enforcement agency (see the last two columns of table 7).

For countries with large government expenditures, such as India, a one percent reduction in bid rigging on state contracts would save the national treasury a sum equivalent to at least 16939 percent of the cost of its competition enforcement agency! This means that India could increase the expenditures on this agency by a hundred fold and still come out ahead—so long as the additional expenditures ensured that bid rigging on state contracts fell by at least one percent. Even for countries, such as Zambia, that have lower levels of government spending a one percent reduction in the extent of bid rigging would yield savings between 268 and 358 percent of the annual cost of running the competition enforcement agency in 2000. In short, the size of government expenditures in most developing countries are large enough that the savings on government purchases which result from less bid rigging is likely to easily offset any additional outlays needed to rigorously enforcing national cartel laws.

### V.2.3 Effects on customers more generally

More rigorous cartel enforcement will not just benefit state purchasers; all customers can in principle benefit. To highlight this point, consider a recent analysis of the overcharges imposed on customers by the decade-long international vitamins cartel. Clarke and Evenett (2003) showed that in Latin America (and Asia and Western Europe for that matter) those jurisdictions that did not enforce their cartel laws (or did not enforce such laws once enacted) suffered greater overcharges than those nations that actively enforced their cartel laws.[162] In Table 8 the overcharges paid by each economy in Latin America that did not have an active cartel enforcement regime is reported along with the estimated reduction in those overcharges had active cartel enforcement occurred. On this one international cartel alone, Honduras would have paid US $5million less in overcharges throughout the duration of the cartel (that is, from 1990 to 1999) had it actively enforced a cartel law. This table, therefore, provides an indicator of the savings to customers in Latin America that would have flowed from national investments in cartel enforcement measures; investments that that implementation of a multilateral framework on competition policy would probably necessitate in most developing countries and least developed economies.

**Table 8: More vigorous cartel enforcement in Latin America in the 1990s would have reduced the amount of overcharges paid on vitamins imports**

| Economy | Overcharges (millions of US dollars) | |
|---|---|---|
| | Paid during the vitamins cartel (1990-1999) | Estimated reduction in overcharges had their been vigorous cartel enforcement in this jurisdiction |
| *Developing countries* | | |
| Argentina | 73.83 | 15.09 |
| Colombia | 54.95 | 11.23 |
| Venezuela | 45.32 | 9.26 |
| Honduras | 25.87 | 5.29 |
| Ecuador | 14.82 | 3.03 |
| Guatemala | 10.41 | 2.13 |
| Paraguay | 4.57 | 0.93 |
| Costa Rica | 3.82 | 0.78 |
| Bolivia | 3.45 | 0.71 |
| Dominican Republic | 3.07 | 0.63 |
| El Salvador | 2.70 | 0.55 |
| Jamaica | 2.11 | 0.43 |
| Nicaragua | 1.20 | 0.25 |
| Trinidad Tobago | 0.81 | 0.16 |
| Panama | 0.68 | 0.14 |
| *Least developed country* | | |
| Haiti | 0.11 | 0.02 |

Source: Derived from estimates in Clarke and Evenett (2003).

[162] See Clarke and Evenett (2003) and Evenett (2003b, part III) for a more general discussion of the costs and benefits of enforcing national anti-cartel laws. The available empirical estimates suggest that the reduction in overcharges incurred in jurisdictions with active cartel enforcement regimes from *only one* major international cartel in the 1990s would have gone a long way to pay for the entire state outlays of Brazil's, Mexico's, and several European Union member states' on their respective competition law enforcement regimes.

More generally, data on the magnitude of national imports and government consumption expenditures can be employed to gauge the likelihood that investing in cartel enforcement will be beneficial for developing countries and for the least developed countries. Table 9 includes data on 26 developing countries for which we could find no record in OECD documentation of active cartel enforcement in the 1990s. The purpose of Table 9 is to estimate the minimum percentage reduction in cartelisation on different purchases that would have to follow from a US $10 million investment in cartel enforcement for this outlay to pay for itself or to more than pay for itself.[163] In the case of a nation's imports, and assuming very conservatively that cartels raise prices by 15 percent, this amounts to asking what reduction in the percentage of imports that are cartelised is needed to generate savings of US$10 million? For these 26 countries, the mean reduction in cartelisation on imports necessary to justify an investment of this magnitude was 1.25 percent. For 12 of these countries, the reduction of cartelisation needed on imports was less than 1 percent.

**Table 9: Very little of a developing country's imports and government spending need to be affected by cartelisation to justify a $10 million outlay on the enforcement on competition law**

| Developing country where there is no record to date of active cartel enforcement | Given a 15 percent price increase on cartelised products, what percentage of a nation's [see column headings below]….would have to be cartelised to justify spending US$10 million on the enforcement of competition law? | | |
|---|---|---|---|
| | Imports in 2001 | Government consumption expenditure in 2001 | Imports plus government consumption expenditure in 2001 |
| Algeria | 0.58 | 0.95 | 0.36 |
| Cameroon | 3.06 | 7.98 | 2.21 |
| Costa Rica | 1.06 | 3.28 | 0.80 |
| Cote D'Ivoire | 2.28 | 8.12 | 1.78 |
| Ecuador | 1.25 | 4.27 | 0.97 |
| Egypt | 0.35 | 0.77 | 0.24 |
| Ghana | 2.05 | 9.30 | 1.68 |
| Guatemala | 1.34 | 7.16 | 1.13 |
| India | 0.10 | 0.15 | 0.06 |
| Indonesia | 0.16 | 0.71 | 0.13 |
| Iran | 0.23 | 0.42 | 0.15 |
| Jordan | 1.24 | 3.61 | 0.92 |
| Kenya | 2.05 | 6.92 | 1.58 |
| Lebanon | 1.09 | 2.50 | 0.76 |
| Malaysia | 0.09 | 0.72 | 0.08 |

[163] The US$10 million figure is almost certainly larger than the outlays necessary to implement a cartel law in a small or middle sized developing economy. It is worth noting in this regard that South Africa—whose competition enforcement agencies and practices are well regarded—currently spends less than US$8 million of taxpayers' money.

| | | | |
|---|---|---|---|
| Mauritius | 2.71 | 13.09 | 2.25 |
| Morocco | 0.63 | 1.25 | 0.42 |
| Pakistan | 0.61 | 1.13 | 0.40 |
| Philippines | 0.20 | 0.76 | 0.16 |
| Senegal | 4.41 | 16.50 | 3.48 |
| Syria | 1.38 | 3.32 | 0.98 |
| Thailand | 0.11 | 0.71 | 0.09 |
| Tunisia | 0.80 | 2.80 | 0.62 |
| Turkey | 0.16 | 0.39 | 0.12 |
| Venezuela | 0.35 | 0.77 | 0.24 |
| Zimbabwe | 4.09 | 4.40 | 2.12 |
| **Mean** | **1.25** | **3.92** | **0.91** |
| **Minimum** | **0.09** | **0.15** | **0.06** |
| **Maximum** | **4.41** | **16.50** | **3.48** |

Notes:

1. The assumptions underlying these calculations are very conservative. For instance, the assumption of a 15 percent price increase due to cartelisation is at the lower end of estimates of the price impact of cartels (see, for example, the case studies in Levenstein and Suslow 2001).
2. Moreover, the US$10 million price tag for the enforcement of national competition law is in excess of what the South African government spends each year on the enforcement of all of its competition laws, not just cartel law. The South African experience is pertinent as it is widely regarded as having an effectively enforced set of competition laws.
3. The underlying data on imports and government consumption expenditures were taken from the World Development Indicators Online.

The third column of Table 9 reports the comparable percentage reduction in state contracts needed to generate US$10 million in savings to the national treasury. These percentages are larger than those for imports and reflect the fact that government consumption expenditures are smaller than the value of imports. Even so, the mean reduction in state contracts affected by bid rigging needed to generate US$10 million in savings In these 26 countries is less than four percent.

**Table 10: For the least developed countries more of their nation's imports and government spending would need to be affected by cartelisation to justify a $10 million outlay on the enforcement on competition law**

| Least developed country where there is no record to date of active cartel enforcement | Given a 15 percent price increase on cartelised products, what percentage of a nation's [see column headings below]….would have to be cartelised to justify spending US$10 million on the enforcement of competition law? | | |
|---|---|---|---|
| | Imports in 2001 | Government consumption expenditure in 2001 | Imports plus government consumption expenditure in 2001 |
| Bangladesh | 0.73 | 3.64 | 0.61 |
| Benin | 11.62 | 27.11 | 8.13 |
| Burkina Faso | 11.02 | 21.17 | 7.25 |
| Chad | 8.41 | 56.76 | 7.33 |
| Congo | 5.81 | 23.55 | 4.66 |
| Ethiopia | 3.84 | 7.25 | 2.51 |
| Guinea | 7.46 | 43.89 | 6.38 |
| Madagascar | 4.96 | 24.88 | 4.14 |
| Malawi | 10.08 | 24.84 | 7.17 |
| Mali | 6.98 | 22.48 | 5.33 |
| Mozambique | 4.47 | 17.62 | 3.56 |
| Nepal | 4.37 | 13.63 | 3.31 |
| Niger | 16.33 | 30.83 | 10.67 |
| Rwanda | 17.81 | 33.13 | 11.58 |
| Tanzania | 3.26 | 8.62 | 2.36 |
| Togo | 12.17 | 65.04 | 10.25 |
| Uganda | 4.48 | 10.81 | 3.17 |
| Yemen | 2.26 | 5.87 | 1.63 |
| **Mean** | **7.56** | **24.51** | **5.56** |
| **Minimum** | **0.73** | **3.64** | **0.61** |
| **Maximum** | **17.81** | **65.04** | **11.58** |

Notes:

1. The assumptions underlying these calculations are very conservative. For instance, the assumption of a 15 percent price increase due to cartelisation is at the lower end of estimates of the price impact of cartels (see, for example, the case studies in Levenstein and Suslow 2001).
2. Moreover, the US$10 million price tag for the enforcement of national competition law is in excess of what the South African government spends each year on the enforcement of all of its competition laws, not just cartel law. The South African experience is pertinent as it is widely regarded as having an effectively enforced set of competition laws.
3. The underlying data on imports and government consumption expenditures were taken from the World Development Indicators Online.

Turning to the least developed countries, the comparable percentages to those calculated in Table 9 for developing economies are reported in Table 10. Taken at face value, the percentages reported in Table 10 suggest that recovering US$10 million in savings would be less likely in the poorest nations than in developing countries more generally. Having said that, the least developed countries would probably need to spend less than US$10 million to properly enforce any cartel laws. Moreover, nothing in the current proposals for a multilateral framework for competition policy prevents these nations from creating a regional competition enforcement agency; which may help spread some of the costs across a number of regional partners. Even so, these calculations may well suggest that the least developed countries are in greater need of budgetary support (as well as other forms of capacity building) than the less poor group of developing countries.

It is important to appreciate that the greater the extent of any sectoral or general exemptions from a multilateral provision banning hard core cartels the smaller the overall benefits of adopting such a provision. Moreover, such exemptions may have a beggar-thy-neighbour aspect to them; as is likely to be the case in certain international transportation sectors. In particular, government-inspired or government-tolerated cartels are rife in ocean liner shipping conferences. These conferences involve cooperative working arrangements as well as agreements to set prices. Fink, Mattoo, and Neagu (2001) estimate that ending these cosy arrangements between private shipping companies would reduce transportation prices on US routes by 20 percent, so reducing the cost of exporting goods to the American market.

There is another form of state encouragement of private international cartels.[164] Many nations appear to have taken the view that their own firms can cartelise markets—so long as those markets are abroad. In fact, numerous jurisdictions have explicitly exempted *export cartels* from their domestic competition laws—essentially providing some legal privileges and immunities to their own nation's firms that are members of export cartels. For example, such export cartels are exempted from US law under the Webb-Pomerene Act and the Export Trading Companies Act. At least 14 jurisdictions have such exemptions in their competition laws (see Evenett 2003c and OECD 1995), although data on the extent to which such laws are actually used by firms is hard to obtain. It is worth noting that in recent years some nations have repealed such exemptions—in part, perhaps, because they fear that if their firms get into the habit of cartelising foreign markets then there is a greater risk that the same firms will attempt to cartelise the home market too.

Initially, such export cartel exemptions were justified on the grounds that small exporters could join together to share the allegedly substantial costs of marketing their products abroad. If these cartel exemptions were specifically to aid small firms, then one might have expected the relevant legislation to be confined to these firms. Invariably, it is not. By encouraging domestic firms to engage in anti-competitive acts abroad, exemptions for export cartels are yet another example of the very beggar-thy-neighbour act that enlightened policymakers have sought to discourage since the wave of retaliatory tariff increases in the early 1930s. Whether these exemptions become an important topic for negotiation or discussion remains to be seen; but their capacity to erode the benefits of a multilateral framework on competition policy are clear.

[164] The use of antidumping investigations and orders to "police" international cartel arrangements also constitutes another state encouragement to fix prices in global markets (see Pierce 2001, Levenstein and Suslow, 2001, and Evenett 2003c). Moreover, Stiglitz (2001) has argued that certain governments went so far as to establish what was effectively a cartel in aluminium in the mid-1990s after leading US producers began to suffer from substantial losses.

### V.2.4 Effects on the poor and the environment

Recalling the discussion in section V.1 above, the effect of more rigorous cartel enforcement is likely to have a number of beneficial effects for the poor and possibly for the environment also. However, the available evidence here is sparse, to say the least. Much more research is needed here to ascertain these particular consequences of adopting a multilateral framework on competition policy.

As cartels are almost always secret conspiracies, researchers, experts, and other commentators cannot observe the entire set of currently cartelised markets and so comprehensive estimates of the likely social and environmental consequences of breaking up those cartels cannot be generated. However, past enforcement actions can provide a guide to the types of non-economic effects that are likely to follow from the implementation of a multilateral framework on competition policy and the anticipated increase in cartel enforcement actions. Table 11 summarises a number of those effects from recent cases in developing economies, which include direct effects of cartels on the price of foodstuffs consumed by the poor (the case of poultry in Peru) and on the price and access to medicines (the case of pharmacists in Romania).

**Table 11: Selected prosecuted cartels with effects on sustainable development in developing countries**

| Country in which cartel operated | Details of cartel | Effects on the poor, the environment, inequality, development |
|---|---|---|
| Egypt | Bid rigging on USAID projects to build sewage facilities in Cairo, 1989-1995 | Fewer of the poor served by resulting more costly projects; making the reduction in disease and environmental degradation fall below levels that would have been achieved in the absence of the cartel. |
| China | Bid rigging on school building contracts, 1998 | Fewer schools build or built over a longer time horizon; retards development of human and social capital of children. Absence of school opportunities may also contribute to higher levels of child labour, especially in rural areas. |
| Estonia | Price fixing of milk products, 2000. | Milk is a staple food product for the poor. |
| Peru | Poultry market, 1995-1996 | Chicken is the staple source of protein for poor Peruvians. Price of live chickens (the preferred way in which Peruvians buy this meat) rose 50 percent during the cartel. Cartel has clear distributional consequences, reducing the standard of living of the poor. |
| Romania | Members of the Pharmacists Association were involved in practices to restrict entry, 1997-2000 | Detrimental impact on access to medicines with attendant implications for health over the three to four years of the cartel. |
| South Africa | Distribution of citric fruits, 1999 | Reduced access to a key source of vitamins, necessary for warding off disease. |

### V.2.5 Effects of voluntary cooperation on the enforcement of national competition laws

The effect of potential multilateral provisions on voluntary cooperation will depend in part on whether those provisions are subsequently used. Here it is important to recognise that jurisdictions with a track record for active cartel enforcement are much more likely to be asked to provide assistance to or to cooperate with another jurisdiction. (For example, a nation is unlikely to receive a request for cooperation in discussing the so-called theory of a case if it has not been active in enforcing similar cases in the past.) Given that most enforcement actions against international anti-competitive practices have been undertaken by the industrialised countries, then developing countries and the least developed countries are unlikely to bear the brunt of most requests for cooperation should multilateral provisions on voluntary cooperation be agreed. In fact, the opposite is more likely with competition officials from the developing world seeking assistance from their more experienced counterparts in the industrialised countries. The recent experience of Brazil (see box 3 below) is instructive in this regard. It would seem, therefore, that if anything the implementation of multilateral provisions for voluntary cooperation would initially intensify such cooperation among industrial countries and less wealthy nations would probably be net demanders for such cooperation in the near term. As the latter gain more experience with enforcing competition laws, then requests for voluntary cooperation will increasingly flow in both directions.

**Box 3: Brazilian investigations into the lysine and vitamins cartels were triggered by public announcements from abroad and benefited from informal cooperation with US agencies**

In a submission to the 2002 OECD Global Forum on Competition, Brazil stated that:

"Despite the signature of the international agreement between Brazilian and North American Antitrust authorities [in 1999], the most valuable source of international cooperation continues being informal. Particularly in three important recent cartel cases, this type of technical assistance proved to be essential.

"The first one is the Lysine International Cartel. Two months before the signature of the above mentioned agreement, in September 1999, in the International Cartel Workshop in Washington DC, the US Department of Justice presented in detail their work in the Lysine International Cartel Case. After the case went to trial, the available material became public, [which] allowed the disclosure of relevant information to Brazilian antitrust officials.

Transcripts of the Lysine Cartel meetings sent to Brazilian authorities showed that Latin America and Brazil were included in the world market division set by the international cartel."

On the vitamins cartel, the Brazilian submission states:

"The second case, the Vitamins International Cartel Case, was also discovered by the US Department of Justice. Seae [the Brazilian Secretariat for Economic Monitoring] decided to initiate its own investigations after press releases announced the prosecution of this cartel in the United States. Notwithstanding, Seae's lack of expertise in hard core cartel investigations hindered further developments in the case."

Concerning issues of confidentiality and informal cooperation with the US authorities, the submission states:

"…the fact that the case ha[d] not gone to trial in the United States unabled [prevented] the shar[ing] of documents because of confidentiality restraints. Hence, all the cooperation remained informal.

"Nevertheless, some important hints provided by North American authorities were essential for the analysis of Brazilian officials. One important [piece of] information received by Seae was that the Vitamins Cartel operated very similarly to the Lysine Cartel…

"The second important hint was provided by an oral statement of a former director of a large vitamin producer. The director revealed that Latin American operations of the major vitamins companies were centralised in Brazil and helped Brazilian authorities to detect the whereabouts of former Latin American regional managers."

The submission goes onto describe how these two hints enabled the Brazilian authorities to assemble a case against the cartel members.

### V.2.6 Summary

This part has presented quantitative and qualitative evidence of the likely consequences of adopting the proposed multilateral framework on competition policy for various economic, social, and environmental indicators. With the possible exception of some of the least developed countries, for each country grouping the reduction in cartelisation and overcharges needed to justify increased outlays on cartel enforcement is very small. This finding alone suggests that the net impact on a national treasury of adopting the provisions of a proposed multilateral framework on competition policy is likely to be positive; in stark contrast to the fears about the implementation costs of adopting multilateral rules on the so-called "new issues" in the world trading system. These benefits for the government budget and for customers more generally are in addition to the positive impact on macroeconomic performance of greater rivalry between firms. Moreover, recent enforcement actions in developing countries suggest that there are also social and environmental benefits from greater enforcement of national cartel laws, although the evidentiary record here is far less developed.

## Part VI

# RECOMMENDATIONS FOR POLICYMAKERS AT CANCUN AND BEYOND

This chapter has presented an assessment of the potential consequences of adopting a multilateral framework on competition policy. This assessment may be of interest to policymakers as they decide whether to launch negotiations on competition policy at the WTO Ministerial in Cancun and, should negotiations be launched, afterwards. Moreover, as competition policy disciplines are increasingly being incorporated in to regional trading agreements, the issues and evidence described here will have some bearing on those matters too.

A feature of the analysis presented here is that it attempts to draw out implications of a multilateral framework on competition policy for key economic issues. Moreover, the available empirical evidence is marshalled to assess the strength of these linkages. This focus on the empirical record—and on what has and has not actually been proposed—underlies the following policy recommendations.

First, negotiations over the provisions of a multilateral framework on competition policy—as currently proposed—do not contain any traps for WTO members. Even the implementation costs of adopting such provisions are likely to be more than offset by savings that result from reductions in bid-rigging on government contracts; and plenty of evidence is available to suggest that bid-rigging is a significant concern for WTO members of all types. Moreover, the proponents of such a framework have explicitly recognised the need to preserve development-related policies—indeed, few of the policies that are typically associated with industrial policy would fall under the remit of a multilateral framework on competition policy.[165]

Second, launching negotiations on a multilateral framework on competition policy will not prevent WTO members from taking independent steps to enact or reform national competition law and enforcement practices; and so no domestic options are being foreclosed by the Ministerial decision in Cancun. Moreover, launching multilateral negotiations in an of itself will not constrain ongoing regional negotiations on competition policy provisions or developments in other international fora, such at the International Competition Network or at the Organisation for Economic Cooperation and Development.

Third, given the dozens of international cartels prosecuted since 1993, it is quite likely that adoption of a multilateral framework will result in a reduction in overcharges on international commerce of billons of dollars. As discussed in part IV of this chapter, the current proposals for a multilateral framework sensibly include provisions on voluntary cooperation and core principles that are central to ensuring that the provisions on hard core cartels are effective, while at the same time providing exporters with greater assurances of equal treatment in any enforcement actions.

Fourth, the benefits from adopting such a framework will depend in large part on the sectors covered and the prevalence of exclusions, exemptions, and the like. Nations with sizeable export interests might want to take a very hard line against those that wish to exclude government-sponsored cartels in national and international transportation sectors. Moreover, it is difficult to see an argument for retaining beggar-thy-neighbour legal provisions such as exemptions from national competition laws for export cartels.

Fifth, while scarcity of resources (financial, human, and other) may justify longer phase-in times for developing countries to comply with the provisions of a multilateral framework, it is hard to justify blanket carve outs to these provisions, including provisions against non-discrimination. Arguments for flexibility and progressivity should be based on identifiable and quantifiable constraints faced by developing countries, be reviewed on a periodic basis to see if the constraints are still binding, have a sound basis in fact and in economic logic, seek only that policy discretion which cannot be obtainable any other legal means.

[165] For a further elaboration of this point see Evenett (2003b, part I).

Sixth, the effective participation of all WTO members in negotiations for a multilateral framework for competition policy will require continued technical assistance and capacity building. These needs are, of course, likely to intensify should any meaningful framework be negotiated.

Finally, there is a strong case on conceptual and evidential grounds for launching negotiations on a multilateral framework on competition policy. That is not to say that these negotiations will necessarily bear fruit or that the evidentiary base is as detailed as one might like. But given the size of the overcharges that hard core cartels have inflicted on customers—firms, governments, as well as private consumers—over last few years, the question really ought be asked as to whether WTO members can afford not to launch a comprehensive negotiating effort to attack these pernicious anti-competitive practices that are eating away at the very benefits created by the world trading system.

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## Appendix: WTO Member Submissions to the Working Group on the Interaction Between Trade and Competition Policy since 2002

Submissions are organized by subject matter in the following order: transparency, non-discrimination, procedural fairness, hard core cartels, voluntary cooperation, capacity building, special and differential treatment, and more general remarks on competition and competition policy.

### Submissions on transparency

| Member | Proposals | Claims made in support of proposal | Evidence cited |
|---|---|---|---|
| **Australia**<br><br>WT/WGTCP/W/211<br>24 September 2002 | Transparency should include:<br>• publication of relevant laws;<br>• inquiry points for requests about laws;<br>• notification to the WTO of changes to laws;<br>• mechanisms for the review of competition decisions upon request;<br>• mechanisms for advising complainants about the status of a matter; and<br>• mechanisms for procedural transparency, to ensure that competition laws are administered in a reasonable, objective and impartial manner.<br>• Public Information<br>• Confidentiality<br>• Exemptions are okay, so long as they are done in a transparent way | • By having these principles in place, they could provide additional support for a competition agency to do its job properly without being influenced by 'non-competition' arguments<br>• this would provide a domestic consumer or business with easy access to legislative information and also provide avenues for making inquiries or complaints to a foreign regulator<br>• provide useful and necessary information about how and where to lodge complaints, what processes etc | ▪ OECD Joint Group on Trade and Competition's set of core principles include transparency, non-discrimination and procedural fairness.<br>▪ 1999 APEC Ministers endorsed the APEC Principles to Enhance Competition and Regulatory Reform |
| **Canada**<br><br>WT/WGTCP/W/226<br>12 March 2003 | • 'sufficiently' high standards of transparency should be adopted, standards which balance progressivity issues with the necessary technical assistance<br>• Obligations should be on Member states rather than private parties | • Transparency crucial to application of exemptions | Evenett, Simon J. (2003). *A Study of Issues Relating to a Possible Multilateral Framework on Competition Policy*, commissioned by the secretariat of the World Trade Organization. 23 February, 2003 |
| **China**<br><br>WT/WGTCP/W/227<br>14 March 2003 | • China supports the inclusion of transparency in a future multilateral framework<br>• Developing countries should be given enough time to build up their transparency and procedural fairness mechanisms progressively | • Transparency is in line with China's draft Law on Legislation and the Draft Anti-Monopoly Law<br>• The five areas of transparency outlined by the OECD will be too burdensome for governments of developing countries to adhere to | • OECD Secretariat, Core Principles in a Trade and Competition Context<br><br>• Thai submission, WT/WGTCP/W/213 |
| **European Community** | • Part of a transparency obligation would be a notification requirement for WTO members | | |

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| WT/WGTCP/W/222<br>19 November 2002 | to the Competition Policy Committee concerning their laws, regulations and guidelines of general application<br>• Sectoral exclusions – the EC suggest that a flexible approach would be to focus - at this stage - on the essential question of transparency and its application to sectoral exclusions and exemptions, as well as their review over time | | |
| **Hong Kong, China**<br><br>WT/WGTCP/W/224<br>5 March 2003 | • The scope of the transparency requirement must be identified. Two levels of transparency can be inferred from current WTO requirements:<br>o Publication<br>o Notification | • The scope of the transparency obligations has very different implications for Members. | OECD, COM/TD/DAFFE/CLP(2001)21, para.29 |
| **India**<br><br>WT/WGTCP/W/215<br>26 September 2002 | • Developing countries cannot be expected to adhere to the same standards as more developed ones in terms of transparency and procedural fairness<br>• Private firms must also be bound by transparency, e.g. they must surrender vital evidence regardless of whether or not it is confidential | • A system that has an inbuilt bias in favour of foreign suppliers cannot be said to be fair | |
| **Korea**<br><br>WT/WGTCP/W/212<br>24 September 2002 | • Desirable to define more clearly in a multilateral agreement the scope of the information subject to publication and notification obligations<br>• Efficient technical assistance should be extended to developing members to ensure their compliance to this obligation | | |
| **Switzerland**<br><br>WT/WGTCP/W/214<br>24 September 2002 | • Transparency is a Core Principle to be included in a Multilateral Competition Agreement<br>• The Swiss define this to mean that domestic and foreign firms should have similar access to competition authorities | • This will ensure an effective competition policy | |
| **Thailand**<br><br>WT/WGTCP/W/213<br>24 September 2002 | • Laws and regulations, exemptions, guidelines and competition authorities' decisions or court deliberations should be disclosed<br>• Each country should maintain the freedom to decide sectoral exemptions that are consistent with its own national industrial policy | | |

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| **USA**<br><br>WT/WGTCP/W/218<br>6 November 2002 | • none | • The US raises several questions in relation to the legality of transparency and non-discrimination in relation to existing GATT law | • background note by the WTO secretariat, June 1999 (WT/WGTCP/W/127)<br>• background note by the WTO Secretariat, "Modalities of Voluntary Cooperation" August, 2002 (WT/WGTCP/W/204)<br>• background note by the WTO Secretariat, "Modalities of Voluntary Cooperation" June, 2002 (WT/WGTCP/W/192)<br>• USDOJ and Federal Trade Commission, Antitrust Enforcement Guidelines for International Operations, April 1995 (www.usdoj.gov/atr/public/guidelines/internt.htm, )<br>• General Agreement on tariffs and Trade, 1947<br>• Federal Trade Commission, Performance Report Fiscal Year 2000, (http://www.ftc.gov/opp/gpra/prfy2000.pdf) |

**Submissions on non-discrimination**

| Member | Proposals | Claims made in support of proposal | Evidence cited |
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| **Australia**<br><br>WT/WGTCP/W/211<br>24 September 2002 | • Defines non-discrimination to be the application of competition principles in a manner that does not differentiate between or among economic entities on the basis of nationality. It relates to the behaviour and decisions made by the competition authority – i.e. that the competition law is applied in a non-discriminatory way<br>• Australia maintains a non-discriminatory approach to the administration of its competition law. However, there are other government policies that co-exist which have allowed the Government to meet other priorities and goals eg. foreign ownership restrictions on Australian media.<br><br>• As regards exemptions from Competition Law<br>- Exemptions must be in the public interest<br>- Subject to review<br>• Non discrimination in terms of enforcement cooperation entails that<br>- Cooperation between Australia and any other nation must be extended on equal terms to any third nation<br>- Exchange and handling of information should be done on a flexible and case-by-case basis | | |

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| **Canada**<br><br>WT/WGTCP/W/226<br>12 March 2003 | • Decisions of competition authorities or implementation of competition obligations should not be subject to scrutiny by dispute settlement panels<br>• Non-discrimination provisions should not be extended to cover existing or future cooperation agreements to avoid implications of MFN<br>• Obligations in a competition agreement should be on Member states, as opposed to private parties | | Evenett, Simon J. (2003). *A Study of Issues Relating to a Possible Multilateral Framework on Competition Policy*, commissioned by the secretariat of the World Trade Organization. 23 February, 2003 |
| **China**<br><br>WT/WGTCP/W/227<br>14 March 2003 | • The flexibility for developing members as provided in the existing WTO Agreements related to competition policy is inadequate | • There is a conflict between competition policy and our industrial and development policy objectives<br>• Distinctions by developing countries in the treatment offered to domestic enterprises as compared to that of foreign enterprises will not be completely avoidable | OECD Secretariat, Core Principles in a Trade and Competition Context<br><br>Thai submission, WT/WGTCP/W/213 |

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| **European Community**<br><br>WT/WGTCP/W/222<br>19 November 2002 | • Suggest a binding core principle that *de jure* discrimination be adopted in the domestic competition law framework<br>• need for the inclusion of the non-discrimination principle in a WTO framework agreement on competition by way of a separate, specific provision, which would take into account the particularities of competition law and policy | • The main reason for limiting WTO provisions to *de jure* discrimination is that, when transposed to a competition context, the concept of *de facto* discrimination could raise complex questions about the enforcement policies, priorities and prosecutorial discretion of competition authorities, including how competition law is being applied to individual cases. | |
| **Hong Kong, China**<br><br>WT/WGTCP/W/224<br>5 March 2003 | • Certain areas of non-discrimination, if implemented, may cause problems for developing countries | • Horizontal and sectoral exemptions and exceptions from non-discrimination exist within developing countries and these may not be fully-consistent with non-discrimination | OECD, COM/TD/DAFFE/CLP(2001)21, para.29 |
| **India**<br><br>WT/WGTCP/W/216<br>26 September 2002 | • Violations of national treatment principle in relation to competition laws are likely to be beneficial to the economic development of developing countries and competition within them | • Less strict application of competition laws in developing countries would prevent wastage and under-utilisation of scarce resources. Firms need to achieve a minimum threshold size to finance their research and development activities<br>• Competition policy that ostensibly applies to all members equally is likely in practice to discriminate against firms in developing countries<br>• Non-discrimination has not been uniformly applied in GATS so no reason it should be uniformly applied under a competition agreement | |
| **Japan** | • Bilateral agreements should be indicated as | • This will avoid "misinterpretations" | |

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| WT/WGTCP/W/217<br>26 September 2002 | exceptions to non-discrimination | | |
| **Korea**<br><br>WT/WGTCP/W/212<br>24 September 2002 | • National treatment and MFN should be applied in a "straightforward" way to competition policy<br>• Multilateral agreement should focus on de jure rather than de facto discrimination | • In terms of de facto versus de jure discrimination, discrimination may only be assessed with regard to what is written into law and based solely on nationality | |
| **Switzerland**<br><br>WT/WGTCP/W/214<br>24 September 2002 | • Non-discrimination is a core principle to be included in a Multilateral Competition Agreement<br><br>• Some exemptions and exclusions should be possible especially in relation to industrial policy, if dealt with in a clear and transparent way<br>o Principle of national treatment needs to be more restricted | • This will ensure an effective competition policy | |
| **Thailand**<br><br>WT/WGTCP/W/213 Rev.1<br>26 September 2002 | • Developing countries should be allowed to exempt national and international export cartels | • Combined strength required to counter the bargaining strength of larger buyers from developed countries | |
| **USA**<br><br>WT/WGTCP/W/218<br>6 November 2002 | • none | • questions legality of transparency and non-discrimination in relation to existing GATT law | • background note by the WTO secretariat, June 1999 (WT/WGTCP/W/127)<br>• background note by the WTO Secretariat, "Modalities of Voluntary Cooperation" August, 2002 (WT/WGTCP/W/204)<br>• background note by the WTO Secretariat, "Modalities of Voluntary Cooperation" June, 2002 (WT/WGTCP/W/192)<br>• USDOJ and Federal Trade Commission, Antitrust Enforcement Guidelines for International Operations, April 1995 (www.usdoj.gov/atr/public/guidelines/internt.htm, )<br>• General Agreement on tariffs and Trade, 1947<br>• Federal Trade Commission, Performance Report Fiscal Year 2000, (http://www.ftc.gov/opp/gpra/prfy2000.pdf) |

## Submissions on procedural fairness

| Member | Proposals | Claims made in support of proposal | Evidence cited |
|---|---|---|---|
| **Australia**<br><br>WT/WGTCP/W/211<br>24 September 2002 | Characteristics of procedural fairness are as follows:<br>• Due process<br>- Rights of complainants to petition competition authorities to take action and to seek explanations for inaction on matters.<br>- Rights of complainants to bring complaints before the competition authority.<br>- Rights of private parties to directly access the judicial system to seek remedies for injury suffered by anticompetitive practices.<br>- Due process for all parties in administrative or judicial procedures including protection of confidential information.<br>- Where competition authorities make dispositive case decisions, publication/explanation of such decisions by the competition authorities should be required.<br>- All parties should have appropriate access to avenues of appeal.<br>• Accountability<br>• Predictability<br>• Independence | | |
| **Canada**<br><br>WT/WGTCP/W/226<br>12 March 2003 | • Certain basic provisions for procedural fairness should be enumerated in a WTO agreement<br>- Notice of charges, fair and equitable proceedings and an appeal process could be sufficient<br>• Obligations should be on Member states rather than private parties | • Adoption and adherence to these basic provisions will provide assurances to private parties that proper procedures are being followed | Evenett, Simon J. (2003). *A Study of Issues Relating to a Possible Multilateral Framework on Competition Policy*, commissioned by the secretariat of the World Trade Organization. 23 February, 2003 |
| **China**<br><br>WT/WGTCP/W/227<br>14 March 2003 | • Each member is entitled to design, establish and maintain its own procedural system that is suitable to its specific national conditions and in accordance | • Procedural fairness pertains to legal provisions, including many complicated operational and technical practices, which are not | OECD Secretariat, Core Principles in a Trade and Competition Context<br><br>Thai submission, WT/WGTCP/W/213 |

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| | with its level of development | easily resolved by developing nations | |
| **European Community**<br><br>WT/WGTCP/W/222<br>19 November 2002 | • effective and adequate domestic remedies,<br>• Such "rights of defence" in favour of firms involved in administrative proceedings before a competition authority could include for instance:<br>o the right for parties to proceedings under the domestic competition law to have access to the agency or court applying the law and to be informed of the objections of the authority to their conduct.<br>o the right for such parties to express their views within a fair and equitable procedure in advance of an adverse decision addressed to them.<br>o The right to be notified of a reasoned final decision detailing the grounds on which such a decision is based.<br>o The right to appeal such administrative decisions by competition authorities and to have them reviewed by a judicial body.<br>• There need to be legal and practical limitations on what information can be exchanged to protect confidential information | | |
| **Hong Kong, China**<br><br>WT/WGTCP/W/224<br>5 March 2003 | • The unique features of individual regimes should be taken into account when designing rules on procedural fairness | • Appeal and review proceedings involved in a due process can be very costly to developing members<br>• Stringent obligations are likely to create costly or insurmountable compliance problems | • Korea submission, WT/WGTCP/W/212 |

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| **Switzerland**<br><br>WT/WGTCP/W/214<br>24 September 2002 | • Due Process is a core principle which needs to be included in a Multilateral Competition Agreement | • It will ensure an effective competition policy | |
| **Korea**<br><br>WT/WGTCP/W/212<br>24 September 2002 | • Competition laws should apply equally to foreign and domestic persons<br>• All parties have the right of appeal<br>• Domestic and foreign parties may appeal to and request remedy measures from competition authorities or courts against anti-competitive practices<br>• Proceedings must go forward in a timely fashion and ensure prompt measure<br>• Rules should define the disclosure responsibilities of private entities in a competition case | • Prompt judgments protect rights and prevent uncertainty or excess costs from delays accruing to applicants | • TRIPS agreement |
| **Thailand**<br><br>WT/WGTCP/W/213 Rev.1<br>26 September 2002 | • Each country should design its own appeal process and confidential information protection schemes<br>• Developing countries be allowed to gradually introduce greater transparency | | • Thai Trade Competition Act, 1999 |
| **USA**<br><br>WT/WGTCP/W/219<br>6 November 2002 | • None | • Raises issues to be considered by the membership in deciding upon procedural fairness | |

## Submissions on hard core cartels

| Member | Proposals | Claims made in support of proposal | Evidence cited |
|---|---|---|---|
| **Australia**<br><br>WT/WGTCP/W/198<br>26 July 2002 | | • Hard-core cartels are the most insidious form of anti-competitive conduct and must be stopped | • OECD Council Recommendation on HCCs, 1998<br>• OECD, Nature and Impact of Hard-Core Cartels and Sanctions against Cartels under National Competition Laws |
| **Canada**<br><br>WT/WGTCP/W/201<br>12 August 2002 | • None (poses questions instead) | | "Private International Cartels and Their Effect on Developing Countries" by Margaret Levenstein and Valerie Suslow<br><br>OECD "New Initiatives, Old Problems" (23 March 2000) |
| **Canada**<br><br>WT/WGTCP/W/226<br>12 March 2003 | • Agreement should include a clear statement that hard core cartels are prohibited<br>- Balance between cartels that are banned and those that are allowed as pro-competitive arrangements or partnerships<br>• Should include domestic and international cartels<br>• Means of cartel prosecution to be at the discretion of individual members<br>• Obligations should be on Member states rather than private parties | • Domestic cartels are as damaging as international ones | Evenett, Simon J. (2003). *A Study of Issues Relating to a Possible Multilateral Framework on Competition Policy*, commissioned by the secretariat of the World Trade Organization. 23 February, 2003 |
| **European Community**<br><br>WT/WGTCP/W/193<br>1 July 2002 | • The EC believes that a global competition concern such as the fight against pernicious hardcore cartels is best addressed by a firm response in the form of an international commitment to ban such practices<br>• A multilateral ban on hardcore cartels would be implemented by means of corresponding domestic legislation and policies<br>• A provision regarding hardcore cartels in a multilateral agreement should have the following:<br>o A clear statement that hardcore cartels are prohibited<br>o A definition of what types of | • Such a ban should be included in a WTO competition agreement as nowhere else would it have the backing of a sufficient number of countries. Any alternative would run the risk of cartels seeking to shift the focus of their illegal behaviour to countries not adhering to the ban, in an attempt to escape the jurisdiction of those countries that do prohibit cartels. The main consequence of this | • OECD Hard Core Cartel Report (2000)<br>• *"An inside look at a cartel at work: common characteristics of international cartels"*, by the US Department of Justice<br>• *"Hard Core Cartels" (2000)*, Organisation for Economic Co-operation and Development<br>• *"Private International Cartels and Their Effect on Developing Countries"* by Margaret Levenstein and Valerie Suslow<br>• World Development Report 2001 background paper<br>• WTO Symposium on 22 April 2002 by Simon J. Evenett<br>• WTO Symposium on 22 April 2002 by Professor Frederic Jenny |

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| | anti-competitive practices could be qualified as "hard-core cartels<br>o An accurate description of the limits of the concept of hardcore cartels, in order to be able to decide which practices should not be covered by the multilateral ban<br>o An inclusion of suitably effective sanctions<br>o Voluntary cooperation and exchange of information between jurisdictions<br>o Be transparent | "forum shopping" would be greater damage to the countries not adhering to the ban | |
| **Hong Kong, China**<br><br>WT/WGTCP/W/224<br>5 March 2003 | • Further deliberations are required on whether a future multilateral competition framework should cover hard core cartels | • If the obligations are prescriptive, developing members will face severe compliance problems<br>• The burden of adjustment will fall upon developing Members because the developed ones already have institutional capacity and basic legislation in place | |
| **Japan**<br><br>WT/WGTCP/W/217<br>26 September 2002 | • Hard core cartels should be globally banned | • The ban should be based on the universal recognition of the harmful effects of hard core cartels | |
| **Korea**<br><br>WT/WGTCP/W/200<br>12 August 2002 | • Definition of hard core cartels should be clear and applicable<br>• Require each member at minimum to prohibit hard core cartels and have procedures or provisions for sanctions and remedies<br>o Sanctions that ensure deterrence<br>o Enforcement procedures and institutions with the power to detect and remedy such cartels<br>• Peer review mechanism should be | • Must provide practical guidance to regulations and obligations of Agreement<br>• Flexible approach necessary for less experienced members, development objectives and differences in legal systems | • United Nations' Set of Principles and Rules on Competition (Set)<br>• OECD Council, 1998 Recommendation of the Council Concerning Effective Action Against Hard Core Cartels (C(98)35/FINAL) |

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| | implemented to improve regulations, learn from member experiences and contribute to a common understanding<br>• Flexible approach warranted | | |
| **Korea**<br><br>WT/WGTCP/W/225<br>5 March 2003 | • There must be a clear statute against hardcore cartels<br>• Must be an authoritative agency that can make independent judgments from the perspective of competition law<br>• There should be procedural guarantees to ensure sufficient level of sanctions and remedies on hardcore cartels<br>• It is not always essential to have a specialized competition law or a separate specialized agency to achieve this<br>• A transitional period for developing countries could be provided for, but only on a temporary basis | | |
| **Mexico**<br><br>WT/WGTCP/W/196<br>14 August 2002 | • Mexico supports the prohibition of hard core cartels | • Hard core cartels have caused much damage (listed in document) to Mexico's economy | • Reference to the pro-competition effect of Mexico's Federal Competition Commission (CFC) and Federal Law on Economic Competition (LFCE) |
| **Switzerland**<br><br>WT/WGTCP/W/194<br>28 June 2002 | • Supports the adoption of a minimum standard for fighting hard core cartels | • It will be difficult for a single competition authority in one nation to successfully prosecute an internationally operating cartel<br>• Bilateral agreements demand time-consuming often-expensive negotiations and implementation measures.<br>• Multilateral cartels may affect other or more countries than are covered by a bilateral agreement | • OECD Competition Committee, Working Party 3, survey of more than 100 cartel cases<br>• Suslow, Levenstein, "Private International Cartels and Their Effect on Developing Countries", World Bank Development Report, 2001<br>• OECD, Annual Report on Switzerland 2001-2002<br>• Havana Charter<br>• OECD Global Forum on Trade, June 2002 |
| **Thailand**<br><br>WT/WGTCP/W/213 | • Thailand believes that international cartels *do not* have a development justification and thus should not be | | • OECD, Competition Policy in Liner Shipping: Final Report, 2002 |

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| 24 September 2002 | included, and should be removed from, the list of sectoral anti-trust exemptions | | |
| **Thailand**<br><br>WT/WGTCP/W/213 Rev.1<br>26 September 2002 | • Thailand believes that international cartels *rarely* have a development justification and should be removed from the list of sectoral anti-trust exemptions | | • OECD, Competition Policy in Liner Shipping: Final Report, 2002 |
| **Thailand**<br><br>WT/WGTCP/W/205<br>15 August 2002 | • Cooperation to fight hard core cartels should include:<br>o Notification<br>▪ Promptly alert concerned authorities in affected countries<br>o Mandatory consultation<br>▪ Engage other governments who may be affected by a discovered cartel<br>o Assistance<br>▪ Cooperation in information, experience and suggestions<br>• Mutual legal assistance should be a medium term goal<br>• Exchange of non-confidential information is recommended | • Without positive comity agreements, developing countries are likely to continue to be victimized by collusive practices | World Bank, World Development Report 2001 |
| **USA**<br><br>WT/WGTCP/W/203<br>15 August 2002 | • Members may wish to consider:<br>o Publicly condemning hard core cartels<br>o Maintaining anti-cartel sanctions of deterrent value<br>o Establish domestic enforcement procedures and institutions sufficient to permit investigation, adjudication and remedy of cartel activities | | • Doha Ministerial Declaration, paragraph 25<br>• OECD cartel recommendation |
| **OECD** | • Investigative tools should include<br>o Leniency Programs | • Cartels are not associated with any legitimate | • Levenstein, Margaret, Valerie Suslow (2001) Background Paper for the World Bank's World Development Report 2001 |

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| WT/WGTCP/W/207<br>15 August 2002 | ○ Sanctions<br>▪ the fines against those that are prosecuted should be at least two or three times the gain,<br><br>• supports exclusions from the agreement of "agreements, concerted practices, or arrangements that<br>○ (i) are reasonably related to the lawful realisation of cost-reducing or output-enhancing efficiencies,<br>○ (ii) are excluded directly or indirectly from the coverage of a Member country's own laws, or<br>○ (iii) are authorised in accordance with those laws."<br>• Sanctions should reflect the fact that potential cartel participants will tend to discount the expected costs of penalties by some factor that represents their view on the likelihood of detection and punishment.<br>• | economic or social benefits that would justify the harm it causes<br>• The harm from cartels falls on developed and developing countries alike<br>▪ The most successful approaches include those that have been based on the cartel members ' total turnover or gross revenues, or on the volume of commerce affected by the cartel. | "Private International Cartels and Their Effect on Developing Countries."<br>• OECD Competition Committee, Report On The Nature And Impact Of Hard Core Cartels And Sanctions Against Cartels Under National Competition Laws, available at http://www.oecd.org/pdf/M00028000/M00028445.pdf |
| **UNCTAD**<br><br>WT/WGTCP/W/197<br>15 August 2002 | • Hard core cartels should not be exempt from national laws<br>○ This prohibition does not exist with respect to price undertakings made by sovereign states (Sovereign Acts of State) with respect to a basic commodity such as oil, for example | | • United Nations Set of Principle and Rules on Competition (Article 9, Section B) |

**Submissions on voluntary cooperation**

| Member | Proposals | Claims made in support of proposal | Evidence cited |
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| **Australia**<br><br>WT/WGTCP/W/199<br>26 July 2002 | • Voluntary cooperation is both necessary and desirable<br>- Informal networks between agencies should be used for the exchange of non-confidential (but not necessarily public) information<br>- Formal antitrust treaties should be used for exchange of confidential information | • Actions against anti-competitive practices can be less rigorous than others in some countries, therefore formalized exchanges of confidential information are preferable.<br>• Convergence of laws and procedures, as well as cooperation between agencies in this context, has the potential to simplify processes, reduce time delays and therefore lower the costs of compliance for the companies involved<br>• Effective domestic enforcement of competition rules is based on having adequate and correct information to determine whether unlawful conduct has taken place; the same is true internationally<br>• With increasing globalization, it is more possible than ever for anti-competitive conduct to transcend national boundaries and have an adverse effect on domestic markets | • As noted in paragraph 13 of the Secretariat paper (WT/WGTCP/W/191), "international cartels are unlikely to respect the neatly defined territories covered by existing bilateral agreements" |
| **Canada**<br><br>WT/WGTCP/W/202<br>12 August 2002 | • Canada takes the view that a WTO Competition Policy Committee should be established. It should<br>- Provide a forum for exchange of information<br>- Coordinate or monitor technical assistance<br>- Examine the interaction between competition policy and international trade policy issues<br>- Provide a forum for non-binding peer review<br>- Consider the long term vision of enhanced cooperation | • Cooperation is integral to a multilateral agreement on competition policy | |
| **Canada**<br><br>WT/WGTCP/W/226 | • Cooperation should be voluntary<br>• The framework for cooperation does *not* need to be flexible<br>• Voluntary cooperation does not need to be | • Certain complementarities exist between different types of anticompetitive activities<br>• A committee could provide a forum | Evenett, Simon J. (2003). *A Study of Issues Relating to a Possible Multilateral Framework on Competition Policy*, commissioned by the secretariat of the World Trade Organization. |

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| 12 March 2003 | limited to cartels<br>• The international community could envisage a competition policy committee as a means of enhancing cooperation. | for information exchange, technical assistance coordination and monitoring, peer review, and providing a long term vision of cooperation<br>• Peer review provides a non-adversarial forum to query and better understand other country policies and practices | 23 February, 2003 |
| **European Community**<br><br>WT/WGTCP/W/222<br>19 November 2002 | • Provisions on non-discrimination should not be extended to cover existing or future cooperation arrangements in the competition area, including bilateral cooperation agreements on competition. Nor should they be extended to cover consultation and cooperation provisions contained in bilateral or regional free trade agreements | • Were such a limitation not to be placed on the non-discrimination core principle, situations could occur whereby one or more WTO members not parties to a bilateral cooperation agreement would seek to avail themselves of the provisions of such an agreement by invoking MFN.[166] | See also WT/WGTCP/W/184 |
| **European Community**<br><br>WT/WGTCP/W/184<br>22 April 2002 | • Two types of cooperation provisions are required for the proposed agreement<br>- provisions to facilitate case-specific cooperation<br>- provisions relating to general exchanges of information<br>• cooperation should be undertaken in close alliance with other relevant international organisations such as UNCTAD, the World Bank and bilateral donors and could only complement the primary role of the WTO, namely that of establishing binding rules and multilateral cooperation modalities | • The WTO can make an important contribution towards the development of a reinforced and better co-ordinated approach to technical assistance in the competition field | UNCTAD, TD/B/COM.2/CLP/21, para. 32 |
| **Hong Kong, China**<br><br>WT/WGTCP/W/224<br>5 March 2003 | • Members will need to make a realistic assessment of the breadth and depth of possible obligations under a future competition agreement | • Members need more information before deciding whether or not they are capable of taking on the obligations involved<br>• Developing members are frequently targeted to provide cooperation assistance to developed members, | |

[166] By the proposed limitation of the non-discrimination principle the ensuing situation would in essence be that which would prevail under normal rules of public international law, cf. Article 34 of the Vienna Convention on the Law of Treaties according to which; "A treaty does not create either obligations or rights for a third State without its consent", and, Article 36 (1) according to which; "A right arises for a third State from a provision of a treaty if the parties to the treaty intended the provision to accord that right either to the third State, or to a group of States to which it belongs, or to all states, and the third State assents thereto. Its assent shall be presumed so long as the contrary is not indicated, unless the treaty otherwise provides."

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| | | creating tremendous burdens for the former. | |
| **Japan**<br><br>WT/WGTCP/W/195<br>12 August 2002 | • Japans suggests three levels for cooperation at an international level<br>  ○ Support for capacity building<br>  ○ Information and experience exchange<br>  ○ Cooperation on individual cases, involving<br>  ▪ Notification<br>  ▪ Enforcement cooperation through information exchange<br>  ▪ Enforcement coordination<br>  ▪ Positive comity<br>  ▪ Comity<br>• Japan is concerned that international cooperation should not take precedence over bilateral cooperation | • A competition authority in a single country will experience difficulties addressing cross-border issues | • Japan-Singapore Economic Partnership |
| **Korea**<br><br>WT/WGTCP/W/225<br>5 March 2003 | • Cooperation should take the form of capacity building and technical assistance where the countries with more experience in competition law enforcement help developing countries enhance the level of competition law enforcement<br>• A requested country should respond to requests to cooperate. If its response is a refusal, then sufficient reasons should be provided for not cooperating<br>• Cooperation can take the form of<br>  ○ Information and evidence exchange<br>  ○ Positive and Negative comity<br>  ○ Coordinated law enforcement<br>• It would be desirable to set up a Competition Policy Committee to<br>  ○ Facilitate the exchange of information<br>  ○ Conduct 'peer' reviews<br>  ○ Evaluate technical assistance programs | • There is a substantial gap between different levels of competition law enforcement and institutional development between Members<br>• Korea believes that effective world-wide regulation of hardcore cartels will be possible when voluntary cooperation between the developed and developing worlds becomes more vigorous | |

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| **Thailand**<br><br>WT/WGTCP/W/205<br>15 August 2002 | • Multilateral cooperation is the favourable alternative for developing economies<br>• Cooperation to fight hard core cartels should include:<br>  ○ Notification<br>  ▪ Promptly alert concerned authorities in affected countries<br>  ○ Mandatory consultation<br>  ▪ Engage other governments who may be affected by an uncovered cartel<br>  ○ Assistance<br>  ▪ *Required* cooperation in information, experience and suggestions<br>• Mutual legal assistance should be a medium term goal<br>• Exchange of non-confidential information is recommended | • Without positive comity agreements, developing countries are likely to continue to be victimized by collusive practices | World Bank, World Development Report 2001 |
| **USA**<br><br>WT/WGTCP/W/204<br>15 August, 2002 | • None | • Antitrust cooperation can be very beneficial in minimizing conflict, enhancing enforcement effectiveness and promoting analytical convergence | • OECD, Revised Recommendation of the Council Concerning Co-Operation Between Member Countries on Anti-Competitive Practices Affecting International Trade, July 1995 (C(95)/Final)<br>• OECD, Revised Recommendation of the Council Concerning hard Core cartels (C(98)35/Final) |
| **OECD**<br><br>WT/WGTCP/W/208<br>17 September 2002 | • There are three basic forms of voluntary co-operation<br>  ○ traditional comity<br>  ○ investigatory assistance<br>  ○ positive comity<br>• Three general principles for voluntary cooperation are<br>  ○ notification<br>  ○ co-ordination<br>  ○ cooperation | | • *Information Sharing in Cartel Cases – Suggested Issues for Discussion and Background Material*, CCNM/GFC/COMP(2002)2, 24 January 2002; available at: http://www.oecd.org/competition.<br>• International Co-operation in Mergers: Summary of Responses to Questionnaire to Invitees and Suggested Issues for Discussion, CCNM/GFC/COMP(2002)6; available at: http://www.oecd.org/competition. |

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| **UNCTAD**<br><br>WT/WGTCP/W/197<br>15 August 2002 | • Voluntary cooperation would consist of<br>  ○ Consultations<br>  ○ Peer reviews | | |

## Submissions on capacity building

| Member | Proposals | Claims made in support of proposal | Evidence cited |
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| **Australia**<br><br>WT/WGTCP/W/190<br>29 May 2002 | • None | Australia recognises the importance of inter agency co-operation in regard to technical assistance and capacity building in the field of competition policy, particularly to the exchange of experience in developing countries, the best way of meeting those needs and identifying specific opportunities that maximize cooperation and coordination. This can be effected by<br>• Participation in international fora<br>• Participation in international organisations | WT/WGTCP/W/125 and WT/WGTCP/W/148 |
| **European Community**<br><br>WT/WGTCP/W/223<br>27 February 2003 | • Detailed tabulation of all technical assistance projects currently funded by the European Community | | |
| **European Community**<br><br>WT/WGTCP/W/184<br>22 April 2002 | • The EC has found that targeted and coordinated technical assistance for capacity-building purposes to boost and upgrade the human and institutional framework of developing country competition law implementation and enforcement is indispensable and could be reinforced by a WTO competition agreement.[167]<br><br>• key principles for a reinforced approach to technical assistance include the following:<br>- greater support to technical assistance in the competition field<br>- an integrated approach to technical assistance<br>- convergence towards "best practices"<br>- the development of a "model work programme"<br>enforcement assistance for developing | • Anti-competitive practices are rarely confined to merely one jurisdiction<br><br>• An integrated approach will ensure | |

[167] This type of technical assistance should be seen as separate and distinct from that which will be provided for purposes of enabling developing countries to participate effectively in future WTO negotiations on competition.

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| | countries affected by cartels domestically and abroad | continuous and coherent support for developing countries and transitional economies at different stages of the development of a domestic competition regime | |
| **Egypt**<br><br>WT/WGTCP/W/187<br>29 May, 2002 | Developed countries should assist in<br>• developing locally appropriate competition legislation<br>• funding the implementation of a competition law<br>• encouraging a competition culture | • Different countries have different needs and capacity building should take place on a country-by-country basis | |
| **Japan**<br><br>WT/WGTCP/W/217<br>26 September 2002 | • Proper technical assistance and capacity building must be carried out | • This will ensure that each participating country has more than a "certain level" of the core principles | |
| **Japan**<br><br>WT/WGTCP/W/186<br>19 June 2002 | • Members should respect different approaches to competition policy from different members<br>• Adequate technical assistance must be provided<br>• Common principles must be agreed upon between donor and recipient | • Japan's experience assisting numerous developing nations has convinced it of the soundness of this approach | • APEC, 1996 "Working Group on Competition Policy and Deregulation"<br>• APEC, 1999 Ministerial Meeting "APEC Principles to Enhance Competition and Regulatory Reform" |
| **Romania**<br><br>WT/WGTCP/W/181<br>17 April 2002 | • Developing and least developed nations require enhanced support for technical assistance<br>• Technical assistance takes place on two levels:<br>o Discussion of theory and models for competition law and policy<br>o Implementation of competition laws, conduct of investigations and market definition | • To obtain the best results from a competition agreement, international organizations must better integrate the developing countries into the international economic system | Lester Thurow (Ed.), "Head to Head", Warner Books, 1993 |
| **Romania**<br><br>WT/WGTCP/W/181/Rev.1<br>22 April, 2002 | | • When countries with successful experiences in operating competition law join these efforts and share their experiences and know-how, the effort of developing nations is much easier | • OECD Competition Law and Policy Committee<br>• OECD, Global Forum on Competition, October, 2001<br>• International Competition Network, October 2001<br>• WTO, Conclusions of the Ministerial Conference, Doha, 2001<br>• UNCTAD, Set of Principles and Rules for the Control of Restrictive Business |

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| | | | Practices |
| **Thailand**<br><br>WT/WGTCP/W/188<br>29 May 2002 | • Capacity building programs should include<br>  o Long-term commitments of 2 – 5 years<br>  o Local needs addressed in a local language<br>  o Flexibility<br>  o Building institutional knowledge by transferring know-how in training<br>• Development of transparent and fair procedures in recipient countries<br>• Sector specific bodies should be involved in the capacity building<br>• Public awareness needs to be built<br>• There should be a particular emphasis on provincial business and consumer communities<br>• Civil organizations such as consumer organizations and the media should be targeted for education as well. | • Short term programs ineffective<br>• In terms of flexibility, locally initiated projects could help advocate competition<br>• Institutional knowledge allows recipient countries to train the trainers and acquire practical know-how<br>• Sector specific bodies ensure consistency across various sectors of the economy<br>• Provincial business are more prone to anti-competitive abuses<br>• Important to build a wide constituency of actors across society to ensure success of competition policy | • World Bank provided drafting expertise for rules and regulations on abuse of dominance which were translated into Thai |
| **USA**<br><br>WT/WGTCP/W/185<br>22 April 2002 | • Characteristics of an effective technical assistance program for antitrust enforcement should include the following:<br>  o Focus on cartels<br>  o Focus on market barriers rather than prices<br>  o Focus on competition concerns only in assessing mergers and acquisitions, ignoring political and social concerns.<br>• Effective antitrust laws should:<br>  o Be effective remedies that act as deterrents<br>  o Be well designed institutions resistant to failure<br>  o Balance between the antitrust authorities and the judiciary<br>  o Provide prosecutorial discretion<br>  o Provide appropriate and realistic deadlines for official action<br>  o Withstand institutional | • New antitrust agencies can benefit from the technical assistance provided by more experienced antitrust authorities | • William E. Kovacic, *Antitrust and Competition Policy in Transition Economies: A preliminary assessment* in Annual Proceedings of the Fordham Corporate Law Institute 537 (Hawk, ed., 2000 Ch. 23) |

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| | demands created by a legislative mandate<br>• Supporting institutions are essential for effective antitrust enforcement | | |

## Submissions on special and differential treatment

| Member | Proposals | Claims made in support of proposal | Evidence cited |
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| **China**<br><br>WT/WGTCP/W/227<br>14 March 2003 | • Special and Differential Treatment should be accorded to developing countries in all respects including least developed countries | | OECD Secretariat, Core Principles in a Trade and Competition Context<br><br>Thai submission, WT/WGTCP/W/213 |
| **Hong Kong, China**<br><br>WT/WGTCP/W/224<br>5 March 2003 | • Special and differential treatment should be a part of any multilateral framework on competition (implied) | • Developing countries face special challenges in establishing effective competition laws and policies attributable to problems developing a competition culture, weak enforcement capabilities, markets characterized by high concentration and historical state intervention | OECD, COM/TD/DAFFE/CLP(2001)21, para.29 |
| **India**<br><br>WT/WGTCP/W/215<br>26 September 2002 | • Developing countries cannot be expected to adhere to the same standards as more developed ones in terms of transparency and procedural fairness<br>• Private firms must also be bound by transparency, e.g. they must surrender vital evidence regardless of whether or not it is confidential | • A system that has an inbuilt bias in favour of foreign suppliers cannot be said to be fair | |
| **Thailand**<br><br>WT/WGTCP/W/213 Rev.1<br>26 September 2002 | • Special and differential treatment constitutes the fourth element of the core principles for competition policy<br>• Priority of core principles be focused on tackling cross-border, rather than domestic, trade | • Will guarantee effective enforcement and fair treatment to all parties involved | |

## Submissions containing more general remarks on competition and competition policy-related matters

| Member | Proposals | Claims made in support of proposal | Evidence cited |
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| **Argentina**<br><br>WT/WGTCP/W/206<br>27 August 2002 | • Supports openly competitive markets<br>• Supports the creation of a competition agency | • Argues that the risk of cartel arrangements is inversely proportional to the level of competition in a market. | • Commerce of Ancient Greece<br>• German legislative reform to competition post-1947<br>  ○ the *Bundeskartellamt* – an institution independent of political power that has significantly contributed to Germany's development and has gained unquestionable international repute |
| **Canada**<br><br>WT/WGTCP/W/183<br>19 April 2002 | Two principles should ideally underpin the early policy choices with regard to competition policy and its development<br>• the concept of economic efficiency, and<br>• the protection of competition and the competitive process, not competitors | • the primary objective of technical assistance is to encourage the elaboration and adoption of welfare-enhancing, economy-wide competition rules that will promote a solid basis for growth and development | Caves, Frankel and Jones in *World Trade and Payments* |
| **European Community**<br><br>WT/WGTCP/W/222<br>19 November 2002 | • A multilateral competition framework should<br>  ○ establish a solid basis for dealing with basic competition policy issues<br>• a WTO competition agreement should *not* imply harmonisation of domestic competition laws and should be able to accommodate differences in national legal systems, as well as in institutional capacities | | |
| **Hong Kong, China**<br><br>WT/WGTCP/W/224<br>5 March 2003 | • There is little if any systematic evidence that significant improvements in the performance of developing economies result from the adoption of a competition law<br>• Sufficient flexibility has to be incorporated into any possible MFC to make it workable and acceptable to the wide membership | | • IMF methodology |
| **Japan**<br><br>WT/WGTCP/W/217<br>26 September 2002 | • Certain flexibility must be allowed in the implementation of a competition agreement | • This is because of "divergencies" in each participating country | |

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| **Korea**<br><br>WT/WGTCP/W/189<br>21 June 2002 | • The minimum requirements for competition law should include<br>o prohibition of hard core cartels<br>o prohibition of vertical restraints<br>o restraints on abuse of dominant market position<br>o prohibition of mergers and acquisitions through the competition system<br>o competition advocacy system<br>o competition regulations and exemptions<br>o rules of process for enforcing competition law | • The core policy of competition policy will be the introduction and enforcement of a competition law which strengthens competitiveness and increases consumer welfare | • Makes reference to Korea's competition commission KFTC |
| **Korea**<br><br>WT/WGTCP/W/225<br>5 March 2003 | • Desirable to set up a Competition Policy Committee to<br>o Facilitate the exchange of information<br>o Conduct 'peer' reviews<br>o Evaluate technical assistance programs | | |
| **New Zealand**<br><br>WT/WGTCP/W/210<br>24 September 2002 | • A multilateral agreement must preserve flexibility at the national level<br>• Exemptions and exceptions should be allowed but implemented in a manner which minimizes economic distortions | • A flexible approach is necessary in recognition of the diversity of circumstances of WTO Member countries | • WTO Secretariat, 7th June 1999 "The Fundamental Principles of Competition Policy" WT/WGTCP/W/127<br>• "APEC Principles to Enhance Competition and Regulatory Reform" |
| **South Africa**<br><br>WT/WGTCP/W/220<br>5 November 2002 | • None | • Principles of transparency, non-discrimination and procedural fairness are reflected in all administrative practice, including competition policy, which has enhanced the credibility of the South African competition authorities and helped promote a competition culture<br>• There is room for positive discrimination in South African law without countenancing discrimination against any class of business or person | • Chaskalson et al (eds), *Constitutional Law of South Africa*, 1999 |
| **UNCTAD**<br><br>WT/WGTCP/W/197<br>15 August 2002 | • The core principles of competition law should be:<br>o a prohibition of cartels;<br>o case-by-case control (based on | | • UNCTAD Model Law, www.unctad.org/competition |

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| | rule of reason) of vertical restraints, especially by dominant firms;<br>o control of concentrations through mergers and acquisitions or other forms of concentrations such as joint ventures, whenever such concentrations may lead to the creation of a dominant firm and ultimately a monopoly<br>• A comprehensive multilateral competition framework would ideally contain<br>o (i) The core trade principles,<br>o (ii) The main competition principles,<br>o (iii) Voluntary cooperation rules<br>• Special and differential treatment should include:<br>o Technical cooperation<br>o Exceptions and exemptions<br>o Specific undertakings for developed countries | | |

# CHAPTER III

# IS THERE A CASE FOR NEW MULTILATERAL RULES ON TRANSPARENCY IN GOVERNMENT PROCUREMENT?

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## EXECUTIVE SUMMARY

1. Given the vast sums of money spent by governments on goods and services it is difficult to under-estimate the importance of having efficient and effective state procurement regimes that embody excellent governance practices and are transparent and open to participation by all qualified suppliers. Attaining this goal, however, has proven to be difficult, especially in developing countries where arguably the need for efficient social provision is even greater than elsewhere. A question arises, therefore, as to whether international initiatives on public procurement can further reform of national laws and practices.

2. The 1990s saw a number of international initiatives on public procurement and these have built on prior agreements, such as the Tokyo Round Agreement on Government Procurement. In light of the Doha Ministerial Declaration, however, the question before policymakers is whether, and on what terms, negotiations on new multilateral rules on transparency in government procurement practices are to be launched. It is noteworthy in this regard that that the Doha Ministerial Declaration explicitly states that further rules on preferences for domestic firms in procurement contracting would not form part of the negotiating mandate. Any future multilateral rules are supposed to address transparency-related matters only and not discrimination against actual or potential foreign bidders for state contracts.

3. The purpose of this chapter is to assess the proposals for further multilateral rules on transparency in government procurement practices, in particular, and more generally, to assess the case for international collective action on public procurement reform. One characteristic of the approach taken in this chapter is to situate the analysis in its appropriate context. That is, to take account of the strength of, and factors underlying, national reform efforts. Moreover, developments in fora outside of the WTO are discussed, enabling an evaluation of a number of international initiatives. In addition, recent economic analyses of the trade-related aspects of government procurement practices are described and are related to current and potential future international initiatives on public procurement reform.

4. The proposals for new multilateral disciplines on transparency in government procurement practices, and the reaction to them by some WTO Members, are discussed in considerable detail. In short, there is a wide divide between WTO Members over the interpretation of the mandate on government procurement in the Doha Ministerial Declaration, over the role and purpose of the associated Working Group at the WTO, as well as over the substance of proposals for new multilateral rules on the transparency of procurement practices. In the light of these marked disagreements, the analysis presented here draws upon economic research to assess the case for international collective action.

5. Without further disciplines on discrimination against foreign bidders for state contracts, the case for new multilateral rules on transparency is weakened. This is because transparent access to foreign procurement markets does little to stimulate competition if overt discrimination against foreign bids is

considerable. (That is not to say that improvements in transparency would not have governance-related benefits to WTO Members.)

6. Likewise, without effective multilateral disciplines on transparency, the benefits from prior (and for that matter, future) disciplines on discrimination against foreign firms in national procurement markets will be reduced. This is because governments can substitute *de facto* discrimination against foreign firms for *de jure* discrimination.

7. Put simply, as an economic matter, there is little to be gained by separating negotiations on transparency from negotiations on foreign access to procurement markets. The Doha mandate on government procurement is, therefore, fundamentally misconceived.

8. Rather than continue on their present trajectory, as far as government procurement-related matters are concerned, WTO Members should consider taking one of the following two options; which can be summarised as "all nothing." The latter option would involve abandoning negotiations on public procurement, with the obvious implication that domestic reform efforts will receive no additional impetus from the initiatives under the WTO umbrella.

9. The "all" option would involve putting market access or discrimination back on the negotiating table. This option would allow for the important interconnections between the transparency-related and discrimination-related aspects of procurement practices to be considered in a comprehensive manner. Moreover, this option could hardly spark additional opposition from those WTO Members that are critical of proposals for more rules on transparency in government procurement practices—precisely because those critics are already on record as suspecting that the desire to improve market access for exporters is what proponents seek from transparency-related rules anyway.

## INTRODUCTION

Ever since the conclusion of the Tokyo Round at the end of the 1970s, the world trading system has had rules in one form or the other on government procurement practices. Those rules, however, have only been codified in plurilateral agreements and most WTO members are not bound by them. The latest discussions on the efficacy of new multilateral rules on government procurement practices started after the Singapore Ministerial meeting in 1996. A Working Group on this subject was formed at the WTO, and its mandate was further clarified in the Doha Ministerial Declaration. Paragraph 26 of that Declaration states:

> "26. Recognizing the case for a multilateral agreement on transparency in government procurement and the need for enhanced technical assistance and capacity building in this area, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations. These negotiations will build on the progress made in the Working Group on Transparency in Government Procurement by that time and take into account participants' development priorities, especially those of least-developed country participants. Negotiations shall be limited to the transparency aspects and therefore will not restrict the scope for countries to give preferences to domestic supplies and suppliers. We commit ourselves to ensuring adequate technical assistance and support for capacity building both during the negotiations and after their conclusion" (WTO 2001).

This mandate is noteworthy for at least three reasons. First, deliberations in the Working Group are to be confined to the transparency-related aspects of government procurement practices; although no further guidance was given as to which practices Ministers had in mind. Second, the Working Group was instructed not to consider further or new rules on preferences for domestic firms, or to be more precise, "the scope for countries to give preferences" which have not have the same meaning. The third point to be made is that WTO Ministers will decide at the Cancun Ministerial meeting whether, and upon what terms, any negotiations will be launched on potential new multilateral disciplines on transparency on government procurement practices.

The purpose of this chapter is to assess the efficacy of new multilateral disciplines on transparency in government procurement practices, as stated by the proponents of such new disciplines (which include Canada, the European Communities, Korea, Japan, and the United States.) To provide the appropriate context, these proposals are evaluated in the light of economic analyses of the trade-related aspects of procurement reform; the political forces that encourage or retard unilateral domestic reforms of procurement regimes; and developments in the WTO and in other international fora. To that end, part I of this chapter describes the impetus towards procurement reform and the latest thinking as to why domestic reforms in this policy area stall so often. This part also describes the various means and ends of national procurement policies, as well as providing some information on the size of procurement markets in OECD member states and in 106 non-OECD economies.

Part II of this chapter describes and comments upon a number of international initiatives on procurement reform in the 1990s. This discussion considers the Uruguay Round Agreement on Government Procurement, which came into force on 1 January 1996 and currently has 28 signatories. As none of these initiatives are comprehensive in scope or membership, and some even do not allow for the potential for rigorous enforcement of agreed disciplines, the question arises as to the efficacy of a new multilateral initiative on public procurement reform. Part III of this chapter describes the differences in view on this matter in the WTO's Working Group on Transparency in Government Procurement and draws upon both the national submissions to that Group and the published minutes of meetings of that Group in 2002. Part IV assesses the case for international collective action in procurement reform more generally, and transparency-related reforms, in particular. Recommendations for policymakers are presented in the final part of this chapter.

# Part I

# OVERVIEW OF TRADE-RELATED ASPECTS OF NATIONAL PROCUREMENT LAWS AND PRACTICES

## I.1 Factors contributing to or impeding national procurement reforms

The growth of spending by central and local governments was one of the most profound economic changes of the twentieth century (Tanzi and Schuknecht, 2000). Although a large portion of that growth was devoted to higher transfer payments, governments of all types spent considerable sums on goods and services produced by the private sector. In addition, state-owned industries procured substantial quantities of inputs from private firms. As a consequence, through its purchases the state has had considerable influence over the allocation of resources in market-based economies.

Throughout much of the post-World War II era most nations' local and central governments were supplied by their own firms. Discrimination against foreign suppliers was rife. Two justifications were offered for this discrimination. First, the prevailing Keynesian macroeconomic orthodoxy emphasised that the increase in national income caused by a rise in government expenditures was greater the smaller was the share of each dollar spent on goods produced abroad (imports). Governments could reduce this share – or what economists call the marginal propensity to import – by refusing to buy goods from abroad. And so procurement discrimination became associated with the noble goal of macroeconomic management. The second rationale for pervasive discrimination against foreign suppliers is far less glorious – nationalism or outright protectionism[168]. Often it was claimed that "our money" should be spent on "our goods" to keep "jobs at home." Consequently, government procurement was excluded from the original General Agreement on Tariffs and Trade. In fact, it was not until the completion of the Tokyo Round of multilateral trade negotiations that an agreement on disciplines for government procurement practices was introduced into the world trading system.

During the Uruguay Round of multilateral trade negotiations, the Agreement of Government Procurement (GPA) was strengthened. Three factors underlie this shift towards greater acceptance of international rules on national procurement practices. First, since the mid-1970s government budgets have come under increased pressure, especially in industrial nations. Spending on welfare states, health, education, and pensions have increased considerably. Governments are then faced with the following unpleasant choices: raising taxes or cutting non-welfare state-related spending. Since the former was became increasingly unpopular in many developing and industrial countries, greater emphasis has been placed on the latter. And one means to reduce non-welfare spending has been to stimulate competition between those firms that bid for government contracts—and allowing foreign suppliers to bid for these contracts helps accomplish this goal. Greater pressure on public budgets, therefore, has been conducive to procurement reform.

The second factor has been the widespread privatisation of state-owned enterprises. Without governments standing behind them, these enterprises know that poor management decisions will not be "bailed out" by the state—leading to what economists refer to as a "hardening of the budget constraint." In addition, the owners of the newly privatised firms know that their profits will not be entirely appropriated by the state. These two changes provide the privatised firm with an incentive to lower costs, including the expenditures on goods and services bought from other firms. Since most state-owned firms procured (like their governments) from domestic firms, privatisation is likely to increase the opportunities for foreign suppliers that sell high-quality competitively-priced goods and services. As privatisation continues in the future, this will reinforce the opportunities for cross-border procurement.

The third factor conducive to procurement reform is often referred to as "export politics." Domestic firms eye profitable opportunities in supplying foreign governments and press their own government to negotiate "access" to those overseas procurement markets. In industries where there are strong economies of scale—that is, average costs which fall as production levels increase—firms have an incentive to increase sales at

[168] For other political economy rationales for reform see Hoekman (1998).

home or abroad. Although one government could begin bilateral negotiations with another government to open the latter's procurement market, the most prevalent path to reform has been for nations in the same region to simultaneously increase the access to their procurement markets to firms from the same region. Reciprocity is at the core of such agreements to liberalise together, as contracts lost by domestic firms to foreign suppliers are compensated for by an increase in the contracts won in neighbouring countries. The export gains can be balanced against the loss in sales to domestic firms—or so the theory underlying this approach to trade negotiation goes. Such a regional approach to procurement reform has advanced furthest in the European Union, and this experience had considerable influence in shaping the Agreement on Government Procurement negotiated during the Uruguay Round.

Another important aspect of procurement reform relates to the so-called transparency of the numerous steps associated with the implementation of a procurement law. Transparency, which refers to the publication, notification, and dissemination of pertinent information about a procurement regime to actual and potential bidders and to the public at large, is quite distinct from overt measures to discriminate against or in favour of one class of potential suppliers for state contracts. The absence of transparency is said to reduce the number of firms willing to bid for state contracts, so reducing competition and increasing costs (OECD 2003). Box 3 provides a list of examples of cost savings that are thought to have resulted from reforms that increase transparency in selected nations' procurement regimes; savings that are to be compared with the expertise and other outlays that such reforms entail.[169]

**Box 1. Examples of cost-savings under transparent procurement systems**

- Through the strengthening of transparency and procurement procedures including, for example, eliminating any tender specifications that favour a particular tender, Guatemala's Ministry of Health reports savings of 43 percent on the purchase of medicines.
- The Colombian Ministry of Defence reports generating 47 percent savings in the procurement of military goods through improvement of transparency and procurement procedures.
- Nicaragua had been spending about 17 percent of its health budget on pharmaceuticals. High drug expenditure had resulted from a lack of pricing and drug information and non-transparent procurement procedures. With the establishment of a transparent procurement agency, accompanied by the effective implementation of an essential drug list, the government was able to reduce drug costs significantly. Within one year of introducing these measures, the government had reduced its pharmaceutical budget from $21 million in 1992 to $13 million in 1993.
- In Pakistan, an open and transparent bidding process has resulted in savings of more than Rs 187 million (US $3.1m) for the Karachi Water and Sewerage Board.
- After introducing transparent procurement procedures in the energy sector, Bangladesh was able to reduce electricity prices to less than US $0.03 a kilowatt-hour, roughly half the price of directly negotiated deals in Indonesia.

*Source*: OECD (2003) and sources cited therein.

Despite its apparent benefits, domestic procurement reform is often notoriously difficult to accomplish. Hunja (2003) has identified the following impediments to unilateral reform:

1. "Deeply Vested Interests and Lack of Political Will" (page 17).
2. "Paucity of Technical Knowledge and Capacity" (page 18).
3. "Complexity of Substantive Issues Involved" (page 18) including the types of legal instruments involved, different means for organising procurement functions, and enforcement-related matters.

[169] OECD (2003) notes in this regard that,

> "…it should be stressed that some of the reforms needed cannot be implemented at no cost, but require resources to build up capacity and initiate long term change. Indeed, resources are required to change the institutional set-up (eg. the cost of making legislative changes and training the necessary staff) and to maintain procedural requirements to ensure transparency and due process" (page 11).

Reviewing the experience of developing countries in this regard, Hunja (2003) argues:

> "Evidence from countries where reform efforts have stalled for a long time indicates that it is very difficult to achieve wholesale, systemic changes to the legal framework in the absence of consistent political commitment and support from within the highest levels of government. Only support at such levels can overcome the progress and substantive obstacles to reform" (page 21).

He goes onto argue that:

> "Because efforts to bring about fundamental changes to a flawed system may attract direct opposition if implemented by a self-standing program, one way to increase the possibility of success is to implement such reforms within the context of an existing package of reforms aimed at increasing the efficiency of the public sector…Many countries are in the process of improving their system of governance (of which management of public resources is a key aspect) and in implementing anti-corruption measures. Procurement reform fits well into any such programs and is bound to attract less direct opposition if it is part of a large reform effort" (page 22).

An alternative means for improving procurement practices is in the context of reforms introduced after signing an international trade agreement and, therefore, the question arises as to whether adopting such agreements can galvanise and sustain support for domestic procurement reform.

## I.2 Targets and instruments of national procurement policies

Tinbergen, the Nobel-prize winning macroeconomist, introduced the distinction between a government's targets and instruments. The former are the objectives that the government wishes to achieve, and the latter are the means employed in attempts to meet those objectives. This distinction in no way validates, or endorses, the targets chosen by the government; nor does it imply that any given instrument has the desired effect. In the case of government procurement policies, these tend to have multiple targets and numerous instruments. This reality complicates an analysis of procurement policies, and in part accounts for the multi-faced nature of international disciplines on the design and implementation of such policies.

### I.2.1 Targets

Perhaps the most common objective of procurement policies is to obtain "value for money" for the government in its purchases. This straightforward objective itself has many facets; it could mean the purchase of goods, that meet certain quality levels, at minimum cost. Alternatively, it could mean choosing that good with the highest quality among a set of similarly priced goods. At a first cut this objective seems unobjectionable. However, this is to forget that the key metric used by economists to evaluate government policies is the effect of such policies on economic efficiency. Efficiency is attained when the price paid for a good (service) reflects the value to society of the resources used to produce the last unit of that good. One classic source of inefficiency occurs when a buyer with considerable market power artificially reduces the quantity purchased so as to induce suppliers to lower their prices. Therefore, it is important to bear in mind that attaining the lowest possible price, or "value for money," in government purchasing need not generate efficient economic outcomes.

Governments also use procurement policies to favour certain groups, firms, regions, and industries. For example, such favouritism is widespread in the United States and India where the central government favours small firms who bid for contracts. More recently, South Africa has considered instituting a scheme which will favour black entrepreneurs and firms that employ stipulated numbers of black employees. This is part of a sweeping initiative to enhance the economic status of the majority black population after the fall of the apartheid regime. Finally, purchases of military equipment have long been subject to different rules, as nations have felt the need to maintain a broad range of military production facilities for national defense purposes. Because these objectives of procurement policy do not directly relate to maximising economic efficiency, economists refer to them as "non-economic" objectives; a term that does not imply that these objectives are misguided or unattainable. Rather, this term is applied when governments have explicitly decided to adopt measures that may well lead to market outcomes that do not maximise economic efficiency.

Given the widespread adoption of non-economic objectives by governments, economists have researched extensively their consequences, especially in the area of international trade policy. The main finding of this research has been to show that the amount of economic efficiency sacrificed to meet a non-economic target varies considerably across instruments—and so it makes sense to determine which instrument attains the desired goal with the smallest reduction in economic efficiency. In so doing, economists have argued that it is better to tackle the direct source of problem at hand rather than take measures that only indirectly bear on the matter.

For example, governments may want to promote the number and production levels of small firms by awarding these firms state contracts even though at least one large firm submitted a lower bid. An economic approach might point to a different course of action: first, the government should identify the impediments faced by small businesses and take measures that directly remedy them. If, for example, the critical impediment to the growth of small firms is access to financial credit, then policies should be directed towards bolstering the supply of credit to small firms—rather than using indirect means such as deliberately increasing the sales of small firms through government contracts.

The arguments above are not theoretical hair-splitting—they have direct relevance for the reform of government procurement policies. Governments may be more inclined to eliminate a procurement scheme that favours a certain industry if they know that other forms of state intervention can better attain this objective. Furthermore, if the chosen form of state intervention directly tackles the constraint of the favoured industry's or group's performance, then economic efficiency can be improved also.

### I.2.2 Instruments

The manner in which governments procure goods and services can be complex and leaves plenty of room for favouritism towards groups of suppliers. The main focus here is on favouritism towards domestic suppliers, or alternatively put, discrimination against foreign suppliers. At this point it is worth noting that a supplier can be foreign, and therefore the potential subject of discrimination, in two respects: the supplier is located overseas or the supplier is located domestically but is partially or fully foreign-owned. The latter includes subsidiaries of multinational corporations whose headquarters are located abroad. Moreover, discrimination that is explicitly stated in national law or published regulations, in which case it is said to be *de jure*. Discrimination that results from the implementation of those laws and regulations is often said to be *de facto*.

A description of the stages of a typical procurement process for goods is helpful in identifying where discriminatory instruments can affect outcomes. (It is should be added that there are additional means by which discrimination against foreign services providers can occur and these are discussed in section I.2.3 below). If a government decides not to effectively ban outright foreign bids for a contract then, in essence, the procurement of goods can be divided into three distinct stages: tendering, evaluation, and award notification and review procedures. At the tendering stage the government notifies a supplier or suppliers of its desire to procure certain types of goods. The government can specify the type of goods that it wishes to buy—including, in principle, the manner in which those goods are produced. There are three types of tendering procedures: open, selective, and limited. In open procedures an interested supplier, located at home or abroad, can submit a bid or, as it is often called, a tender. Under selective procedures only those pre-qualified firms may submit a tender. Pre-qualification is an additional step where a firm must demonstrate that potential to deliver goods of appropriate quality in a timely fashion. As this determination depends on the judgement of the procuring officials, some suppliers (including foreign firms) may be at a disadvantage if they do not have a track record in supplying the relevant goods. A limited tendering procedure tends to be the most restrictive as the procuring agency involved contacts individual suppliers and invites only these suppliers to submit tenders. This is not to say that limited tendering is always inappropriate. (Indeed, ensuring quick delivery in a time of national emergency may require the use of limited tendering.) Rather, that limited tendering frustrates one of the principal objectives of procurement reform—namely, to stimulate competition among suppliers which is likely to result in lower prices paid by the government. Finally, if governments rely on existing suppliers when conducting limited tendering, then new foreign and domestic suppliers will almost certainly lose out on procurement opportunities.

The specification of the goods being procured also introduces the potential for discrimination. For example, a government might require that the goods be produced in firms that adhere to certain health and safety standards for workers. As these regulations differ across countries, foreign suppliers may find their costs have to rise to meet another nation's standards, reducing their ability to effectively compete in a tendering process. Even if a foreign firm already meets those standards, there may well be costly verification procedures which too reduce the effective competition from foreign bidders. Tendering procedures, therefore, can result in two forms of *de facto* discrimination against foreign suppliers—discrimination that directly or indirectly reduces the number of bidders and discrimination that increases the costs of foreign bidders. In what follows, these government measures are referred to as "entry" and as "cost" discrimination, respectively.

The evaluation of tenders is the next critical stage in the procurement process. As firms rarely bid to supply identical goods, the procuring official will have to assess not only the price of the tender but also a whole series of non-price factors—such as the quality of the good, the quality of after-sales service, the reliability of the supplier, and the like. Many of these factors are hard to quantify and some subjective judgements are inevitable. However, such judgement is to be distinguished from explicit discrimination against certain groups of suppliers. Governments may employ price preferences to inflate the bids of disfavoured suppliers. For example, a ten percent price preference against foreign suppliers implies that their actual bids will be inflated by ten per cent before being compared to bids by domestic suppliers. This puts foreign firms at a disadvantage as raising a bid typically reduces the probability of winning a government contract.

There is one caveat to the presumption that a lower priced bid increases the chances of securing a state contract, and that is when a bid is too low to be commercially viable. At first this may seem implausible, however, it is important to remember that firms often supply a good well after the contract is awarded. For example, if a firm is building a bridge for a government and the firm runs out of money (because its bid was below the cost of producing the bridge), then the government is in something of a bind. Does the government begin the procurement process afresh, or is it cheaper to pay the existing contractor additional sums to complete the bridge? The latter involves the supplier being "bailed out" by the government; and so the bridge costs more (possibly much more) than originally envisaged. Furthermore, the possibility that a supplier may be subsequently bailed out affects the prices that each firm bids in the first place. And, if domestic firms are more likely to be bailed out than foreign firms, this confers an advantage on domestic bidders for state contracts.[170] Procuring officials often check, therefore, that tenders with exceptionally low bids have the capacity, and the incentive, to complete any contract that is awarded to them.

The role of intangible factors—that are part of the decision as to which firm to award a contract to—can undoubtedly cause controversy. Firms that do not win the contract may feel that they were discriminated against, that the evaluation was conducted unfairly or incorrectly, or that irrelevant factors were taken into account. Consequently, many governments have established review procedures that enable firms to challenge the decisions of procuring officials. The specific details of these procedures determine, in large part, their effect of the tendering and award steps of the procurement process. If aggrieved parties can only recover the cost of preparing the bid and the cost of mounting a challenge, then a firm will be disinclined to object to a procurement decision, unless there is the expectation that similar tenders will be issued in the future and that the challenge will alter the subsequent behaviour of procuring officials. (Of course, the firm might also be concerned about retaliation by these officials in future tenders.) In contrast, if the challenge procedure offers the potential to win substantial damages, then this may well reduce inappropriate behaviour by procuring officials. This beneficial effect must be seen beside the costs of frivolous challenges, and the increased bureaucratic measures that officials will take in order to reduce the likelihood of successful challenges by initially unsuccessful bidders. Finally, to the extent that foreign firms believe that they are unlikely to receive a fair and objective hearing from a domestic challenge procedure, then another form of discrimination is introduced into a nation's procurement system. This increases the likelihood that the entry-based, cost-based, and price-based discrimination identified earlier will occur, again reducing the benefits that accrue to governments from competition between potential suppliers.

[170] This argument is developed at length in Mattoo (1997).

### I.2.3 Services

Up until now this discussion has focused on purchases of goods, with the implicit assumption that a foreign firm can supply a domestic government contract by exporting a good. This mode of supply is, in the parlance of trade experts, called the "cross-border movement of goods." When discussing the procurement of services three other modes of supply are of importance, each of which reflects the fact that many services can only be delivered when the supplier is physically proximate to the purchaser. The first of these three modes of supply is referred to as establishing "commercial presence." Here a foreign firm sets up a subsidiary, or forms a joint venture with a domestic firm, within the borders of the "home" nation. Once established, this subsidiary or joint venture can attempt to bid for the home government's service contracts. The ability to establish presence, and therefore to bid for government contracts, is highly contingent on government policies towards foreign direct investments, joint ventures, and foreign mergers and acquisitions of domestic firms. Strict rules on foreign takeovers of domestic firms are likely to reduce this method of establishing presence and, therefore, will alter the nature and extent of tendering for government service contracts.

The other two modes of supply relate to the movement of people across national boundaries. To effectively supply some services, such as accounting, auditing, consulting, and legal services, may require the temporary movement of personnel. Other services, such as recurring maintenance and perhaps nursing, may require longer term or even permanent migration of workers, especially if there is insufficient expertise in the domestic labour force. In both cases the ability of a foreign firm to contest the domestic service market—irrespective of whether the buyer is a government or not—depends critically on the nation's policies towards work visas and migration.

This discussion implies that a government that wants to reap the full benefits of competition between potential service suppliers cannot confine themselves to implementing a transparent and non-discriminatory government procurement regime. As services can be supplied through four modes of supply (cross border-movement for tradeable services—and the additional three modes described above), policies towards each mode of supply can affect the intensity of competition in the services market. It should be noted that foreign firms do have some choice over which mode of supply to use. For this reason, some have argued that a nation may not need to open all modes of supply in order to derive the benefits from foreign competition. While there may be some validity to this argument in certain situations, in general just because a foreign firm has access to at least one mode of supply does not imply that the permitted mode(s) are the lowest cost mode(s) of supply. Furthermore, as the costs of each mode of supply are likely to vary across industries and over time, there is little reason to suppose that opening any one mode of supply in general (such as permitting foreign direct investments) will maximise the benefits to governments of foreign competition for procurement contracts.

### I.2.4 Corruption and collusion

Given that firms (domestic and foreign) want to secure lucrative government contracts, and that some officials may be motivated by personal self-interest as well by promoting the public interest, it should come as no surprise that corruption and collusion are a feature of government procurement. Firms may decide to reduce the competition for contracts by agreeing (or "rigging") the prices that they submit to the procuring entity. Often, these conspiracies involve each firm taking its turn to win a government contract. For these conspiracies to be sustained there must be repeated tendering by the state over time, so holding out the prospect of future contracts for those engaged the conspiracy. As a separate matter, a firm or firms could attempt to bribe or induce government officials to view their tenders more favourably, and such corruption has been extensively researched (see Bardhan, 1997, and Rose-Ackerman, 1999, for recent surveys.)

Without attempting to present a full analysis of the sources and effects of corruption here, for present purposes it is important to recognise that procurement rules—whether national or domestic—should be designed with the possibility of corruption in mind. Given the considerable scope for discretion on the part of procuring officials, much can be done to force those officials to make their decisions in an open and transparent fashion. Likewise, so-called carrots and sticks can be offered to officials to induce them not to take bribes.

## I.3 Evidence on the scale of national procurement markets

Given the importance of the state sector as a determinant of national economic performance, it is perhaps surprising that there is little systematic cross-country and inter-temporal evidence on the size of national procurement markets. OECD (2001) surveys what evidence has been provided[171], and adds to the evidentiary base by using System of National Accounts (SNA) data (reported by the International Monetary Fund and the United Nations) to compute the magnitude of government spending in the OECD member states and in 106 non-OECD economies. Specifically, measures of government spending were obtained by adding state expenditures on investment[172] to either expenditure on all current acquisitions[173] or expenditure on final consumption[174] and subtracting from the total outlays on the compensation of employees. Table 1 reports the estimates in OECD (2001) of this size of procurement markets in the OECD member states.

[171] See, for example, Francois, Nelson, and Palmeter (1997).
[172] Strictly speaking, a measure known as gross fixed capital formation is used here (and is reported in the SNA).
[173] Strictly speaking, a measure known as intermediate consumption is used here (and is reported in the SNA).
[174] Strictly speaking, a measure known as final consumption expenditure is used here (and is reported in the SNA.)

**Table 1: Size of government procurement markets in OECD nations, 1998**

| OECD member | Total government expenditure less outlays on defence and compensation, as a percentage of GDP | | | | | |
|---|---|---|---|---|---|---|
| | SNA-based measure | | | SNA-based measure that takes into account intermediate consumption | | |
| | (1) General government | (2) Central government | (3)=(2)/(1) | (4) General government | (5) Central government | (6)=(5)/(4) |
| Australia | 7.64 | 0.86 | 0.11 | | | |
| Austria | 11.71 | 2.31 | 0.20 | 11.71 | 2.31 | 0.20 |
| Belgium | 4.84 | 1.95 | 0.40 | 3.87 | 2.03 | 0.52 |
| Canada | 10.40 | 0.62 | 0.06 | | | |
| Czech Republic | 15.74 | 2.71 | 0.17 | 11.21 | | |
| Denmark | 10.04 | 2.75 | 0.27 | 10.04 | | |
| Finland | 9.00 | 3.58 | 0.40 | | | |
| France | 7.63 | 1.81 | 0.24 | 7.63 | 1.81 | 0.24 |
| Germany | 6.72 | 0.81 | 0.12 | 6.62 | 0.81 | 0.12 |
| Greece | 6.73 | 3.76 | 0.56 | | | |
| Hungary | 16.78 | 7.03 | 0.42 | | | |
| Iceland | 11.76 | 3.62 | 0.31 | | | |
| Ireland | 9.93 | 2.59 | 0.26 | | | |
| Italy | 7.38 | 2.12 | 0.29 | 7.11 | 1.94 | 0.27 |
| Japan | 8.98 | 1.29 | 0.14 | | | |
| Korea | 7.20 | 1.94 | 0.27 | | | |
| Netherlands | 7.98 | 2.71 | 0.34 | 8.11 | 2.71 | 0.33 |
| New Zealand | 6.67 | 3.05 | 0.46 | 8.34 | 5.94 | 0.71 |
| Norway | 9.65 | 3.82 | 0.40 | | | |
| Poland | 9.72 | 5.57 | 0.57 | | | |
| Portugal | 6.22 | 3.80 | 0.61 | 6.18 | 3.49 | 0.56 |
| Slovak Republic | 14.09 | 8.21 | 0.58 | | | |
| Spain | 8.06 | 1.95 | 0.24 | 8.40 | 2.08 | 0.25 |
| Sweden | 13.01 | 4.67 | 0.36 | | | |
| Switzerland | 8.02 | 1.50 | 0.19 | 7.86 | 1.45 | 0.18 |
| Turkey | 6.84 | 4.96 | 0.73 | | | |
| United Kingdom | 9.97 | 5.88 | 0.59 | 9.77 | 6.09 | 0.62 |
| United States | 6.18 | 1.09 | 0.18 | | | |
| OECD weighted average | 7.57 | 1.75 | 0.23 | 8.22 | 2.79 | 0.34 |
| EC weighted average | 8.03 | 2.53 | 0.32 | | | |

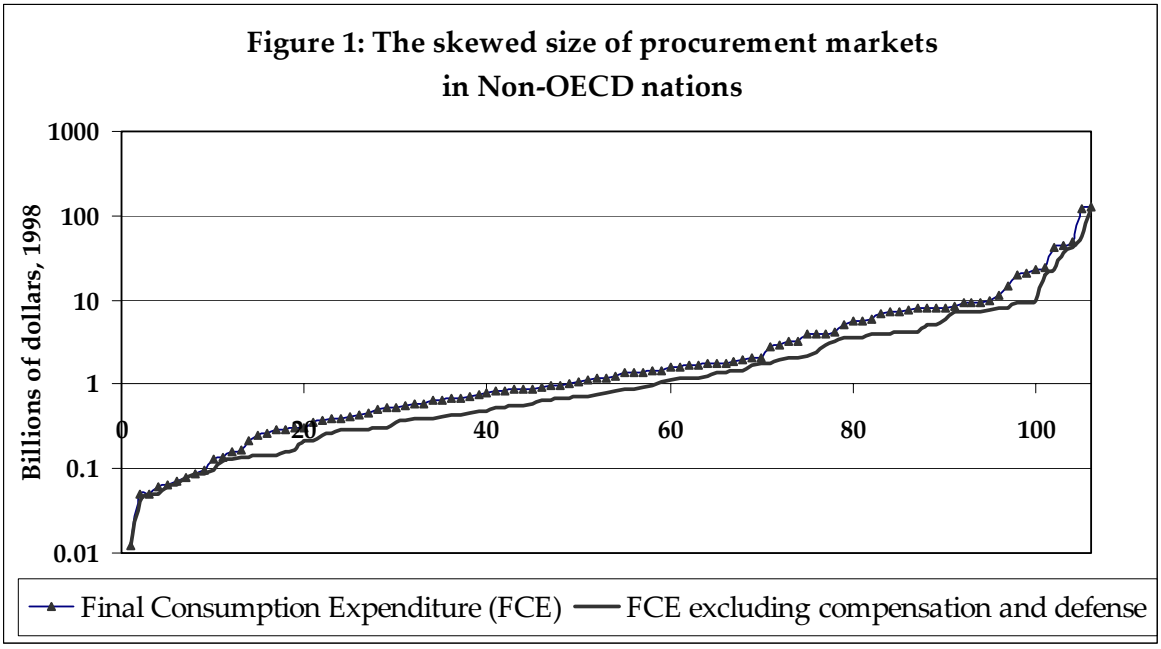
*Source*: OECD (2001)

On average, in the OECD nations government procurement on items other than defense and compensation for state employees entails outlays equivalent to 7.57 percent of national incomes. These calculations imply that in 1998 approximately US $1.795 trillion of government expenditures were potentially contestable by firms located at home and abroad. Moreover, between a quarter and a third of those outlays are undertaken by central governments, highlighting the importance of sub-national authorities.

Turning to the economies that are not members of the OECD, OECD (2001) reports that on average their contestable government expenditures amounted to 5.10 percent of their national incomes. The total amount of such expenditures in these non-OECD nations equals US$287 billion, approximately one-sixth of the size of the contestable procurement markets in OECD nations. Moreover, as Figure 1 makes clear, the size of the contestable procurement markets in non-OECD nations is highly skewed with 60 of the 106 nations having

procurement outlays less than US$1 billion. In 1998, around 10 non-OECD nations have contestable procurement outlays of US$10 billion or more. (For a full breakdown of the procurement outlays by non-OECD economy see Appendix 1 at the end of this chapter.)

The fact that so many non-OECD countries have relatively smaller contestable procurement outlays do not imply that state procurement is unimportant in these economies. However, the magnitude of their state outlays does suggest that in absolute terms the maximum size of market access to their procurement markets is far more limited than in the OECD nations and in a few of the larger non-OECD countries.



## Part III

# EXISTING PLURILATERAL DISCIPLINES ON GOVERNMENT PROCUREMENT AND OTHER INTERNATIONAL INITIATIVES IN THE 1990s

Although a second Agreement on Government Procurement (GPA) was adopted by some WTO Members at the conclusion of the Uruguay Round, there have been a number of other important international initiatives in the 1990s that have had considerable bearing on content and application of national procurement laws. The purpose of this part of the chapter is to describe these international initiatives, to contrast them with the provisions in the current GPA, and to assess along a number of dimensions how comprehensive these measures are.

### II.1 The Uruguay Round Government Procurement Agreement

The WTO's Government Procurement Agreement entered into force on January 1, 1996. At present the agreement has twenty-eight members (Austria, Belgium, Canada, Denmark, European Communities, Finland, France, Germany, Greece, Hong Kong China, Iceland, Ireland, Israel, Italy, Japan, Korea, Liechtenstein, Luxembourg, Netherlands, Netherlands with respect to Aruba, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom, and the United States), and over twenty economies hold observer status. Furthermore, at present, Bulgaria, Estonia, Jordan, the Kyrgyz Republic, Latvia, Panama, and Chinese Taipei are negotiating accession to the GPA. In sum, the membership of the GPA comprises mainly of industrial nations and many developing nations have evidently chosen not to accept this agreement's disciplines and reporting requirements.

According to the WTO (2000):

> "The GPA establishes an agreed framework of rights and obligations among its Parties with respect to their national laws, regulations, procedures and practices in the area of government procurement. The cornerstone of the rules in the Agreement is non-discrimination. In respect of the procurement covered by the Agreement, governments Parties to the Agreement are required to give the products, services and suppliers of any other Party to the Agreement treatment "no less favourable" than that they give to their domestic products, services and suppliers and not to discriminate among goods, services and suppliers of other Parties (Article III:1). Furthermore, each Party is required to ensure that its entities do not treat a locally-established supplier less favourably than another locally-established supplier on the basis of degree of foreign affiliation or ownership and do not discriminate against a locally-established supplier on the basis of country of production of the good or service being supplied (Article III:2) In order to ensure that the basic principle of non-discrimination is followed and that access to procurement is available to foreign products, services and suppliers, the Agreement lays heavy emphasis on procedures for providing transparency of laws, regulations, procedures and practices regarding government procurement."

The annexes of the GPA outline, for each member, which government entities (central government, sub-central governments, and other state bodies such as utilities) and which purchases of goods and services are potentially covered by the disciplines of the GPA. Even then, only those transactions which exceed certain threshold levels are actually covered by the GPA. Although a common threshold of SDR 130,000 was established for central government utilities purchases of goods and non-construction services, these thresholds tend be much higher for construction projects and purchases by non-central government entities (see the top panel of Table 2 overleaf).

The treatment of goods and services in the GPA differs in one important respect. All goods purchases are subject to GPA disciplines unless a nation secured exemptions during the agreement's negotiation (or during subsequent accession to the agreement.) In contrast, only those services which a nation lists in the Annexes to the agreement are covered by the GPA's disciplines. Nevertheless, the WTO suggests that the scope of government procurement covered by the current GPA is approximately $300 billion, which is ten times the estimated coverage of the Agreement of Government Procurement negotiated during the Tokyo Round.

As the quotation above made clear non-discrimination is at the core of the GPA. However, unlike many other WTO agreements, many members have conditioned their own commitments on the market access offered by other members of the GPA. This has effectively meant negotiating a raft of bilateral obligations on reciprocal access to procurement markets, and is at odds with the well-established principle that nations grant unconditionally the same access to all members of a WTO agreement. To the extent that such reciprocity actually prolongs discrimination against foreign suppliers, then the benefits of enhanced competition to supply domestic procurement contracts will be reduced. Finally, the GPA's national treatment disciplines ensures that foreign bidders are treated no less favourably than domestic bidders, and effectively bans price preferences against foreign bidders located in nations which are members of the GPA.

**Table 2: Thresholds for Korean government procurement**

**(a) Threshold values for procurement by GPA-covered entities**

| Classification | Type of contract | Threshold value (SDR) |
|---|---|---|
| Central government entities | Supplies and services | 130,000 |
| | Construction services | 5,000,000 |
| Sub-central government entities | Supplies and services | 200,000 |
| | Construction services | 15,000,000 |
| All other entities | Supplies | 450,000 |
| | Construction services | 15,000,000 |

Note: These thresholds were also notified in national currency fixed for two years.

**(b) Korean government contracts, by tender procedure, 1997-98**

| | 1997 US$ million (%) | 1998 US$ million (%) |
|---|---|---|
| **Goods** | 7,264 (100) | 5,192 (100) |
| Tender procedure: | | |
| Single | 3,083 (42.4) | 2,814 (54.2) |
| Restricted | 2,109 (29.0) | 1,043 (20.1) |
| Open | 2,072 (28.5) | 1,335 (25.7) |
| **Public works** | 14,184 (100) | 9,103 (100) |
| Single tendering | 1,798 (12.7) | 1,256 (13.8) |

Note: More recent data on procurement methods were not available.

*Source:* The latest Trade Policy Review for Korea, which cites the original sources as WTO document GPA/W/81, 11 February 1999; and the Ministry of Finance and Economy, Government of Korea.

The GPA has two other important features: measures to improve transparency in the procurement process and enforcement provisions. The agreement contains measures on the use of selected and invited tendering, the nature of technical specifications listed in a tender, and the criteria used to make procurement awards. Tables 2, 3, and 4 contain information on the use of different tendering procedures by government entities in Korea, Israel, and Norway, respectively.

The article on technical specifications, Article VI, contains a number of loopholes as it only enjoins nations from creating "unnecessary" obstacles to trade. Furthermore, the agreement notes that specification should "where appropriate" relate to performance, rather than to the manner in which a good or service is designed, produced, or marketed.

The GPA preserves some discretion on the part of procuring entities when it comes to deciding which bidder to award the contract to. Contracts must be awarded to the supplier that is deemed capable of undertaking the contract and satisfies one of the following two requirements: (i) the supplier made the lowest bid or (ii) the supplier best meets the evaluation criteria laid out in the original tender. Essentially, this latter requirement prohibits a procuring entity from refusing to award a contract to a supplier on grounds that were not specified in the tender. Of course, the effectiveness of this requirement depends critically on how broad are the evaluation criteria in the tender.

On the subject of transparency two other provisions of the GPA are worth noting. First, the GPA allows a government to refuse to award a contract on "public interest" grounds that, alas, are not defined. Second, once a contract award has been made the procuring entity does not have to provide an explanation to those bidders who did not win the contract. The latter is only required when a member government intervenes on behalf of a bidding firm under the GPA's enforcement procedures.

The enforcement provisions of the GPA are of particular interest. Recognising that aggrieved bidders want to have rapid redress, perhaps even reversing an ongoing procurement process, the GPA mandates that Members establish impartial domestic arbitration procedures capable of making swift decisions. Furthermore, complainants are allowed to invoke the provisions of this WTO agreement in making their case in a domestic arbitration procedure. In addition to these domestic procedures, WTO Members are allowed to bring cases before the WTO dispute settlement body, including when it is thought that a domestic arbitration procedure has misinterpreted the GPA. Naturally, the effectiveness of this domestic dimension to enforcing an international trade agreement depends crucially on the manner in which national adjudication is carried out. There will inevitably be differences in such procedure across nations and, perhaps more worryingly, differences in the ability of adjudicators to resist pressures to favour domestic suppliers.

**Table 3: Key Israeli government procurement practices**

| Procurement procedures | Instances when the method is applied |
|---|---|
| 1. No tender | *Contracts up to*:<br>- NIS 39,000 (or about US$9,500 in June 1999) for Ministry, other than defence;<br>- NIS 15,600 for defence establishment; and<br>- NIS 156,000 for government company or subsidiary.<br>*Examples of other instances*: a contract that is urgently needed in order to prevent substantial harm; a contract pertaining to a transaction for which a tender is liable to cause substantial harm to national security; additional contracts within three years of the conclusion of the first contract; and a contract concerning the subject of marketing of agricultural produce, advertising in the media, cultural, artistic, entertainment, or certain areas of medicine. |
| 2. Closed tender (award is based on most advantageous offer, mainly based on price) | *Contracts*:<br>- from NIS 39,000 up to NIS 312,000 for Ministry, other than defence; and<br>- from NIS 15,600 up to NIS 156,000 for defence establishment<br>*Examples of other instances*: selective tendering procedure based on a list of qualified suppliers for the acquisition of goods with special properties and with "uncommon characteristics"; for the acquisition of medical equipment; insurance; research and development activities. |
| 3. Public tender (award is based on most advantageous offer, mainly based on price) | *Contracts above:*<br>- NIS 312,000 for Ministry, other than defence;<br>- NIS 156,000 for defence establishment; and<br>- NIS 156,000 for government company or subsidiary. |
| 4. Extraordinary tender (award is based on price, and technical and administrative details) | *Contracts:*<br>- transaction with respect to R&D or scientific work;<br>- when no technical specification is available;<br>- for educational or vocational training; and<br>- when because of defence consideration the Ministry will need to make investments in infrastructure. |
| 5. Shortened tender (award is based on price only) | Closed tender for purpose of shortening procedures, applicable to tenders up to NIS 30,000 |
| **Preferences for domestic industries** | |
| A. All international tenders, except for GPA tenders: price preference of up to 15% to domestic suppliers. | |
| **Preferences for "priority areas"** | |
| B. All tenders, including domestic, except for GPA tenders: price preference of 5% in respect of goods and services from Area B and 15% from Area A[a]. | |
| **Preferences for local subcontracting** | |
| C. Tenders offering local subcontracting, except for GPA tenders: a foreign company receives a 1% price advantage over other foreign companies for the first 10% and an additional 1% for every additional 5% subcontracting, up to a maximum 35% of the contract; the maximum preference for local subcontractors may not be greater than 5%. | |
| **Business cooperation** | |
| D. International public tenders with a value of above NIS 1.5 million: minimum "cooperation" of 35% of the value of the contract[b]. | |

a The sum of these preferences and the domestic suppliers preferences may not exceed 15%. Areas A and B are within the meaning of the priority areas defined in the Capital Investment Encouragement Law.

b The offset requirement can be satisfied in the form of subcontracting to local companies, investment in local industry, know-how transfer, or acquisition of goods made in Israel or of work or services in Israel.

*Source*: The latest Trade Policy Review for Israel, which reports the original sources as: WTO Secretariat, based on Mandatory Tenders Law of 1992; Mandatory Tenders Regulations of 1993; Mandatory Tenders Regulations (Defense Establishments Contracts) of 1993; Mandatory Tenders Regulations (Preference for Israeli Products and Mandatory Business Cooperation) of 1995; Mandatory Tenders Regulations (Preference for Products from National Priority Areas) of 1995; and Mandatory Tenders Regulations (Preference for Products from National Priority Areas) of 1998.

**Table 4: Norwegian government procurement statistics, 1996-97**

| | 1996 | | | | 1997 | | | |
|---|---|---|---|---|---|---|---|---|
| | Number of contracts | % | Value of contracts | % | Number of contracts | % | Value of contracts | % |
| **Supply contracts**, of which: | 323 | 100 | 3,052 | | 260 | 100 | 5,460 | 100 |
| Open procedures | 251 | 78 | 2,289 | 75 | 176 | 68 | 2,894 | 53 |
| Selective procedures | 53 | 16 | 549 | 18 | 23 | 9 | 382 | 7 |
| Negotiated procedures | 19 | 6 | 244 | 8 | 61 | 23 | 2,184 | 40 |
| Awarded to domestic supplier | 304 | 94 | .. | .. | 247 | 95 | .. | .. |
| Awarded to foreign supplier | 19 | 6 | .. | .. | 13 | 5 | .. | .. |
| **Service contracts** | 138 | 100 | 1,388 | 100 | 139 | 100 | 2,040 | 100 |
| Open procedures | 92 | 67 | 1,138 | 82 | 92 | 66 | 1,530 | 75 |
| Selective procedures | 30 | 22 | 167 | 12 | 33 | 24 | 449 | 22 |
| Negotiated procedures | 13 | 11 | 83 | 6 | 14 | 10 | 69 | 3 |
| Awarded to domestic supplier | 137 | 99 | .. | .. | 138 | 99 | .. | .. |
| Awarded to foreign supplier | 1 | 1 | .. | .. | 1 | 1 | .. | .. |
| **Works contracts** | 243 | 100 | 1,960 | 100 | 143 | 100 | 1,803 | 100 |
| Open procedures | 213 | 88 | 1,548 | 79 | 131 | 92 | 1,569 | 87 |
| Selective procedures | 27 | 11 | 373 | 19 | 2 | 0 | 90 | 5 |
| Negotiated procedures | 3 | 1 | 39 | 2 | 12 | 8 | 144 | 8 |
| Awarded to domestic supplier | 242 | 99 | .. | .. | 142 | 99 | .. | .. |
| Awarded to foreign supplier | 1 | 1 | .. | .. | 1 | 1 | .. | .. |
| **Utilities contracts** | 284 | | 17,741 | | 87 | | 2,602 | |
| Open procedures | .. | .. | .. | .. | .. | .. | .. | .. |
| Selective procedures | .. | .. | .. | .. | .. | .. | .. | .. |
| Negotiated procedures | .. | .. | .. | .. | .. | .. | .. | .. |
| Awarded to domestic supplier | .. | .. | .. | .. | .. | .. | .. | .. |
| Awarded to foreign supplier | .. | .. | .. | .. | .. | .. | .. | .. |
| **Total contracts** | 988 | 100 | 35,117 | 100 | 629 | 100 | 11,904 | 100 |

.. Not available.

*Source:* The latest Trade Policy Review for Norway, which cites the original sources as WTO documents GPA/21, 29 May 1998 and GPA/22/Add.1, 23 April 1999.

## II.2 Economic impact of the GPA

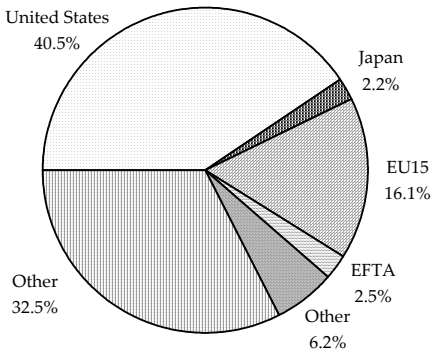
An important component of any assessment of the case for further international disciplines on government procurement is an analysis of the economic impact of the existing plurilateral GPA. This section starts by reporting some pertinent facts concerning the proportion of government contracts sourced from abroad then goes on to discuss the economic literature on the effects of procurement discrimination in markets and in auctions, and concludes with some remarks about the likely effects of the current GPA.

The Trade Policy Reviews of national policies, that are carried out periodically by the WTO secretariat, often provide useful information on the degree of preferences awarded to different types of domestic firms and on the proportion of contracts sourced abroad. For example, in Table 3 above, the preferences in the Israeli procurement code are described. Israeli firms that are competing in a tender against firms that are not located in GPA members receive a 15 percent price preference, indicating the degree of conditional

discrimination in this case. Moreover, the number of contracts awarded to foreign firms by Norwegian procuring entities during 1996-1997 is reported in Table 4. In addition, Figure 2 reports that in 1999 2087.5 billion won of Korean government contracts were awarded to foreign firms, of which forty percent were awarded to firms from the United States. A further 16.1 percent were awarded to firms from the European Union. (One important to bear in mind when interpreting such numbers is that it is not clear whether procurement contracts awarded to the local subsidiaries of a given foreign economy's firms is included in the reported total of sourcing from that foreign economy.)

**Figure 2: Korean government procurement by origin of foreign suppliers, 1999**

**Per cent**




**Total: Won 2,087.5 billion**

*Source* : Information provided by the authorities of the Republic of Korea and reported in Korea's latest Trade Policy Review at the WTO.

Some countries report by procuring entity and by type of good the extent of foreign sourcing. The latest Trade Policy Review for Japan reports by type of good that nations government's purchases from abroad (see Table 5). Of the 769,630 million yen of reported procurement expenditures, 16.1 percent was awarded to foreign firms. Moreover, there is considerable variation across different types of product, with no foreign sourcing in stone etc. (product number 8 in this table), ships and boats, and sanitary, plumbing, heating and veterinary equipment. In contrast, 93.3 percent of the Japanese government purchases of aircraft and associated equipment were from abroad as were 88 percent of mineral purchases; no doubt reflecting the lack of domestic suppliers of these items. For an extensive analysis of Japanese state procurement patterns, see Evenett and Shingal (2002).

With this factual record in mind, the discussion now turns to research of the effects of discrimination against foreign suppliers in markets and in auctions.

### II.2.1 Economic analyses of procurement discrimination in markets

In recent years the forms of procurement discrimination identified in the last section has received greater attention from researchers. As is usual economic research differentiates between two types of question: what is the effect of a specific government measure on market outcomes? And what is the effect of that measure on national welfare, which aggregates the benefits that purchasers (including the government) and suppliers derive from market exchange? Most of the scholarly attempts to answer there questions have focused on the effects of procurement discrimination in a single market or auction. However, it is important to realise that international trade research stresses actions in one market can have knock-on effects in other markets, an approach which emphasises so-called "general equilibrium" effects.

**Table 5: Japanese procurement composition by product and by origin, 1997 (¥ 100 million, per cent)**

| No. | Products | Total value | Share | |
|---|---|---|---|---|
| | | | Domestic | Foreign |
| 1. | Products from agriculture, and from agricultural and food processing industries | 1.9 | 84.5 | 15.5 |
| 2. | Mineral products | 199.1 | 12.0 | 88.0 |
| 3. | Products of the chemical and allied industries | 33.7 | 62.4 | 37.6 |
| 4. | Medicinal and pharmaceutical products | 261.1 | 73.5 | 26.5 |
| 5. | Artificial resins and plastic materials, cellulose esters and ethers, and articles thereof; rubber, synthetic rubber, factice, and articles thereof; raw hides and skins, leather, furskins and articles thereof, other than articles of apparel and clothing accessories of leather, saddlery and harness, articles of animal gut | 40.2 | 99.2 | 0.8 |
| 6. | Wood and articles of wood; wood charcoal; cork and articles of cork; paper making material; paper and paperboard and articles thereof; manufactures of straw of esparto and of other planting materials, basketwork and wickerwork | 407.1 | 99.9 | 0.1 |
| 7. | Textiles and textile articles, footwear, headgear, umbrellas; sunshades; walking sticks, whips, riding crops and parts thereof; travel goods; hand-bags and similar containers; articles of apparel and clothing accessories, of leather or composition leather | 106.8 | 98.8 | 1.2 |
| 8. | Articles of stone, plaster, asbestos, mica and similar materials; ceramic products, other than sanitary fixtures; glass and glassware, other than illuminating and signalling glassware and optical elements of glass, not optically worked nor of optical glass | 14.6 | 100.0 | 0.0 |
| 9. | Iron and steel and articles thereof, other than boilers and radiators for central heating, air heaters and hot air distributors not electronically heated | 167.1 | 99.2 | 0.8 |
| 10. | Non-ferrous metals and articles, other than lamp and lighting fittings | 124.9 | 93.2 | 6.8 |
| 11. | Power generating machinery and equipment | 52.4 | 91.5 | 8.5 |
| 12. | Machinery specialised for particular industries | 89.8 | 93.3 | 6.7 |
| 13. | General industrial machinery and equipment, and machine parts | 196.3 | 99.3 | 0.7 |
| 14. | Office machines and automatic data processing equipment | 2,613.8 | 90.0 | 10.0 |
| 15. | Telecommunications and sound recording and reproducing apparatus and equipment | 968.3 | 98.2 | 1.8 |
| 16. | Electrical machinery, apparatus and appliances, and electrical parts thereof | 160.6 | 95.1 | 4.9 |
| 17. | Road vehicles | 379.3 | 97.7 | 2.3 |
| 18. | Railway vehicles and associated equipment | 56.8 | 56.8 | 43.2 |
| 19. | Aircraft and associated equipment | 104.1 | 6.7 | 93.3 |
| 20. | Ships, boats and floating structures | 23.7 | 100.0 | 0.0 |
| 21. | Sanitary, plumbing, heating and veterinary equipment | 1.2 | 100.0 | 0.0 |
| 22. | Medical, dental, surgical and veterinary equipment | 509.1 | 56.5 | 43.5 |
| 23. | Furniture and parts thereof | 79.0 | 99.4 | 0.6 |
| 24. | Professional, scientific and controlling instruments and apparatus | 887.0 | 68.3 | 31.7 |
| 25. | Photographic apparatus, equipment and optional goods; watches and clocks | 82.0 | 81.8 | 18.2 |
| 26. | Miscellaneous articles | 136.4 | 82.3 | 17.7 |
| | Total | 7,696.3 | 83.9 | 16.1 |

*Source:* Information provided by the Japanese authorities, as reported in the latest Trade Policy Review for Japan.

### II.2.1.1 General equilibrium analyses

One effect of discrimination against foreign suppliers is on the levels of demand for different goods and on the inputs that are used to make them. Suppose that a government decides to no longer buy a certain good from abroad, effectively favouring the domestic suppliers of that good. This will raise the relative price of that good (the price of that good compared to other goods) because the additional resources that favoured domestic firms need to use, in order to satisfy the government's higher demand for their products, must be lured away from other productive resources. Immediately, then a procurement ban will affect the payments to factors of production, such as land, labour, and capital. The factor of production that gains (loses) from the imposition of this procurement ban is the one which is used most (least) intensively in the production of the good that the government is now buying solely from domestic firms. For example, if the amount of capital used per worker to produce one unit of steel is greater than one unit of textiles, then increased government demand for domestically–produced steel will raise the demand for capital more than the demand for labour, with predictable consequences for the payments to capital owners and workers. *The first knock-on effect of procurement discrimination in the domestic goods market is felt in domestic labour and capital markets*.

The second knock-on effect is on the quantity of exports and imports. There are two mechanisms at work here: one which works through relative prices and one that works in industries where higher output levels translate into higher productivity levels. To consider the first mechanism, it is useful to return to the steel and textile example introduced in the last paragraph. The imposition of a procurement ban on foreign steel raises the relative price of steel. There are two cases to be distinguished. First, if the nation was already exporting steel before the procurement ban, then the ban's imposition will raise the relative price of steel to all purchasers—including foreigners—that in turn buy less domestically-produced steel. In other words, the procurement ban would lead to a fall in domestic exports. Second, if the nation was importing steel before the procurement ban is imposed, then the increased relative price of steel would reduce the total (government plus private sector) domestic demand, and therefore, the imports of steel fall. In both cases, the total quantity of steel traded internationally falls as a result of the procurement ban.[175] More importantly, both cases involve the world price of steel (relative to textiles) being affected by the nation's procurement ban. Not many nations are likely to have such clout over the world price of even a few goods. In contrast, the mechanism described in the next paragraph can operate when a nation's procurement ban has no effect on world prices.

Suppose that technological and managerial capabilities of a firm are such that the amount of labour and capital needed to produce a unit of a given good falls as the production runs lengthen. (That is, output per worker employed and output per machine rise when production is higher.) Taking up the steel and textile example again, what are the effects when a government stops making purchases of foreign steel and when this procurement ban has no effect on world prices? The government switches its demand for foreign steel to domestic steel producers, that may increase output. Any increase in output will require the use of less labour and capital and so incremental production costs fall. This increases the incentive for domestic steel production to expand sales to other markets—including the export market. In sum, an expansion the procurement ban can increase exports as well as the production of domestic steel. This is a consequence of the assumptions made about the technology available to a firm and the opposite effect can be generated if the amount of labour and capital needed to produce an additional unit of a good rises as production runs lengthen. Even so, whatever technologies firms employ, *it is quite possible for a domestic procurement ban to have knock-on effects in export markets.*

### II.2.1.2 Partial equilibrium analyses

The first influential analyses of procurement discrimination examined the effects on outcomes in a single market. The essential feature of these analyses is that there are two sources of supply (domestic and foreign) and *two sources of domestic demand* (the government and consumer). The principal finding, which may seem a little counterintuitive at first, is that a procurement ban on foreign purchases by the government will affect output levels, imports, and prices only if government demand exceeded domestic supply at the moment the

[175] Both cases are based on the reasonable assumption that the demand for steel falls as its relative price increases.

ban was imposed. An example will make this a little clearer: Suppose that in the market for cars before the procurement ban was imposed, government demand was 60 cars, private sector demand was 40 cars, the domestic private sector supplied 45 cars, and 55 cars were imported. Initially, then the government must have imported at least 15 (60-45) cars. So at the prices that prevailed before the ban was imposed, government demand exceeded domestic supply. In this case, when the ban is imposed the price of cars paid by the government must increase to encourage domestic supply to expand to meet government demand. At this higher price government demand equals domestic supply at, say, 52 cars. In which case, government demand has fallen by 8 cars, domestic production has risen by 7 cars, and imports have fallen by at least 15 cars.

The effect on the domestic (non-governmental) consumers depends critically on whether the initial pre-ban price was determined by world prices or by domestic market forces. If the world price determined the pre-ban price, then the domestic consumers are unaffected by the procurement ban. After all, domestic consumers do not need to pay the higher post-ban price charged to domestic government, as they can buy all the cars they want on world markets at the world price. In contrast, if foreign producers customise their cars to the domestic market, the procurement ban leaves foreign producers with at least 15 cars which they used to sell to the domestic government but are now prevented from doing so. Since these cars were customised for a specific market (suppose they have steering wheels on the left hand side), then the possibility of selling these cars on the world market is remote. The foreign car suppliers are left with little choice but to offer additional cars to domestic consumers at lower prices. In this case, domestic consumers actually gain from a government ban on purchases from foreign cars—as the ban creates a temporary surplus of foreign goods which results in lower prices being paid by domestic consumers.

The arguments in the last two paragraphs considered the case when the government demand for cars (60 in this case) exceeded domestic private sector supply (45) at the time the procurement ban was imposed. Now, suppose that government demand was less than or equal to domestic private sector supply, then the imposition of a procurement ban would have *absolutely no effect* on imports, output, or national welfare. To see this, the preceding example need be changed in just one respect—assume now that before the ban is imposed government demand is 45 cars and domestic private sector supply is 60 cars. (Everything else in the example is as before.) In this case, the procurement ban would merely reshuffle demand between foreign suppliers and the domestic producers of cars. To see why, suppose originally the government bought 5 cars from abroad then those 5 cars must now be supplied by domestic firms, which in turn would have 5 fewer cars to supply the domestic consumers. However, foreign firms have exactly 5 unsold cars which they can now supply to domestic consumers, making up any apparent shortfall. Therefore, when government demand is relatively small, a procurement ban merely reshuffles sales between domestic and foreign firms, with no effect on overall imports, output, or prices. This striking result was first pointed out in Baldwin and Richardson (1972), and implies that *there are circumstances under which procurement discrimination has no effect on market access*.

Unfortunately, the clear-cut nature of these predictions only provide a test of whether the *future* imposition of a procurement ban will affect market outcomes; specifically, a procurement ban on a good by a nation's government will only affect market outcomes if the level of government demand before the ban exceeds domestic private sector supply. This test, however, yields no information as to whether an *existing* procurement ban restricts market access to foreign firms. More constructively, if government demand after the ban is imposed is less than domestic private sector supply, then the argument in the last paragraph applies and removal of the ban will have no effect on market outcomes, including imports. However, if observed government purchases equal the quantity supplied by the domestic private sector after a ban is imposed, then one cannot tell if the ban has distorted market outcomes. This is because this equality could have prevailed before the ban—in which case the imposition of the ban would have had no effect on imports. Thus, this simple test does not always provide a reliable guide about the market-access reducing effect of an existing *de facto* or *de jure* procurement ban.

In sum, this framework is useful as it implies that procurement discrimination effectively segments the domestic market into a market to supply domestic government and a market to supply other domestic customers. The domestic government forgoes the benefits of foreign competition and may pay a higher price and purchase few units—if its pre-ban demand was relatively large (compared to domestic supply).

Domestic producers can gain (only if they have to coaxed into supplying goods more with higher prices) and the effect on domestic consumers depends on whether domestic prices were initially set by world prices or by domestic market forces.

#### II.2.1.3 Allowing for firm entry

The framework described in the last section has been extended to consider the implications of firm entry (see Evenett and Hoekman, 2000a). In the case where procurement discrimination raises the price paid by the government, domestic firms expand output and see their profits rise. As is typical in a market economy, profits act as a signal to entrepreneurs who are deciding which industry to set up production in. New "domestic" firms want to enter this protected industry—and if they do, then the number of firms who can supply the domestic government increases, and the price paid by the government will tend to fall until the incentive to enter this market (the higher-than-usual profits) has gone. Indeed, the principal consequence of allowing free entry into the market is that the price paid by the government may now fall to equal the world price—potentially eliminating any price wedge between that paid by consumers and that paid by the government.

Whether entry occurs depends on the prevalence of natural–and policy-induced barriers—to entry. Entry by domestic entrepreneurs may be frustrated by rules, regulations, and licensing. Entry by foreign entrepreneurs, that could set up production facilities in the nation which has imposed the procurement ban, depends upon a slew of policies towards foreign direct investments. Therefore, the long term consequences of a procurement ban are determined in part by domestic competition policies and restrictions on foreign direct investments. The fewer the barriers to entry the smaller the difference between the prices paid by the domestic government and by the domestic consumer, and the smaller the distortion to government consumption decisions. However, if the new entrants have long run costs of production than exceed those of overseas producers, then the elimination of the procurement ban will still improve market access—that is, if domestic suppliers cannot take steps to lower production costs in the face of increased foreign competition.

#### II.2.1.4 Corruption

Another important consideration is the effect of corruption and bribery on the benefits of procurement liberalisation. It has been widely acknowledged that corrupt government officials can solicit payments from actual and potential potential suppliers of goods and services to the public sector. Naturally, the nature and extent of corrupt practices differ across the world, and it is impossible to give a comprehensive account of corruption in the space available here. Instead, the focus here is on two distinct lines of argument developed in Evenett and Hoekman (2000b, 2002). The earlier of these two papers considered the impact on procurement and procurement reform when a corrupt government official took bribes in a transparent fashion. The second paper considers the case when a corrupt official shifts government expenditures towards goods where the procurement process is relatively more non-transparent, which in turn facilitates the collection of bribes.

The first paper proceeds from the assumption that a procurement official cares about two factors: the quantity of goods that the official's government agency buys (which is associated with size of its agency and the prestige of the agency), and the benefit the official derives from spending any income it receives as bribes from the firms which supply its government agency. Now suppose that these firms can also sell in the world market at a price of $1. This means that these firms' revenues from supplying the government, net of bribes paid to the official, can never fall bellow $1, otherwise the firms would concentrate on supplying the world market. The official has to decide what bribe $b (per unit of good sold to the government) has to be paid by the firms. Competition among the firms ensures that they charge the government $(1+b). In making its choice the official knows that a lower bribe will increase the quantity that its agency purchases, which increase the official's welfare, but may reduce its total income from graft. The official will choose that bribe level which equates the incremental benefits of the former to the incremental benefits of the latter. Under quite standard assumptions on the official's preferences, this will result in positive bribes being set. (A bribe of $0 would, of course, result in no income from bribery.) Now the corrupt official does not, in this set up, really care whether a domestic or foreign firm pays the bribe, so long as the bribe is paid. Therefore, it is perfectly possible for a corrupt official to buy some goods from abroad.

As argued above, bribery raises the price paid by the government and reduces the quantity purchased. The reduction in the quantity purchased also determines whether or not the *subsequent* imposition of a procurement ban has any effect. The following example underlines this point. Suppose that the government only decides to buy 5 units of a good when the official is corrupt. Before the procurement ban is imposed those 5 units were supplied by both domestic and foreign firms. If the domestic industry supplies more than 5 units to all buyers when bribery occurs then, just as Baldwin and Richardson found, a procurement ban merely reshuffles demand between domestic and foreign suppliers. This is because the domestic firms need not change their production plans in order to meet all of the government's demand. Furthermore, the greater is the reduction in government demand due to bribery, the higher the likelihood that are procurement ban has no effect.

However, if the domestic firms initially supply less than 5 units, then the imposition of the procurement ban will result in government demand exceeding these firms' pre-ban output. To meet the governments' demand the domestic firms have to expand output and can only be induced to do so if the price (charged to the government) rises. Just like the Baldwin and Richardson model, procurement bans can distort market outcomes. However, in this framework the greater the effect of bribery on government demand, the less likely is a subsequent procurement ban to distort prices, outputs, and market access. *Put another way, the number of markets in which the removal of an economy-wide procurement ban will improve market access and result in lower prices paid by the liberalising government will be less in those nations where official corruption influences procurement from more sectors*. (Notice that the argument developed above did not need to invoke non-transparency in order to come to this finding.)

In a later paper Evenett and Hoekman (2002) introduced an additional realistic wrinkle: that the procurement processes for differentiated products tend to allow for more discretion by procurement officials—potentially presenting opportunities for corrupt officials to collect bribes. The first step in Evenett and Hoekman's argument was to appeal to the following finding, which is supported by a growing body of empirical literature on the nature and effects of corruption in procurement settings, namely,

> "that corrupt officials deliberately expand expenditures on goods and projects—such as aircraft and construction—which are highly differentiated and for which there are few, if any, comparable reference prices in world markets. Recent econometric analysis supports the contention that governments which are perceived to be more corrupt spend more on military procurement and on arms imports. Put simply, officials with an interest in rent collection are likely to employ non-transparent procurement regimes to expand government spending on those items where the opportunities for self-enrichment are greatest (page 11)."

This finding suggests that the composition of government spending is shifted towards goods and services that have relatively less transparent procurement processes. In addition, Evenett and Hoekman pointed to separate evidence which suggested that small and medium enterprises are less willing to bid for government contracts if they have to bribe government officials. In economic terms, to the extent that non-transparent procurement procedures reflect the desire to collect bribes by corrupt government officials, then the willingness of firms to supply the government's needs here is smaller than it would otherwise be.

These two stylised facts were used to analyse the effects of *successfully* eliminating non-transparency in procurement procedures[176], perhaps as part of an international trade agreement. Evenett and Hoekman argued that such an agreement would shift government demand away from more differentiated towards more homogenous goods, and would increase the number of firms willing to bid to supply differentiated products. In most of the cases analysed in their paper, Evenett and Hoekman found that the demand for imported differentiated products would fall—suggesting that eliminating transparency need not raise foreign market access in total. It would be very interesting to see if subsequent research comes to a similar conclusion as it would call into question the value (from a market access perspective) of negotiating additional disciplines on transparency in government procurement at the WTO. This is not to say that enhanced transparency would not have other development-friendly effects.

[176] Thus, this argument does not take a stand on whether national or international measures can successfully eliminate non-transparency in procurement practices. The purpose of the argument in the body of the text is gauge the most that could be obtained from measures to improve transparency.

### II.2.2 Economic analyses of procurement discrimination in auctions

In the analyses of procurement discrimination in markets outlined in the last two sections, the discrimination never resulted in a fall in the market price paid by the government—underlying the presumption that zero discrimination maximises both government purchases and the benefits derived from scarce government resources. However, many government purchases are not made through markets, but with are in fact made after procuring entities seek bids from suppliers. The question arises as to whether this presumption carries over to so-called procurement auctions.

Typically, each firm submits a bid price at which it is willing to complete the contract and also takes into account the price it thinks other firms are bidding for the contract. If the price paid to the contractor were the only consideration, the government would choose the bid with the lowest price. Economists have developed theories of auctions to examine such bidding behaviour, and the discussion here concentrates on what these theories imply about the effects and desirability of discriminating against one class of bidders (specifically, foreign bidders).

The first finding is that outright bans on foreign bids unsurprisingly reduce the competition faced by each domestic bidder, that in turn all submit higher bids. The government then finds itself choosing from a range of higher bids, and the overall cost of the contract rises. This finding establishes a strong presumption against forms of discrimination that exclude foreign bidders, and evidence from simulated auctions reported McAfee and McMillan (1989) implies that *restricting the number of bidders (from any source) considerably increases procurement costs*.

The second finding is that *any measure that increases the cost of one group of bidders results not just in that group raising their bids (or possibly not bidding at all) but also in other bidders raising their bids too.* This is because each relatively favoured bidder takes into account the higher prices that the disfavoured bidders are expected to submit and raises their bid by a smaller percentage, so increasing *both* the probability that one of the favoured bidders wins the contract and the profit-margin made in that eventuality. As every bidder submits higher prices, the government will see its procurement costs rise. This outcome could be result from *de facto* discrimination against foreign bidders. For example, suppose that a government decided that all bidders for state contracts—both domestic and foreign—must incur costs to verify that they can meet or have met certain domestic health and safety standards. Furthermore, assume that even though domestic firms faced the same requirements the latter are enforced less rigorously for domestic firms. This asymmetric enforcement would effectively discriminate against potential foreign bidders by raising their costs. This would result in higher bids by all firms—domestic and foreign—and higher procurement costs. In simulations of such procurement auctions, Deltas and Evenett (1997) found that such *de facto* "cost" discrimination against foreign firms can raise procurement costs significantly. However, comparing their findings with McAfee and McMillan's simulations, the outright prohibition on foreign bidding tends to raise the expected procurement outlays more than cost discrimination.

The third finding differs from the first two in that *one form of discrimination–price preferences–can actually lower procurement costs*. McAfee and McMillan (1989) demonstrated this result in an analysis of optimal procurement auctions. *The significance of this finding is that it undermines the presumption that a procurement official that seeks to minimise state outlays would always choose not to discriminate against any bidder, domestic or foreign*. To understand the intuition underlying McAfee and McMillan's result it is important to bear in mind two points. First, just as in the last paragraph, in most analyses of auctions, if one supplier raises its bid then other suppliers have an incentive to raise their bids too. The second point relates to the manner in which price preferences work. A price preference is only used to inflate the actual bids of foreign suppliers when comparing domestic and foreign bids. If a foreign supplier's inflated bid is still the lowest, then the government awards the contract to that foreign supplier but only pays an amount equal to that stated in the winning bid. For example, suppose there is a 10% price preference for domestic firms. If a foreign supplier bids $10 for a contract, then for the purpose of comparison with domestic bids the domestic government treats the foreign supplier as if it had bid $11. Now if $11 is the lowest amount that any supplier bids, then the contract is awarded to the foreign supplier and the latter is only paid $10 (the actual pre-inflated bid).

McAfee and McMillan's insight was to show that foreign firms set their bid prices knowing that a price preference will be used to inflate their bids. Foreign firms respond to high price preferences by lowering

their actual bids, but not by enough so that their inflated bid falls. What is more, foreign firms accept a larger reduction in their profit margins as price preferences become more stringent. The inflated bids of the foreign firms reduce how much competition domestic firms effectively face. Since the price preferences raise the foreign firms' (inflated) bids, then domestic firms respond by raising their actual bids and, therefore, their profit margins. The effect of higher price preferences on procurement costs is ambiguous; however, *if the probability of a foreign firm making the lowest bid is high, then increasing price preferences might actually reduce procurement costs because the actual amount paid by the government to any successful foreign bidder has gone down*. In particular, McAfee and McMillan show that if the foreign firms have on average lower costs than domestic firms, then an increase in price preferences from zero will always reduce procurement costs because, under these circumstances, the probability of a foreign firm still winning the contract is so high.

In procurement auctions, domestic firms benefit from higher price preferences, because their profit margins expand if they win the contract and, so long as they do not increase their bids too much in response to the higher preferences, the probability of one of them winning the contract increases too. In sum McAfee and McMillan show that, compared to setting no price preference, there is *a certain range of price preferences* that will result in lower procurement costs for the government and higher expected profits for domestic firms. (McAfee and McMillan also show that if the government is prepared to trade off higher procurement costs against higher domestic profits, then the government should always impose price preferences. It is always possible to find a price preference that increases domestic firm's profits more than such preferences raise procurement costs.)

But how much of a reduction in procurement costs can be accomplished by using price preferences? Both McAfee and McMillan (1989) and Deltas and Evenett (1997) found in simulations of auctions that the cost reductions were very small (often less than 1%). Worse still, Deltas and Evenett found that if the government accidentally chose the wrong rate of price preference then these cost reductions would quickly become cost increases–-even for small errors. This is particularly important as policy makers do not typically have access to all the relevant information (including the actual probability distributions of the costs of the domestic and foreign firms) to choose the optimal price preference. And even if they did, political factors would probably "encourage" policymakers to choose a higher-than-optimal price preference which benefits domestic firms. Indeed, Deltas and Evenett's simulations imply considerable gains in the expected profitability of domestic firms result from even quite modest (5-10%) price preferences. Overall, even though McAfee and McMillan (1989) demonstrated in theory that it is possible to reduce procurement costs by imposing price preferences, in practice the reductions are very small and given the realities of policy making will almost certainly never be realised. This form of procurement discrimination is bad policy too.

One final point is that, comparing across simulations of procurement auctions, three types of procurement discrimination in auctions can be clearly ranked in terms of their adverse consequences for procurement costs. Price discrimination tends to have the least adverse effect, followed by *de facto* cost discrimination, which in turn is less distortionary than outright bans on bids from foreign suppliers (or *de facto* measures that have the effect of eliminating all bids from foreign firms). Given these findings, it is noteworthy that the current WTO Agreement on Government Procurement Agreement has strong measures against *de jure* discrimination—such as price preferences—and effectively imposes much weaker disciplines on *de facto* discrimination, which can result in the other two forms of procurement discrimination discussed above.

### II.2.3 Implications of these analyses for the impact of the GPA

Even though this assessment will be quite critical of selected aspects of the GPA, it should not be forgotten that this plurilateral agreement has expanded considerably the disciplines on public procurement practices. On the basis of available research, one can expect with a reasonably high degree of confidence that membership of this agreement translates into lower procurement costs, allowing members to spread stretched government budgets across a wider range of activities. (For sure, the extent to which procurement costs have fallen has yet to be established with confidence.) Nevertheless, the agreement falls short of its potential for two reasons. First, discrimination has only been tackled partially. Second, the benefits of membership of this agreement are highly contingent on the extent of bribery and corruption in an economy. Each concern is discussed in turn.

The provisions in the GPA allowing for *conditional* non-discrimination need to be rethought. Removing conditionality would increase the number of foreign suppliers that are treated similarly to domestic suppliers, encouraging competition for state contracts, and lowering procurement costs.

The more important concern about the GPA's disciplines on discrimination is that they *only* effectively ban *de jure* discrimination, such as price preferences. The GPA's provisions on *de facto* discriminatory measures against foreign firms in regard to their costs, or to their ability to bid for state contracts in the first place, are much weaker. This is a concern because price preferences tend to be the least (economically) costly form of procurement discrimination (Deltas and Evenett 1997, McAfee and McMillan 1989). One implication is that the *status quo* is likely to encourage policymakers that want to circumvent the GPA's disciplines to substitute transparent price preferences for murkier forms of discrimination; so reducing the potential market access and welfare benefits of the GPA. (Of course, the GPA is not the only international trade agreement where possibility for substitution between trade policy instruments exists.)

One reform option might be to tighten up on the *de facto* cost-based and entry-based discrimination, through more stringent rules on transparency of public procurement practices and tougher domestic and international review procedures, and to relax the ban on price preferences. The goal here is to try to channel any protectionist pressures into higher levels of observable price preferences, whose level can then subsequently be negotiated down over time. In addition, one could modify the pre-selection procedures to allow firms that have not pre-qualified to bid to do so, but with a fixed price preference applied against them. Apart from this price preference, the bids of such unqualified firms would be treated identically to those firms who pre-qualified. The advantage of this provision in that it caps any distortions created by the pre-qualification process.

With respect to bribery and corruption, recent research has shown that this narrows the circumstances under which procurement reform yields benefits (Evenett and Hoekman 2002). To the extent that bribes and pay-offs to government officials result in a higher price being paid by taxpayers for a good, then this reduces the quantity demanded by government. This increases the likelihood that this government demand can in principle be met solely by domestic producers, which means that the subsequent imposition of a procurement ban (or other form of discrimination) against foreign bidders merely redistributes government sales from foreign firms to domestic firms, without the latter's output rising. Domestic consumers' demand shifts from domestic firms to foreign firms at exactly the same rate as government demand is shifting in the opposite direction. Under these circumstances, the net effect of procurement discrimination on imports (market access) is zero. By the same logic, the removal of such discrimination will not increase imports (market access) either. This implies that the benefits of membership of the GPA are contingent on the degree of bribery, corruption, and other governance-related problems in national procurement practices. This finding does not necessarily provide an argument against joining the GPA *per se*, rather it suggests that joining the GPA may have to be complemented with measures to improve governance practices if the maximum benefits of acceding to this international trade agreement are to be garnered.

### II.2 The UNCITRAL Model Law on Procurement

At its twenty-sixth meeting the United Nations Commission on International Trade Law (UNCITRAL) adopted the UNCITRAL Model Law on Procurement of Goods, Construction and Services. This "Model Law" contains the elements of a procurement law that nations might adopt and as such it is a non-binding recommendation of best practices. Specifically, The Model Law contains the 57 articles organised into six chapters (titled General Provisions, Methods of Procurement And Their Conditions For Use, Tendering Procedures, Principal Method For Procurement Of Services, Procedures For Alternative Methods Of Procurement, and Review.) As the following discussion will make clear, by and large the UNCITRAL Model Law is consistent with the principles and provisions of the Uruguay Round GPA, although the latter contains some provisions that are not in the former. (A further comparison of the UNCITRAL Model Law and the GPA can be found in Appendix 3).

UNCITRAL has published a "Guide to Enactment of the UNCITRAL Model Law on Procurement of Goods, Construction, and Services" (document number A/CN.9/403) from which the following quotations are drawn. UNCITRAL notes the following purpose of the Model Law:

> "The Model Law on Procurement of Goods and Construction is intended to serve as a model for States for the evaluation and modernization of their procurement laws and practices and the establishment of procurement legislation where none presently exists" (page 46).

Moreover, UNCITRAL describes as follows the motivation for formulating the Model Law and stresses the important developing country-specific factors that were taken into account when devising the Model Law:

> "The decision by UNCITRAL to formulate model legislation on procurement was taken in response to the fact that in a number of countries the existing legislation governing procurement is inadequate or outdated. This results in inefficiency and ineffectiveness in the procurement process, patterns of abuse, and the failure of the public purchaser to obtain adequate value in return for the expenditure of public funds. While sound laws and practices for public sector procurement are necessary in all countries, this need is particularly felt in many developing countries, as well as in countries whose economies are in transition. In those countries, a substantial portion of all procurement is engaged in by the public sector. Much of such procurement is in connection with projects that are part of the essential process of economic and social development. Those countries in particular suffer from a shortage of public funds to be used for procurement. It is thus critical that procurement be carried out in the most advantageous way possible. The utility of the Model Law is enhanced in States whose economic systems are in transition, since reform of the public procurement system is a cornerstone of the law reforms being undertaken to increase the market orientation of the economy" (page 46).

And,

> "Furthermore, the Model Law may help to remedy disadvantages that stem from the fact that inadequate procurement legislation at the national level creates obstacles to international trade, a significant amount of which is linked to procurement. Disparities among and uncertainty about national legal regimes governing procurement may contribute to limiting the extent to which Governments can access the competitive price and quality benefits available through procurement on an international basis. At the same time, the ability and willingness of suppliers and contractors to sell to foreign Governments is hampered by the inadequate or divergent state of national procurement legislation in many countries" (pages 46-7).

Many of these considerations have found themselves into the preamble of the Model Law:

> "Preamble
>
> WHEREAS the [Government] [Parliament] of ... considers it desirable to regulate procurement of goods, construction and services so as to promote the objectives of:
>
> (a) Maximizing economy and efficiency in procurement;
>
> (b) Fostering and encouraging participation in procurement proceedings by suppliers and contractors, especially where appropriate, participation by suppliers and contractors regardless of nationality, and thereby promoting international trade;
>
> (c) Promoting competition among suppliers and contractors for the supply of the goods, construction or services to be procured;
>
> (d) Providing for the fair and equitable treatment of all suppliers and contractors;
>
> (e) Promoting the integrity of, and fairness and public confidence in, the procurement process; and
>
> (f) Achieving transparency in the procedures relating to procurement."

Interestingly, the Model Law was conceived as having the widest potential scope:

> "In order to facilitate the widest possible application of the Model Law, it is provided in article 1(3) that, even in the excluded sectors, it is possible, at the discretion of the procuring entity, to apply the Model Law" (page 48).

Moreover, at least as far as procurement of goods is concerned, the Model Law requires the use of open tendering procedures:

> "As the rule for normal circumstances in procurement of goods or construction, the Model Law mandates the use of tendering, the method of procurement widely recognized as generally most effective in promoting competition, economy and efficiency in procurement, as well as the other objectives set forth in the Preamble" (page 49).

Transparency is an important feature of the UNCITRAL Model as the following commentaries on Articles 5 and 11 of that Law (on "Public accessibility of legal texts" and "Record of procurement proceedings") makes clear:

> "This article [5] is intended to promote transparency in the laws, regulations and other legal texts relating to procurement by requiring public accessibility to those legal texts. Inclusion of this article may be considered important not only in States in which such a requirement is not already found in its existing administrative law, but even in States in which such a requirement was already found in the existing applicable law. In the latter case, the legislature may consider that a provision in the procurement law itself would help to focus the attention of both procuring entities and suppliers and contractors on the requirement of adequate public disclosure of legal texts concerned with procurement procedures." (pages 60-1).

And,

> "One of the most important ways to promote transparency and accountability is to include provisions requiring that the procuring entity maintain a record of the procurement proceedings. A record summarizes key information concerning the procurement proceedings. It facilitates the exercise of the right of aggrieved suppliers and contractors to seek review. That in turn will help to ensure that the procurement law is, to the extent possible, self-policing and self-enforcing. Furthermore, adequate record requirements in the procurement law will facilitate the work of Government bodies exercising an audit or control function and promote the accountability of procuring entities to the public at large as regards the disbursement of public funds" (page 63).

The Model Law also touches on a number of matters that are currently being discussed in the WTO. The first concerns the role of domestic review procedures. UNCITRAL notes:

> "An important safeguard of proper adherence to procurement rules is that suppliers and contractors have the right to seek review of actions by the procuring entity in violation of those rules. Such a review process, which is set forth in chapter VI, helps to make the Model Law to an important degree self-policing and self-enforcing, since it provides an avenue for review to suppliers and contractors, who have a natural interest in monitoring compliance by procuring entities with the provisions of the Model Law" (page 54).

Similar remarks are made about Article 14 of the Model Law on publication of procurement awards. Article 15 concerns inducements from suppliers and contractors, and UNCITRAL motivates its provisions in this regard as follows:

> "Article 15 contains an important safeguard against corruption: the requirement of rejection of a tender, proposal, offer or quotation if the supplier or contractor in question attempts to improperly influence the procuring entity. A procurement law cannot be expected to eradicate completely such abusive practices. However, the procedures and safeguards in the Model Law are designed to promote transparency and objectivity in the procurement proceedings and thereby to reduce corruption. In addition, the enacting State should have in place generally an effective system of sanctions against corruption by Government officials, including employees of procuring entities, and by suppliers and contractors, which would apply also to the procurement process" (page 55).

Given the interest in international trade negotiations on matters of discrimination, it is worth observing that the Model Law contains detailed provisions on the use of preferences and the manner in which tenders are to be evaluated. Article 34 of the Model Law (on the "Examination, evaluation and comparison of tenders) addresses the latter issue and the Guide accompanying the Model Law makes the following four remarks:

> "Although ascertaining the successful tender on the basis of the tender price alone provides the greatest objectivity and predictability, in some tendering proceedings the procuring entity may wish to select a

tender not purely on the basis of the price factor. Accordingly, the Model Law enables the procuring entity to select the "lowest evaluated tender", i.e., one that is selected on the basis of criteria in addition to price. Paragraph (4)(c)(ii) and (iii) list such criteria. The criteria in paragraph (4)(c)(iii) related to economic-development objectives have been included because, in some countries, particularly developing countries and countries whose economies are in transition, it is important for procuring entities to be able to take into account criteria that permit the evaluation and comparison of tenders in the context of economic development objectives. It is envisaged in the Model Law that some enacting States may wish to list additional such criteria. However, caution is advisable in expanding the list of non-price criteria set forth in paragraph (4)(c)(iii) in view of the risk that such other criteria may pose to the objectives of good procurement practice. Criteria of this type are sometimes less objective and more discretionary than those referred to in paragraph (4)(c)(i) and (ii), and therefore their use in evaluating and comparing tenders could impair competition and economy in procurement, and reduce confidence in the procurement process" (page 76).

"Requiring that the non-price criteria should be objective and quantifiable to the extent practicable, and that they be given a relative weight in the evaluation procedure or be expressed in monetary terms, is aimed at enabling tenders to be evaluated objectively and compared on a common basis. This reduces the scope for discretionary or arbitrary decisions. The enacting State may wish to spell out in the procurement regulations how such factors are to be formulated and applied. One possible method is to quantify in monetary terms the various aspects of each tender in relation to the criteria set forth in the solicitation documents and to combine that quantification with the tender price. The tender resulting in the lowest evaluated price would be regarded as the successful tender" (page 76).

"Paragraph (4)(d) permits a procuring entity to grant a margin of preference to domestic tenders, but makes its availability contingent upon rules for calculation to be set forth in the procurement regulations. (See paragraph 26 of section I of the Guide concerning the reasons for using a margin of preference as a technique for achieving national economic objectives while still preserving competition.) It should be noted, however, that States that are parties to the GATT Agreement on Government Procurement and member States of regional economic integration groupings such as the European Union may be restricted in their ability to accord such preferential treatment. In order to promote transparency, resort to the margin of preference may be made only if authorized by the procurement regulations and approved by the approving authority. Furthermore, the use of the margin of preference is required to be predisclosed in the solicitation documents and reflected in the record of the procurement proceedings" (page 76).

"As to the mechanics of applying the margin of preference, this may be done, for example, by deducting from the tender prices of all tenders import duties and taxes levied in connection with the supply of the goods or construction, and adding to the resulting tender prices, other than those that are to benefit from the margin of preference, the amount of the margin of preference or the actual import duty, whichever is less" (page 77).

UNCITRAL makes the following general remarks about the efficacy of using preferences to discriminate against foreign bidders, noting that a number of factors should determine the optimal level of preferences:

"It may be noted that the Model Law provides in article 34(4)(d) and 39(2) for the use of the technique referred to as the "margin of preference" in favour of local suppliers and contractors. By way of this technique, the Model Law provides the enacting State with a mechanism for balancing the objectives of international participation in procurement proceedings and fostering national industrial capacity, without resorting to purely domestic procurement. The margin of preference permits the procuring entity to select the lowest-priced tender or, in the case of services, the proposal of a local supplier or contractor when the difference in price between that tender or proposal and the overall lowest-priced tender or proposal falls within the range of the margin of preference. It allows the procuring entity to favour local suppliers and contractors that are capable of approaching internationally competitive prices, and it does so without simply excluding foreign competition. It is important not to allow total insulation from foreign competition so as not to perpetuate lower levels of economy, efficiency and competitiveness of the concerned sectors of national industry. Accordingly, the margin of preference could be a preferable means of fostering the competitiveness of local suppliers and contractors, not only as effective and

economic providers for the procurement needs of the procuring entity, but also as a source of competitive exports" (page 53).

Having said that, UNCITRAL does offer the following remarks about restricting competition generally and from foreign sources:

> "In line with the mandate of UNCITRAL to promote international trade, and with the notion underlying the Model Law that the wider the degree of competition the better the value received for expenditures from the public purse, the Model Law provides that, as a general rule, suppliers and contractors are to be permitted to participate in procurement proceedings without regard to nationality and that foreign suppliers and contractors should not otherwise be subject to discrimination. In the contexts of tendering proceedings and the principal method for procurement of services, that general rule is given effect by a number of procedures designed, for example, to ensure that invitations to tender or to submit proposals and invitations to prequalify are issued in such a manner that they will reach and be understood by an international audience of suppliers and contractors.
>
> "At the same time, the Model Law recognizes that enacting States may wish in some cases to restrict foreign participation with a view in particular to protecting certain vital economic sectors of their national industrial capacity against deleterious effects of unbridled foreign competition. Such restrictions are subject to the requirement in article 8(1) that the imposition of the restriction by the procuring entity should be based only on grounds specified in the procurement regulations or should be pursuant to other provisions of law. That requirement is meant to promote transparency and to prevent arbitrary and excessive resort to restriction of foreign participation. The reference in article 8 to exclusions of suppliers or contractors on the basis of nationality pursuant to provisions in the procurement regulations or other provisions of law, supported also by article 3 on the primacy of international obligations of the enacting State, also permits the Model Law to take account of cases in which the funds being used are derived from a bilateral tied-aid arrangement. Such an arrangement would require that procurement with the funds should be from suppliers and contractors in the donor country. Similarly, recognition is thereby given to restrictions on the basis of nationality that may result, for example, from regional economic integration groupings that accord national treatment to suppliers and contractors from other States members of the regional economic grouping, as well as to restrictions arising from economic sanctions imposed by the United Nations Security Council" (pages 52-3).

More generally, the Model Law was designed to be deferential to a nation's international obligations:

> "It provides that such international obligations (e.g., loan or grant agreements with multilateral and bilateral aid agencies containing specific procedural requirements for the funds involved; procurement directives of regional economic integration groupings) prevail over the Model Law to the extent of any inconsistent requirements" (page 48).

In sum, the UNCITRAL Model Law can be seen as an attempt to develop best practices that nations can incorporate into their procurement legislation. Although this international initiative is not binding on the members of the United Nations, it has become the foci for many discussions on procurement laws in developing and industrialised economies. Moreover, the Model Law does contain provisions that are the subject of current international trade disciplines on government procurement (transparency, discrimination, and review procedures) and is, more or less, consistent with the latter.

### II.3 Provisions on government procurement in regional trading agreements

The 1990s also saw the signing of a large number of regional trade agreements (World Bank 2001). Many of these agreements contained provisions on government procurement and the question arises as to whether these provisions contradict or accord with those in the GPA and whether regional agreements offer a substitute to a new multilateral initiative on government procurement.

OECD (2002) contains a detailed analysis of the procurement provisions of regional trading agreements. With respect to the procurement provisions in several regional trading agreements, OECD (2002) notes:

> "In a number of recently signed RTAs government procurement is a major focus, with a whole chapter dedicated to the issue. This includes the EU-Mexico FTA as well as initiatives in the Pacific Rim region,

such as the agreement between New Zealand and Singapore on a Closer Economic Partnership (CEP) and the Japan-Singapore Economic Partnership Agreement (JSEPA). These agreements contain extensive provisions dealing with transparency and various aspects of procurement procedures. Another important observation concerning regional initiatives in the procurement field is that developing and emerging economies are increasingly entering into bilateral or regional procurement agreements whether or not they are parties to the GPA. The Group of Three Accord[177] and other bilateral agreements concluded by Mexico, such as the Mexico-Bolivia FTA, the Mexico-Costa Rica FTA and the Mexico-Nicaragua FTA, show that developing countries are increasingly concluding regional procurement agreements with other developing countries. Likewise, NAFTA and more recently the EU-Mexico FTA demonstrate that it is possible to bring countries at different levels of economic development together in a liberalising agreement on public procurement" (page 5).

By and large the provisions in these regional trading agreements share many of the features of the GPA. One major difference is that some regional initiatives—such as the Asia Pacific Economic Cooperation (APEC) set of Principles on Government Procurement—are non-binding. (As noted earlier, the GPA is binding on its members.) OECD (2002) summarises the commonalities and differences as follows:

"The review of the procurement provisions in RTAs shows that there are many common elements, if not a symbiosis, between the procurement liberalisation process in the WTO GPA and the procurement reform process at the regional level. This reflects the recognition that foreign suppliers of goods and services require not only market access in the sense of non-discriminatory treatment; in order to compete effectively they also require transparent, predictable and fair procedures. These happen also to be the features that are needed as part of the ongoing modernisation and reform of procurement rules and systems at the national level" (page 4).

Moreover,

"Typically, RTAs include provisions that are similar to the WTO GPA, but to different degrees. There are two ways in which RTAs appear to have gone beyond or provide something in addition to the WTO Agreement. First, some RTAs have gone beyond the WTO by adopting obligations substantially similar to the GPA, but including countries that are not parties to the GPA. In the post-Doha scenario, particularly with the scheduled negotiations on transparency aspects of procurement, this can have a positive effect in that countries not Members to the GPA can gain experience in meeting the transparency requirements agreed to at the regional level. In this regard, it may be noted that a number of countries are seeking accession to the GPA.

"Second, some RTAs have gone beyond the WTO by providing for broader coverage or by allowing for the provision of additional information. For instance, several RTAs have expanded the procurement coverage, widened the scope by covering more entities or reduced the thresholds of procurement contracts covered.

"Another noteworthy point concerns the effects on third-party goods and services. Although procurement-related provisions contained in most RTAs are of a preferential nature, the procedures dictated in these provisions may help foster the practice of transparency more widely and so, eventually, yield more far-reaching benefits. In "addition, the regional experience may point the way toward confidence building among a wider group of countries, thereby helping extend WTO disciplines." (page 5)

OECD (2002) goes on to identify for five procurement provisions any substantial divergence in the treatment in the Uruguay Round GPA and existing regional trading agreements. The differences have been collated and reported in Table 6 below.

[177] OECD (2002) notes that parties to this Accord are Colombia, Mexico and Venezuela.

**Table 6: Differences identified by the OECD between the GPA's disciplines and those found in regional trading agreements; other than the fact that the APEC Principles are non-binding.**

| Procurement provision | Divergence in provisions between GPA and those in regional agreements |
|---|---|
| Scope and coverage of respective agreement | "The EC Directives, for example, apply to purchases of supplies, works and services, including entities in the formerly excluded utilities field. The extended coverage includes purchases of products, works and services, by railway operators, entities active in the field of energy other than electricity and telecommunications providers. In contrast to the GPA, the entity coverage includes all entities, at the State, regional and local level, whether or not they are listed in annexes to the Directives" (page 9).<br><br>"NAFTA, in contrast to the GPA, does not cover state and provincial governments. At the same time, NAFTA—which also comprises goods and services, including construction services—expands upon the obligations of the GPA by adopting lower thresholds and a negative list approach to the coverage of services procured by the listed entities. Consequently, all services are covered unless specifically exempted" (page 9).<br><br>"In this connection, another interesting RTA is that signed by the EU and Mexico. In this Agreement, Mexico offers to the EU the lower thresholds of the NAFTA, while the EU offers to Mexico the higher thresholds of the GPA (and of the EC Directives). This has been done to facilitate the tender procedure through a transparent and widely-known rule identical for all tenderers within each of the Members, and to avoid, for both procuring entities and suppliers, the need to handle different thresholds and verify which agreement applies for each call for tender." (page 10) |
| Non-discrimination | None identified other than the non-binding nature of APEC's Principles (see body text). |
| Open and fair procurement procedures | Few differences were identified. However, in the case of the EC Directives on Procurement, OECD (2002) notes "the GPA covers issues that are not addressed in the Directives, such as specific rules on the opening of bids" (page 11). |
| Rules on transparency | No major discrepancies identified but OECD (2002) does note that the New Zealand and Singapore on a Closer Economic Partnership (CEP) is not as detailed as the comparable provisions in the GPA (page 13). |
| Accountability and due process | "With respect to bid challenge provisions [to the GPA], the ANZGPA adopts a different approach. The relevant procedures for dealing with complaints are designed to resolve problems and avoid recurrence through discussion and mutual agreement between the "designated bodies". The Agreement relies on the political will and commitment of the parties for compliance, rather than any legal redress. Thus, the final authority for decision is the relevant Minister in the purchasing jurisdiction. Should there continue to be serious concern on the part of one or more of the other jurisdictions, this would be raised and discussed in the Council at officials' and/or Ministerial level in order to reach a mutually agreeable outcome. But the Agreement does not contain any formal provision for negotiation of a solution at these levels" (page 14). |

*Source*: Collated from OECD (2002).

In terms of economic impact, the conditional nature of any provisions on discrimination against foreign bidders is a feature of some regional trading agreements and the plurilateral GPA and, more importantly,

can be a source of inefficiency. This is because the introduction of conditional non-discrimination can result in government contracts that were previously awarded to the lowest cost foreign supplier being switched towards higher cost—but no longer discriminated against—regional partners. (The analogy to trade in goods in a regional trading agreement is not quite complete as governments often do not collect tariff revenue on its own purchases from abroad; so the losses of tariff revenue that arise from forming regional trade agreements more generally do not arise in conjunction with provisions on procurement provisions.) In sum, both the current GPA and regional trading agreements can result in government contracts being shifted away from non-members, harming the latter's export interests.

Another important implication of regional trading agreements concerns their provisions on transparency. To the extent that such an agreement results in improvements in the transparency of a nation's procurement regime then it is quite likely that this will encourage more bids from *all* sources; that is, from both members and non-members of the regional agreement. This is because firms from non-members are going to have the same access to publicly available information as members to the regional trading arrangements. Unlike the provisions on conditional non-discrimination, then, the provisions on transparency can create opportunities for non-members. The overall effect on the latter of the provisions in regional trading arrangements (and the plurilateral Uruguay Round GPA, for that matter) will depend on which of these two effects dominates.

### II.4 Summary

Although the 1990s saw many international initiatives on government procurement there is, as of yet, no international agreement that is comprehensive in membership, comprehensive in procuring entities covered and in provisions included, and binding and enforceable. This is not to say that these initiatives have not been used by some governments to introduce procurement reforms and to reduce discrimination against foreign bidders for state contracts. Rather, it is a statement about just how far international initiatives on procurement reform could develop in the future.[178] It is fitting, therefore, that the discussion now turns to proposals by some WTO members for further multilateral rules on government procurement practices.

[178] That such initiatives *could* develop in the future does not mean they *should* develop. The efficacy of future international collective action on procurement matters is the subject of parts IV and V of this chapter.

## Part III

# PROPOSALS FOR NEW MULTILATERAL DISCIPLINES ON TRANSPARENCY IN GOVERNMENT PROCUREMENT LAW AND PRACTICE

A Working Group on Transparency in Government Procurement Practices was established after the 1996 WTO Ministerial Meeting in Singapore.[179] The mandate of this Working Group was contained in that meeting's Ministerial Declaration and called for:

> "the working group to conduct a study on transparency in government procurement practices, taking into account national policies, and, based on this study, to develop elements for inclusion in an appropriate agreement."[180]

As noted in the Introduction to this chapter, WTO Ministers further clarified the mandate of the Working Group in Doha and noted that any

> "[N]egotiations shall be limited to transparency aspects and therefore will not restrict the scope for countries to give preferences to domestic supplies and suppliers" (WTO 2001, paragraph 26).

This statement appears to rule out negotiations over explicitly discriminatory policies, such as price preferences. It would seem that those practices included in the negotiating mandate must have some transparency-related aspect to them. Moreover, given the emphasis of some on trade impacts, would those practices that have a transparency-related aspect to them but do not affect trade flows fall within the negotiating mandate? As will become clear below, these questions have tended to recur in one form or another in the deliberations in the Working Group.

Although the focus of this part of the chapter is on the recent proposals for new multilateral disciplines on transparency in government procurement, an important point to bear in mind is that—if the submissions by WTO members are anything to go by—the Working Group was particularly active before the WTO Ministerial in Seattle in 1999. The principal submissions relating to proposals for new multilateral rules are summarised in Appendix 3. What is particularly noteworthy is that in November 1999 two submissions (one by the European Communities and the other a joint submission by Hungary, Korea, Singapore, and the United States) went so far as to propose text for a new multilateral agreement on transparency in government procurement.[181] It appears that these proposed texts did not become the focus of subsequent discussions in the Working Group. Instead, discussions have centered around a number of procurement practices that are thought have a transparency-related aspect to them. To help structure discussions, successive Chairmen of the Working Group have issued and updated a "List Of The Issues Raised and Points Made." This "List" identified the following twelve topics that have been examined to differing degrees in the Working Group:

1. Definition and scope of government procurement
2. Procurement methods
3. Publication of information on national legislation and procedures
4. Information on procurement opportunities, tending and qualification procedures
5. Time-periods
6. Transparency of decisions on qualification
7. Transparency of decisions on contract awards
8. Domestic review procedures

[179] For an analysis of the origins of this Working Group, its relationship to the Uruguay Round GPA, and the likely consequences of strengthening transparency provisions in the GPA, see Arrowsmith (1997).
[180] See "Singapore Ministerial Declaration—Adopted on 13 December 1996," World Trade Organisation, document WT/MIN/96/DEC.
[181] These two proposed agreements are reported in their entirely in Appendices 3a and 3b at the end of this chapter.

9. Other matters related to transparency
10. Information to be provided to other governments (notification)
11. WTO dispute settlement procedures
12. Technical cooperation and special and differential treatment for developing countries

A number of WTO Members have made submissions on elements of this List and the contents of those contributions are summarised in Appendix 3. Since 1 January 2002, Canada, the European Communities, Japan, Korea, and the United States have made submissions that are supportive of the development of new multilateral rules on transparency in government procurement. Examination of the submissions in Appendix 3 and of the publicly available minutes of the Working Group's meetings (which it should be noted are at the time of writing only available through to the end of 2002), a number of more general observations can be made about deliberations in the Working Group. These observations are pertinent as they reveal much about the views and concerns of certain WTO Members about the efficacy of new multilateral disciplines. As will become clear, India and Malaysia have taken a consistently sceptical—if not critical—view of the proponents' proposals.

At the 29 May 2002 meeting of the Working Group, India and Malaysia offered the following interpretations of the Doha Ministerial Declaration's paragraph on government procurement and its implications for the discussions in the Working Group. These two delegations appear to be implacably opposed to any attempt in the Working Group to negotiate new provisions or to reach a consensus; these tasks are apparently those of Ministers. The minutes of this meeting report:

> "The representative of India[182] said that the mandate in the Doha Ministerial Declaration had to be read in conjunction with the statement by the Chairman of the Ministerial Conference prior to the adoption of the Declaration expressing his understanding in relation to Singapore issues. Since the Chairman's Understanding had been arrived at on the basis of consultations with Members and had not been opposed by any delegation, his delegation believed that it was binding on all Members even though it had not been included in the text of the Ministerial Declaration. His delegation therefore believed that there should be no attempt at consensus building on the various issues before the Working Group. Any Member would have the right to take a position that would prevent a decision on launching negotiations in this area at the Fifth Ministerial Conference. The study phase was solely aimed at furthering the understanding of Members on various issues. The representative of Malaysia said the Group was still at the study phase. The Ministers would have to agree on the modalities for negotiations by explicit consensus at the next Ministerial meeting before moving on to the negotiating phase" (WTO 2002c, page 1).

Moreover, India and Malaysia contend that some of the matters and government practices discussed in the Working Group are unrelated to transparency, and have implications for market access:

> "The representative of India said that the mandate of the Working Group did not extend to market access issues, such as the grant of preferences to domestic suppliers and supplies. Therefore the main issue before the Group was to gain a greater understanding of the meaning of transparency in the context of government procurement. All the elements identified in the informal note by the Chair "List of Issues Raised and Points Made", were in fact elements common to procurement systems in place in any of the Members, but there had been differences among Members in identifying the transparency-related aspects of these elements. Elements such as procurement methods, time-periods, decisions relating to evaluation of offers and awarding of contracts, domestic review mechanism, and application of the WTO Dispute Settlement Understanding were not directly related to the issue of transparency, and hence should not form part of the work of the Group. In the context of the WTO, transparency involved the obligation to make information on related laws and regulations available and the obligation to provide notifications to WTO Members of these laws and regulations, including any changes thereto, without questioning the fairness and reasonableness of the laws themselves. The issue of the administration of laws and regulations related to government procurement did not fall

[182] As a matter of convention, minutes of meetings of WTO Working Groups underline the name of any WTO member that is reported therein.

within the purview of transparency. The representative of Malaysia said that there were elements in the Note by the Chairman "List of Issues Raised and Points Made" that were not related to transparency *per se*, and delved into the area of market access. In addition to the elements relating to domestic review procedures and making a transparency agreement subject to the WTO Dispute Settlement Understanding, his delegation was prepared to consider other elements that may need to be deleted from the "List of Issues Raised and Points Made" for the purposes of the transparency agreement" (WTO 2002c, pages 1-2).

The difficulties in drawing a fine line between transparency-related and market access-related issues has been acknowledged by the United States, but it appears that the latter believes this should be the starting point of a discussion on clarifying the Doha mandate and not the end point. The minutes of the 29 May 2002 report:

"The representative of the United States said that his delegation recognized that that discussion on transparency aspects could to an extent creep into market access questions and consideration could be given to how this could be limited. It had to be recognized also that even issues that may delve into market access also had transparency components. In the course of its examination of individual elements, the Group should try to identify the specific characteristics which related to transparency. The delegation of Switzerland recognized that, although transparency and market access questions were not sometimes easy to separate, given the quantity of work accomplished on the basis of the "List of Issues Raised and Points Made", Switzerland believed that the Group should continue discussion on the basis of the issues listed in that document" (WTO 2002c, page 2).

Further evidence of disagreements over the mandate of the Working Group can be found in the divergent positions taken during discussions on specific elements of the Chairman's "List", as box 2 makes clear in the case of the time-limits for firms to respond to tenders.

**Box 2: Do the time-periods to reply to tenders have a transparency-related aspect to them?**

The following exchange between five WTO members indicates a degree of disagreement over the mandate of the Working Group in the first place:

"The representatives of India and Jamaica said that prescription of time-periods was not a matter of transparency. The representative of India said that time-periods should be set in a non-discriminatory manner and that entities should be able to decide time-periods on a case-by-case basis. The representative of Jamaica, joined by the representative of the United States, said that making known the specific time-periods applicable to a particular procurement was a transparency matter. The representative of India, joined by the European Community, said that information on time-periods, including any changes thereto, should be made available to suppliers. The representative of the United States said that time-periods should be sufficient to allow for responsive bidding, but that the period itself should be determined by national authorities or procurement entities as appropriate. The representative of Malaysia said that his delegation shared the view of the United States that the issue of time-limits was related to transparency to the extent that, if sufficient time was not provided or if sufficient time was provided to one party and not to others, transparency would be affected. Joined by the representative of Malaysia, the representative of India said that harmonization on this issue would not be advisable, on the basis of the wide divergence existing among national practices in this regard" (WTO 2002c, page 13).

"The representative of India said that, since time-periods *per se* were not an element of transparency for the purposes of the work of the Group, they should be deleted from the "List of Issues Raised and Points Made". The representative of the United States, joined by the representative of Malaysia, said that the issue of time-periods required further debate. The representative of the European Community said that the question of time-periods had to be discussed in light of the use of electronic means of communication which allowed quicker responses to tenders than in the past" (WTO 2002c, page 13).

In addition to disputing the mandate of the Working Group, a least one prominent WTO member has raised fears that the mandate may well be subsequently expanded to include market access issues. The following exchange between India and the European Communities during the 29 May 2002 meeting is telling:

> "The representative of India expressed concern that the main agenda for the European Community was to use an eventual agreement on transparency to address market access issues. He noted that the representative of the European Community had referred to a 'springboard to move on to the next stage' and stated that the threat contained therein, to move further on market access issues on completion of the work of the Group on Transparency, diminished the support from developing countries for the development of rules on transparency. He said that India, as well as other delegations sharing similar concerns, were opposed to any such movement. In that connection, he reiterated that the Doha Ministerial mandate had excluded any discussion which went beyond transparency. In response, the representative of the European Community said that the statement made by his delegation had been misunderstood, since the reference to using the discussions which would take place in the Working Group during the first and second meetings of 2002 as a 'springboard for the next stage' referred to the work which would be ongoing in 2003 and onwards towards the fifth Ministerial Conference. He reiterated that the European Community supported the mandate as it stood, including the reference to any agreement being limited to transparency issues" (WTO 2002c, page 3).

These disagreements over the mandate of the Working Group continued throughout 2002. At the meeting on 10-11 October 2002, Japan and the United States both made submissions that sought to clarify the elements for discussion in the Working Group with an eye to the forthcoming Cancun Ministerial Meeting. Japan began its submission (WT/WGTGP/W/37) with the following remarks:

> "Since the transparency provisions in the Agreement on Government Procurement in Annex IV of the WTO Agreement are difficult for developing country Members to follow as it stands, the provisions of a transparency agreement should be flexible enough, so that all WTO Members could accept them" (paragraph 2(1)).

And,

> "[A] transparency agreement should be legally binding and effective" (paragraph 2(2)).

Japan then argued that

> "[I]t is a prerequisite that all WTO Members participate in a transparency agreement. Therefore, the framework of such an agreement should be simple, focusing on core principles such as transparency in procurement opportunities" (paragraph 2(3)).

This submission goes on to elaborate that the important elements of a transparency agreement are: non-discrimination in transparency; definition and scope; core transparency principles including preparation and publication of procurement rules and enquiry, publication of procurement opportunities, and transparency in decisions on contract awards; domestic review; consultations and dispute settlement; and technical cooperation and special and differential treatment for developing countries.

The United States' submission (WT/WGTGP/W/35) proceeds in a similar vein, noting that

> "[W]hile Members use a myriad of procurement procedures and practices, there is no common set of transparency provisions. Thus, the primary focus of the agreement should be to establish core transparency elements that suppliers throughout the world can be assured of finding in the procurement system of every member" (seventh paragraph).

The US submission proceeds by arguing that the Working Group should identify those elements that it might be appropriate to include in a multilateral agreement. This submission suggests organising the possible elements of an agreement into the following four categories: general parameters of a potential agreement; transparency of procurement systems; transparency of specific procurements; and operational provisions to fulfil the objectives of a potential agreement. Having said that, the submission does state "[A]t this juncture, it is not necessary for the Working Group to decide how a particular element would be addressed in the agreement" (tenth paragraph).

Both of these attempts to prioritise the Working Group's discussions met with considerable resistance. The following reported statements by Malaysia, India, and Cuba suggest considerable unwillingness to conclude the post-Doha "study" phase of the Working Group's activities. The minutes from the 10-11 October 2002 report:

"The representative of Malaysia said that, while a convergence of views seemed to be emerging in some areas, it was premature to begin the categorization of issues at this stage. The Group had yet to conclude its work on the clarification of certain issues before it could reach consensus on any of the elements pursuant to the Doha Ministerial mandate. Developing countries had difficulties essentially with two elements, namely domestic review procedures and the application of WTO dispute settlement procedures. Although the details of some of the other elements might also cause some difficulties, by and large, they were acceptable. The categorization of elements could only be feasible if there were an explicit consensus to proceed with the negotiations at the Cancún Ministerial meeting built on the progress achieved by that time" (WTO 2003, page 2).

"The representative of India said that the categorization of elements was premature. The Group's main task was to achieve a better understanding of what transparency in government procurement meant. Matters relating to administration of domestic laws and regulations did not fall within the purview of transparency. The Working Group should address any burden that future requirements might incur on developing countries. One question with respect to the benefits of transparency was whether the additional cost of a transparent procurement system could be justified by its incremental benefits. Transparency could not be the overriding priority in all procurement cases. It might have to be balanced against certain other objectives, for example providing local manufacturers with certain advantages under employment-generating programmes or better utilising locally available factors of production. The Group's work should focus on the type of information that should be provided to suppliers on a Member's government procurement system. On the other hand, the need for transparency in specific procurements would depend on the purpose of the procurement and the policy objectives sought. While the information provided in tender notices would have to be adequate for the preparation of responsive bids and should be uniformly provided to all suppliers, the provision of information on who should be eligible to respond to a particular tender should take into account policies targeting certain suppliers. As to the ramifications of transparency beyond government procurement, the fight against corruption required better policing, a matter which went beyond the concern of the WTO. Finally, Members generally agreed to the benefits of transparency but several elements discussed in the Group did not pertain to transparency at all and some only to the extent that the future requirements would be limited to provision of information. Whether a future agreement would be a binding agreement or a principle-based one could be decided once Members had a clearer view of what transparency meant. Her delegation was not convinced of the need for any linkage to the WTO Dispute Settlement Understanding given that only transparency in government procurement was under consideration" (WTO 2003, page 3).

"The representative of Cuba said that, in order to comply with the Doha mandate which referred to development priorities, the Group should carry out its work on the basis of the List of Issues. If the discussions were to be speeded up, the Group would find itself with the same problems that it had faced with the proposals that had been tabled prior to the Seattle Ministerial Conference. At that time, a number of developing country Members had not been in a position to go along with the proposals that had gone beyond the Singapore mandate" (WTO 2003, page 4).

Developing countries have raised other concerns about further potential disciplines on transparency in government procurement. Malaysia has highlighted the role that certain procurement policies have played in favouring specific economic, regional, and other interests, as the following remarks make clear:

"Joined by the representative of Malaysia, the representative said that government procurement played an important role in nation building. It was an important policy tool in relation to social and economic development in developing countries in particular for promoting the development of small and medium enterprises and disadvantaged regions. Given this aspect of government procurement, caution was required in moving forward in this area, albeit the work was limited to transparency. A transparency agreement should impose no obligation on Members to change their domestic laws and regulations given the near unanimous view in the Working Group that the primacy of the domestic rules and regulations should be fully preserved. In this regard, the representative of Malaysia added that the mandates on transparency in the Singapore and Doha Declarations recognized that any eventual agreement shall be based on national practices" (WTO 2002c, page 2).

Moreover, a number of developing countries have called for differential obligations in an potential multilateral agreement, as the following report of a discussion at the 29 May 2002 meeting of the Working Group highlights:

> "On the question of threshold levels, the representative of India, joined by the representatives of Malaysia, Indonesia and the European Community, supported the use of threshold levels for the purposes of the application of requirements in a transparency agreement. The representative of Indonesia added that the inclusion of minor procurements within the scope of a transparency agreement could impose an undue burden on entities in developing countries. The representative of India, supported by the representative of Malaysia, suggested having a higher threshold for contracts subject to any future obligations as a 'Special and Differential Treatment' provision for developing countries" (WTO 2002c, page 7).

Turning now to the specific elements of a potential multilateral agreement, even though transparency itself is seen as desirable[183], some have called into question how an multilateral obligations might be structured:

> "The representative of India said that, in spite of the generally shared view that transparency was important in all fields including in government procurement, differences remained among Members with regard to consideration of future obligations in this area. The issue was complex for India since numerous government departments were involved in government procurement. The complexity would remain even if future obligations were to be limited to central or federal government departments. The representative of the United States said that his delegation agreed with the delegation of India that government procurement was an important policy tool for realizing socio-economic and other benefits associated with nation building; however it remained unclear whether a lack of transparency in pursuing such a policy tool provided any benefits. He recognized that, although transparency was critical to nation building, the issue was more a question of the orientation of government procurement as a policy tool. In responding to the representative of the United States, the representative of India considered that the available policy options should be preserved in the context of government procurement. The domestic procurement process in India was as transparent as similar systems in other countries, including those existing in the United States" (WTO 2002c, page 2).

Another source of disagreement has been over the scope of the agreement, with India and Malaysia diverging markedly with two of the proponents of new multilateral rules (the European Communities and the United States). India has called for a "better understanding" of what different definitions might mean:

> "The representative of the European Community, joined by the representative of the United States, said that, in the absence of lists of covered entities which provided certainty about the scope and coverage of rules, a definition of government procurement was especially important in a transparency agreement. His delegation considered that, although the contours of a definition remained a matter for further discussion, any definition which was eventually arrived at should be as broad as most Members could agree to. The representative of India, joined by the representative of Malaysia, said that a wide divergence remained in the Group on the question of definition. The study phase should be used for a better understanding of the various issues related to definition. This issue should be resolved through discussions in the Working Group rather than through negotiations" (WTO 2002c, page 5-6).

Moreover, Indonesia and Malaysia have joined India in arguing that services procurement should be excluded from the remit of any potential multilateral rules:

> "With regard to the question of whether the scope of an agreement should include both goods and services, the representatives of India, Malaysia and Indonesia stated that procurement of services should be excluded from the scope of the work of the Working Group. The representative of India said a combination of goods and services should also be excluded given that the relationship between elements identified as related to the transparency aspect of procurement and their application in the larger context

[183] See, for example, the following statement of China:

> "By way of general comments under this agenda item, the representative of China said that transparent procurement procedures enabled governments to obtain the greatest value for expenditure, contributed to a predictable and stable investment environment and to reducing and eliminating corruption" (WTO 2003a, page 1)

of procurement required further examination and clarification. The representative of India added that the services sectors in developing countries were not as advanced as those in developed countries. The representative of Indonesia said that, although his delegation recognized that in practice it could be difficult to distinguish between services and goods, and that often mixed contracts involved both goods and services, procurement in the services sector in developing countries was less systematized than that in the goods sector. There should be differentiation with regard to the procurement of services, given that the scope and coverage was different to that of goods. The United States, joined by the representative of Switzerland, stated that scope should include services" (WTO 2002c, page 7).

India and Malaysia have gone even further to constrain the scope of any potential disciplines, by arguing that procurement which is not open to foreign bidders should not fall within the scope of any multilateral agreement:

"The representative of India, joined by the representative of Malaysia, said that procurement not open to foreign suppliers should not form part of the discussions of the Working Group. In this regard, India had suggested the possibility of having different rules for procurement open to foreign suppliers and procurement reserved for domestic suppliers. In relation to the grant of preferences to domestic suppliers and supplies, and also in regard to pursuing policies of economic, social and regional development, there should be no restriction concerning procurement policy *per se*. The representative of the United States asked how a procurement that was not open to foreign suppliers would be defined. Would preferences to national suppliers qualify a procurement as open to foreign suppliers? Would a procurement restricted to domestic suppliers, goods or services, except where there was no domestic supplier, good or service, qualify that procurement as closed to foreign participation? In response, the representative of Malaysia said that, in its national practice, price preferences were clearly set out in the tender documents. If there was a price preference, the tender must necessarily be open to foreign suppliers. Transparency was in this way achieved, since foreign suppliers were not deceived into believing that they could make a successful bid without meeting these conditions. This national practice would continue to be followed as long as it remained to the developmental benefit of Malaysia. Supporting the view expressed by the representative of Malaysia, the representative of India added that procuring entities were free to determine whether individual tenders should be open to foreign suppliers. Where tenders were restricted to domestic suppliers, foreign suppliers would not submit their tenders. His delegation could not understand why any other WTO Member should be interested in these specific procurements. Entities should also be entitled to provide preferences, where procurements were open to foreign suppliers" (WTO 2002c, page 8).

Such arguments have not gone unanswered, as the following reported statement by Chile makes clear:

"The representative of Chile said that the Indian delegation should define what would be included in the scope and definition of government procurement and what would be the percentage of government procurement in India that would be subjected to a transparency agreement according to the definition suggested by India. In response, the representative of India said that its position was designed to address its national concerns, and that the exercise of the Group was not simply a matter of assuming negotiations on transparency" (WTO 2002c, page 8).

On the need to provide information about national procurement practices there appears to be a far amount of agreement at the Working Group. However, that agreement quickly dissolves once the type of information to be provided and other related matters are discussed, as the last three of the following four reports from the minutes of the 29 May 2002 demonstrates:

"The representative of India said that providing information on any aspect of the procurement process, whether information on national legislation and procedures or on procurement opportunities, was a transparency-related element, since complete disclosure of information aided efficient and fair procurement. Several countries had detailed web sites providing information on their procurement systems. Any efforts to expand the scope of information-related elements by proposing examination of the rules and laws, prescribing amendments to the laws, or listing out the content of the information would go beyond the mandate of the Working Group. The representative of Malaysia said that publication of information on national legislation and procedures was a key element in any transparency

agreement. The representative of the European Community said that there appeared to be agreement in the Working Group that the availability of information on national legislation and procedures to all interested parties aided the efficiency of procurement and that common ground within the Group on this issue should be relatively easy to achieve" (WTO 2002c, page 10).

"On the question of the type of information to be made available, the representative of India said that requirements relating to the provision of complete information should take into account the administrative capacity of the procuring entity. The representative of the European Community considered that, at a minimum, all rules of general application should be published so as to increase procurement efficiency. The representative of Brazil said that this approach appeared to be similar to that in the provisions of Article X of GATT. The representative of Malaysia said that while it could be feasible to provide selected information on a particular procedure, providing complete information regarding national regulations and procedures, especially in one of the WTO languages, would be too onerous. He considered that it would be sufficient to state that the relevant information was available and to list the salient or most important features of the particular regulation or law. The representative of the European Community said that, while his delegation recognized the concerns of some Members with regard to the capacity of certain entities to provide information where information requirements were burdensome, he nonetheless emphasized that an essential element of transparency was the facilitation of access to laws, regulations and rules applicable to procurement" (WTO 2002c, page 10).

"The representative of the European Community, joined by the representatives of Thailand and Brazil, considered that any requirement for a list of essential procurement information should attempt to meet a minimum set of information requirements without being overly prescriptive… The representative of India stated that the information content of tender opportunities should be left to that prescribed in the applicable national laws or in the procedures of the entities themselves. He said that any prescription regarding information on individual procurement opportunities had to be examined carefully, and that the requirement for providing information should take into account that limitations on providing information may exist due to low value of the procurement, the technology available to the procuring agency to disseminate the information, the cost of making such information available, and the tender being addressed to a small group of locally based contractors. He considered that several countries had detailed web sites providing information, including on individual procurement opportunities. The representative of the European Community said his delegation appreciated the difficulties that could be encountered by developing countries with regard to capacity in this area. His delegation recognized the possibility that developed countries could be required to apply a higher standard of information disclosure than that required from developing countries" (WTO 2002c, page 19).

"The representative of Thailand said that since government agencies in Thailand issued notices of invitation to tender throughout the year, translation requirements should be limited to big projects; otherwise, the requirement could become burdensome. The representative of Brazil, joined by the representative of Thailand, said that translation of all requests for tenders into an official WTO language would be problematic. In this regard, the representative of Brazil noted the existence of 2,500 entities at the federal level authorized to conduct government procurement in Brazil" (WTO 2002c, pages 19-20).

Since the 10-11 October 2002 meeting a number of submissions have been made on domestic review mechanisms, other review mechanisms, and Korea's thoughts on the contents of any multilateral agreement. Unfortunately, the minutes of the Working Group's meetings in 2003 are not yet available for analysis and it may well be the case that there has been a narrowing of positions from those stated in 2002 (and summarised above.) In the absence of any convergence of views, it appears that there is very little support—certainly from leading developing countries—for further multilateral rules on transparency in government procurement. A core group of industrialised economies support negotiations on such rules and in the light of such disagreement it may be useful to consider what, if any, is the basis for international collective action in this area; and that is the goal of the next part of this chapter.

## Part IV

# IS THERE A CASE FOR INTERNATIONAL COLLECTIVE ACTION ON THE REFORM OF PUBLIC PROCUREMENT PRACTICES?

So as to provide a benchmark, it will be useful to recall that in the case of tariffs on industrial goods, multilateral trade reform is said to break the political logjam that prevents policymakers from undertaking unilateral tariff reductions. The former galvanises domestic export interests whereas the latter does not. Moreover, the support of domestic export interests for multilateral trade reform is said to counter the opposition to reform by import-competing firms. (Private consumers, on this view, are said to be too numerous and individually to have to little at stake to organise effectively in the political arena on trade reforms.) The fourth part of this chapter is devoted to examining whether this political-economy logic carries over to multilateral reforms to discrimination and transparency in government procurement; and therefore examines whether there is a case for international collective action on public procurement reform.

It is important first to identify the different groups in society that might support or oppose reforms to state procurement systems. Even though they are likely to gain significantly from reform, taxpayers are assumed to be too numerous and to have too little at stake to organise politically on this issue and are left to one side (just as personal consumers were left out of the explanations in the last paragraph.) As far as domestic producer interests are concerned three types of interested party can be identified: those firms that already supply government contracts; those that do not; and those domestic firms that are actual or potential winners of foreign government contracts ("exporters"). Government officials are another interest group, especially if they are inefficient (or, more precisely, are resistant to greater workloads or to changes in procedures) or if they are corrupt. Of course, an inefficient official need not be a corrupt official, and visa versa.

With respect to reducing discrimination against foreign firms in a national procurement system, unilateral reform is likely to face opposition from domestic firms that currently win government contracts (that dislike the additional competition that results from less discrimination), from inefficient government officials (that dislike changes to their procedures and potentially higher workloads), and from corrupt officials (to the extent that more competition for government contracts reduces the profits that can be shared between the winner of the contract and the corrupt official.) Domestic exporters will not support unilateral reform as it does not offer the promise of greater market access abroad. Overall, then, unilateral reform of procurement discrimination faces pretty tough opposition and no clear supporters among producer interests.

Can multilateral reform of discriminatory procurement practices do any better? Multilateral reform does offer the prospect of winning contracts abroad, and the strength of that prospect will condition the degree of support that exporters provide for reform. Here two considerations are pertinent. First, as was discussed in section II.2.1.2 above, economic analysis has shown that when a given foreign government's demand for a good is smaller than the amount actually supplied by that foreign nation's own firms, then there is no improvement in market access of reducing procurement discrimination. This consideration, therefore, reduces the number of domestic export sectors or industries that have an interest in supporting multilateral reductions in procurement discrimination.

The second consideration is that a multilateral agreement to reduce *de jure* foreign discrimination against bids from domestic exporters may encourage some foreign procuring entities to engage in covert *de facto* discrimination. In other words, a transparent form of discrimination might be substituted for a non-transparent form of discrimination. (There are parallels here to the case of trade in industrial goods where it has long been argued that falling tariffs have been replaced by less transparent import barriers, such as antidumping measures.) To the extent that domestic exporters believe that such a substitution will take place, then their support for multilateral reform of *de facto* discriminatory practices will diminish.

One implication of the argument in the last paragraph is that domestic political support for multilateral reforms to procurement discrimination will be greater if it is accompanied by provisions on transparency and the like that make *de facto* discrimination more difficult or more costly to undertake. This logic may well

account for the fact that the Uruguay Round Agreement on Government Procurement contained provisions on both discrimination and transparency. It may also account for the fact that transparency-related matters become (or remain) a subject of international trade negotiations after multilateral provisions to reduce procurement discrimination have been adopted; here transparency measures can be seen as preserving the "original bargain" created by the prior reductions in procurement discrimination. To summarise, the foregoing arguments suggest that as far as maximising domestic political support for multilateral reform is concerned, future provisions on discrimination should be accompanied by new provisions on transparency.

What about the distinct matter of the degree of domestic support for reforming the transparency-related aspects of national procurement practices? Does multilateral trade reform offer the prospect of breaking political bottlenecks to unilateral reform? In what follows, it is assumed that improving transparency will encourage more domestic firms to bid for government contracts and may encourage more foreign firms to do so (assuming there are no other impediments for them to do so.)

Unilateral transparency reform will attract opposition from those firms that currently supply the government (that fear greater competition for state contracts), from inefficient officials (who oppose either greater workloads associated with more bidders or changes in their existing operating procedures), and from corrupt officials (if greater competition from state contracts reduces the total amount of inducements paid.) Domestic exporters will not support unilateral reform as it offers no prospect of greater sales abroad. The only domestic producer interest to support unilateral reform will be those domestic firms that believe that, after transparency is improved, their prospects of winning a profitable government contract at home have increased. Moreover, this support for unilateral reform will be attenuated to the extent that foreign firms are now more willing also to bid for domestic government contracts. In sum, then, these considerations suggest that the extent of domestic support for unilateral transparency reform is likely to be weak. Worse still, in order to maximise the support for unilateral reforms to transparency, a government may be tempted to couple such reforms with greater discrimination against foreign bidders, hence reducing the likelihood that new domestic bidders for state contracts face stiffer competition from foreign rivals.

Can a multilateral initiative to improve the transparency of government procurement practices mobilise more political support than unilateral reform? Here there are two additional factors to take into account. To the extent that domestic exporters feel that a multilateral initiative increases the probability of them winning profitable contracts from foreign governments, then they will lend their support. However, the extent of that support will depend critically on domestic exporters' perceptions of the degree of existing foreign discrimination against their bids and whether more bids by domestic exporters in the future is likely to result in greater foreign discrimination against them. (Recall that a more transparent foreign procurement regime can still involve considerable *de jure* discrimination against domestic exporters.) Therefore, the extent of domestic political support for a multilateral initiative to improve the transparency of government procurement practices will be greater if such an initiative is coupled with measures to reduce discrimination against domestic bidders for foreign contracts. The case for international collective action to improve transparency and to reduce discrimination *together* is stronger than the case for collective action on either one alone; a finding that casts the Doha mandate on government procurement in a poor light.

# Part V

## RECOMMENDATIONS TO POLICYMAKERS

Almost all members of society, in particular the poor and the vulnerable, depend on the quality and extent of goods and services provided by governments and associated state bodies. It is for this reason that reforms to public procurement practices have been a priority for many national governments and for some international institutions. However, unilateral reform is difficult to accomplish and to sustain. A question therefore arises as to whether multilateral initiatives offer greater potential to mobilise support for procurement reform. This question is of considerable importance as WTO Members will soon have to decide in Cancun whether, and on what terms, to launch new negotiations on transparency in government procurement practices.

The discussion in this chapter has highlighted a number of matters that are relevant for policymakers. First, even among the current members of the Uruguay Round Agreement on Government Procurement, the proportion of goods contracts awarded to foreign firms is tiny; suggesting there may be considerable room for expanding access to national procurement markets. Second, even though there have been a number of arguably beneficial international initiatives in the 1990s to improve the transparency of government procurement practices and, to a lesser extent, to reduce discrimination against foreign bidders for state contracts, the effects of these measures are circumscribed by limited memberships and the scope of procuring entities covered.

Third, the decision of WTO Ministers in Doha to exclude from negotiations on government procurement practices measures that discriminate against foreign bidders is seriously misconceived. The primary goal of international collective action in government procurement is to stimulate sustainable domestic support for national reforms to procurement laws and practices. This objective is compromised if domestic exporters believe that improvements in the transparency of foreign procurement regimes offers them little prospect of winning more foreign government contracts because they will still face substantial formal discrimination.

Given the intensity of opposition by leading developing countries to new multilateral rules on transparency in government procurement practices, WTO Members may be better served by either abandoning negotiations all together or by expanding the Doha mandate to include negotiations on reducing preferences for domestic firms, thereby expanding access to national procurement markets. The latter option is likely to galvanise more support from domestic exporters than negotiations that are confined to transparency-related matters—and, more importantly, to the extent that this support translates into further reform, governments will pay lower prices for goods and services and a more efficient allocation of societal resources will ensue. Furthermore, putting market access-related matters back on the negotiating table is unlikely to run into more tangible opposition than has been generated by proposals for new multilateral rules on transparency, precisely because critics of the latter believe that proponents of such rules are motivated by the desire to improve market access for their exporters anyway.

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**Appendix 1 Government procurement ratios in non-OECD countries, by regions**

| Regions | Final Consumption Expenditure (FCE) | | | | Total Expenditure (TE) | | | GDP |
|---|---|---|---|---|---|---|---|---|
| General government (% of GDP) | FCE | ex. Com | ex. Def. | ex. C&D | TE | ex. Com | ex. C&D | 1998 US$ Billion |
| **Africa** | | | | | | | | |
| Benin | 12.59% | | | | | | | 2.32 |
| Botswana | 27.10% | | | | | | | 4.98 |
| Burundi | 17.36% | | | | | | | 0.98 |
| Cameroon | 10.22% | | | | | | | 8.70 |
| Ivory Coast | 16.76% | 4.32% | | | 20.39% | 7.96% | | 11.10 |
| Egypt | 9.45% | | | | | | | 82.71 |
| Ghana | 11.88% | | | | | | | 7.17 |
| Kenya | 16.27% | 3.16% | 14.43% | 2.75% | 19.17% | 6.06% | 5.66% | 10.37 |
| Lesotho | 17.06% | | | | | | | 0.37 |
| Madagascar | 8.25% | | | | | | | 3.75 |
| Malawi | 15.31% | | | | | | | 1.69 |
| Mali | 14.91% | | | | | | | 2.65 |
| Mauritius | 11.73% | 3.23% | 11.37% | 3.07% | | | | 4.20 |
| Morocco | 16.59% | | | | | | | 36.12 |
| Mozambique | 20.18% | | | | | | | 3.82 |
| Namibia | 29.33% | 9.89% | | | 35.78% | 16.34% | | 3.00 |
| Niger | 17.24% | | | | | | | 2.01 |
| Nigeria | 3.89% | 1.23% | | | | | | 36.14 |
| Reunion | 27.35% | | | | | | | 7.25 |
| Rwanda | 21.28% | | | | | | | 2.04 |
| Senegal | 13.26% | | | | | | | 4.86 |
| Seychelles | 28.75% | | 24.98% | | | | | 0.56 |
| Sierra Leone | 7.56% | | | | | | | 0.65 |
| South Africa | 19.74% | | | | 21.77% | | | 116.73 |
| Swaziland | 20.80% | | | | | | | 1.18 |
| Uganda | 9.10% | | | | | | | 6.06 |
| Tanzania | 8.29% | | 6.74% | | | | | 8.09 |
| Tunisia | 16.29% | 3.55% | | | 21.60% | 8.86% | | 20.02 |
| Zambia | 19.33% | | | | | | | 3.35 |
| **Americas** | | | | | | | | |
| Anguilla | 13.83% | | | | | | | 0.09 |
| Bahamas | 14.06% | 3.42% | 13.47% | 3.27% | 14.62% | 3.98% | 3.83% | 4.12 |
| Barbados | 19.75% | | | | | | | 2.33 |
| Belize | 19.47% | | 18.24% | | | | | 0.67 |
| Bermuda | 12.70% | | 12.48% | | | | | 2.31 |
| Bolivia | 12.45% | 1.84% | | | | | | 7.96 |
| Brazil | 16.46% | 7.21% | | | | | | 776.94 |
| Cayman Island | 14.67% | | | | | | | 0.93 |
| Chile | 9.54% | | | | 11.51% | | | 74.32 |
| Colombia | 10.27% | 1.55% | 9.06% | 1.02% | 13.48% | 4.75% | 4.19% | 90.41 |
| Costa Rica | 16.75% | | | | 18.36% | | | 10.42 |
| Dominica | 20.16% | | | | | | | 0.25 |
| Dominican Rep. | 4.23% | | | | | | | 16.04 |
| Ecuador | 9.33% | 4.21% | 8.05% | 3.63% | 13.23% | 8.11% | 7.53% | 19.30 |
| El Salvador | 9.74% | | | | 11.14% | | | 11.86 |
| French Guiana | 34.54% | | | | 48.75% | | | 1.50 |
| Greneda | 19.73% | | | | | | | 0.31 |
| Guadeloupe | 30.35% | | | | 39.25% | | | 3.50 |
| Guatemala | 6.34% | | | | 8.37% | | | 19.01 |
| Guyana | 13.04% | | | | | | | 0.74 |
| Honduras | 11.12% | | | | | | | 5.34 |
| Jamaica | 7.56% | | | | | | | 7.06 |
| Martinique | 28.75% | | | | 36.19% | | | 4.38 |
| Panama | 16.37% | 3.72% | | | | | | 9.82 |
| Paraguay | 19.33% | | | | | | | 10.93 |

Notes:

Com=Compensation of state employees

Def.=Defense expenditures

C&D=Total of compesnation of state employees and defense expenditures

**Appendix 1 (continued) Government procurement ratios in non-OECD countries, by regions**

| Regions | Final Consumption Expenditure (FCE) | | | | Total Expenditure (TE) | | | GDP |
|---|---|---|---|---|---|---|---|---|
| General government (% of GDP) | FCE | ex. Com | ex. Def. | ex. C&D | TE | ex. Com | ex. C&D | 1998 US$ Billion |
| **Americas (continued)** | | | | | | | | |
| Peru | 7.94% | | | | 9.87% | | | 64.06 |
| Puerto Rico | 14.12% | | | | | | | 50.51 |
| Suriname | 26.27% | | | | | | | 0.82 |
| Trinidad-Tobago | 16.44% | 2.59% | | | | | | 6.14 |
| Uruguay | 13.70% | | | | | | | 20.95 |
| Venezuela | 8.60% | 2.31% | | | 10.28% | 4.00% | | 95.02 |
| **Asia** | | | | | | | | |
| Azerbaijan | 19.86% | 4.24% | 11.73% | 2.11% | | | | 4.10 |
| Bahrain | 26.07% | | | | | | | 5.35 |
| Bangladesh | 13.95% | | 12.53% | | | | | 41.42 |
| Bhutan | 21.58% | | | | | | | 0.36 |
| China | 12.84% | | | | | | | 960.79 |
| Cyprus | 17.81% | | 13.49% | | | | | 8.88 |
| Fiji | 17.44% | | | | | | | 2.33 |
| Hong Kong, China | 8.69% | 2.49% | | | 11.00% | 4.81% | | 166.45 |
| India | 10.54% | 3.44% | 7.42% | 1.74% | 13.29% | 6.18% | 4.46% | 420.31 |
| Indonesia | 9.20% | | | | | | | 215.00 |
| Iran | 11.06% | 2.63% | 8.00% | 1.90% | | | | 187.42 |
| Iraq | 30.82% | | | | | | | 4.60 |
| Israel | 25.95% | 10.01% | | | | | | 91.32 |
| Jordan | 23.74% | | | | | | | 7.45 |
| Kuwait | 37.30% | | | | | | | 26.45 |
| Kyrgyzstan | 20.04% | 11.74% | | | 21.60% | 12.88% | | 1.87 |
| Malaysia | 13.75% | | 10.76% | | | | | 67.48 |
| Maldives | 21.97% | | | | | | | 0.40 |
| Nepal | 8.72% | | | | | | | 4.48 |
| New Caledonia | 33.02% | | | | | | | 3.56 |
| Oman | 27.34% | | | | | | | 14.96 |
| Pakistan | 12.87% | 6.61% | | | 16.29% | 10.03% | | 64.13 |
| Papua New Guinea | 23.24% | | | | | | | 3.71 |
| Philippines | 9.85% | 2.94% | | | 14.29% | 7.38% | | 82.24 |
| Qatar | 34.44% | | | | | | | 11.70 |
| Saudi Arabia | 33.86% | | | | | | | 125.84 |
| Singapore | 9.35% | | | | | | | 84.38 |
| Sri Lanka | 13.17% | 5.57% | 10.03% | 4.24% | 17.42% | 9.82% | 8.48% | 15.70 |
| Syrian Arab R. | 14.34% | | | | | | | 64.93 |
| Thailand | 9.67% | 3.08% | | | 17.31% | 10.72% | | 117.04 |
| United Arab Emirates | 17.01% | | | | | | | 47.23 |
| Uzbekistan | 22.71% | | | | | | | 14.19 |
| Vanuatu | 28.24% | 16.86% | | | | | | 0.25 |
| Viet Nam | 15.93% | | | | | | | 24.60 |
| Yemen | 27.42% | | | | | | | 5.33 |
| **Europe** | | | | | | | | |
| Albenia | 10.20% | | | | | | | 3.03 |
| Belarus | 19.15% | 10.54% | 10.54% | 5.62% | 21.27% | 12.65% | 7.74% | 14.28 |
| Bulgaria | 8.08% | | | | | | | 12.06 |
| Estonia | 16.62% | 8.06% | 15.96% | 7.75% | 21.05% | 12.50% | 12.18% | 5.11 |
| Latvia | 14.70% | 7.79% | | | 17.09% | 10.18% | | 6.19 |
| Lithuania | 15.68% | | | | | | | 10.69 |
| Malta | 17.56% | 4.24% | 15.20% | 3.67% | 21.87% | 8.55% | 7.99% | 3.99 |
| Romania | 13.77% | | 8.49% | | | | | 41.70 |
| Russia | 17.39% | | 12.70% | | | | | 283.82 |
| Slovenia | 19.62% | | | | | | | 19.99 |
| Ukraine | 15.77% | 7.95% | 9.33% | 4.72% | 18.15% | 10.33% | 7.10% | 42.70 |

Notes:

Com=Compensation of state employees

Def.=Defense expenditures

C&D=Total of compesnation of state employees and defense expenditures

**Appendix 2: Comparison of the UNCITRAL Model Law's and the existing WTO Agreement on Government Procurement's (GPA) treatment of twelve matters that are the subject of discussion in the World Trade Organization's Working Group on Transparency in Government Procurement.**

Please note that the source for all quotations in items I-V of the list below is WTO (2002a). The source for all quotations in items VI-XII of the list below is WTO (2002b). Occasionally, these documents refer to characteristics that are common to both the UNCITRAL Model Law and the GPA and in these instances, the relevant remarks are reported in only one column and a cross-reference from the other column is reported.

| Item number | Aspect of the procurement process | Related provisions in the UNCITRAL Model Law | Related provisions in the WTO's Agreement on Government Procurement, and other related WTO agreements |
|---|---|---|---|
| I | Definition and scope of government procurement | 1. "The Model Law is designed to be applicable, in principle, to all types of procurement of goods, construction and services. What is meant by "goods", "construction" and "services" is listed in the Model Law" (page 2).<br>2. "In order to take into account the existence of procurement legislation at different levels of government, the Model Law presents two options as to the levels of government to be covered. The first option brings within the scope of the Model Law all governmental departments, agencies, organs and other units within the enacting State pertaining to the central government as well as to provincial, local or other governmental subdivisions of the enacting State. A second option allows States to enact the Model Law only with respect to the organs of the national government" (page 2).<br>3. "The Model Law allows a procuring entity engaging in low-value procurement in which there is unlikely to be interest on the part of foreign suppliers to forgo certain procedural requirements relating to announcements at the international level" (page 2). | 1. "The Agreement on Government Procurement (GPA) covers the procurement of goods, and of all services and construction services that are specified in lists, found respectively in Annexes 4 and 5 of Appendix I. General Notes at the end of most Parties' schedules provide for a number of exceptions" (page 2).<br>2. "The GPA obligations under the Agreement apply to procurement by the procuring entities that each Party has listed in its schedule in Annexes 1 to 3 of Appendix I, relating respectively to central government entities, sub-central government entities and other entities such as public utilities" (page 2).<br>3. "The international instruments provide for the size of procurement contracts to be taken into account in determining the requirements to which they are subject. The provisions of the GPA apply to procurement in respect of procurement contracts above certain threshold values. Each Party indicates such thresholds applying to the procurement of goods and services under Annex 1, 2 and 3 entities" (page 2). |
| II | Procurement methods | 1. "Under certain circumstances, in which the open procurement method is not considered to be appropriate, alternative methods are offered. The special conditions for the use of these other procedures are often related to ensuring adequate transparency. For example, the Model Law contains a requirement that decisions to use alternative methods should be supported in the record of the procurement proceedings by a statement of the grounds and | 1. "Under the GPA, entities are required to prepare a report on each procurement awarded under limited tendering including a statement of the conditions which prevailed" (page 6). |

| Item number | Aspect of the procurement process | Related provisions in the UNCITRAL Model Law | Related provisions in the WTO's Agreement on Government Procurement, and other related WTO agreements |
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| | | circumstances on which the procuring entity has justified the use of the method in question" (page 6). | |
| III | Publication of information on national legislation and procedures | 1. "The Model Law and the GPA require the public accessibility of relevant texts" (page 8). | 1. "The GPA explicitly requires Parties to publish any law, regulation, judicial decision, administrative rulings of general application and any procedure regarding government procurement in such a manner as to enable other GPA Parties and suppliers to become acquainted with them" (page 8).<br>2. "Reference has also been made to the existing publication obligations contained in Article X of GATT 1994 and Article III of GATS relating to laws, regulations, judicial decisions and administrative rulings of general application. It has been observed that government procurement is not excluded from the scope of these provisions" (page 8). |
| IV | Information on procurement opportunities, tendering and qualification procedures | 1. "The Model Law and the World Bank Guidelines require procurement notices also to be published in a specialized publication of wide international circulation. Under the Model Law and the World Bank Guidelines, the procuring entity is required to respond to any request for clarification submitted within a reasonable time, as well as communicating the clarification to all other participating suppliers" (page 10). | 1. "Under the GPA, Parties are required to publish the tender notice in a publicly accessible publication as indicated in each Party's Appendix II to the Agreement" (page 10).<br>2. "Under the GPA, reasonable requests for explanations relating to tender documentation under open and selective procedures must be promptly replied to. Replies to such a request from a participating supplier shall be provided on condition that such information does not give that supplier an advantage over his competitors" (page 10).<br>3. "Under the GPA, entities must publish also a summary of the main elements of the information in a tender notice in one of the official WTO languages" (page 10). |
| V | Time-periods | 1. "The Model Law recognizes that the length of that period of time may vary from case to case depending on the circumstances of the given procurement and it is left to the procuring entity to fix the deadline by which tenders must be submitted" (pages 14-5). | 1. "The GPA prescribes certain minimum deadlines that must be allowed for the preparation, submission and receipt of tenders to enable responsive tendering and for potential suppliers to prequalify. The relevant provisions also contain general considerations that should govern when entities set time-periods for tendering and delivery" (pages 14-15). |
| VI | Transparency of | 1. "With regard to qualification criteria…[T]he UNCITRAL Model | 1. With respect to qualification criteria, the "Agreement on |

| Item number | Aspect of the procurement process | Related provisions in the UNCITRAL Model Law | Related provisions in the WTO's Agreement on Government Procurement, and other related WTO agreements |
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| | decisions on qualification, specifically with reference to qualification criteria; fair and non-discriminatory application of qualification procedures; listing and registration of suppliers; and notification of qualification decisions. | Law sets forth the range of criteria that procuring entities may require the suppliers to meet in order to qualify for participation in procurement proceedings" (page 2).<br>2. With respect to fair and non-discriminatory application, "[T]he Model Law requires that same criteria must be applied to all suppliers participating in the procurement process" (page 2).<br>3. With respect to the provision of information on qualification decisions, "[U]nder the Model Law, each supplier that has submitted an application to pre-qualify must be notified whether or not it has been pre-qualified" and "the procuring entity must, upon request, communicate to suppliers whose application to qualify was rejected or whose qualification has been brought to an end the grounds therefor" (page 3). | Government Procurement (GPA) requires that any conditions for participation in tendering procedures be limited to those which are essential to ensure the firm's capability to fulfil the contract in question" (page 2).<br>2. With respect to fair and non-discriminatory treatment, the "GPA emphasizes that entities must not discriminate among suppliers of other GPA Parties and between domestic suppliers and suppliers of other Parties and among suppliers of other Parties with regard to conditions of participation. In certain cases, countries make the eligibility of suppliers of other countries to participate in a procurement depend on these countries providing reciprocal treatment to its suppliers" (page 2).<br>3. With respect to the provision of information on qualification decisions, "[T]he GPA requires the entity concerned to advise any supplier having requested to become a qualified supplier of its decision in this regard" and "the procuring entity must, upon request, communicate to suppliers whose application to qualify was rejected or whose qualification has been brought to an end the grounds therefor" (page 3). |
| VII | Transparency of decisions on contract awards: transparency of evaluation criteria | 1. "…tender documents should contain the criteria, including any factor other than price, to be considered by the procuring entity in determining the successful tender and for awarding the contract. They [the relevant international instruments] also emphasize that entities should evaluate tenders only on the basis of the criteria that have been previously published" (page 5).<br>2. "The provisions of the Model Law on examination, evaluation and comparison of tenders require the procuring entity to evaluate and compare the tenders in order to ascertain the successful tender in accordance with the procedures and criteria set forth in the tender documents and prohibit the use of any criterion that has not been set forth in the tender solicitation documents" (page 5).<br>3. "Particular attention is given in the three instruments to ensuring the transparency and objectivity of technical specifications criteria | 1. As point 1. in the UNCITRAL Model Law.<br>2. "The GPA also explicitly provides that awards should be made in accordance with the criteria and essential requirements specified in the tender documentation" (page 5).<br>3. With respect to ensuring the transparency and objectivity of technical specification criteria and their evaluation, the GPA requires "that technical specifications prescribed by procuring entities shall be based on international standards, where such exist, otherwise, on national technical regulations, recognized national standards or other equivalent standards, or building codes. The GPA has an explicit preference for the use of specifications based on performance rather than design or descriptive characteristics" (page 6). See also point 3. in the UNCITRAL Model Law. |

| Item number | Aspect of the procurement process | Related provisions in the UNCITRAL Model Law | Related provisions in the WTO's Agreement on Government Procurement, and other related WTO agreements |
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| | | and their evaluation. The GPA and the Model Law stipulate that technical specifications prescribed by procuring entities shall not be prepared, adopted or applied with a view to, or with the effect of, creating unnecessary obstacles to international trade" (page 6).<br>4. "The Model Law requires that any specifications, plans, drawings, designs and requirements or descriptions be based on the relevant objective technical and quality characteristics of the goods" (page 6).<br>5. With respect to provisions concerning the application of the principle of non-discrimination in tenders and the award of contracts, the "The Model Law provides that any restrictions on procurement from foreign sources with the purpose of protecting certain economic sectors or on account of certain legal obligations should only be on grounds specified in the procurement regulations or should be pursuant to other provisions of law. The objective of transparency is promoted by requiring a procuring entity to declare any limitations on participation on the basis of nationality in the invitations to tender and to include in the record of the procurement proceedings a statement of the grounds and circumstances on which a procurement entity has relied for limitation of participation on the basis of nationality. In these cases, the procuring entity is exempted from the obligation to give wide international circulation to the invitation to tender or invitation to pre-qualify. The Model Law also provides for the possibility that, in evaluating and comparing tenders, a procuring entity may grant a margin of preference in favour of local goods, services and suppliers which permits the procuring entity to select the overall lowest-priced tender of a local supplier when the difference in price between that tender and the lowest-priced tender falls within the range of margin of preference. The rules for calculation of such preference margins should be set forth in the procurement regulations. Moreover, the use of a margin of preference is to be pre-disclosed in the tender documents and reflected in the record of the procurement proceedings" (pages 6 | 4. With respect to non-discrimination, "[U]nder the GPA and in respect of procurement covered by the Agreement, governments Parties to the Agreement are required to give the products, services and suppliers of any other Party to the Agreement treatment "no less favourable" than that given to their domestic products, services and suppliers and not to discriminate among the goods, services and suppliers of other Parties (Article III:1). Furthermore, each Party is required to ensure that its entities do not treat a locally established supplier less favourably than another locally established supplier on the basis of the degree of foreign affiliation or ownership and do not discriminate against a locally established supplier on the basis of the country of production of the good or service being supplied (Article III:2). Certain derogations from the fundamental principles of the Agreement are provided for in national schedules appended to the Agreement. In addition, special and differential treatment for developing countries under Article V of the GPA allows for agreed exclusions from the requirement of national treatment under the GPA. Furthermore, the GPA prohibits the use of offsets which are defined as measures used to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements. However, a developing country may at the time of its accession negotiate conditions for the use of offset requirements, to be used only for qualification of suppliers and not as criteria for awarding contracts (page 7). |

| Item number | Aspect of the procurement process | Related provisions in the UNCITRAL Model Law | Related provisions in the WTO's Agreement on Government Procurement, and other related WTO agreements |
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| | | and 7). | |
| VII | Transparency of decisions on contract awards: receipt and opening of tenders | 1. "The Model Law and the World Bank Guidelines set forth detailed conditions which are aimed at preventing any non-transparent action or decision by the procuring entity in the process of the opening of tenders and at enabling suppliers to observe that the entity complies with the procurement criteria and procedures" (page 8).<br>2. Both the Model Law and the GPA "set forth a number of other provisions that safeguard transparency at the bid evaluation stage. The procuring entity may ask bidders for clarifications of their tenders that are needed to evaluate them, but no changes are to be asked or permitted with a view to making unresponsive bids responsive except for the correction of arithmetical errors appearing in the tender" (page 8). Furthermore, the "Model Law prohibits negotiations between the procuring entity and a supplier with respect to a tender submitted by the supplier" (page 8).<br>3. With respect to the confidentiality of tenders, "[U]nder the procedures on negotiations in the Model Law and in the GPA, entities are required to treat information in tenders, in particular any technical, price or other market information, confidentially and not to provide information intended to assist particular participants to bring their tenders up to the level of other participants" (page 8). | 1. "The GPA provisions require that procedures and conditions for the receipt and opening of tenders guarantee the regularity of the openings and be consistent with the national treatment and non-discrimination provisions of the GPA" (page 8).<br>2. See also point 2. on UNCITRAL Model Law.<br>3. With respect to transparency at the bid evaluation stage, "[T]he GPA requires that any opportunity that may be given to tenderers to correct unintentional errors of form between the opening of tenders and the awarding of the contract shall not be permitted to give rise to any discriminatory practice" and "[U]nder the GPA, negotiations with entities may only take place where prior notice has been given or where no one tender is obviously the most advantageous in terms of the specific evaluation criteria set forth earlier in the notices or tender documentation" (page 8).<br>4. See also point 3. on UNCITRAL Model Law. |
| VII | Transparency of decisions on contract awards: ex post information on contract awards | 1. See point 1. in the GPA column to the right.<br>2. "Under the Model Law, the procuring entity is required to give a notice to other suppliers after it has entered into a contract with a supplier, specifying the name and address of the supplier and the contract price. Furthermore, the Model Law and the GPA allow an unsuccessful tenderer to seek and obtain pertinent information concerning the reasons why its tender was not selected" (page 9).<br>3. "The provisions of the Model Law bar the procuring entity from disclosing certain information, including that relating to the | 1. "The Model Law and the GPA require entities to publish a notice award after the award of each contract. The publications in which individual GPA Parties publish such notices are identified in Appendix II to the GPA. The GPA sets forth in detail the type of information that such notices, to be published within a specified time-limit after the award of each contract, must contain. In addition to the publication of a notice of contract award, the GPA goes on to require entities to promptly inform directly those suppliers that have participated in a tender of the decision on the contract award, in writing if requested" (page 9). |

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| | | examination, evaluation and comparison of tenders so as to safeguard the public interest or the commercial interest of parties involved in the proceedings" (page 9). | 2. "The GPA also requires the provision of information on the characteristics and relative advantages of the tender selected as well as the name of the winning tenderer" (page 9).<br>3. "As regards the treatment of confidential information on contract awards, the GPA foresees that entities may decide to withhold certain information on contract awards where release of such information may impede law enforcement or otherwise be contrary to public interest or would prejudice the legitimate commercial interests of particular enterprises or might prejudice fair competition between suppliers" (page 9). |
| VIII | Domestic review procedures | 1. See point 1. in the GPA column to the right.<br>2. See point 2. in the GPA column to the right.<br>3. "Under the Model Law, unless the complaint is resolved by mutual agreement, the procuring entity shall, within prescribed time-limits, issue a written decision including a statement on the reasons for the decision and indicating any corrective measures that are to be taken. If the matter is not settled through this procedure, the complainant is entitled, under the Model Law, to seek an administrative review. The functions of an administrative review may be vested in an existing appropriate administrative body or a body whose competence is exclusively to resolve disputes in procurement matters and which is independent of the procuring entity. The decisions of the review bodies or failure to make a decision within prescribed time-limits shall be subject to judicial review. The Model Law also lays down certain procedures to ensure the openness and fairness of review procedures" (page 12).<br>4. "The provisions of the Model Law also provide for the suspension of procurement proceedings which takes account of the need of the procuring entity to conclude a contract in an economic and efficient way without undue disruption and delay in the procurement process" (page 13). | 1. "Review procedures are often considered a key component of transparency and accountability of government procurement practices. The rules set out in the Model Law and the GPA establish the basic features that national review mechanisms must have without going into great detail. The purpose of these provisions is to give suppliers believing that an entity has breached national law or, in the case of the GPA, the rules of the GPA itself, a right of review" (page 12).<br>2. "Under the Model Law and the GPA, as an initial step, complainants are encouraged to seek resolution of their complaints through consultations with the procuring entity itself prior to recourse to an administrative review body" (page 12).<br>3. "Under the GPA, Parties may confer the authority to hear challenges by suppliers on national courts or on an impartial and independent review body of an administrative nature. In the event that a bid challenge is heard by a review body which does not have the status of a court of law, either its decisions must be subject to judicial review or it must follow the criteria laid down in detail in Article XX:6(a)-(g). These minimum standards are mainly designed to ensure the openness, fairness and equity of the proceedings" (page 12-13).<br>4. "Under the GPA, a review body must have the authority to order |

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| | | | the correction of a breach of the Agreement or compensation for the loss or damages suffered by a supplier, but this may be limited to costs for tender preparation or protest. Pending the outcome of the challenge, the review body must be able to order rapid interim measures, including the suspension of the procurement process, to correct breaches of the GPA and to preserve commercial opportunities. However, procedures may provide that overriding adverse consequences for the interests concerned, including the public interest, may be taken into account in deciding whether such measures should be applied" (page 13). |
| IX | Other matters related to transparency: maintenance of records of proceedings; information technology; language; and fight against bribery and corruption. | 1. See point 1. in the GPA column on the right.<br>2. "The Model Law establishes an explicit requirement for the maintenance of a record of the key decisions and actions taken by the procuring entity during the course of the procurement proceedings. As is explained in the Guide to the Enactment of the Model Law, the maintenance of a record is one of the principal mechanisms for ensuring adherence to the rules and also facilitates the exercise of the right of aggrieved suppliers to seek review" (page 13).<br>3. See point 2 in the GPA column on the right.<br>4. "Under the Model Law, the language of documentation is generally the official language(s) of the enacting State, or, in certain specified cases, in a language customarily used in international trade. The formulation and submission of tenders can be in any language in which the tender notices have been issued or in any other language stipulated by the procuring entity" (page 19).<br>5. See point 4. in the GPA column to the left. | 1. "Both the Model Law and GPA have provisions for the maintenance of records of procurement proceedings. The GPA requires that this information be retained by procuring entities for use, if required, under various procedures such as provision of information by entities (Article XVIII), between governments (Article XIX), under bid challenge procedures (Article XX) and under dispute settlement (Article XXII). Moreover, where limited tendering – rather than open or selective procedures have been adopted, the GPA requires a specific report to be prepared on each such occasion of limited tendering" (page 18).<br>2. Both the GPA and the Model Law "also set out the minimum content of information to be maintained; these cover the procurement requirement, the procuring entity, suppliers and evaluation of tenders" (page 18).<br>3. "The GPA recognizes the useful role that information technology could play in government procurement and, at Article XXIV:8, provides for the Committee on Government Procurement to consult regularly in the light of unfolding developments with the aim, in particular, of using information technology to promote transparent, efficient, open and non-discriminatory government procurement. In the context of the renegotiation of the Agreement under Article XXIV:7(b), the Committee on Government Procurement has initiated work on possible amendments to the relevant provisions of the GPA to reflect recent developments in |

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| | | | information technology" (page 19).<br>4. "Under the GPA, a summary of the invitation to tender has to be submitted in a WTO official language, and, if an entity allows tenders to be submitted in several languages, then one of those must be an official WTO language" (page 19).<br>5. "Neither the GPA nor the Model Law have explicit provisions specifically directed at the fight against bribery and corruption" (page 20). |
| X | Information to the provided to other governments (notification) | 1. No remarks on the Model Law. | 1. "The GPA, being an international instrument that sets contractual rights and obligations between governments in the area of government procurement, includes provision on exchange of procurement-related information between governments. The relevant provisions relate to provision of information on national legislation; notification of national legislation; provision of information on contract awards; and statistical reporting" (page 22).<br>2. "The GPA Parties are required, in response to a request by any other GPA Party, to explain their government procurement procedures; supply copies of laws, regulations, judicial decisions, administrative rulings or other measures relevant to the Agreement; and provide information concerning procurement by covered entities and their individual contract awards" (page 22).<br>3. "As regards the establishment of enquiry points, the provisions on special treatment for developing countries in the GPA require developed country Parties to establish information centres to respond to reasonable requests from developing country Parties for information relating to, among others, laws, regulations, procedures and practices regarding government procurement, addresses of the entities covered by the Agreement, and the nature and volume of products or services procured or to be procured, including available information about future tenders. The coordinates of the contact points of GPA Parties have been notified to the GPA Committee" (page 22). |

| Item number | Aspect of the procurement process | Related provisions in the UNCITRAL Model Law | Related provisions in the WTO's Agreement on Government Procurement, and other related WTO agreements |
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| | | | 4. "As regards the notification of national legislation and any changes, the GPA Committee has adopted relevant procedures for such notifications, including responses to a checklist of issues. GPA Parties are required to submit the complete texts of their basic legislation (laws and regulations) on government procurement, including the basic legal instruments pursuant to which effect is given to the provisions of the Agreement, in the original language to the Secretariat. Each Party is also required to provide a summary of the implementing legislation in a WTO language" (page 22).<br>5. "Further to the obligations of entities under the GPA relating to the provision of information by procuring entities to an unsuccessful tenderer, the GPA allows the government of an unsuccessful tenderer to seek such additional information on the contract award as may be necessary to ensure that the procurement was made fairly and impartially. To this end, the procuring government is required to provide information on both the characteristics and relative advantages of the winning tender and the contract price. The government may disclose the information thus obtained provided it exercises this right with discretion. In cases where the release of such information would prejudice competition in future tenders, this information shall not be disclosed except after consultation with and agreement of the Party which gave the information to the government of the unsuccessful tenderer" (page 23).<br>6. "The GPA has a general provision in Article XIX:4, requiring that confidential information provided to any government Party to the GPA shall not be revealed without formal authorization from the Party providing the information" (page 23).<br>7. "As a means of monitoring procurement covered by the GPA, Article XIX:5 of the GPA requires each Party to collect and provide to the Committee on an annual basis statistics on its procurements covered by the GPA. The type of information that such reports shall contain is stipulated in detail in Article XIX:5, paragraphs (a) to (d). |

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| | | | Statistical reports of GPA Parties can be found on the WTO website" (page 23). |
| XI | WTO dispute settlement procedures | 1. No remarks on the Model Law. | 1. "Under the GPA disputes between Parties are subject to the procedures of the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes. Dispute settlement procedures are applicable to all the rules of the Agreement. Because of the area covered and of the plurilateral nature of the Agreement, GPA provisions on dispute settlement contain a number of special rules or procedures, for instance on composition of panels, time-periods for panel proceedings and disallowing cross-retaliation in case of disputes arising under other WTO Agreements. Moreover, under the GPA, the DSB has the authority to authorize consultations among parties to the dispute regarding remedies when withdrawal of violating measures is not possible. By their nature, the issue of government-to-government dispute settlement does not arise in the other two international instruments" (page 25). |
| XII | Technical cooperation and special and differential treatment for developing countries | 1. "The UNCITRAL Model Law …do not have specific provisions related to technical cooperation" (page 27). | 1. "The obligations of GPA Parties in this respect are set out in Article V of the Agreement under which developed countries are required to provide technical assistance which they may deem appropriate to developing countries. The provision of technical assistance is upon request, on mutual agreement between the Party making the request and the donor Party. The types of assistance envisaged in the GPA include the solution of particular technical problems relating to the award of a specific contract, translation of qualification documentation and tenders made by suppliers of developing countries into an official WTO language and resolving any other problems in the field of government procurement. There are also specific provisions for technical assistance to least-developed countries. These require developed country Parties to provide assistance to potential tenderers in such countries in submitting their tenders and selecting the products or services which are likely to be of interest to its entities as well as to suppliers, and likewise assist them to comply with technical |

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| | | | regulations and standards relating to products or services which are subject of the intended procurement" (page 27). |

**Appendix 3: Submissions on potential new multilateral disciplines on transparency by WTO members to the Working Group on Transparency in Government Procurement, 1997-2003**

Note: Many submissions to the Working Group concern the specific procurement practices of WTO members and do not draw any implications for potential new multilateral disciplines on transparency in government procurement practices; consequently, those submissions were excluded from the table below. Moreover, submissions by international organisations—which mainly concerned on-going technical assistance efforts—were omitted from this table too.

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| Hong Kong, China<br>WT/WGTGP/W/11<br>19 December 1997:<br><br>APEC Non-Binding Principles on Government Procurement: Transparency | This submission summarises the elements of and means of enhancing transparency in procurement practices that were identified by the APEC Government Procurement Experts Group (GPEG). These elements and means were endorsed by APEC Government Ministers at their meeting in Vancouver, Canada, in 21-22 December 1997.<br><br>Before describing these elements and means, GPEC notes "that the elements of transparency in [government procurement] identified by the GPEC are non-binding and individual economies are in the best position to decide on the applicability of individual elements of transparency to them, and how best to translate these elements into practical measures, taking into account the specific circumstances of their economy and possibly the costs and benefits of adopting specific transparency measures" (paragraph 2).<br><br>GPEC notes that "[T]he general principle is that sufficient and relevant information should be made available to all interested parties consistently and in a timely manner through a readily accessible, widely available medium at no or reasonable cost. This general principle is applicable to all aspects of [government procurement], including the general operational environment, procurement opportunities, purchase requirements, bid evaluation criteria and awards of contracts…" (paragraph 3).<br><br>GPEC also states a preference for open and competitive | The need to provide sufficient and relevant information is justified as follows: "to enable potential suppliers to make informed decisions. For example, potential suppliers must have access to information on the conditions for participation and the requirements of the intended procurement in order to decide whether to participate and to prepare a responsive offer" (paragraph 3).<br><br>The need to provide timely information is justified as follows: "to ensure that the information is valid when available to the receiver" (paragraph 3).<br><br>The need to make information available to all parties is justified on the grounds that it will "ensure that the procurement process is fair to all participants and seen to be fair" (paragraph 3).<br><br>Requiring the accessibility to information through a medium at no or reasonable is cost is to "ensure that information is accessible in practice" (paragraph 3).<br><br>The rationale for making transparent the laws, regulations, judicial decisions, administrative rulings etc covering procurement is to "let suppliers know the rules of the game so that they can decide whether to participate" (paragraph 6).<br><br>Transparency in procurement opportunities is justified | No national experience was cited.<br><br>No economic evidence was cited. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| | tendering.<br><br>GPEC also notes that "[D]ue process and public accountability are essential elements of fair, open and impartial procurement procedures, and the availability of an avenue/channel for review of complaints is an element of transparency" (paragraph 15). | on the grounds that "[T]his would encourage wider participation leading to increased choices for the buyer and enhanced competition, contributing to achieving better value for money in procurement activities" (paragraph 8).<br><br>Transparency in purchase requirements is justified on the grounds that "this is to facilitate effective and efficient participation by potential suppliers in the procurement process. Also, because potential suppliers know the specific requirements, the non-responsive offers that the buyer may have to process can be minimized, increasing the operational efficiency of the buyers" (paragraph 10).<br><br>Transparency in bid evaluation criteria is "to ensure fairness and integrity" (paragraph 12).<br><br>The award of contracts should be transparent so as to "demonstrate government accountability to suppliers and the public" (paragraph 14). | |
| United States<br>WT/WGTGP/W/15<br>19 February 1998<br><br>Review Mechanisms | States that a multilateral agreement should include review mechanisms that have the following three features: impartiality, "rapid decisions or possibility to suspend the procurement process," and "adequate remedies" (second paragraph).<br><br>The submission notes that "[R]emedies should include the possibility of retendering procurements or damages to cover legitimate claims" (second paragraph).<br><br>Written records of decisions and deliberations of the review mechanisms should be kept. | These provisions are justified as follows: "[R]eview mechanisms can ensure due process and public accountability in the procurement process. In fact, the opportunity to seek review should be seen as a cornerstone of transparency. Public procurement authorities are much more apt to vigorously and conscientiously implement transparency provisions if their failure to do so may be challenged before an impartial body. Moreover, there is ample precedent in WTO agreements for review or appeal mechanisms" (first paragraph). | Referred to three WTO agreements as well as to Article X:2(b) of the GATT 1994. |
| United States<br>WT/WGTGP/W/16<br>19 February 1998 | While recognising that there are legitimate circumstances under which a government may engage in single tendering, a plurilateral agreement should "set forth specific conditions on the circumstances under which single tendering is justified" | The need for disciplines on single tendering is justified as follows: "[I]f a government has unfettered discretion to utilize single tendering for any or all procurements, it could effectively escape the obligations of a WTO | Referred to United States' statutes and regulations on single tendering. Cited three international instruments: the |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| Transparency In Procurement Methods | (Introduction)<br>"Additionally, a transparency agreement could provide that single tendering be conducted with a minimum level of transparency" (third paragraph).<br>The submission lists the following circumstances under which single tendering could be justified: extreme urgency, absence of tenders or collusion in tenders, proprietary procurements, commodity markets and fire sales, and national security. This list is not intended to be exhaustive. | transparency agreement. To avoid such a potential loophole and ensure a common level of mutually agreed balance in obligations, WTO members may want to specify the general circumstances under which single tendering is justified" (third paragraph). | current GPA, the UNCITRAL Model Law, and World Bank Guidelines.<br>No economic evidence cited. |
| European Communities<br>WT/WGTGP/W/17<br>25 May 1998<br><br>Ensuring That Transparency In Procurement Policies and Practices Is Achieved | States elements of potential multilateral disciplines on transparency as they relate to the following aspects of procurement processes: choice of procurement method, providing information on national legislation and procedures, publication of procurement opportunities and procedural requirements, information supplied, time-limits, decisions made on supplier qualification and contract award, domestic review procedures, language used in official documentation, and the use of information technology.<br>The following general statement about transparency is made in this submission: "Transparency means ensuring that information on procurement rules, practices and opportunities are made widely available in an easily usable form to all interested parties (and particularly potential suppliers), as well as ensuring the right of access to that information. Furthermore, procurement practices should be seen to be transparent and information provided should be respected" (second paragraph).<br>The submission is said not to address "more horizontal issues which would need to be addressed in a developing a WTO transparency agreement, such as definition and scope, exchange of information between governments or technical assistance" (first paragraph). | The following statement is made about the effects of transparency: "…transparency can be a useful tool to encourage open and competitive procurement regimes, thereby helping both purchasers and suppliers to achieve economic benefits" (second paragraph). | Reference is made to EC procurement practice and to submission WT/WGTGP/W/6.<br>No economic evidence is cited. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| European Communities<br>WT/WGTGP/W/18<br>25 May 1998<br><br>Technical Assistance | "Technical assistance is an important element to ensuring the success of a future transparency agreement" (first paragraph).<br><br>"The EC fully supports the inclusion of a provision on technical assistance in any future transparency agreement and would advocate the use of language which mirrors that of Article 67 of the TRIPS Agreement" (fifth paragraph).<br><br>The submission describes forms and reasons underlying EC's programme of technical assistance in government procurement. | Technical assistance "can and should play a role in helping WTO Members (present and future) to implement the agreement, in developing domestic regimes and in taking further practical steps to enhance transparency of procurement policies and practices" (first paragraph). | Describes EC technical assistance programmes. Refers to the TRIPS agreement.<br><br>No economic evidence cited. |
| Hong Kong, China<br>WT/WGTGP/W/22 7 April 1999:<br><br>APEC Non-Binding Principles on Government Procurement: Accountability and Due Process | This submission summarises the elements of the principle of accountability and due process in procurement practices that were identified by the APEC Government Procurement Experts Group (GPEG). These elements were developed at GPEG's meeting on 4 February 1999.<br><br>The submission notes that "the principle of accountability and due process to be developed by the GPEC is non-binding. Individual member economies are in the best position to decide on the applicability of individual elements to them, taking into account the specific characteristics of their economy and the costs and benefits of adopting specific measures" (third paragraph of the statement of "Non-Binding Principles.")<br><br>The submission states that "[T]he general principle is that government procuring agencies and individual procuring personnel should be, and are seen to be, accountable to their governments, the end users, the public and suppliers for the efficient, cost-effective and fair conduct of their procurement; and that mechanisms for scrutiny of the procurement process and avenues/channels for review of complaints should be available" (fourth paragraph).<br><br>The submission goes on to state the following "elements of | None offered. | No national experience or international accords are referred to.<br><br>No economic evidence is cited. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| | accountability and due process": procurement process, record keeping, independent scrutiny, review mechanisms, and "openness and transparency" (final sub-section). In the case of record keeping, independent scrutiny, and review mechanisms, specific practical steps are also described that are supportive of the general principle enunciated above. | | |
| United States<br>WT/WGTGP/W/23<br>24 June 1999<br><br>Domestic Review Mechanisms | The submission notes that discussions in the Working Group have differentiated between domestic review procedures and WTO dispute settlement procedures. In fact, these procedures are distinguished as follows: "…domestic review mechanisms are provided to resolve supplier complaints at a national level under the sovereign jurisdiction of a particular country, while WTO dispute settlement is available to resolve differences between WTO members relating to the implementation of WTO obligations" (third paragraph.) The submission goes on to note that many jurisdictions already have domestic review mechanisms and that many WTO agreements already provide for such mechanisms in different contexts.<br><br>As far as proposals are concerned, the following statement is made in this submission. "We believe a transparency agreement should include a simple and flexible provision on domestic review mechanisms—one that can accommodate different Members' existing independent administrative or judicial tribunals and review procedures. Such a provision should ensure that there are transparent, timely and independent decisions on complaints or appeals relating to the transparency of procuring entities' actions and procedures" (seventh paragraph). The submission goes on to qualify this proposal as follows: "[T]he scope of review of this provision under WTO procedures should be limited to actions relating to the implementation, through domestic laws and procedures, of the requirements of this Agreement" (seventh paragraph). | None offered. | Refers to GATT Article X:3(b), the Agreement on Rules of Origin, the Agreement on Import Licensing, the Agreement on Implementation of Article VII of the GATT 1994, the Agreement on Technical Barriers to Trade, the Agreement on Subsidies and Countervailing Measures, and the TRIPS Agreement. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| | The submission contains the following proposed text for a provision on domestic review procedures in the context of a multilateral agreement on transparency in government procurement: "Members shall maintain judicial, arbitral or administrative tribunals or procedures for the purpose of the prompt review and correction of procurement actions that may be inconsistent with the requirements of this Agreement, as implemented in Members' laws. Such tribunals or procedures shall be independent of the agencies responsible for procurements covered under this Agreement and shall provide for rapid decisions that, as appropriate, can affect the modification or reversal of any inconsistent actions" (ninth and final paragraph). | | |
| Hong Kong, China WT/WGTGP/W/22 7 April 1999:<br><br>APEC Non-Binding Principles on Government Procurement [: Final] | This submission includes the full and final set of non-binding principles agreed by officials from APEC member economies on 8 August 1999. These officials were convened as the Government Procurement Experts Group (GPEG). This group has identified the following elements of the non-binding principles on government procurement: transparency, value for money, open and effective competition, fair dealing, accountability and due process, and non-discrimination.<br><br>On the "[E]lements of Transparency," the submission notes: "[T]he general principle is that sufficient and relevant information should be made available to all interested parties consistently and in a timely manner through a readily accessible, widely available medium at no or reasonable cost. This general principle is applicable to all aspects of [government procurement], including the general operational environment, procurement opportunities, purchase requirements, bid evaluation criteria and awards of contracts…" (paragraph 3); which is the same principle enunciated in submission WT/WGTGP/W/11 above. | See entry for submission WT/WGTGP/W/11 above for the rationale for adopting transparent procurement processes.<br><br>The rationale offered for adopting a principle of non-discrimination is that "[T]he use of discriminatory practices in government procurement undermines the competitive process and thus the ability of member governments to active the best possible value for money outcomes" (paragraph 70). | None. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
|---|---|---|---|
| | Of particular note is the "[E]lements of Non-discrimination," where the submission states that "[T]he general principle is that procurement laws, regulations, policies, administrative guidelines, procedures and practices should not be prepared, adopted or applied so as to afford protection/favour/preference to, or discrimination/bias against, the goods, services or suppliers of any particular economy/economies" (paragraph 70). The submission goes on to say of the non-discriminatory principle that "[T]his principle should apply to all stages of procurement" (paragraph 71). The submission goes on to list seven forms of non-discrimination in procurement tendering (paragraph 72). | | |
| European Communities<br>WT/WGTGP/W/26<br>5 November 1999<br><br>Elements For An Agreement On Transparency In Government Procurement | This submission contains the draft text of 18 articles that might form a multilateral agreement. It is said that:<br><br>"[T]he proposed text favours a "principles-oriented approach" to transparency in government procurement. In the European Communities' view, it is not necessary in this context to impose one single set of rules onto Members that widely diverging systems and, in some cases, limited resources" (second paragraph of covering note).<br><br>The EC states that it consulted with a number of delegations before this text was proposed and that "the attached draft has, on most points, struck a fair balance between the different views" (third paragraph of covering note). The EC goes onto note that "during this exercise it became clear that introducing multilateral rules on transparency in procurement will not be sufficient to resolve possible distortions in procurement practices. Therefore, further work on additional multilateral rules on government procurement is necessary. Obviously, commencing any such negotiations does not imply an automatic opening of procurement markets, but it will create a rules-based environment" (final paragraph of covering note). | None offered. | Reference is made to the GATT 1994 (generally and specifically to Articles X:1, XX, XXI and XXII), the GATS (generally and specifically to Articles III:1, III:2, XIV, XIVbis, XXII, and XXIII).<br><br>No reference is made to country experience or to economic evidence. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
|---|---|---|---|
| | The draft text of a multilateral agreement in this submission contains 18 articles, organized into four parts. This text is reported in Appendix 3a of this chapter. | | |
| Hungary, Korea, Singapore, and the United States<br>WT/GC/W/85<br>WT/WGTGP/W/27<br>9 November 1999<br><br>Preparations For The 1999 Ministerial Conference | This joint submission contains a "draft consolidated text for an agreement on transparency in government procurement" (first paragraph of the covering note.) It is noted that the text "is the result of ongoing informal consultations with a number of delegations…" (first paragraph of the covering note).<br><br>The text of the proposed agreement contains text on the following subjects: General Objective of the agreement, Non-Discrimination in Transparency, Scope and Application, Transparency of Information on Procurement Opportunities, Exceptions, Transparency of Procurement Rules, Transparency in Qualification and Bid Documentation, Transparency of Decisions and Contract Awards, Other Provisions on Information Relating to Procurement, Domestic Review Procedures, Review and Institutional Provisions, Dispute Settlement, Technical Cooperation, and Final Provisions.<br><br>The provision on "Non-Discrimination in Transparency" is as follows: "In carrying out its obligations under this Agreement, each Member shall accord to suppliers from any other Member treatment no less favorable than that which it accords its own suppliers or to suppliers from any other country" (third paragraph of draft agreement). | An extensive rationale for the proposed agreement is offered in this submission. The rationale is as follows:<br><br>"Recent instability in global financial markets has underscored the importance of capacity building in the public sector and, in particular, of continuing to improve economic management. Members recognize that transparent and predictable procurement practices are a critical element of good economic governance, and help to build public confidence, encourage long-term business commitments, and provide a solid foundation for sustained economic growth and development.<br><br>"Transparency in procurement also helps to ensure that governments obtain the best value for money they spend, freeing up resources to address pressing economic and social needs. For example, the Ministry of Health of one Member recently reported that it was able to reduce by 20 percent the price of medicines supplied to patients as a result of the introduction of transparent procurement procedures. All Members can clearly benefit, often on an even greater scale, from the consistent use of such procedures" (third and fourth paragraphs of the covering note). | The submission refers to Articles X:1, XX, XXII, and XXIII of the GATT; Articles III:1, III:2, XIV, XXII, and XXIII of the GATS; and Article X of the Agreement Establishing the World Trade Organization.<br><br>No economic evidence is cited, however the experience of one (unnamed) WTO Member is cited. |
| United States<br>WT/WGTGP/W/35<br>30 September 2002<br><br>Proposal For A Work Plan To Build On The Progress Of The | After summarising certain aspects of the discussions in the Working Group, ad describing the benefits of a transparent government procurement system, the submission goes on to state that: "[W]hile Members use a myriad of procurement procedures and practices, there is no common set of transparency provisions. Thus, the primary focus of the agreement should be to establish core transparency elements | This submission offers an extensive account of the "Benefits of a Transparent Government Procurement System." The relevant text is stated below:<br><br>"Transparent government procurement systems engender benefits not only for domestic and foreign suppliers, but also ultimately for the governments | No country experience, international agreements or rules, or economic evidence is cited. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| Working Group | that suppliers throughout the world can be assured of finding in the procurement system of every member" (seventh paragraph).<br><br>The submission argues that the Working Group should identify those elements that it might be appropriate to include in a multilateral agreement. Having said that, the submission does state "[A]t this juncture, it is not necessary for the Working Group to decide how a particular element would be addressed in the agreement" (tenth paragraph).<br><br>This submission suggests organizing the possible elements of an agreement into the following four categories: General parameters of a potential agreement; Transparency of procurement systems; Transparency of specific procurements; and Operational provisions to fulfil the objectives of a potential agreement.<br><br>The draft text of a multilateral agreement in this submission contains 18 articles, organized into four parts. This text is reported in Appendix 3b of this chapter. | themselves and their citizens. The full disclosure of information is essential to a predictable and efficient government procurement process. The use of transparent and predictable procedures will help to ensure that governments obtain the greatest value for their money, resulting in the purchase of better quality goods and services and leading to more efficient use of public resources. This will enable Members to provide more social services, economic and social infrastructure and other public goods to their citizens. Transparent procurement systems will also provide an important tool for Members to combat corruption in public procurement.<br><br>"Ensuring transparency of government procurement systems also has ramifications beyond the government procurement sector. Transparent and predictable procurement procedures are a critical element of good economic governance. They help build public confidence in the management of government affairs, establish a stable and predictable commercial and investment environment, encourage long-term business commitments and provide a solid foundation for sustained economic growth and development" (paragraphs three and four). | |
| Canada<br>WT/WGTGP/W/36<br>30 September 2002<br><br>Transparency of Contract Award Decisions | The submission begins by noting that WTO Members need to have flexibility in establishing criteria for deciding on the award of a contract, in criteria for the qualification of bidders, and the registration of bidders.<br><br>The submission goes on to note that: "[W]ithin the context of flexibility for choice of award criteria, transparency of decisions can be assured by:<br><br>• specifying the chosen award criteria and other | The submission provides an extensive rationale for these provisions. This rationale is reproduced below.<br><br>"Benefits of transparency of award decisions<br><br>*1. Efficiency of the international trading system:*<br><br>• The importance of transparency, predictability and consistency in the application of measures relating to international trade has been recognized since the GATT 1947. | No country experience, international agreements or rules, or economic evidence is cited. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
|---|---|---|---|
| | requirements in the tender documentation, registration or qualification documentation or other information that is provided to all participating suppliers;<br>• basing award decisions solely on the criteria provided to all participating suppliers; and<br>• making information available to suppliers and other parties on award decisions" (paragraph two). | • Government procurement is an important contributor to world trade. Most governments, like Canada, cannot supply all their government needs through domestic sources. Even where bidding can be restricted to domestic sources, those sources will need to draw on inputs from other parts of the world.<br>*2. Economic efficiency:*<br>• Procuring organizations and the taxpayer will get better value for their money through lower prices and better products.<br>• By providing clear information on the basis for making decisions, potential suppliers will be able to make informed decisions about whether to bid.<br>• Potential suppliers will be able to make better bids if they understand the government's needs and priorities.<br>• Providing information on local content or other requirements for domestic benefits permits potential suppliers, domestic and foreign, to seek effective and efficient ways of meeting these requirements;<br>• Potential suppliers from other countries will understand whether they may bid, thus avoiding wasted effort bidding on requirements for which they are not eligible.<br>• Potential sub-contractors will be able to make more effective proposals to possible prime contractors.<br>• Providing feedback on the outcome of an award permits bidders to prepare better bids in the future. | |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| | | *3. Confidence in the procurement system*:<br>• Predictability and confidence in the government procurement system is ensured through consistency in describing applicable criteria and following the criteria for award of contracts.<br>• Transparency of award decisions reduces the possibility of corruption.<br>• Providing feedback on the outcome of the award of a contract establishes confidence that the criteria have been applied as described" (paragraphs two and three). | |
| Japan<br>WT/WGTGP/W/37<br>14 October 2002<br><br>Japan's View On Transparency in Government Procurement | After citing the relevant paragraphs of the Singapore Ministerial Declaration and the Doha Ministerial Declaration, states that "Japan attaches a great importance to the following" [three points] (paragraph 2).<br>The first point is as follows: "Since the transparency provisions in the Agreement on Government Procurement in Annex IV of the WTO Agreement are difficult for developing country Members to follow as it stands, the provisions of a transparency agreement should be flexible enough, so that all WTO Members could accept them" (paragraph 2(1)).<br>The second point is that "[A] transparency agreement should be legally binding and effective" (paragraph 2(2)).<br>The third point is that "[I]t is a prerequisite that all WTO Members participate in a transparency agreement. Therefore, the framework of such an agreement should be simple, focusing on core principles such as transparency in procurement opportunities" (paragraph 2(3)).<br>The submission goes on to elaborate that the important elements of a transparency agreement are: Non-discrimination | Much of the rationale for the positions taken in this submission are found in the quotations in panel to the immediate left. | The existing Agreement on Government Procurement is mentioned. However, no other international agreements or rules, nor country experience nor economic evidence are cited. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
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| | in transparency; Definition and scope; Core transparency principles including preparation and publication of procurement rules and enquiry, publication of procurement opportunities, and transparency in decisions on contract awards; Domestic review; Consultations and dispute settlement; and Technical cooperation and special and differential treatment for developing countries. | | |
| United States<br>WT/WGTGP/W/38<br>31 January 2003<br><br>Considerations Related To Enforcement Of An Agreement On Transparency in Government Procurement | The submission contains the following general statement, which is followed by more specific remarks about the enforcement of a potential multilateral agreement. "A [Transparency in Government Procurement] agreement would be an important addition to the rules-based international trading system by setting out basic transparency obligations that suppliers throughout the world could expect to find in the government procurement systems of all Members. These obligations should be subject to the same types of enforcement as existing commitments in other WTO agreements. However, it is important to emphasize that regardless of the enforcement mechanisms that may be built into a [Transparency in Government Procurement] agreement, such mechanisms could not be used to challenge domestic preference programmes, which the Doha Declaration has explicitly excluded from a [Transparency in Government Procurement] agreement" (second paragraph).<br><br>With regard to specific proposals on domestic review procedures, the submission states: "[A] [Transparency in Government Procurement] Agreement should require that Members make available domestic review procedures for both domestic and foreign suppliers to use if they had concerns that a particular procurement was not in compliance with the transparency provisions of an agreement. An agreement could specify that the use of such procedures would be the only method through which a specific procurement could be | As noted in the panel of text to the left, the submission does provide a rationale for the manner in which potential provisions on the application of the WTO's Dispute Settlement Understanding to government procurement could be tailored to meet the stated concerns of WTO Members. | The submission makes reference to GATT Article X:3(b), Articles 2(j) and 3(h) of the Agreement on Rules of Origin, Article 5(e) of the Agreement on Import Licensing, Article 11 of the Agreement on the Implementation of Article VII of the GATT 1994, the Agreement on Technical Barriers to Trade, the Agreement on Subsidies and Countervailing Measures, the Agreement on Antidumping Practices, and the TRIPS Agreement.<br><br>No mention is made of any national experience or economic evidence. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
|---|---|---|---|
| | challenged" (fifth paragraph).<br><br>The submission goes on to note that many existing WTO agreements already provide for domestic review procedures.<br><br>The submission also notes that "a [Transparency in Government Procurement] Agreement could include a simple and flexible provision on domestic review procedures that would accommodate different Members' existing independent administrative and judicial tribunals and review procedures" (ninth paragraph).<br><br>The submission argues that to address some Members' concerns—about the relationship between WTO Dispute Settlement Understanding and the domestic review procedures and the application of that Understanding and the potential to overturn or rescind particular enforcement decisions—it might be worth considering whether to phase-in the application of some of the provisions of a multilateral agreement on transparency in government procurement. Furthermore, a provision in such an agreement could be introduced that "resort to the [Dispute Settlement Understanding] would not be available to challenge a specific procurement, and thus could not be used to overturn a contract award" (tenth paragraph). | | |
| European Communities<br>WT/WGTGP/W/39<br>3 February 2003<br><br>Domestic Review Mechanisms Related To Transparency In Government Procurement | The submission notes that "it examines the kinds of provisions that should be envisaged in the future agreement on transparency in government procurement to ensure that parties' measures subject to a future agreement can be reviewed by domestic procedures" (second paragraph.)<br><br>Moreover, "[A] future agreement would thus, on the one hand, ensure the transparency of domestic review procedure and, on the other hand, ensure suppliers' rights to challenge a procurement in breach of transparency provisions" (third paragraph). | None offered. | The submission makes reference to the GATS, the GATT, the Agreement on Rules of Origin, the Agreement on Import Licensing, the Agreement on Customs Valuation, the TRIPS Agreement, and the existing Government Procurement Agreement. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
|---|---|---|---|
| | The submission goes on to describe the possible disciplines under three headings: Transparency of domestic review procedures, Challenge procedures within a future agreement on transparency in government procurement, and Special and Differential treatment for developing countries. The first includes provisions that the review procedures be transparent and notes that similar provisions are found in a number of existing WTO Agreements. The second would include a provision enabling suppliers to challenge a procurement proceeding that the supplier or suppliers think are in breach of the multilateral agreement. With respect to the third, the EC proposes a "flexible" approach to implementing domestic review provisions.<br><br>With respect to the independence of the body undertaking the domestic review, the submission states that "[T]he EC considers that sufficient independence from the procuring entity would be secured if this independence is foreseen at any one step of the review procedure" (eleventh paragraph).<br><br>The submission goes on to note that, although a domestic review procedure would remain within the sovereignty of the respective WTO member, under a multilateral agreement the procedure would have to meet the following criteria: to "render prompt and timely decisions, preserving suppliers' commercial interests"; to involve "no discrimination between domestic bidders and those from other parties"; "decisions taken by the review body are effective and enforceable"; "challenge procedures provide for adequate measures to correct proven infringements of the agreement and to protect suppliers' interests in a tender" (thirteenth paragraph).<br><br>In this submission the EC also proposes deferring a discussion of the appropriate remedies or measures that a domestic review procedure might have at its disposal. Moreover, the EC | | No mention is made of any national experience or economic evidence. |

| WTO member, document number, date; and title of submission | Proposals made and matters raised | Rationale(s) offered | Evidence and agreements cited |
|---|---|---|---|
| | feels that there is a need for further elaboration as to which parties have access to review procedures and as to whom and in what manner the decisions and non-decisions of review bodies are communicated. | | |
| Korea<br>WT/WGTGP/W/39<br>3 February 2003<br><br>Work Ahead Up To The Cancun Ministerial | After summarizing the discussions in the Working Group and the Doha Ministerial Declaration, the submission notes "[K]orea also believes that the multilateral rules on [Transparency in Government Procurement] should be legally binding and subject to the [Dispute Settlement Understanding]. Otherwise, it would be difficult to ensure effective implementation of the rules, substantially diminishing the benefits of such rules" (fifth paragraph).<br><br>The submission goes on to state that in the following six months the Working Group should "[I]dentify the core elements to be negotiated after the Cancun Ministerial. They do not have to be exhaustive and detailed down to the negotiating text"; "[I]dentify issues of particular concerns to developing countries, based on the core elements as above…"; and "[E]xplore ways to address those specific concerns" (seventh paragraph).<br><br>In Korea's view the following elements should be included in a multilateral agreement: Scope and definition; Non-Discrimination; Measures to ensure transparency through publication of procurement-related measures; Measures to ensure transparency in the procedures for award decision; Transparent domestic review process; Exceptions; Dispute settlement and consultations; Special and differential treatment for developing countries; and Technical Assistance.<br><br>The submission also notes three possible means for addressing the concerns of developing countries: transitional periods, "a set of flexibilities for developing countries and their phase-out," and technical assistance (ninth paragraph). | None offered. | No country experience, international agreements or rules, or economic evidence is cited. |

## Appendix 3a:

## Elements for an Agreement on Transparency in Government Procurement

## As proposed by the European Communities in a Document WT/WGTGP/W/26 submitted to the WTO's Working Group on Transparency in Government Procurement on 5 November 1999

### Text

*Members,*

*Recognizing* the need to further the objectives of the GATT 1994 and of the General Agreement on Trade in Services,

*Desiring* to render more transparent the legislation and administrative procedures applied in government procurement,

*Taking into account* the needs of developing country Members in particular with respect to trade and administration,

*Realizing* that further negotiations are necessary to ensure that governments obtain the best value for money in their procurement practices,

*Desiring* to provide for a consultative mechanism and the effective and equitable resolution of disputes arising under this Agreement, taking account of the peculiarities of government procurement,

Hereby *agree* as follows:

Article 1

*General Objective*

1. This Agreement aims at ensuring transparency throughout government procurement covered by GATT 1994 and GATS.

2. The requirements under this Agreement shall be met on a non-discriminatory basis.

3. Members shall adopt and apply their legislation in good faith so as not to undermine the aims of this Agreement.

### Part I: Definitions and Scope

Article 2

*Scope*

1. This Agreement applies to procurement by governmental agencies of products[184] and services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale, without prejudice to Articles XX and XXI of GATT 1994 and Articles XIV and XIV*bis* of GATS, as appropriate.

2. Notwithstanding the obligation for any procurement to be transparent, any Member may limit the application of Articles 5.1, 5.2, 5.3, 6, 7, 8.3, 9.2 and 14.1 of this Agreement to procurement above the following amounts:

[184] "Products" in the context of this Agreement include products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods for sale.

| *Maximum threshold* | *Applicable for:* |
|---|---|
| 130,000 SDRs | central government contracts for supply of products and services, |
| 200,000 SDRs | sub-central government contracts for supply of products and services, |
| 400,000 SDRs | public enterprise contracts for supply of products and services, |
| 5,000,000 SDRs | all contracts for public works, |

provided Member's legislation contains clear and unambiguous provisions on contract valuation.

3. Members shall ensure that procuring entities do not divide intended procurements for the purposes of avoiding application of this Agreement.

**Part II: Principles of transparency**

Article 3

*Public Accessibility of Domestic Legislation*

1. Without prejudice to the obligations in Article X:1 of GATT and Article III:1 and 2 of GATS, each Member shall ensure that through a public medium its laws implementing this Agreement, procurement regulations and all administrative rulings of general application in connection with procurement, and all amendments thereof (hereafter: "laws and regulations"), are readily and easily accessible.

2. Members shall notify the WTO Secretariat of the (electronic) medium used. Information shall be provided at no more than the cost of copying and despatch.

Article 4

*Methods of Procurement*

1. Irrespective of the methods of government procurement used, they shall be specified in advance and applied in accordance with the laws and regulations. The procurement method chosen shall be transparent in accordance with the requirements of this Agreement.

2. Each procuring entity shall ensure that technical specifications are not prepared, adapted or applied in a manner that constitutes a disguised means of achieving objectives which are unrelated to that entity's procurement functions.

Article 5

*Tendering Procedures*

1. Wherever Members resort to government procurement through open tendering procedures, they shall publicise all necessary information and amendments thereof through an accessible source within sufficient time for potentially interested suppliers to respond in a meaningful manner.[185]

2. The information referred to in paragraph 1 shall be adequate to allow suppliers to assess their potential interest in a particular procurement and, should they wish to participate in the procurement process, to submit responsive bids. Such information shall at least include:

(a) name of the procuring entity;

(b) the goods or services to be procured, and their specifications;

(c) the procurement procedure used;

(d) any (pre-)qualification requirements;

(e) any restrictions on market access and/or domestic preferences granted;

[185] This paragraph also covers pre-qualification procedures, wherever applicable.

(f) the contact details for obtaining tender documentation and additional information;

(g) the award criteria;

(h) the deadlines for the submission of tenders; and

(i) the date and time for the opening of tenders.

3. Members shall ensure that the information referred to in paragraph 2 is made available through the use of tender notices, tender documentation, or by other means, provided they allow for broad and easy access to potentially interested suppliers or service providers.

4. Members shall ensure that their laws and regulations clearly prescribe the conditions and, if applicable, thresholds under which procuring entities may choose to utilise procurement methods in which information on the procurement opportunity is provided only to one supplier or to a limited number of suppliers selected in advance by the procuring entity. Members shall ensure that procuring entities do not utilise such methods for the purposes of restricting participation in the procurement process in a non-transparent manner.

Article 6

*Bid Periods*

1. Sufficient time should be allowed for the preparation, submission and receipt of responsive bids. Time-limits set should not undermine the principles and objectives of this Agreement. They should take account of the particular circumstances as well as the complexity of the envisaged procurement.

2. Members shall clearly define in advance their policy on whether and in what circumstances late tenders may be accepted.

Article 7

*Decisions on (Pre-)qualification and Contract Awards*

1. Decisions on (pre-)qualification and contract awards shall be taken on the basis of the conditions and criteria (including technical specifications) which have been made known in advance, e.g. through a tender notice or tender documentation. Notwithstanding Article 6.2, only bids of suppliers whose tenders have been received before the previously published final date for submission of tenders may be considered.

2. Once the contract is awarded, the participating suppliers shall be informed of the rejection of their bid. Unsuccessful bidders can, on request, obtain more detailed information as to why their bid was rejected and/or the winning bid was chosen.

Article 8

*Domestic Review*

1. Each Member shall maintain fair and transparent judicial, arbitral or administrative review bodies or procedures for the purpose, *inter alia*, of the prompt review of decisions of procuring entities creating legal effects.

2. Such bodies and procedures shall operate independently of the procuring entities and shall provide all interested parties that are directly and individually affected by a decision as mentioned in paragraph 1 with access to review.

3. Members shall ensure that each procuring entity is able to respond to requests for information on the way the procurement was carried out by maintaining a comprehensive administrative record of the procurement proceeding.

Article 9

*Confidentiality*

1. Any information which is by nature confidential shall be treated as such by the procuring entities. Such confidential information shall not be disclosed without specific permission of the party submitting it.

2. In case information is treated confidentially, where appropriate the procuring entities will furnish a meaningful non-confidential summary thereof.

Article 10

*Language*

Except if otherwise laid down in this Agreement, Members are encouraged to ensure that all information referred to in this Agreement is provided in a WTO language.

**Part III: General provisions**

Article 11

**Notification Requirements**

Laws and regulations shall be promptly notified to the WTO Secretariat. Members shall further provide a list in one of the WTO languages of the relevant generally applicable instruments. The WTO Secretariat shall endeavour to make such lists available to the general public through an electronic medium.

Article 12

*Requests for Information*

On request by another Member, Members shall provide information and explanations on their laws and regulations, procedures and practices affecting the implementation and operation of this Agreement.

Article 13

*Dispute Settlement*

1. The provisions of Articles XXII and XXIII of GATT 1994 or Articles XXII and XXIII of GATS respectively, as elaborated and applied by the Understanding on Rules and Procedures Governing the Settlement of Disputes under the WTO Agreement (hereinafter referred to as the "Dispute Settlement Understanding") shall be applicable within the limitations specified below.

2. The scope of paragraph 1 is limited to disputes among Members regarding the implementation of this Agreement and to decisions of the bodies mentioned in Article 8.1 for as far as such decisions concern procurements exceeding the maximum thresholds listed in Article 2.2.

3. In the case of a dispute in which provisions both of this Agreement and of one or more other Agreements listed in Appendix 1 of the Dispute Settlement Understanding are invoked by one of the parties to the dispute, paragraphs 1 and 2 shall apply only to issues of interpretation and application relating to this Agreement.

4. Panels established to examine disputes under this Agreement shall include at least one person qualified in the area of government procurement.

Article 14

*Committee on Transparency in Government Procurement*

1. The Committee on Transparency in Government Procurement ("the Committee") shall review promptly any particular matter which a Member considers to be detrimental to its interests under this Agreement and where consultations between it and the Member(s) concerned have failed to produce a mutually satisfactory solution. On such matters, the Committee may make such observations as it deems appropriate.

2. The Committee shall review the implementation and provisions of this Agreement, including the thresholds mentioned in Article 2.2, two years after its entry into force and periodically thereafter.

3. After the entry into force of this Agreement, the Committee shall initiate a study how to achieve "best value for money" in government procurement and develop elements for further multilateral rules for adoption in due course.

Article 15

*Use of Information Technology*

Members are encouraged to make use to the largest extent possible of tools of information technology to disseminate information, in particular for the dissemination of information about procurement opportunities and contract awards.[186]

Article 16

*Technical Assistance*

In order to facilitate the implementation of this Agreement, Members shall provide, on request and on mutually agreed terms and conditions, technical cooperation to developing and least developed country Members. Parties recognize in particular the need for developing countries to receive technical assistance to enable them to set up and operate electronic systems for ensuring transparency of procurements.

**Part IV: Final provisions**

Article 17

1. Members' implementation of the provisions of this Agreement shall not affect their rights and obligations, if any, under the WTO Agreement on Government Procurement.

2. This Agreement is without prejudice to Members' rights and obligations under GATT 1994 and GATS.

Article 18

*Entry into Force*

This Agreement shall be open for acceptance, by signature or otherwise, by all WTO Members. It shall enter into force on the date determined by Ministers at […] and shall remain open for acceptance for a period of two years following that date. An acceptance following the entry into force of this Agreement shall enter into force on the thirtieth day following the date of such acceptance

[186] Members recognize the difficulties which developing countries may have in applying tools of information technology.

## Appendix 3b:

## Draft Text For An Agreement On Transparency In Government Procurement

**As proposed by Hungary, Korea, Singapore and the United States in a document WT/WGTGP/W/27 submitted to the WTO's Working Group on Transparency in Government Procurement on 9 November 1999**

**TEXT:**

*Members,*

*Recognizing* that government procurement may provide a means of achieving or supporting Governments' social, environmental and economic objectives for the betterment of their communities,

*Recognizing* that efficient, effective and appropriate government procurement enhances the management of government resources, the quality of governance and the economic performance of the community as a whole,

*Recognizing* that transparency, integrity and predictability are integral to efficient and effective government procurement and to the functioning of the multilateral trading system, and

*Desiring* to establish a multilateral framework of transparency obligations to assure all parties that government procurement shall be conducted fairly, ethically and predictably,

Hereby *agree* as follows:

**General Objective**

This Agreement aims at ensuring transparency [, integrity and predictability] in government procurement. Each Member shall adopt and apply its procurement laws, regulations and requirements in good faith and in a manner that does not undermine the aims of this Agreement.

**Non-Discrimination in Transparency**

In carrying out its obligations under this Agreement, each Member shall accord to suppliers from any other Member treatment no less favorable than that which it accords to its own suppliers or to suppliers from any other country.

**Scope and Application**

1. This Agreement shall apply to any law, regulation or requirement governing the procurement by governmental agencies of goods and services purchased for governmental purposes and not with a view to commercial resale nor to use in the production of goods or services for commercial sale.

[2. This Agreement

*Option 1:* [applies to all procurement [within the jurisdiction] of a Member]

*Option 2:* [does not apply to procurement by government agencies other than those of a Member's central or Federal government and the highest level of sub-central government]

*Option 3:* [applies to all procurement of a Member's central or Federal government [, including departments that perform administrative, research, supervisory, advisory or regulatory functions of a governmental nature]].[187]]

3. This Agreement shall not apply to a procurement contract with a value of less than [the *de minimus* threshold specified in domestic procurement rules, which shall in no case be greater than]

[187] [This Agreement shall not apply to the granting of exclusive rights by a Member.]

*Option 1:* [... SDRs]

*Option 2:* [... SDRs for goods and services and ... SDRs for construction services].

3.1 Each Member shall ensure that its procuring entities do not divide intended procurements for the purposes of avoiding application of this Agreement.

**Exceptions**

Nothing in this Agreement shall prevent any Member and its procuring entities from taking any action which that Member considers necessary for the protection of its essential security interests or any action which is necessary under GATT Article XX or GATS Article XIV. Any Member and its procuring entities may refrain from disclosing confidential business information or information that would impede law enforcement.

**Transparency of Procurement Rules**

1. Without prejudice to the obligations of Article X:1 of GATT and Article III:1 and 2 of GATS, each Member shall publish in a timely manner all laws, regulations, and requirements that specifically relate to government procurement and are of general application (hereinafter collectively referred to as "procurement rules") in officially designated media which are readily accessible to the public. Each Member shall publish in the same media and in a timely manner all additions and changes to its procurement rules.

[1.1 Members' procuring entities shall not be required to publish materials which could be prejudicial to the objective and non-discriminatory evaluation of bids or applications for qualification.]

2. *Option 1*: [Such procurement rules shall describe the conditions under which it is appropriate to use different procurement methods. A procuring entity's choice of procurement method shall be in accordance with those conditions.

2.1 When a procuring entity uses a procurement method in which information on the procurement is provided only to one supplier or to a limited number of suppliers who are selected in advance by the procuring entity through a selection process other than a qualification process, it may depart from the provisions of Articles VI and VII [and VIII] of this Agreement.]

*Option 2*: [In selecting a procurement method, which may include open, sole source, pre-qualification arrangements, short-listing, staged procurement and other methods of procurement, entities may select the most efficient and effective method to achieve their procurement objective, taking into account market circumstances and the costs and benefits of each procurement method.]

3. Each Member shall, upon request by another Member, provide in a timely manner, information and explanations of their procurement rules, procedures, practices and policies, affecting the implementation and operation of this Agreement.

[4. Within one year from the date on which this Agreement takes effect, each Member shall notify to the WTO Committee on Transparency in Government Procurement a list of the titles of its laws, regulations and administrative rulings of general application specifically relating to government procurement [and its officially designated media for publishing information]. Such notifications shall be made in an official WTO language.]

[5. Each Member shall establish an enquiry point which shall disseminate information and provide answers to all reasonable questions from other Members and interested parties in other Members' countries or territories relating to government procurement policies and procedures. Each Member shall notify to the Committee on Transparency in Government Procurement, established in accordance with Article XI of this Agreement, the name, address and other appropriate contact information for this enquiry point.]

**Transparency of Information on Procurement Opportunities**

<u>Invitations to participate in the procurement process</u>

1. Whenever a procuring entity issues an open invitation for bids, or, where appropriate, an invitation to participate in a qualification process, it shall publish the invitation in a medium of general distribution which is readily accessible to the public.

1.1 Where an invitation for bids is extended only to suppliers that the entity has pre-qualified or selected in advance, it shall ensure that the invitation is provided to all such suppliers.

2. The invitations shall include sufficient information to allow suppliers to assess their potential interest in a particular procurement process and to submit responsive bids, and shall include at least the following:

2.1 a description of the proposed procurement, including the nature of the goods and services to be procured and all relevant time-periods;

2.2 the procurement method to be used and information on any applicable preferences or other conditions for participation [, or an explicit reference to procurement rules setting out applicable preferences or other conditions for participation]; and

2.3 information on how to contact the procuring entity to obtain relevant information on the bidding or qualification process and requirements.

Time-periods

3. Procuring entities shall disseminate such invitations in sufficient time to enable interested suppliers to obtain qualification documentation, where appropriate, and tender documentation, and to prepare and transmit responsive submissions.

3.1 Procuring entities shall ensure that such time-periods are the same for all suppliers.

3.2 Entities shall ensure that time-periods for the receipt of bids are determined with due consideration of the particular circumstances of the procurement, including the conditions and the complexity of the procurement.

Invitations relating to closed lists of qualified suppliers

4. Whenever a qualification process covers multiple procurements over a period of time and is not open at all times to applications from interested suppliers:

[4.1 an invitation to apply for qualification shall be published [at least once a year] [regularly]];

4.2 current lists of qualified suppliers shall, on request, be made available in a timely manner; and

4.3 each invitation to apply for qualification shall include the date and time for receipt of applications for qualification.

Changes to information provided

5. Procuring entities shall disseminate any changes to information provided in an invitation for bids or an invitation to participate in a qualification process in the same medium in which the invitation was provided.

**Transparency in Qualification and Bid Documentation**

1. With regard to qualification and bid documentation, procuring entities shall provide complete documentation in a timely manner to any interested supplier, upon request, and inform participating suppliers in a timely manner of any changes to the documentation.

2. Where a procuring entity uses a qualification process, qualification documentation shall clearly set out all the criteria that the entity will use to evaluate a supplier's qualifications to participate in the procurement process.

3. Bid documentation shall specify all the information necessary for an interested supplier to prepare and submit responsive bids. Such information, if not already provided in a prior invitation to participate, shall include:

3.1 all specifications and criteria the entity will use to evaluate the offered goods or services; and

3.2 the date and time for the receipt of tenders and, where appropriate, the date and time for the opening of tenders.

4. Procuring entities shall specify explicit and objective requirements that are, to the greatest extent possible, defined in terms of required functional performance.

5. *Option 1*: [Whenever a procuring entity obtains advice or assistance in the preparation or development of specifications from a supplier [that has a potential interest in the relevant procurement, the entity shall inform suppliers participating in the procurement of such advice or assistance and] [, such supplier shall not be eligible to participate in the relevant procurement].]

*Option 2:* [When an entity obtains advice or assistance on the development of specifications from a potential supplier, the entity shall apply that advice in a non-discriminatory manner.]

**Transparency of Decisions on Qualification and Contract Awards**

1. Procuring entities shall base contract award decisions and qualification decisions solely on the criteria and other requirements that have been specified in the bid or qualification documentation or other information that has been provided to all participating suppliers.

2. Having awarded a contract, entities shall:

2.1 inform suppliers that have submitted bids of the contract award decision;

2.2 provide suppliers, upon request, with information as to why their bid was rejected or, where applicable, the reasons for the denial of their request to become a qualified supplier; and

2.3 ensure that any debriefing provided by the entity is available to all participating suppliers.

Other post-award information

3. Each entity shall make information on contract awards [publicly available] [available to participating suppliers] for a reasonable period of time. Such information shall include the name of the procuring entity, a description of the goods and services procured, [and] the name of the winning supplier [, and the value of the contract award].

[3.1 In cases where procurements are conducted under conditions set forth in Article V:2.1, the entity shall cite in such information the condition in its procurement rules allowing the use of that procurement method.]

**Other Provisions on Information Relating to Procurements**

1. Procuring entities shall maintain [, and make available upon request by another Member,] records of tendering procedures relating to procurements subject to this Agreement. Such records shall be maintained for a period of at least three years.

[1.1 In cases where procurements are conducted under conditions set forth in Article V:2.1, the entity shall include in the records the condition in its procurement rules allowing the use of that procurement method.]

2. Members and procuring entities may utilise electronic or paper-based communication methods in all stages of the procurement process, provided that whatever media is chosen complies with the requirements of this Agreement. Members and procuring entities are encouraged to use, to the extent possible, electronic communications at all stages of the procurement process, provided that it complies with the requirements of this Agreement.

3. Except as provided for in Article V.4 of this Agreement, information required under this Agreement shall be provided either in an official national language or in an official WTO language.

**Domestic Review Procedures**

1. Members shall encourage the resolution of procurement disputes relating to the implementation of this Agreement, in the first instance, through consultations between the procuring entity and suppliers.

2. Each Member shall maintain fair and transparent judicial, arbitral or administrative bodies or procedures for the purpose of the prompt review of procurement practices or actions that may be inconsistent with the requirements of this Agreement, as implemented by the Member.

3. Such bodies or procedures shall be operated independently of the procuring entities and shall provide all interested parties who participated in the procurement process and are affected by the practice or action with access to review and timely decisions [that, as appropriate, can address any inconsistent practice or action].

4. Each Member shall ensure that information about domestic review bodies, procedures and decisions is publicly available. Each Member shall maintain an administrative record of the review proceeding for a three-year period.

**Review and Institutional Provisions**

1. A Committee on Transparency in Government Procurement (hereinafter referred to as "the Committee") shall oversee the functioning of this Agreement and perform such additional functions related to government procurement as assigned by the General Council.

2. The Committee shall review the implementation of this Agreement [two] years from the date on which it enters into force.

**Dispute Settlement**

1. Consultations and the settlement of disputes among Members regarding the implementation [in domestic procurement rules] of this Agreement shall be in accordance with Articles XXII and XXIII of GATT 1994 [and Articles XXII and XXIII of GATS], as elaborated and applied by the Understanding on Rules and Procedures Governing the Settlement of Disputes under the WTO Agreement [, except as otherwise specifically provided below].

2. Panels established by the Dispute Settlement Body to examine disputes under this Agreement shall include persons qualified in the area of government procurement.

3. [With regard to any dispute relating to the implementation of this Agreement, each Member should, as appropriate, encourage its interested parties to use the domestic review procedures provided for in Article IX of this Agreement before the Member invokes the provisions of Article XII:1.] [Members recognize that there must be no further judicial remedies available under domestic law against the inconsistent measure before the provision of Article XII:1 is invoked.]

4. [If a panel or the Appellate Body concludes that a measure is inconsistent with this Agreement, it shall only make recommendations that do not affect prior contract awards.]

**Technical Cooperation**

1. In order to facilitate the implementation of this Agreement, Members shall provide, on request and on mutually agreed terms and conditions, technical cooperation in favour of developing and least developed country Members.

2. In order to ensure the greatest possible efficiency of such technical cooperation, the Committee on Transparency in Government Procurement shall identify specific priorities for individual Members, including with respect to the following areas:

2.1 development of national legislation and procedures;

2.2 training;

2.3 institution building;

2.4 access to information by suppliers [, including establishment of enquiry points]; and

2.5 the use of information technology.

3. The Committee on Transparency in Government Procurement shall develop a plan to assess and monitor assistance on an ongoing basis, and to coordinate such efforts with other relevant organizations.

**Final Provisions**

Acceptance and entry into force

[1. Subject to Article X of the Marrakesh Agreement Establishing the World Trade Organization, this Agreement shall enter into force on 1 January 2001 for those Members which have ratified the Agreement by that date.]

Reservations

2. Reservations may not be entered in respect of any of the provisions of this Agreement.

[Transitional provisions]

Operation of other agreements

[3. Members' implementation of the provisions of this Agreement shall not affect their rights and obligations under the WTO Agreement on Government Procurement or any other international agreement covering government procurement.] [The rights and obligations of a Member under the WTO Agreement on Government Procurement or any other international agreement relating to government procurement to which a Member is a party shall prevail to the extent of any inconsistency between the rights and obligations of a Member under this Agreement and the rights and obligations of a Member under the WTO Agreement on Government Procurement or those other international agreements.]

# CHAPTER IV

# IS THERE A CASE FOR FURTHER MULTILATERAL RULES ON TRADE FACILITATION?

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## EXECUTIVE SUMMARY

1. A number of countries support, in principle, negotiations on various trade facilitation-related matters in the Doha Development Round. National submissions to the World Trade Organization ("WTO") have often been broad in scope, in particular in the issues covered and in the suggestions offered for improving trade facilitation.

2. Trade facilitation initiatives are critical to improving the competitiveness of countries and reducing onerous trade-related costs. A 1997 study found that reforming trade facilitation would create a gain of 0.25% of real GDP (or about US$45bn) to the Asia-Pacific Economic Cooperation ("APEC") members. Further, the increase in intra-APEC trade due to trade facilitation gains is greatest for large APEC exporters: the United States (US$46bn), Japan (US$38bn), and Korea (US$11bn). In addition, many APEC developing economies (Russia, Hong Kong, Chile, and Chinese Taipei) could also enjoy double-digit increases in exports to the APEC region as a result of such reforms.

3. This chapter will argue that negotiations on the modalities of trade facilitation should be launched at Cancun and that a multilateral agreement at the WTO is not only economically sound but also politically feasible. The exposition is organised in the following manner: The first part introduces the key concepts and summarises of the evolution of how trade facilitation has been viewed by experts and officials. The second part looks at the key economic issues by examining both the classic and the new motivations for improving trade facilitation, seeking examples through case studies and exploring available empirical studies. The third part describes the discussions on trade facilitation at the WTO and in other fora, and highlights the significant overlap in the work programmes carried out by a number of international institutions. The fourth part makes the economic case for collective action and puts forth reasons as to why the WTO is the proper forum for making progress on trade facilitation. The final part of this chapter offers recommendations to policymakers.

4. Although trade facilitation lacks a generally agreed definition, there appears to be a narrow and a broad definition of this phenomenon. Some organisations and countries have limited the scope of the definition to reforming customs procedures and technical regulations relating to the flow of goods across national borders. Others have expanded this definition to include the environment in which cross-border transactions occur, such as customs administration, payments system, rules of origin, transport, technical regulations, health and safety, government procurement, competition policy, and tax collection. Efforts to improve transparency and reduce corruption, to upgrade technical capabilities, or to ameliorate transport networks, all contribute to development. Naturally, whichever definition is adopted will colour views as to which policy initiatives are needed and which areas of government need to reform.

5. In discussing the merits of reforming trade facilitation, the pertinent costs and benefits of such reforms were identified. The objective of reform is often to reduce the following costs of undertaking

international trade: compliance costs; charges for trade-related services; procedural delays; lack of predictability; and lost business opportunities. From an economic point of view, compliance costs and charges are similar to a tariff or a tax (although the government may not collect any revenues.) For imports, delays in processing goods at borders or restricting entry adds an additional cost and uncertainty to doing business. Delays in importing inputs also retard production of end goods or products further down the supply chain. For exports, poor port management or expensive trade insurance increases the cost either to the exporter or to the end user through higher prices and irregular supplies.

6. The benefits of improving trade facilitation include: increasing trade in goods and services; promoting competition which can spur productivity gains as well as lower prices; enhancing efficiency in both the state sector and the private sector; improving the business environment and so encouraging foreign direct investment ("FDI"); and increasing participation of small- and medium-sized enterprises ("SMEs") in international trade.

7. Studies have shown that regional trade facilitation initiatives could create gains equivalent to 0.25% of national income for APEC members; specifically, US$46bn for the US economy, US$38bn for the Japanese economy, and US$11bn for the Korean economy. In addition, many APEC developing countries (Russia, Hong Kong, Chile, and Chinese Taipei) could also enjoy double-digit increases in exports to the APEC region.

8. The additional benefits from trade facilitation for developing countries include: attracting FDI associated with regional and global production networks and production chains; reducing revenue losses from tariff reductions; and reducing the likelihood that inefficient border procedures impede increases in export volumes as developing countries expand their production capacities.

9. Trade facilitation initiatives have become more urgent due to changes in global trading patterns and trade liberalisation. The greater pressure for reform has been due to several factors: the creation and expansion of cross-border production networks; fast delivery and 'just-in-time' manufacturing techniques; associated increases in intra-firm trade; and an increase in the use of e-commerce.

10. Most agree that improvements in trade facilitation are needed, however unilateral efforts have often stalled in developing countries. In addition to the traditional opposition to reforms of border measures by import-competing firms and their employees, to the extent that such reforms reduce the amount of extra-legal payments and other rents that accrue to some government officials, this will generate another important constituency opposed to reform. Moreover, shortages of trained officials and inadequate physical infrastructure create additional barriers to reform.

11. The desire to codify reforms and to standardise procedures accounts has resulted in several international agreements; however, the latter have uneven memberships, differing and overlapping obligations, and enforcement mechanisms of varying degrees of strength. This paper will highlight the four main areas in which intergovernmental and regional measures have been taken: Work Programmes on Trade Facilitation, Customs Procedures, Regulatory Reform, and Electronic Commerce. In addition to this current set of international agreements and initiatives have created substantial overlaps, and evidence of the lack of transparency and cooperation between the associated bodies is provided.

12. The latest set of discussions on trade facilitation at the WTO did not begin until after the 1996 Singapore Ministerial meeting. Along with discussions on investment, competition policy, and government procurement, trade facilitation has been highlighted by some WTO members as an issue for reform. Certain members have suggested amendments to Articles V, VIII, and X of the GATT.

13. With respect to Article V, Canada, the EC, and South Korea have all proposed a simplification, limitation, and standardisation of customs procedures and documentation requirements, as well as clarification of the fees and charges for customs services.

14. With respect to Article VIII, many countries seem to favour the 'single-window' approach at border points and the simplification, reduction and standardisation of documentation and data requirements and procedures.

15. And with respect to Article X, the EC, Japan, Korea, and Canada have argued that this article needs to be updated to reflect the growing importance of transparency and predictability in world trade. This would include widening the scope of information to be published, enquiry points, and the establishment of a prior

consultation mechanism. Another matter discussed by WTO Members is the permissibility of advance rulings and a non-discriminatory, legal right of appeal. Technical cooperation and capacity building initiatives have been proposed to accompany any new multilateral disciplines on trade facilitation.

16. There is a strong case for international collective action on trade facilitation-related matters. An argument of long-standing is that multilateral reform is essential to overcome the barriers to reform that are encountered in countries. Multilateral commitments will help reformist governments by galvanising export interests to overcome the opposition of local and parochial interests including, in this instance, the possible opposition of government officials who wish to cling to inefficient (or quite distinctly, corrupt) practices. Moreover, the fragmentation of production across national borders, the rise of production networks, and of e-commerce, will strengthen the support of domestic firms for reforms to trade facilitation practices abroad; an outcome that multilateral reform can accomplish but unilateral reform cannot.

17. There is a strong case that any international commitments on trade facilitation should be made multilaterally and bound at the WTO. Though some have suggested that an international agreement on trade facilitation already exists in the form of the World Customs Organisation's ("WCOs") Kyoto Convention, and that this could form the basis of further reform, few countries have signed or ratified this Convention. Without binding and enforceable rules, countries tend not to readily meet their commitments in international agreements. Moreover, alternatives to more WTO rules have already been tried with inconsistent and often unimpressive results. The WTO offers the same possibilities for scope along with the potential for reduced overlap and stronger incentives for compliance. In addition, since the number of policy measures that affect trade facilitation is increasing (to include, in the eyes of some, competition policy, government procurement of goods, technical barriers, trade remedies), the synergies between these different measures can be fully exploited during negotiations under the WTO umbrella.

18. Some developing countries worry about costs of implementing new commitments on trade facilitation and about further exposure to dispute settlement. Industrialised countries have recognised this concern and negotiations on trade facilitation at the WTO provides an opportunity for developing countries to solicit and 'lock-in' firm commitments from their richer counterparts on capacity building and technical assistance.

19. Reforms to trade facilitation are essential to maximise the benefits from international commerce and for development, more generally. Ideally, these reforms are best achieved through a comprehensive multilateral framework on trade facilitation-related matters that covers the growing number of measures that are thought to impinge on trade facilitation, that ensures compliance, and that exploits the synergies with other areas proposed for negotiation at the WTO. The current modalities for negotiations at the WTO on trade facilitation go some way towards this eventual goal, providing a good starting point that can be expanded in subsequent trade rounds.

# INTRODUCTION

Due in part to the increase in volume and complexity of world trade, trade facilitation has become a key area for reform in the multilateral context. The modalities for future possible negotiations at the WTO on trade facilitation will be discussed at the Fifth WTO Ministerial in Cancun, and a number of countries' submissions to the WTO on this subject have, for the most part, broadly supported the need for further negotiations. There is a case for all WTO members, and perhaps especially for developing countries, to improve trade facilitation so as to secure the gains from prior trade reforms and to take advantage of new and increasingly important ways of organising production across national borders.

This chapter's aim is to offer guidance to policymakers in the current Round by providing an extensive survey on trade facilitation. Specifically, this chapter (1) describes the key economic issues at hand and stresses that changes in global trading patterns have reinforced the momentum for reforms to improve trade facilitation at the national and international levels; (2) highlights the significant overlap created by the involvement and programmes of several inter-governmental and regional organisations that address trade facilitation matters; (3) summarises the country submissions to the WTO on proposals for reform of Articles V, VIII, and X of the GATT Agreement; and (4) assesses arguments in favour and against further multilateral rules on trade facilitation. Given the evidence on the benefits of improving trade facilitation, ideally any new negotiations ought to include modalities with a wider scope and breadth than currently proposed. This is not to say that existing proposals for negotiations on this subject will not provide a useful basis for discussions. However, adopting broader disciplines on trade facilitation could pose a problem for some developing countries, that are rightly concerned about implementation costs. This chapter offers a number of suggestions as to how to better develop capacity in developing countries during and after any future multilateral negotiations on trade facilitation-related matters.

Trade facilitation lacks a generally agreed definition and broad and narrow definitions are presented. In the narrow sense, trade facilitation reforms focus on reducing the costs and uncertainty of transporting goods across national borders, including reducing the documentation needed to do so. In the broad sense, improvements in trade facilitation seek to improve the commercial and policy environment in which transactions occur[188], including but not limited to the harmonisation and simplification of customs procedures, greater transparency of regulations and procedures, use of newer information technologies, and reforms to institutions and agencies that implement trade facilitation-related matters.

There are two compelling arguments for improving trade facilitation. An argument of long-standing is that countries will not fully realise the gains from trade liberalisation unless they also prioritise trade facilitation. Current and previous reductions in tariff levels—at home and at abroad—will offer fewer benefits to economies whose customs houses and transportation infrastructures are ill-equipped to handle increased imports or are unable to clear exports with sufficient speed. The newer argument as to why reform is imperative relates to the nature of changing production and trading patterns. Specifically, countries must improve their policies towards trade facilitation in order to take advantage of new forms of time-sensitive trade (which often includes trade in parts, components, and high-value consumer goods), to encourage FDI associated with cross-border production networks, and to retain or develop the competitiveness of national firms. Countries that cannot or will not reform trade facilitation will find it more difficult to break out of their traditional trading patterns and their exports may lose overseas markets to rivals in better-placed jurisdictions.

[188] Wilson *et al.* (2002)

Proponents of trade facilitation reform have emphasised both the long-standing and newer arguments, as the following quotations make clear:

*Business supports trade facilitation initiatives:*

> "Because customs administration can be an important barrier to trade, countries with inefficient customs administrations are breaking faith with their partners who have made tariff concessions" (International Chamber of Commerce, "ICC")[189].
>
> "As tariff and other trade barriers are reduced or eliminated through global and regular trade negotiations, customs modernization becomes more and more important to a country's interest in attracting foreign direct investment" (Ibid).
>
> "Equally important is logistics – the ability to maintain a reliable, low-cost flow of raw materials and components into a manufacturing facility, and an effective system to distribute finished products flowing out of the facility" (Ibid).

*Some WTO members see the benefits of improving trade facilitation:*

> "There are many benefits of measures to simplify import and export procedures. For governments it is better information and control, revenue protection and more efficient administration. For business and industry, particularly small and medium sized enterprises it is added certainty and transparency, reduced costs and delays, and more competitive import and export conditions. For the community it is lower prices and a more efficient public sector" (Australia, 2002, Submission to the WTO).[190]
>
> "Indeed, the trading operations of one country affect those of another and thus, in one way or another, have a bearing on the performance of trading partners. Furthermore, the myriad of requirements and administrative procedures can have repercussions on competitiveness and become means of trade discrimination and protectionism…. There is, however, a large grey area as regards streamlining the handling of some trade-related requirements and administrative procedures, which continue to be dealt with as a matter of autonomous policy" (Columbia, 2002, Submission to the WTO).[191]

*International Organisations recognise the value of improving trade facilitation:*

> "Free trade agreements, while a necessary condition, are not sufficient to guarantee continued growth in world trade. Sustainable growth can only be accomplished by increasing the participation of small and medium-sized enterprises in international trade. For this to happen, international trade must be made easier and simpler, i.e. progress needs to be made in reducing and harmonizing the cumbersome and time-consuming paperwork, formalities and procedures often required for trading. This is the facilitation of administration, commerce and transport - and it is UN/CEFACT's goal." (United Nations Centre for Trade Facilitation and Electronic Business, "UN/CEFACT").[192]
>
> "Trade facilitation, notably customs reform, directly improves tax returns by enabling effective collection of import duties. Reforming customs procedures, notably through automation, harmonisation of information requirements, and risk-assessment methods, reduces levels of evasion, under declaration, fraud, and collusion with customs officials, and allows comprehensive, correct and prompt duty calculation and tax collection, with obvious benefits for the public purse" (WTO).[193]

The following statement made by Maria Livanos Cattaui, the Secretary General of the ICC, at a United Nations Economic Cooperation for Europe ("UNECE") Forum on Trade Facilitation, summarises both the traditional and the new motivations for improving trade facilitation:

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[189] http://www.iccwbo.org/home/statements_rules/statements/1999/trade_liberalization.asp
[190] G/C/W/443, 5 December 2002
[191] G/C/W/425, 1 October 2002
[192] www.unece.org/cefact, see About UN/CEFACT
[193] http://www.wto.org/english/news_e/news02_e/speech_stoler_30may02_e.htm

**Box 1: Why is trade facilitation important to the world economy?**

The following statement summarises both the traditional and new motivations for improving trade facilitation:

- "Customs needs to modernize to manage the exponential growth in volumes of cross-border trade in goods."
- "Small and medium-sized businesses particularly in developing countries…stand to suffer most [from poor trade facilitation]. Costs and delays in exporting can deter even the largest companies from undertaking a transaction – smaller companies with less capital and personnel to deal with these administrative burdens are first in line to forego these business opportunities. Conversely, the rise of multinationals has made it easier to spot the costs due to border delays and administrative burdens."
- "Trade liberalization and the resulting reduction or elimination of tariffs has drawn attention to non-tariff barriers and practical obstacles to international trade, particularly cumbersome customs procedures. These obstacles must be overcome to fully realize the benefits of negotiated agreements."
- "More and more industrial products sold throughout the world are assembled in one country from components manufactured in several others. As complexity in the supply chain increases, the delays and costs caused by slow and inefficient border procedures are multiplied."
- "Increased reliance on just-in-time production and just-in-time delivery makes just-in-time customs clearance a major issue for business."
- "Most important – investment decisions are often based on the ability of a country to ensure a reliable, low-cost flow of raw materials and components into and out of a manufacturing facility. Efficient customs procedures have become a national competitive advantage, especially in terms of attracting foreign direct investment."

*Source:* M. Cattaui, Speech made at the UNECE International Forum on Trade Facilitation, 29 May 2002, Geneva.

These claims beg the following question: Since there are clear gains to trade facilitation, why have governments not reformed unilaterally? Unilateral efforts have occurred more often in industrialised countries that are keen to improve their firms' competitiveness and, of course, have the resources to do so. Some developing countries have embarked on ambitious reform projects but powerful domestic interests often frustrate unilateral reform steps. Extra-legal payments to Customs officials are a primary source of income for some, while other officials may be motivated by the desire for a quiet life; both are likely to vigorously oppose reform. Corruption continues to be a major problem for some developing countries and so improving trade facilitation has a governance angle to it. Moreover, many developing countries face shortages of trained or available personnel, limited financial resources, and inadequate physical infrastructure; all of which constrain their ability to reform.[194]

Given the limited ability or willingness of certain nations to engage in unilateral reform, this chapter explores whether reform might be more easily accomplished in the context of an international agreement. In this regard, it should be noted that there are already a number of international initiatives that pertain to trade facilitation. Some international organisations have recognised the benefits of reform and provide both structure and funding for trade facilitation initiatives. Moreover, several international agreements have some bearing on trade facilitation but they suffer from uneven memberships, differing and overlapping obligations, and varying degrees of enforceability and compliance. One alternative international approach is for further multilateral rules on trade facilitation that seeks to reduce overlapping commitments, expand coverage to more sectors, more relevant government functions, and more trading partners, and that is binding upon its members and where disputes are adjudicated by an impartial body with clout. This chapter explores the relative merits of different international approaches and draws out implications for the policymaking community in the run up to the Cancun Meeting of WTO Ministers in September 2003, where Ministers will have to decide whether and upon what terms any negotiations on further multilateral disciplines on trade facilitation might take place.

[194] Patrick Low, Presentation to the Swiss State Secretariat for Economic Affairs ("SECO") on Trade Facilitation, Appenberg, Switzerland, 11 March, 2003.

The remainder of this chapter is organised as follows. Part I summarises different views on the nature of trade facilitation and discusses their relationship to international commerce. Part II examines the key economic arguments underlying the arguments for reforms to national policies that have some bearing on trade facilitation and draws upon case studies and more quantitative research. Part III summarises the status of discussions on trade facilitation at the WTO and in other fora. This part will also highlight the significant overlaps in the obligations contained in many regional and international agreements that have some bearing on trade facilitation. Part IV examines the economic case for international collective action on trade facilitation, and Part V advances the case that the WTO is the best forum for progress on reforms in trade facilitation. The final Part (VI) offers a number of policy recommendations and discusses the means by which the circumstances of developing countries can be taken into account in any future multilateral negotiations on trade facilitation.

# Part I

## TOWARDS A MORE EXPANSIVE NOTION OF TRADE FACILITATION

As mentioned earlier, trade facilitation has been defined both narrowly and broadly. Some analysts and international organisations have been weary of expanding the definition for fear that countries will not be able to implement any reform mandates arising from this definition. The WTO, the United Nations Conference on Trade and Development ("UNCTAD") and the Organisation for Economic Cooperation and Development ("OECD") have restricted the scope of their definitions to the movement of goods, and more specifically to customs procedures and technical regulations that can impair or delay this trade:

**Table 1: Narrow Definition of Trade Facilitation**

| |
|---|
| WTO and UNCTAD: "simplification and harmonization of international trade procedures, including activities, practices, and formalities involved in collecting, presenting, communicating, and processing data required for the movement of goods in international trade." (WTO website, and UNCTAD, E-Commerce and Development Report 2001, p. 180) |
| OECD: "simplification and standardization of procedures and associated information flows required to move goods internationally from seller to buyer and to *pass payments* in the other direction." (OECD, TD/TC/WP(2001) attributed to John Raven) |

*Source*: Reproduced from Wilson *et al.* (2002). Italics in original document.

Some of the research on trade facilitation has limited itself to using a narrow definition. Messerlin and Zarrouk (2000) suggest that due to changes in the pattern of world trade, "it makes sense to examine customs regulations and TRS [Technical Regulations and Standards] *together*, under the general headline of *trade facilitation*. Both components of the trade facilitation agenda give rise to the same challenge: how to minimize the unnecessary burden for trading partners of the national application of national regulations, which reflect each WTO Member's right to regulate its own economy as it wishes" (2000:1).[195] Specifically, the authors identify technological regulations, conformity assessment and certification as key facilitation issues.

In recent years, some organisations and researchers have expanded their definitions of trade facilitation because improvements in communication technologies, falling transportation costs,[196] reductions in tariffs, the reorganisation or fragmentation of production in many industries, and increased speeds of delivery, imply that many more government policies impinge on the cost, uncertainty, and speed with which firms can get their goods and services across national borders. As a result, many definitions have been broadened to include measures beyond customs procedures and technical regulations and to cover the policy-related and commercial environment in which transactions occur.

[195] Italics in the original.

[196] Hummels (1999a) challenges the authenticity of claims that transportation costs have been falling in the post-war era (see Krugman, 1995; Rose, 1991; Baier and Bergstrand, 1998; and Djankov, Evenett, and Yeung, 1998). Hummels notes that though the decline in costs was well-documented for the 1850-1913, claims that transport costs have also fallen as a result of similar increase in trade growth, are largely unsubstantiated.

**Table 2: Broad Definitions of Trade Facilitation**

| |
|---|
| UN/ECE: "*comprehensive and integrated approach* to reducing the complexity and cost of the trade transactions process, and ensuring that all these activities can take place in an efficient, *transparent, and predictable manner*, based on internationally accepted norms, standards, and best practices." (draft document 3/13/2002) |
| APEC: "trade facilitation generally refers to the simplification, harmonization, *use of new technologies* and other measures to address procedural and administrative impediments to trade." (APEC Principles on Trade Facilitation 2002) |
| APEC: "the use of technologies and techniques which will help members *to build upexpertise*, reduce costs and lead to better movement of goods and services." (APEC Economic Committee 1999) |

*Source*: Reproduced from Wilson *et al.* (2002).Italics in original document.

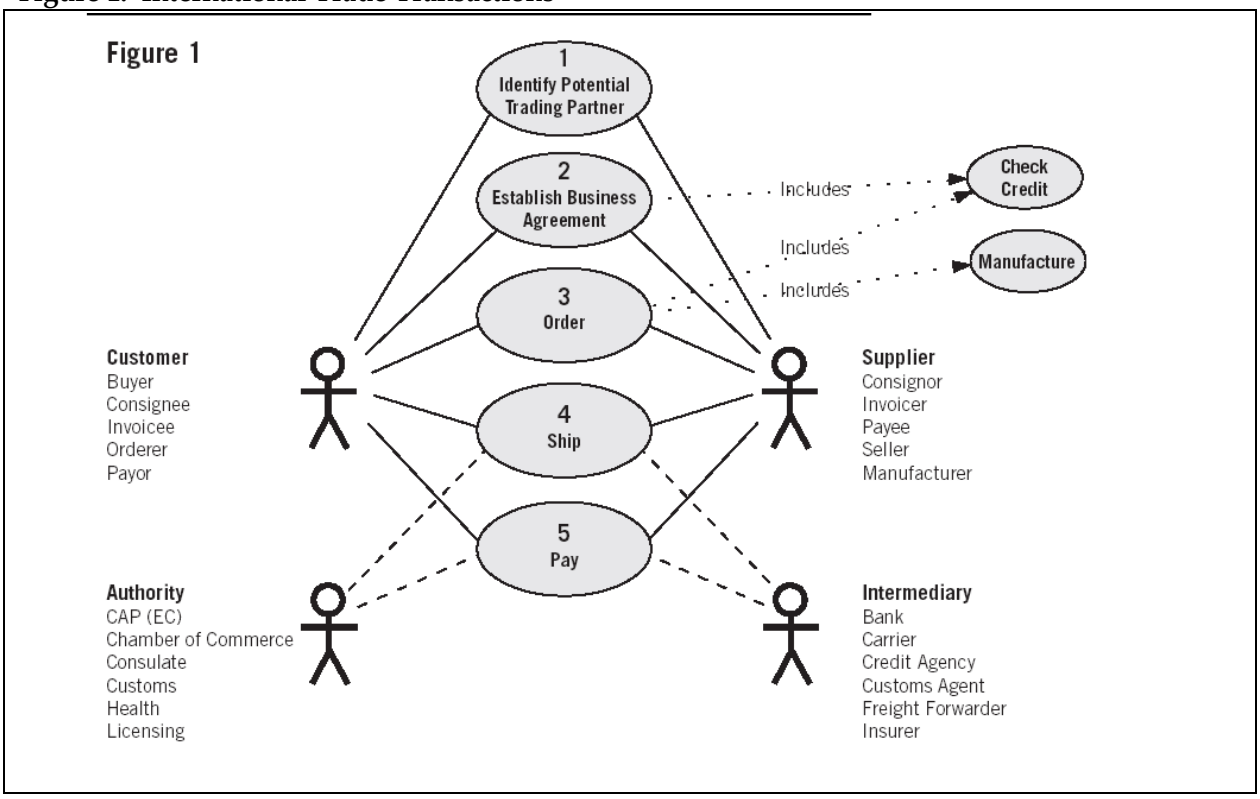
Dee, Geisler and Watts (1996) expanded the definition beyond customs procedures and technological regulations to include competition policy, government procurement, and transparency. Within the context of a discussion of APEC's initiatives in this regard, these authors develop two alternative estimates of the direct cost savings from facilitation measures: one from savings accrued from administration and delays only and the other that includes simplification and harmonisation of customs procedures. Indeed, they report that APECs action agenda on trade facilitation includes measures to encourage

"transparency of standards and broad participation in mutual recognition arrangements…[to] introduce or maintain effective and adequate competition policy….[to] develop a common understanding on government procurement policies and systems…[and] the transparency of regulatory regimes, and [to] eliminate trade and investment distortions" (13).

The scope of the definition of trade facilitation will determine, in part, which policy initiatives are identified and which government measures might be affected. Improvements in trade facilitation may, therefore, touch upon the following matters: customs administration, the national payments system, rules of origin, the cost and efficiency of different modes of transportation, technical regulations, health and safety regulations, government procurement policies, competition policy, and tax collection practices. Cross-border transactions involve many processes and many actors and the effects of uncertainty and of inefficiencies can compound significantly. The following figure (Figure 1) is illustrates the numerous actions and parties involved in a typical international trade transaction. [197]

[197] See Appendix I for an activity diagram for the shipment of goods.

**Figure 1: International Trade Transactions**




*Source*: Swedish National Board of Trade ("SWEPRO"), 2002. www.kommers.se

Initiatives to improve the components of trade facilitation have drawn upon the resources and expertise of some of the leading development banks and of other international organisations. A World Bank-funded project on trade facilitation in Tunisia targeted significant weaknesses its export infrastructure, which at the time of reform saw the average time to clear unloaded goods of between 8-18 days. Another example is a World Bank project in Albania that focused on customs improvements., and is described by Wilson (2001) as follows:

> "The project's objectives are to reduce regulatory barriers and reduce smuggling and corruption at border crossings. The project is targeted at customs reform, strengthening interaction and cooperation between private and public parties at regional, national and local levels, disseminating information, and providing training to the private sector" (7).

Both of these projects sought to improve the basic infrastructure for processing and expediting exports and imports. Other projects have tried to implement more up-to-date technologies and to promote a better environment for international commercial transactions. Examples of the former include the introduction of electronic customs clearance systems, of risk assessment techniques, of pre-arrival processing and of post-release audits. Chile estimates that it saves $1 million each month through automation and a greater use of risk assessment, with clear implications for tax collection. Of course, efforts to improve transparency and reduce corruption, to upgrade technical capabilities, or to ameliorate transport networks, contribute more generally to development.

# Part II

## WHY HAS TRADE FACILITATION BECOME A CRITICAL ISSUE?

Since 1990, nations have implemented numerous trade reforms, often in response to regional and multilateral initiatives. While these reforms have lowered tariff and non-tariff barriers, protectionist sentiments—and outright inefficiencies in customs administration and in the other areas associated with trade facilitation—can attenuate the impact on trade flows and on national economic performance. By employing available qualitative and quantitative evidence, the purpose of this section is to assess the importance of trade facilitation for national economies. One important theme that will emerge is that changes in trading patterns have placed an even larger premium on the efficient operation of certain types of government measures that affect cross-border trade. It is worth bearing in mind that the costs of cross-border transactions discussed here need not be discriminatory and often apply to a nation's exports as well as to its imports.

### II.1 Clarification and Measurement of potentially non-discriminatory, State-related cross-border transaction costs

UNCTAD estimates that the "average customs transaction involves 20-30 different parties, 40 documents, 200 data elements (30 of which are repeated at least 30 times) and the re-keying of 60-70% of all data at least once".[198] The following Box, compiled by Anthony Kleitz at the OECD Trade Directorate, summarises the direct and indirect costs of trade transactions:

**Box 2: Transaction costs associated with international trade**

***"1. Direct Costs:***
*Compliance Costs* related to supplying information and documents required for the movement of goods or related means of payment
*Charges for trade-related services* (e.g. trade insurance, port management); these may be affected by government policies, e.g. limiting entry or restricting operations and competition.
***2. Indirect Costs****:*
*Procedural Delays*, e.g. time for customs clearance and cargo handling. These costs are related to the market life of products (spoilage of agricultural products; product cycles for technology-intensive products, etc.)
*Lack of predictability* in the nature, application or interpretation of regulations, formalities and contracts. This derives from factors such as the lack of transparency of arbitrary interpretations.
*Lost business opportunities*: Although difficult to calculate, these may be significant since delays in one country may have negative effects along the whole global production chain. Suppliers of trade-related services may also see their business reduced."

*Source*: A. Kleitz, OECD Trade Directorate Speech at the UNECE Forum "Costs and Benefits of Trade Facilitation", 2002. http://www.unece.org/trade/forums/forum02/presentations/session_ii/akleitz.pdf

As Kleitz (2002) demonstrates, the direct and indirect costs of transactions are spread to different degrees across both importers and exporters. Furthermore, when parts and semi-finished products cross many borders in regional or global supply chains, these costs compound.

Analytically, speaking these trade-related costs can be separated into three main categories:

Expenditures by traders

The direct costs (compliance costs and charges for trade-related services) are similar to a tariff on goods or an additional cost of doing business. This cost can be onerous and may either be passed-on to consumers or absorbed by exporters. In some cases governments, customs administrations, and associated officials, receive rents from these services. Inducements paid to corrupt customs officials are also similar to a tax however, the

[198] www.wto.org

government treasury tends not to receive any benefit. With respect to some of the indirect costs of doing business, procedural delays, lack of predictability, and lost business opportunities act as a barrier to trade much in the same way that transportation costs do.

The research in this area has shown that poor transport networks prevent countries from fully engaging in the world trading system.[199] The consistent finding is that transport costs, like poor facilitation efforts, create a barrier that is larger than tariffs. Transport costs prevent countries from moving goods quickly, taking advantage of their competitive advantage or creating large exporting networks. Studies have shown that African countries and land-locked countries suffer the most from poor transportation networks since the additional cost of doing business is exactly the lost opportunities to export more of their goods. Due to the changing nature of production networks (increased specialisation) and the value of time, transport costs act as a barrier to trade flows between countries: "Remoteness and poor transportation and communications infrastructure isolate countries, inhibiting their participation in global production networks. Recent liberalisations have reduced artificial trade barriers, and mean that the effective rate of protection provided by transportation costs is for many countries, considerably higher than that provided by tariffs" (Limao and Venables, 1999: 1).

Quantity Restrictions

To the extent that procedural delays limit the quantity of imports into a country during a given time frame, these indirect costs bear a similarity to the costs associated with imposing quotas.

Uncertainty created by two former costs

Poor customs procedures, poor and opaque regulatory processes, poor port logistics and transportation networks, large inventories, and/or onerous transaction costs, often create uncertainties relating to cost levels and shipment and delivery times. For imports, delays in processing goods at borders add an additional cost to doing business, as firms have to wait longer to receive revenues. If goods are spoiled while waiting for inspection, the costs involved are supplementary to the normal cost of trade. Delays in importing inputs would retard production of the end good, again imposing a "time cost' to the transaction which translates into a fiscal expense. Worse, the consequences of a lack of predictability can be acute since business cycles in manufacturing often force companies to take decisions a year in advance. For exports, poor port management or expensive trade insurance will increase the cost of the goods. If these costs are passed on, the exports become less competitive in the world market. If the exporter absorbs the cost, it increases the costs of production. Both will, ultimately, affect the level and predictability of profits.

If trade reforms are frustrated by high non-discriminatory costs of undertaking cross-border transactions, exporters will not be able to benefit from greater access to foreign markets. One goal of trade facilitation measures is to recapture those lost opportunities, often by getting rid of the pure waste of inefficient procedures and regulations. In addition, the increase in specialised production networks and the growing importance of time as a factor in trade reinforce the importance of keeping the costs of cross-border transactions as stable and low as possible; a factor whose importance is discussed in the section below.

## II.2 New considerations and changing trading systems: The time value of exports

This section will highlight the costs and benefits of these new production networks and new technologies, and emphasise that measures to facilitate trade are no longer just about taking advantage of prior trade liberalisation initiatives. As will become clear, countries should recognise these developments in order to maintain and improve the competitiveness of their national firms. Four hypotheses are advanced:

1. New production networks which have changed the way companies manufacture and transport goods;
2. Companies and consumers who require faster delivery services and 'just-in-time' manufacturing;
3. An increase in intra-firm trade; and

[199] See Finger and Yeats (1976), Hummels (1999a, 1999b), Limao and Venables (1999).

4. An increase in the use of e-commerce, changing purchasing patterns and delivery expectations.

### II.2.1 Changing Production Networks

For a number of technological and policy-related reasons, the cost of transporting goods internationally has decreased. Moreover, globalised and more competitive markets, faster and cheaper forms of transportation and transportation management techniques, and lower tariffs have been factors in the disaggregation of production. Outsourcing and production sharing have become more common since it is more cost-effective for companies producing homogenous products. The emergence of global suppliers has allowed companies to source their inputs without having to invest directly in the country (e.g. through joint-ownership). According to the World Bank (2003), firms gain flexibility by sourcing their goods from different suppliers and mitigate the risks and costs associated with FDI. Some argue that these production networks of firms and operational clusters, particularly in East Asia, have resulted in a surge of trade in parts and components (Ng and Yeats, 2001; Hummels, Ishii and Yi, 2001). These components account for one-fifth of manufacturing exports and are concentrated in the trade in telecommunications equipment parts, office machinery parts, switchgear, and electronic components (Ng and Yeats, 2001).

The development of the hard disk drive (HDD) industries in Singapore and Thailand are good examples of the growth of operational clusters. Both countries sought to minimize the cost of undertaking international trade and to encourage FDI by aggressively carving out positions for themselves in the HDD industry. Singapore attracted this FDI by providing "the powerful combination of rapid plant startup, rapid time-to-volume production, scale economies, and low cost" (McKendrick *et al*., 2000:163). In 1983, 26,000 drives per year were assembled per firm. By 1998, the average number had jumped to 7.2 million each.[200] By the end of 1999, the cluster in Singapore had grown and diversified. It now "encompassed media manufacturing and associated fine chemicals; flex-circuit manufacturing; and even drive design, associated chip design services, and R & D activities" (156). Singapore was preferred to other Asian countries from an overall cost perspective because "[t]he logistics infrastructure allowed tight inventory management, the technical infrastructure was deep and the government moved quickly" (166).

Here, the benefits of improved trade facilitation are reaped by Singapore. In this respect, Singapore provided the ideal environment in which to conduct cross-border business. Companies were able to quickly source inputs from abroad that, in turn, fostered the creation of value-added jobs and the introduction of productivity growth through continuous technological upgrading (Low *et al*. 1993). Since these policies were in place first in Singapore, it had a first-mover advantage in attracting FDI. Singapore is not only open to trade but it has invested heavily in "trade investment, related infrastructure, transport and communication network facilities, industrial parks, and cost-competitive public utilities" (McKendrick *et al*., 2000: 174). The development of the HDD industry depends primarily on efficient communication and transport services.

The emerging cluster in Singapore helped to promote regional production networks, which further integrated markets. Other firms were induced to come to Singapore or neighbouring countries to use them as bases for the development of regional supply chains. Thailand was able to carve out a position in this market as a result of the Singaporean production cluster. Exports by the Thai hard-disk drive (HDD) industry grew from $2.6 million in 1985, to $1.3 billion in 1990, and to $5.3 billion in 1998. As in Singapore, a cluster-related dynamic emerged in Thailand: "As firms trained personnel and established operations near suppliers and customers, they increased both pools. Such agglomeration helped create a set of location-specific assets and increased the competitive benefits for firms operating there" (186-7). The Thai government, though not as proactive as Singapore, also designed policies aimed at attracting FDI to the region and benefiting from these new production networks. The government pushed for tariff reforms and incentives for FDI, for streamlined customs procedures, for reduced electricity costs, and for expanded sea and air transport facilities. However, these efforts have not been as effective as those of Singapore – in comparison, the trade infrastructure created costly delays to suppliers to the HDD industry and the state customs bureau was found to have the worst record for damage to goods (196). Further, the logistics cost component in Thai retail goods is between 15%

[200] Ibid.

and 20% higher than for other firms with well-established support infrastructure.[201] Consequently, Thailand is still performing below its potential due to insufficient investment and reform in trade facilitation measures.

Companies involved in the technology or parts and components business have an incentive to broaden the definition of trade facilitation. Unilateral reforms, initiated by Singapore and Thailand seemed to have encouraged the development of industry and created and reinforced inter-firm linkages in the economy.

### II.2.2 Speed of Delivery

Express delivery companies like FedEx and DHL have been the biggest corporate advocates for measures to improve trade facilitation in the WTO since their operations depend critically on customs facilitation and logistics management. Customs facilitation has already been addressed earlier in this paper and no more is added here. Logistics management refers to the process of planning, implementing, and controlling the flow and storage of goods and services from the point of origin to the point of consumption.[202] SWEPRO (2002) claims that "a major international express delivery company can, as a result of the faster customs procedures implemented by the Swedish Customs, utilise all their transport vehicles one extra hour a day, resulting in an hour of extra revenue. An hour of extra revenue will roughly increase the overall profits by 5-10%" (21).

Hummels (2001) examines the importance and cost of time as a trade barrier and relates these costs to patterns of production and commercial transactions. The author measures a firm's willingness-to-pay for timesavings in shipment by looking at the variation in the trade off between price and speed of delivery. This results in a direct measure of the ad valorum barrier that is equal to a day's travel time. Hummels estimates that each additional day spent in transport reduces the probability that a U.S. firm will source from that country by 1-1.5%. In addition, the arrival of faster transport is equivalent to a tariff reduction of 23% on goods.[203] Lengthy shipping times impose costs[204] that impede trade, and importers exhibit a significant willingness-to-pay to avoid such costs. These lengthy shipping times result in high inventory and depreciation costs. Inventory-holding costs include not only the cost of capital but also the cost of the inventory needed to respond to demand fluctuations and variation in delivery of shipments. Moreover, depreciation costs arise when a newly produced good is preferred to an older one. For example, goods that depreciate quickly and require speedy delivery are perishables, information content goods, goods with seasonal demand, or luxury goods where demand is more fickle. These costs will increase along each production stage as markets become more fragmented and production is 'internationalised'.

The textile industry is a good example of an industry where speed and flexibility are crucial to a firm's performance. Retailers need to offer a wide range of choices to consumers, and in turn, manufacturers need to respond quickly to retailers' demands for shipments. Innovation in distribution practices followed the emergence of mass-buyers like Wal-mart and Kmart. As a result, economies of scale required rapid-replenishment practices, distribution centre operations, and up to date information technology. Delays at customs will prevent firms from responding quickly to these changes in demand and in product proliferation.

Retailers need to reduce their inventory costs and increase their ability to respond to on-demand orders. Abernathy *et al.* (1999, 2001) call this the 'lean retailing' model: The idea of "continuously adjusting the supply of products offered to consumers at each retail outlet to match actual levels of market demand, thereby reducing their exposure to the risks of selling perishable goods" (55). As some manufacturers were able to respond quickly to this new demand, the overall ratio of inventories to final sales of domestic textiles business in the U.S. fell from 2.78 in 1987 to 2.34 in 1997.[205]

Another important aspect to the discussion is the pressure from the demand-side for 'just-in-time' manufacturing. The computer industry has been successful in this regard since depreciation on computers is almost instantaneous. Dell Computers provides tailor-made computers shipped almost immediately. Dell has consistently outperformed its competitors with its 'just-in-time' manufacturing and direct-to-customer

[201] Cost component for successful firms is between 20-25% but the average of such costs is 40% for Thailand (Peters 1998). The World Bank estimates that Thai infrastructure needs for 1995-2004 will total $145 billion (Brooker Group 1997:20).
[202] www.usinfo.state.gov
[203] From 32% to 9% between 1950 and 1998
[204] Hummels estimates this at 0.8% Ad-Valorum duty.
[205] Abernathy *et al.*,(1999, 2001)

sales. This demand in the end-user market for immediate and customised orders has, paradoxically, also created a trend towards the regional organisation of production systems.[206] Deardorff (2001) asserts that unlike other countries that allowed time determine its trading pattern; "Japanese manufacturers were able to break the law of comparative advantage, in a sense, by changing the technology. That is, by pioneering just-in-time production and other production and manufacturing tools, they gave themselves a comparative advantage in sectors where, due to their distance from markets and the associated time-costs of trade, they would have lacked a comparative advantage otherwise" (19).

### II.2.3 Increase in Intra-firm trade

Cross-border trade between multinationals (in particular where the subsidiaries of the same firm are at both ends of a cross-border transaction) now accounts for a significant part of trade between OECD countries. This development reflects the growing tendency of large manufacturing companies, particularly from the U.S., to split complex manufacturing production processes between foreign affiliates. It is estimated that Multinational companies (MNCs) now account for 25% of global output and that intra-firm trade between operations represents 33% of all world trade.[207] Given the increasing importance of FDI,[208] intra-firm trade has also increased at the global level. The majority of this trade is in finished goods exported from foreign affiliates whose main role is marketing and distribution of goods. It is estimated that intra-firm trade in goods accounts for one-third of exports from the US and Japan, one-third of imports into the US and one-quarter of imports into Japan.[209] Intra-firm trade is said to reduce transaction costs as goods are increasingly traded between divisions of the same entity (though detailed firm-level surveys on this have not taken this into account in the empirical literature). Messerlin and Zarrouk (1998) contend that the growth of intra-firm trade causes large firms to be less willing to accept external constraints on their domestic firms to minimize costs of internal production. The following table produced by the OECD but sourced from data at the U.S. Dept of Commerce, reflects the importance of intra-firm trade for the US market:

**Table 3: Intra-firm trade of the United States, with selected trading partners, as a percent of all goods traded with partner country**

| ***Imports*** | ***Level 1999*** | ***Change, 1992-99*** |
|---|---|---|
| Japan | 73.7 | -1.3 |
| Mexico | 66.4 | 3.1 |
| Korea | 49.3 | 22.5 |
| Canada | 43.1 | -2.9 |
| Eastern Europe | 32.1 | 20.1 |
| Taiwan | 20.8 | 4.9 |
| China | 17.6 | 7.1 |
| ***Total*** | 46.7 | 1.7 |
| | | |
| ***Exports*** | | |
| Mexico | 44.3 | 5.6 |
| Canada | 42.4 | -2.9 |
| Japan | 36.3 | 0.1 |
| Taiwan | 16.0 | 6.0 |
| Eastern Europe | 12.3 | 2.6 |
| China | 11.6 | 5.0 |
| ***Total*** | 32.1 | 1.2 |

**Note:** Partner countries shown are those with the highest level of intra-firm trade in 1999 or the largest increase over the period 1992-99.

*Source*: www.oecd.org, Taken from data provided by United States Department of Commerce (2001).

[206] Abernathy *et al.*, (1999, 2001)
[207] www.dfat.gov.au/toos/archive/2001/3.html. Data originally from UNCTAD.
[208] Except in the parts and components and technology trade (Evenett 2003)
[209] *OECD Outlook 71*, www.oecd.org

Intra-firm trade seems to be more prevalent in capital-intensive industries like transportation equipment, chemicals, and computer equipment. To the extent that such trade is dependant for the state of trade facilitation measures, the latter is becoming more critical to a firm's competitive advantage. As mentioned earlier, trade facilitation is increasingly essential in attracting FDI. MNCs tend to provide the technology and the training but if government 'red tape', corruption, or inefficiency prevents rapid distribution, MNCs will shift production to countries with fewer impediments in this region.

### II.2.4 Rise of E-Commerce

The rise of e-commerce has led to changes in purchasing patterns and delivery expectations, changes that must put a premium on further improvements in trade facilitation. Since there is no universal definition of e-commerce, Mann (2000) posits that e-commerce is best understood in terms of its infrastructure. According to Mann, e-commerce necessitates a 'technical' infrastructure to create an Internet marketplace, a 'process' infrastructure to connect the Internet marketplace to the traditional marketplace, and a 'basic' infrastructure of protocols, laws and regulations. When an order is placed with Amazon.com, the purchaser has the choice of having the entire shipment delivered when all of the goods are available, or having it sent item by item, as Amazon, the distributor, receives them. Batch sizes have, in some cases, become smaller and individual transactions have become more common in e-commerce. The aim of online sales is to customise retailing for individual customers so that some distributors are eliminated and foreign goods are accessible at the click of a button. Businesses have also made use of e-commerce not only to source inputs and materials, but also to sell their products directly to the end-user.

The following table, assembled by the OECD, gives an indication of the percentage of individuals who are using e-commerce:

**Table 4: Percentage of individuals purchasing over the internet**

| Country | Individuals using the Internet | Individuals ordering goods or services over the Internet |
|---|---|---|
| Sweden | 76.0 | 28.5 |
| Finland | 63.7 | 11.2 |
| Denmark | 62.0 | 23.3 |
| Canada | 60.8 | 14.6 |
| United States | 58.4 | 22.5 |
| Netherlands | 57.0 | 11.4 |
| United Kingdom | 55.0 | 20.9 |
| Australia | 47.0 | 7.1 |
| France | 38.0 | 1.9 |
| Portugal | 33.3 | 3.0 |
| Italy | 18.5 | 1.7 |
| Turkey | 9.1 | 0.4 |
| Mexico | 8.8 | 0.1 |

*Source:* OECD, ICT database, August 2002. www.oecd.org

The second table, taken from a survey by Eurostat for the OECD, indicates the percentage of businesses that are using e-commerce:

**Table 5: Percentage of businesses using the internet for purchasing and selling, 2001**

| Country | Businesses using the Internet | Businesses receiving orders over the Internet | Businesses ordering over the Internet |
|---|---|---|---|
| Denmark | 94.8 | 24.1 | 46.5 |
| Japan | 91.5 | 22.5 | 18.1 |
| Finland | 90.8 | 13.7 | 34.5 |
| Sweden | 89.9 | 17.4 | 53.6 |
| Australia | 86.0 | 16.3 | 31.8 |
| New Zealand | 84.0 | 10.1 | 26.0 |
| Austria | 83.7 | 10.8 | 13.5 |
| Norway | 82.0 | 17.2 | 29.5 |
| Netherlands | 79.0 | 36.0 | 40.0 |
| Italy | 72.0 | 1.7 | 7.8 |
| Portugal | 72.0 | 6.5 | 12.2 |
| Canada | 70.8 | 4.7 | 15.9 |
| Spain | 67.0 | 6.1 | 9.4 |
| United Kingdom | 63.4 | 10.3 | 20.8 |
| Luxembourg | 54.6 | 6.9 | 17.6 |
| Greece | 54.2 | 4.9 | 5.3 |

*Source:* OECD, ICT database, August 2002; Eurostat, *E-commerce Pilot Survey 2001.*

With respect to trends in e-commerce in developing countries, Mann (2000) notes that e-commerce generated $1.1 billion in 1999[210] in sales in South Africa. Online spending in the Philippines rose by more than $7.4 million from December 2001 to June 2002 to $600 million. In Brazil, e-commerce revenues were expected to reach $255 million in 2002, total online sales are up 150% since 2001 and the number of Brazilian companies online has risen 30% since 2001.[211] Lastly, 60% of businesses in China are reportedly using the Internet and e-commerce revenues were expected to rise to $1.9 billion in 2002.[212]

Mann argues that e-commerce is essential for developing countries who want to be part of the global economy: "Multinational firms and strategic business alliances communicate, get price quotes, submit bids, transfer data, produce product designs, and basically do business in an international arena. Countries that do not have an environment conducive to Internet usage and electronic commerce will be marginalized from the globalized production process and global economy, at increasingly great cost to their citizens" (2000: 6).

However, there are several domestic reforms that need to be undertaken in order for e-commerce to prosper:[213]

1. Creation of Internet monthly access fees. More importantly, the existence of a competitive telecoms market is essential to help keep these costs down;

2. Electronic payments infrastructure and encryption technology. Credit card penetration is a key requirement for e-commerce to work smoothly;

3. Efficient financial clearing operations to ensure rapid authorization and payments;

4. Floating currency. Exchange controls and preferential access to foreign exchange prevents prosperity; and

5. Efficient and rapid distribution and delivery systems. Trade facilitation reform is clearly an essential component of e-commerce. These e-commerce transactions have added to the workload of customs houses, as the same procedure must be repeated for each individual transaction. Moreover, without efficient payments systems and rapid distribution, the gains from buying on the Internet cannot

[210] See http://www.nua.ie/surveys. This includes both online purchases and business-to-business commerce.
[211] Ibid.
[212] See Mann (2000). Original source: International Telecommunications Union, Challenges to the Network: Internet for Development, October 1999 (updated), pg 47. Using data from International Data Corp.
[213] See Mann (2000) for an elaboration of some of these proposed reforms.

be attained. This reinforces the idea that speed of delivery is integral to the changing environment for commercial transactions.

There are clear benefits to both industrialised and developing countries of improving e-commerce opportunities as improved market access and lowering trade barriers are essential conditions for global e-commerce to flourish. The traditional argument for trade facilitation holds: In order to realise the gains from trade liberalisation, trade facilitation initiatives is imperative. Since e-commerce will grow as a result of trade liberalisation, it reinforces the need for reforming trade facilitation. In view of the above remarks, is there a point of putting e-commerce on the negotiating agenda at the WTO? Despite the technological spillovers that exist, doing so would demand a huge capital investment in the way of development assistance. The answer to this question depends on relative size of the costs of establishing an e-commerce infrastructure and the benefits outlined above; the latter is the subject of the following section of this chapter.

### II.3 Benefits of reforming trade facilitation

A body of evidence on the benefits of improving trade facilitation has emerged. To facilitate reading, the evidence is broken down into three components: qualitative studies, case studies, and empirical studies.

#### II.3.1 Qualitative Studies

Most of the relevant economic literature has been qualitative, focusing on the effects of an increase in trade regulations, delays in customs procedures and differentiated effects. With respect to general surveys on the benefits of improving trade facilitation, the 1997 Background Note by the WTO Secretariat and Staples (1998) are useful guides. Staples also provides an excellent overview and numerous policy proposals. The Compendium of Trade Facilitation Recommendations prepared by UN/CEFACT is extremely useful for outlining the recommendations of various international organisations and the programmes relating to trade facilitation being pursued therein. Wilson *et al.* (2002) provide a comprehensive overview of trade facilitation along with key summaries on the work of other international fora. A recent paper by SWEPRO (2002) summarises the gains from reform to trade facilitation and emphasises the chain effects that multiply the direct monetary gains several times. Another recent survey by the OECD (2001c) provides a useful summary of the literature written on the gains and costs of improving trade facilitation.

There are also several interesting regional studies of the effects of recent trade facilitation efforts: Ramani (2001) for insights on the ESCAP region; Arichi (1999) and Mikuriya (2001) on efforts of ASAM and Japan; Guasch and Spiller (1999) for an examination of Latin America and the Caribbean; and the World Bank (1995) for information on African transport corridors. Anecdotal information regarding improvements in developing countries is also available (see Gutierrez Ossio, 2001).

Specifically, Messerlin and Zarrouk (1999), limit their examination to customs procedures and technical regulations and standards (TRS), examine the EC experience to assess the interest in trade facilitation in developing countries and the frequency and importance of trade facilitation matters in WTO dispute settlement cases. The authors rightly limit trade facilitation to a discussion of trade liberalisation (TRS in services liberalisation and customs procedures in Kyoto Convention). Mann (2000) examines specifically the potential benefits from e-commerce on developing countries and offers policy recommendations and negotiating advice for developing countries.

Kleitz (2002) identifies benefits to the economy and the public sector from trade facilitation improvements. More efficient procedures and lower transaction costs benefit the economy in both static and dynamic ways by:

1. Increasing trade in goods and services, and promoting export growth;
2. Promoting competition, enhancing efficiency, and realising productivity gains;
3. Increasing the incentive for FDI; and
4. Increasing participation of SMEs in international trade.

With respect to the public sector, Kleitz maintains that benefits will accrue through more efficient implementation of customs regulations. For example, reducing paperwork or the number of customs officials, eliminating bribes solicited from traders, and collecting tariff revenues more efficiently. The benefits of trade facilitation accrue to both the government and firms, and to the extent that lower prices exist, to consumers. The UNECE has summarised these in the following box:

**Box 3: Benefits accruing to governments and traders**

*"1. Government Benefits*
- Increased effectiveness of control methods
- More effective and efficient deployment of resources
- Correct revenue yields
- Improved trader compliance
- Accelerated economic development
- Encouragement of foreign investment

*2. Trader Benefits*
- Cutting costs and reducing delays
- Faster Customs clearance and release through predictable official intervention
- Simple commercial framework for doing both domestic and international trade
- Enhanced competitiveness"

*Source*: UNECE, *Trade Facilitation…An Introduction to the Basic concepts and Benefits*, 2002, www.unece.org/trade/forums/forum02/docs/o2tfbroch.pdf

Trade liberalisation at the WTO has increased market access for developing countries, preventing opportunities for exporters. Trade facilitation can contribute as well to the overall trade development strategy "by optimising the use of the trade infrastructure and complementing the trade promotion efforts by improving the country's image as an efficient trading center."[214] In addition, it is argued that developing countries that benefit from preferential trading agreements will profit more if they have clear and objective rules of origin.

There are additional benefits from trade facilitation for developing countries:

1. It makes use of more modern manufacturing techniques (i.e. just-in-time delivery) rather than expensive, slow procedures will attract FDI.

2. It stimulates intra-regional trade and better competitive ability to take advantage of market access concessions.

3. It reduces the likelihood that governments suffer lower revenue after tariff reductions without the accompanying trade facilitation reforms (i.e. Net costs for a consignment sustained by customs will rise).

4. It reduces the effect of inefficient procedures on export volumes as developing countries try to expand production capacity. The costs are great and would eventually overwhelm the developing country.[215]

In principle, trade facilitation measures will require some initial costs in return for some long-term gains. These costs are mainly related to:

1. Structural adjustments, re-arranging and re-training of personnel, and implementation of new procedures;

2. Automation and computerisation costs; and

3. Loss of revenue from customs duties (though some trade facilitation measures, such as post-release audits, can increase collection efficiency).[216]

[214] Source: Trade Facilitation Handbook for the Greater Mekong Subregion, p.2, www.unescap.org
[215] See www.dti.gov.uk
[216] See "Improving Export Clearance in Jamaica", Box 16.2, World Bank Handbook, 2002.

However, as Kleitz (2002) states "it can be assumed that the overall net effects of trade facilitation over time will be positive" (3) despite the initial cost of the abovementioned measures. In addition, there exists a large volume of compelling business complaints and success stories for countries that have implemented improvements in trade facilitation. The following section describes the results of reforms in Peru, the Philippines, and Botswana.

### II.3.2 Case Studies – How has trade facilitation affected competitiveness?

i) Peruvian Customs Reform

An efficient customs administration is essential to ensure that goods are cleared quickly, that delivery is on time and predictable, and that procedures are transparent. The reform of the Peruvian Customs Administration is a good example of the benefits accruing to countries from trade facilitation measures and specifically, the subsequent competitive advantage Peru acquired over its neighbours. The value of imports into Peru increased by almost 100% between 1990 and 1996. During this time, Peru simplified its tariff rates and lowered its duties, reduced its customs staff, improved inspection times and frequency, automated the collections system and standardized the customs' processes. As a result, collections increased over 400% and customs' contribution to national revenue collections increased by 12% to 35% of total revenues. The following Box summarises these figures:

**Box 4: Results of reform to Peruvian Customs: 1990 and 1996**

***Measure taken:***

"- The tariff was simplified and duty rates were lowered significantly from 39 levels between 10 and 84% to 2 levels at 15 and 25%.

- Staffing was reduced by approximately 30% from 3800 to 2600.
- Cargo inspections were reduced from a level of 70 to 100% to a maximum of 15%.
- Cargo release times were reduced from an average of 30 days to one or two days for red channel cargo(i.e. cargo to be inspected) and frequently same day release for green channel cargo.
- Manual processing and a paper-based system were replaced by an automated system with direct deposit of collections into banks by Customs agents.
- Inconsistent, non-uniform, and undocumented Customs processes were replaced by documented systems and published regulations".

***Results:***

"- The value of imports of into Peru increased by almost 100% from $4 billion to $7.5 billion.

- Collections increased from $626 million to $2723 million, in spite of a reduction in staffing and reduced inspections and lower duty rates.
- Customs' contribution to national revenue collections in Peru increased from 23% of total revenues to 35%."

*Source*: C. Draper, *Reforming Customs Administration: The unlikely case of Bangladesh?*, World Bank (2000), pg 5-6 http://www1.worldbank.org/wbiep/trade/othertrade/files/Draper_customs.pdf

ii) Philippine Bureau of Customs

Maniego (1999) provides anecdotal evidence of the Philippine Bureau of Customs' success in introducing information technology. ASYCUDA (software developed by UNCTAD) was adapted to Philippino requirements in 1995 as part of a drive for technological improvements to the Bureau of Customs. The introduction of the software simplified the procedures, improved efficiency and reduced delays, reduced the paperwork, introduced standardized electronic format and streamlined inspections. The results of computerisation have been summarised by Maniego:

**Box 5: Technology improvements to the Philippine Bureau of Customs**

| Procedures | Before computerization | After computerization |
|---|---|---|
| | | |
| Required Signatures | 79 | 5 |
| Cargo Release Time | 6-8 days | 4-6 hours for green lane; 48 hours for yellow and red lanes |
| Shipments examined | All | 15% physical examination (red); 15% document examination (yellow); 70% no examination (green) |
| Supporting Documents required | Payments orders, official receipts, and proof of bank payments | Payments are made to banks and electronically transmitted to Bureau of Customs by computer |
| Place of examination | Anywhere in the port | Designated examination area |
| Accountable forms required | Many forms | Single Administrative Document (SAD) |
| Inward manifest documents submitted to Bureau | 13 | 3 copies in electronic format |

*Source*: Maniego (1999)

Data on the success of the programme in the Philippines has not yet been assembled. A UN Report however stated that: "In a very short time, new systems and procedures implemented have significantly improved revenue collection, considerably speeded up the clearance of cargo and led to a marked improvement in staff morale and image" (Maniego, 1999:71)

iii) Botswana Customs Division (BIDPA)

At the SATRN First Annual Trade Symposium in Kasane, Botswana (17-21 November 2002), Magdeline Gabaraane from the Botswana Customs Division (BIDPA) discussed the reforms undertaken by the division in the area of customs reforms. The constraints felt by the Division were skill shortages, lack of modernised IT systems, and financial limitations. By addressing these issues, specifically by the increased use of computers, the Division was able to reduce the number of forms and procedures, process data faster, and ultimately achieve higher revenue collection. Though the implementation costs will be the subject of future research, Botswana intends to apply this exercise to other areas, including agriculture and trade. Until the Division knows what the implementation costs were versus the benefits, they will be unaware of the magnitude of investment required. As a first step though, the results seem promising.

### II.3.3 Empirical Studies

There is little quantitative evidence on the benefits of trade facilitation in the existing literature, reflecting the difficulty in gathering data in this area. Most of the estimates seem to be based on secondary references or do not provide information on the methodology employed. Some estimated gains are greater than others due to differences in the definition of trade facilitation. Some other studies focus only on particular costs i.e. compliance costs (SWEPRO, 1985; Cecchini, 1988), documentation costs (EU COST 306, 1989), or transaction costs (UNCTAD, 1994b).

More generally, Keitz (2001) notes that there have been three methodologies employed to measure the costs and benefits associated with improvements in trade facilitation:

1. Inventories of business complaints, that provide information on the scope of problems faced but little in the way of quantitative estimates;
2. Detailed firm-level surveys, which are often extensive, systematic but also costly;
3. Modelling trade and welfare effects using computable GE Models, such as the so-called GTAP Model.

Maskus, Otsuki and Wilson (2001) examine the challenges involved in measuring empirically the gains from trade facilitation arising from harmonised regulations. In order to measure the effects of NTBs, specifically product standards and technical barriers to trade, the authors develop a set of steps to generate useful empirical research. These include:

1. Firm level surveys in developing countries;
2. Devising methods of measuring the trade restrictiveness of standards; and,
3. Estimating new econometric approaches, using survey and micro data, to assess the effects of standards.

Some earlier empirical estimates of the impact of trade facilitation include studies undertaken by Ernst and Whinney (1998), APEC (1997), and UNCTAD (1998) and the results are summarised in Table 5. For example, APEC (1997) pointed to gains from reforming trade facilitation of the order of 0.25% of real GDP (or about $45 billion) for APEC members.[217] More recently, Wilson *et al.* (2002) use the GTAP computable general equilibrium model and estimate that, for APEC as a whole, bringing the below-average APEC members halfway to the APEC average in four key areas of trade facilitation[218] would increase intra-APEC trade by about $280 billion. Moreover, the estimated increase in intra-APEC trade due to improvements in trade facilitation is greatest for large APEC exporters: US ($46 billion), Japan ($38 billion), and Korea ($11 billion). However, the authors also point out that many other APEC developing economies (Russia, Hong Kong, Chile, and Chinese Taipei) could also enjoy double-digit increases in exports to the APEC region.

In a related study by Wilson, Mann, and Otsuki (2003), the authors claim "the required improvement in trade facilitation indicators are relatively small compared to the tariff reduction. In particular, the improvement of port efficiency to generate a similar trade gain is far smaller" (17-18). Using a similar computable general equilibrium model, the authors conduct simulations of the effects of sub-par trade facilitation in APEC member economies of port logistics, customs environment, regulatory environment, and e-commerce use by business. The authors estimate that a reduction of all tariffs to zero from an average of 6.5% for APEC countries would create a saving of $27.8 billion. Moreover, they find that the improvements in trade facilitation necessary to generate the same gain are tiny. For example, improving port efficiency by .55%, customs environment by 5.5%, or e-business by 3.7% can achieve a similar saving of $27.8 billion.[219]

Hummels (2001) examines the importance of time as a trade barrier.[220] Using a formal and careful economic analysis, Hummels' work alerts researchers to the importance of time in international trade. Since air shipment is roughly seven times more expensive than sea shipment, the fact that air shipment is used extensively may indicate that speed is indispensable to traders. An alternative approach to measuring the effects of time is given by Evans and Harrigan (2001). The authors agree that 'time is money' but that distance, not shipping costs proxies for time to market. By examining the dual effects of lean retailing and the movement of textile distribution centres to Mexico and the Caribbean from East Asia, the results suggest that countries closer to the core (U.S.) will benefit from increased trade in textiles despite higher wages. This is due to the fact that they are able to get the goods there faster. Using a general equilibrium approach, the results suggest that products where timeliness is important grew much faster from nearby countries than they did from traditional producers in South and East Asia. Finally, in addition to this literature, a report produced jointly by Australia and China entitled "Paperless Trading: Benefits to APEC" (2001) suggests that the savings from electronic documentation could be up to $60 billion. This suggests that the economic rationale for updating technological systems and using the Internet for e-commerce could well be a wise long-term investment. Taken together, these results imply that small improvements in trade facilitation may generate sizeable increases in trade and national welfare.

[217] In 1995 United States dollars.

[218] Port logistics, standards harmonisation, administrative transparency and professionalism, and e-business usage.

[219] As with the original study (2002), the elasticity of port logistics was much greater than the other indicators. This explains why a smaller scale improvement is required.

[220] Results explained in previous section

**Table 6: Summary of some of the major estimates on trade transaction costs and trade facilitation benefits**

| Study | Scope | Estimates on costs | Estimate on benefits | Note |
|---|---|---|---|---|
| US NCITD (1971) | direct costs: documentation costs required by government; finance & insurance; carrier; and forwarder/broker/or their contractual counterpart | average documentation costs are $375.77 for exports and $320.58 for imports. Total costs aggregate represent 7 and 1/2 % of the value of the total US export and import. | (none) | based on business survey |
| Ernst and Whinney (1988a,b) for Cecchini *et al* (1988) | (1) direct costs: customs compliance costs. (2) indirect costs: road hailers; and business foregone | customs compliance costs (7,500 million ECU), road haulers (415-830 million ECU), and business foregone (4,500-15,000 million ECU). Approximately around 1.5% of total intra-EC trade value for customs compliance; 1-3% for business foregone. | (none) | based on business survey: survey on lost business opportunities and road haulers had some methodological reservation |
| SWEPRO (1985) | direct costs: customs compliance costs | customs compliance costs are 4% of the value of import or export; i.e. 8% of the total value of goods traded | (none) | apparently certain figures were obtained from Swedish customs and businesses |
| EU COST 306 Final Report (1989) | direct costs: documentation costs | documentation costs are 3.5-7% of the value of goods traded; with errors becomes 10-15% | (none) | no information about the methodology |
| UNCTAD (1994b) | direct and indirect costs - transaction costs include: banking/insurance; customs; business information; transport; telecommunication | transaction costs are $400 billion (10% of the total world trade value), trade transaction costs are at 7-10% of the world trade value. [221] | one-quarter of transaction costs ($100 billion) can be saved by "efficiency" by the year 2000, (i.e. one-quarter of $400 billion): approximately 2-3% of import value | Use NCITD (1971), EU COST 306 Final report (1989), SITPRO (1991) and some other. |
| Dee, Geisler and Watts (1996) | APEC trade liberalization programs including trade facilitation measures, TBT, competition policy, government procurement, and transparency | mentioning estimates of Cecchini (1988), UNCTAD (1994b) and Dee, Geisler and Watts (1996), but did not provide which one it took | 5% of value of value of goods traded (trade facilitation measures only); 10% (if TBT, competition policy, government procurement, and | apparently use a secondary reference |

[221] The gains are greater in the UNCTAD study because it used a broader definition of trade facilitation. The 'Cecchini' Study only looked at the administrative costs whilst the UNCTAD study looked at the total cost of trade transactions (including lost opportunities)

| | | | | |
|---|---|---|---|---|
| | | | transparency measures are taken into account) | |
| APEC (1997) | APEC trade liberalization programs including trade facilitation measures, TBT, competition policy, government procurement, and transparency | mentioning estimates of Cecchini (1988), UNCTAD (1994b) and Dee, Geisler and Watts (1996), but did not provide which one it took | While assuming that a consensus estimate on direct savings from trade facilitation is around 2-3% of total import value, use 1 and 2% | apparently use a secondary reference |
| Staples (1998), *et al* | Direct costs: customs compliance costs | customs compliance costs are 7-10% of the value of international trade | (none) | apparently use a secondary reference |
| Wilson, Mann, Woo, Assnie and Choi (2002) | Facilitation measures in MAPA: These include those contained in member economies' individual action plans, collective actions, Osaka Initial Actions and the Information Technology Agreement. Look at scenarios of 'improved' trade facilitation; specifically improved port logistics, standards harmonization, administrative transparency and professionalism, and e-business usage | (none) | Gain of 0.26 percent of real GDP to APEC (or about $45 billion)<br>1% percent of import prices for the direct cost savings from trade facilitation for the newly industrializing economies of Korea, Chinese Taipei and Singapore, and 2% for the other developing economies. | assessed using GTAP Model. Bilateral trade is handled via the Armington Assumption |

*Source*: Wilson *et al.* (2002) from original chart prepared by OECD TD/TC/WP(2001). Updated by author.

# Part III

# STATUS OF DISCUSSIONS ON TRADE FACILITATION AT THE WTO AND IN OTHER FORA

## III.1 Discussions in other fora

Discussions outside of the WTO on trade facilitation have been driven by certain international and regional initiatives, and by the private sector through NGOs. These international organisations include, but are not limited to, the World Customs Organisation (WCO), the UN Agencies such as UNCTAD and UNECE, the World Bank, the OECD, the IMF, the International Maritime Organisation (IMO), and the International Civil Aviation Organisation (ICAO). Some of the regional initiatives include APEC, ASEA, the FTAA, MERCOSUR, and the EU. Perhaps the greatest lobbying efforts have arisen from the private sector through the International Chamber of Commerce (ICC) and the International Transport Organisation (ITO).

Wilson *et al*. (2002) and the OECD (2002a) provide a useful summary of the various trade facilitation programmes run under the auspices of different international agencies and groups. The following Table reports the main areas of work in trade facilitation being done by a select group of organisations, as well as the amount budgeted on these endeavours.

**Table 7: Work in trade facilitation in international fora, selected organisations**

| Organisation | Mandate | Main Instruments | Budget/year $ |
|---|---|---|---|
| UNCTAD | Simplify and harmonise trade procedures. Six areas of focus: customs, transport, banking and insurance, information for trade, business practices | SITE, Columbus Ministerial on Trade Efficiency, Tradepoint, ASYCUDA | $ 8.6mn |
| WCO | Enhance efficiency of customs administrations in the areas of compliance with trade regulations, protection of society and revenue collection | Kyoto Convention Harmonised System | $ 2mn |
| World Bank | Project lending (transport), adjustment lending (customs, quality standards and simplification of procedures), technical assistance loans (customs modernization) and economic and sector work (export promotion and competition) | Regional Trade Facilitation Work Programmes and Projects | $ 15.3 bn |
| APEC | Core facilitation areas are standards and conformance, customs procedures, and mobility of business people. Other areas include NTBs, services, deregulation, ROOs | Collective Action Plans (CAP) Individual Action Plans (IAP) | $1.1mn, 2002. Total of $ 29.3 mn since 1993. |
| FTAA (ongoing negotiations) | Adoption of eight measures: Temporary imports, express shipments, simplified procedures, electronic systems, HS system, guide to customs procedures, codes of conduct and risk analysis | Customs-Related Business Facilitation Measures at Ministerial meetings | N/A |
| ICC | To promote customs modernization and simplification of trade procedures by contributing to efforts made by the WCO and the WTO. Advocate ratification of the Kyoto Convention and formulate policy proposals on transport, e-commerce, investment and services | Research Industry Interface Lobbying Customs Guidelines | N/A |

*Source*: Compiled from information provided in Wilson *et al*. (2002) and www.iccwbo.org

### III.1.1 APEC, UN agencies, and the ICC: further elaboration

Some international organisations have been extremely active in advocating and seeking trade facilitation reforms. Three organisations, which are contributing volumes to the trade facilitation debate, will be discussed more extensively in this section: APEC, UN bodies, and the ICC.

Since 1989, APEC has been one of the most active proponents of trade facilitation initiatives. Its goal is to reduce transaction costs by 5% over the next 5 years. In an effort to achieve this goal, APEC has spent nearly $30 million on trade facilitation activity since 1993. This is divided between facilitation efforts in Standards and Conformance (44%), Customs (15%), Business Mobility (8%), E-Commerce (12%), Regulatory Reform (4%), and Other (17%). Although APEC has a limited budget for trade facilitation it has offered itself as a coordinator between the WTO and other international organisations for pursuing trade facilitation goals.

The UN Bodies play an important role in implementing the new strategies for trade facilitation. The UNECE, UNCTAD, and the International Trade Centre ("ITC") work together, but each has its own specific role:

1. The UNECE develops trade facilitation standards and recommendations for reducing and automating procedures;
2. ITC develops programmes and training in trade for developing countries; and,
3. UNCTAD, through its trade efficiency programmes, provides delivery mechanisms and assistance for the measures and programmes developed by the UNECE and ITC as well as technical advice in trade areas not covered by the other two organisations.[222]

The ICC has been aggressive with raising the level of awareness for the need for trade facilitation. Since it represents industry, it is concerned with highlighting the constraints faced by traders from delays at international borders and frontiers. In addition to the adoption of the Kyoto Convention, the ICC has suggested numerous improvements to the current GATT articles, and advocated the adoption of a multilateral agreement on trade facilitation administered by the WTO.

### III.1.2 A spaghetti bowl of obligations and commitments

The following Table highlights the four main areas in which intergovernmental and regional groups are active: Work Programmes on Trade Facilitation, Customs Procedures, Regulatory Reform, and Electronic Commerce. The organisations mentioned below are not exhaustive; the Table provides an indication of how many organisations are currently working in this area and the potential for overlap in commitments and regulations.

[222] www.unece.org/cefact

**Table 8: Overlapping interests in trade facilitation**

| Organisation | Issue 1 | Issue 2 | Issue 3 | Issue 4 |
|---|---|---|---|---|
| | Work Programmes on TF | Customs Procedures | Regulatory Reform | E-Commerce |
| World Bank | * | * | | |
| APEC | * | * | * | * |
| ADB | * | | | |
| IDB | * | | | |
| IMF | | * | | |
| UNCTAD | * | * | | * |
| WCO | | * | * | * |
| G7 | | * | | |
| OECD | | | * | * |
| IMO | | * | * | * |
| ICAO | | * | * | * |
| FTAA | | | | * |
| UN/CEFACT | | | * | * |
| ICC | | | | * |
| WTO | | * | * | |
| UN/ECE | | * | * | * |

*Source*: Compiled from Wilson *et al.*. (2002) and OECD (2002).

With respect to the work already being doing in the Regional Trading Agreements (RTAs), the following Table provides an illustration of the progress in undertaking reform to various elements of trade facilitation.

**Table 9 Principles and concepts central to trade facilitation in RTAs**

| RTAs | Rules on transparency and due process | Harmonisation of procedures and formalities | Simplification and avoidance of unnecessary restrictiveness | Modernisation and the use of new technology |
|---|---|---|---|---|
| APEC | * | * | * | * |
| EFTA | * | * | * | |
| NAFTA | * | * | * | * |
| ASEAN | * | * | * | |
| WCO | * | | | |
| MERCOSUR | | * | | |
| EEA | | | * | |
| ANZCERTA | | * | | |
| AUS/NZ CUSTOMS AGT | | | | * |

*Source*: Compiled from OECD (2002). www.oecd.org

It is evident from the previous two Tables that there exists significant overlap in the initiatives of organisations involved in trade facilitation. Appendix II taken from the UN/CEFACT Compendium on trade facilitation outlines the recommendations of several international organisations to enhance coordination between them. Wilson *et al.* (2002) agree "these organizations have worked primarily in parallel tracks, with limited mechanisms for coordination. If these institutions established new consultation mechanisms, they could accomplish more collectively in accelerating trade facilitation goals" (85). Another concern is the lack of transparency between organisations – coordination and cooperation for mutually supportive actions is only possible when international or regional groups work together in an open environment.

Appendix III provides a list of trade facilitation instruments that countries have agreed to or acceded to. A cursory look at the number of ratified agreements highlights the following:

1. Industrialised countries have accepted or acceded to more Trade Facilitation instruments;
2. More countries have accepted or acceded to the UN organisation agreements (IMO, ICAO), the ICC UCP 500, and the Harmonised Standards convention from the WCO. For the most part, few countries have accepted or acceded to either UN/ECE agreements or the other WCO agreements;
3. African, Caribbean, and Pacific States ("ACP") countries participate in few agreements on trade facilitation;[223]
4. The EU countries and accession countries are the only countries to have signed the UNECE's convention on the simplification and harmonisation of customs procedures ("HAR").

The following section will discuss the developments at the WTO in order to consider the possibility of consolidating the existing international initiatives and agreements on trade facilitation with the goal of eliminating overlaps and duplication.

### III.2 Developments at the WTO

Though the discussions on trade facilitation have been occurring in other fora, the latest discussions at the WTO began after the Singapore Ministerial meeting in 1996. Along with discussions on investment, competition policy, and government procurement, trade facilitation has become a critical issue at the WTO and another potential source of discord between policymakers. The scope of the discussions on trade facilitation is clear from the definition given by the WTO: Trade facilitation is the "simplification and harmonization of international trade procedures, including activities, practices, and formalities involved in collecting, presenting, communicating, and processing data required for the movement of goods in international trade."[224] Some activities covered by the WTO's definition include transport, payments, and electronic facilities as well as, and most importantly, issues related to customs and border-crossing. These include: 1) documentation requirements; 2) official procedures; 3) automation and use of information technology; 4) transparency, predictability, and consistency; and 5) modernization of border-crossing administration.[225]

Trade facilitation is covered in various ways by the following articles and agreements: 1) GATT Articles V, VII, VIII, X; and 2) Agreements on Customs Valuation, Import Licensing, Preshipment Inspection, Rules of Origin, Technical Barriers to Trade, and the Agreement on the Application of Sanitary and Phytosanitary Measures. However, the Singapore Ministerial Conference has mandated that only GATT Articles V, VIII, and X be considered for future multilateral negotiations. Article V relates to the Freedom of Transit of goods and transportation vessels across territories. Article VIII covers the fees and formalities connected with the importation and exportation of goods. Article X relates to the publication and administration of trade regulations, that is, measures to ensure transparency. Common features of the existing legal framework include:

1. Fair and equitable administration of procedures – Import Licensing, Preshipment Inspection, Rules of Origin;
2. Publication of laws and regulations prior to application – All agreements; and,
3. Right to appeal administrative decisions – Customs Valuation, Import Licensing, Preshipment Inspection. [226]

Though the articles will be addressed independently, they are closely-related and intertwined. Other issues may be added to the negotiating table at the Cancun Ministerial Meeting, however, as yet, there is no mandate to do so.

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[223] According to the World Bank, a new Regional Assistance Strategy has been developed with the aim of improving trade links and enhancing the economic integration of six African countries (Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon). The strategy is aimed at building new roads and improve existing ones, modernize, streamline and integrate the banking sector, and by speeding up transaction time at the ports and customs. This will reduce transaction costs, generate infrastructure to facilitate the movement of goods, people, and capital. http://web.worldbank.org/WBSITE/EXTERNAL/NEWS

[224] www.wto.org

[225] See the "Checklist of Issues raised during the WTO Trade Facilitation Symposium – Note by the Secretariat", Council for Trade in Goods, WTO, G/C/W/113, 21 April 1998, for specific problems raised by the participants and the suggested policy remedies.

[226] Patrick Low, Presentation to SECO on Trade Facilitation, Appenberg, Switzerland, March 11, 2003.

The rate at which countries have adapted to the new trading environment differ and may have resulted in frictions between WTO Members. There have been a number of cases brought to the WTO dispute settlement body that involve either customs procedures or technical regulations fall under the following agreements: GATT (Articles VII, VIII, XI, X), Agreement on Licensing Procedures, TBT, SPS, and the Agreement on Customs Valuation. The following Table outlines the total number of cases or requests for consultations that have occurred in relation to customs procedures or technical regulations:

**Table 10: WTO cases related to trade facilitation**

| Cases | Year | Type of Report/Status | TF Article or Agreement Covered (if any) | Subject of Dispute |
|---|---|---|---|---|
| *India – Measures Affecting Customs Duties* | 1998 | Consultations | | Customs Duties |
| *Mexico – NAFTA Discrimination* | 1996 | Consultations | | Customs Valuation |
| *Brazil – Minimum Import Prices* | 2000 | Consultations | Agreement on Customs Valuation, Agreement on Import Licensing | Customs Valuation |
| *Romania – Measures on Minimum Import Prices* | 2001 | Mutual Solution | Agreement on Customs Valuation | Customs Valuation |
| *EC – GSP India* | 2002 | Request for consultations | | GSP Coverage |
| *EC – GSP Thailand* | 2002 | Consultations | | GSP Coverage |
| *EC – Sale, Importation and Distribution of Bananas* | 2002 | Adopted by EC | Agreement on Import Licensing | GSP Preferences, Import Measures |
| *EC – Hormones* | 1998 | Appellate Body | SPS | Health |
| *Japan – Agricultural Products* | 1999 | Appellate Body | SPS | Health |
| *Australia – Salmon* | 2000 | Article 21.5 | SPS | Health |
| *EC – Poultry* | 1999 | Appellate Body | Article X GATT Agreement on Import Licensing | Implementation Import Licensing |
| *U.S. – Hot Rolled Steel* | 2001 | Appellate Body | Article X GATT | Implementation |
| *Brazil – Import Licensing* | 1999 | Consultations | Agreement on Import Licensing | Import Licensing |
| *Nicaragua – Measures Affecting Imports from Honduras and Columbia* | 2000 | Panel Request and Consultations | | Import Measures |
| *US – Section 301 – 310* | 2000 | Panel Report | Article VIII | Import Measures |
| *US – Import Measures on EC Products* | 2001 | Appellate Body | Article VII GATT | Import Measures |
| *Australia – Fresh Fruit and Vegetables* | 2002 | Consultations | Agreement on Import Licensing, SPS | Import Measures |
| *Australia – Fresh Pineapple* | 2002 | Consultations | SPS | Import Measures |
| *India – Import Restrictions* | 1998 | Consultations | Agreement on Import Licensing | Import Restrictions |
| *India – Import and Export Restrictions* | 2003 | Consultations | Article X GATT SPS, TBT, Agreement on Import Licensing | Import Restrictions |
| *Argentina Footwear* | 1998 | Appellate Body | Article VII GATT | Import Tax |
| *Japan – Photographic Film* | 1998 | Panel Report | Article X | Publication |

| Cases | Year | Type of Report/Status | TF Article or Agreement Covered (if any) | Subject of Dispute |
|---|---|---|---|---|
| *and Paper* | | | | Requirements |
| *United States – Restrictions on Imports of Tuna* | Un-adopted | Panel Report | Article IX GATT | Technical Regulations |
| *United States – Import Prohibition of Certain Shrimp and Shrimp Products* | 1998 | Article 21.5 | TBT | Technical Regulations |
| *EC – Measures Affecting Asbestos and Asbestos-Containing Products* | 2001 | Appellate Body | TBT | Technical Regulations |
| *EC – Sardines* | 2002 | Appellate Body | TBT | Technical Regulations |

*Source*: Compiled by author from WTO legal database. www.wto.org

At the same time as these disputes were being aired, developments in the WTO on trade facilitation continued. Of particular note is the issuance of a Background Note by the Secretariat in 1997. This was updated in 1998 and in 2000. Moreover, in March 1998, the WTO held a Trade Facilitation Symposium that involved both traders and trade policy officials. The symposium highlighted the following issues as being of greatest importance to traders:[227]

1. ***Excessive documentation or procedural requirements:***

"Persisting predicaments for border-crossing existed mainly because of unclear, unspecified, bureaucratic and irrelevant customs (and immigration) procedures; underdeveloped facilities at, and understaffing of, busy border posts; … and attitudes of officials." - D. Meyer[228]

2. ***Lack of automation and insignificant use of information-technology:***

"As a result of EDIFACT use, [Chile's] customs' response for processing an import declaration had been lowered from an average of 10.8 hours to 2.2 hours. Errors resulting from typing had been eliminated, and much fewer people were today needed to handle import data, allowing for re-assignment to other tasks. Likewise, electronic data reception allowed for much more efficient risk assessment, thus improving the quality of customs controls while reducing the necessity for physical intervention." - E.F. Ivanovic[229]

3. ***Lack of transparency; unclear and unspecified import and export requirements:***

"Often, administrations would apply new regulations ahead of publication, and often administrative instructions were clearly not published because they were in violation of WTO rules. Traders were defenceless against customs arbitrariness, as customs' power to delay clearance of the goods at borders was practically unrestrained, even in many developed countries. In the absence of internationally accepted standards, documentation related to sanitary and technical requirements was too extensive." - N. Ozanam[230]

4. ***Inadequate procedures; especially a lack of audit-based controls and risk-assessment techniques***

"For the chemical industry world-wide, estimated losses related to border crossing had represented US$ 37 billion in 1996. Customs procedures and information requirements appeared to be based on the premise that all traders were villains, instead of focusing specifically on high risk consignments. [It is] recommended that low-risk consignments should be handled with minimal intervention. The multiplicity of documentation and data requirements needed to be curbed and the remainder should be standardized under consideration of what information was essential for goods to move, and how much

[227] www.wto.org, WTO Symposium on Trade Facilitation
[228] President of the Zimbabwe National Chamber of Commerce
[229] National Director of Customs, Chile
[230] Deputy Director-General of the Federation of French Wine and Spirits Exporters

information could be retrieved from commercial documentation or through audits at a later stage." - D. Wakeford[231]

***5. Insufficient cooperation among customs and other government agencies, and backward techniques which thwart efforts to deal effectively with increased trade flows***

"Too many official control functions were exercised in connection with border-crossing. Such a policy was not only old-fashioned and a wrong use of human resources, but also a waste of time, and altogether a costly exercise for both customs and trade…. A WTO Agreement on Trade Facilitation could set the parameters for becoming an authorized trader. Through such a WTO Agreement the status of authorized trader could be recognized internationally and would enable such traders to clear their goods through a "green channel". The WTO should coordinate all facilitation initiatives including those already undertaken by other international organizations." - A. Snoodijk[232]

Divergences in opinions between Members became apparent between 1998-1999 and in the events leading up to the Doha Ministerial. However, the failure to launch a new round in Seattle allowed the WTO to conduct further exploratory and analytical research. In 2000, work was organised into three categories: National Experiences, WTO Principles and Trade Facilitation Measures, and Technical Assistance and Capacity Building. In May 2001, Members requested that the WTO run a workshop on Technical Assistance and Capacity Building in Trade Facilitation. Developing countries continued to voice their concerns that to reduce their exposure to dispute settlement, additional rules should be implemented slowly or not implemented at all.

Some developing countries have argued that there is no need for additional WTO obligations, especially as they are still struggling to implement Uruguay Round rules on trade facilitation. Another concern expressed by developing countries is that new rules on trade facilitation could overlap or interfere with other programmes of other organisations like WCO, UNCTAD, World Bank, etc., an opinion shared by this author.

Uruguay, Pakistan, India, Indonesia, Malaysia, and Cuba have all stressed that the Doha mandate did not call for negotiations until after a decision is made in Cancun. Brazil and India in particular have challenged the view that Article X needs reforming since current proposals have failed to show its deficiencies. Reform, it is argued, should proceed by reworking existing obligations rather than by adopting new ones. India has also claimed that the patterns of trade of developing countries are very different from those of industrialised countries (that are dominated by the intra-firm trade of MNCs) and therefore, any new disciplines cannot follow a "one-size fits all" approach. Malaysia also stressed that rule-making alone will not build a customs infrastructure in developing countries.[233] In general, many developing countries feel that trade facilitation should be undertaken unilaterally (or regionally) where parties are more likely to have similar domestic capacity and needs. The stated positions of various Members are summarised in the Appendix IV.

The following Box summarises the position of economies in transition and possible policy suggestions which take into account their special circumstances:

**Box 6: Principles and objectives of trade facilitation from a transition standpoint**

"1. The aim of a trade facilitation framework should be to the benefit of the developing and transition economies, by encouraging them to implement the best practice that will speed up the customs process, reduce costs, improve collection of revenues and detect illegal transactions.
2. A WTO framework must provide a clear strategy, based upon the core WTO principles, and avoid trade distortions.
3. The framework must provide the necessary tools for assuring a degree of assessment and enforcement.
4. Developing countries should be enabled to assess the consequences of the facilitating measures they are to implement.
5. Because of their sensitivity, dispute settlement provisions will need special consideration.

[231] International Trade Manger of Imperial Chemical Industries (ICI)
[232] External Customs Adviser with Coopers & Lybrand
[233] www.twnside.org.sg

6. The developing countries will always adopt a lower degree of trade facilitation compared to developed economies (the known principle of special and differential treatment, used also in the other WTO Agreements).
7. The framework should provide for a transitional period of time in favour of the developing economies and support measures from the developed countries (technical assistance and capacity building). US, EU and other developed nations are already doing just that.
8. Trade facilitation should be negotiated in the formal trade Rounds, possibly in a package with other WTO agreements ("single undertaking" principle). I think this is the only "win-win" solution.
9. A set of obligations of the developed and developing countries should be clearly drawn up, and a minimum level of trade facilitation to be reached out within, for example, 10 years of signature of the WTO results of negotiations (the usual transitional period in the WTO).
10. The Members should be encouraged to bind their obligations, to define a work program and a review mechanism to assess the performances, under the aegis of the Council for Trade in Goods and the support of the WTO Secretariat."

*Source*: N. Ropotean, Romanian Ambassador, Speech given at the UNECE Round Table, 29-31 May 2002.

After several meetings and consultations, the Ministers in Doha agreed on the following statement about trade facilitation:

> "Recognizing the case for further expediting the movement, release and clearance of goods, including goods in transit, and the need for enhanced technical assistance and capacity building in this area, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations. In the period until the Fifth Session, the Council for Trade in Goods shall review and as appropriate, clarify and improve relevant aspects of Articles V, VIII and X of the GATT 1994 and identify the trade facilitation needs and priorities of Members, in particular developing and least-developed countries. We commit ourselves to ensuring adequate technical assistance and support for capacity building in this area."[234]

The proponents of further initiatives on trade facilitation in the WTO are: Australia, Canada, Chile, Columbia, Costa Rica, EC, Hong Kong, Hungary, Japan, Korea, Morocco, New Zealand, Norway, Paraguay, Singapore, Switzerland, and the United States. The Colorado Group (32 members) proposed a two-track approach to negotiations: a) Binding rules on WTO provisions (Articles V, VIII, X) and WTO principles (transparency, due process, simplification, efficiency, and non-discrimination); and b) Technical Assistance and Capacity Building. This approach is similar to that taken to 'build-up' agreements on certain provisions of the GATT (TBT, CVD, AD) during the Tokyo Round.

However, only a few countries have submitted proposals to the WTO. These include: Australia (General), Canada (Articles V, VIII, X), Columbia (Article VIII), European Communities (Articles V, VIII, X), Hong Kong, China (Article VIII), Japan (Articles VIII, X), Korea (Articles V, VIII, X), and the United States (Article VIII). Special submissions have also been made with respect to Special and Differential Treatment, technical assistance, and capacity building.

The following section will look closely at some of the proposals, notably from the EC, Canada, Korea, Japan, and Columbia. These and other submissions are summarised in greater detail in Appendix IV.

### III.2.1 Article V GATT: Freedom of Transit

Canada, the EC, and South Korea have all proposed simplification, limitation, and standardisation of customs procedures and documentation requirements, as well as clarification of the fees and charges for customs services. They also agreed that technical assistance and capacity building must be part of ny new multilateral initiative. Specifically:

[234] http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm#tradefacilitation

i) European Community

The EC has proposed the most ambitious reforms for Article V, seeking to redraft sections of the Article and to extend its scope. The EC maintains that conditions have changed since the Article's drafting and that real freedom of transit is often thwarted. The EC also notes: "Traders seek, as a matter of priority, simple, transparent international transit regimes, that correspond to the just-in-time business methods and integrated multi-country supply chains increasingly applied throughout the world. As international trade increases, the volume of transit operations does likewise, making it all the more essential to review or improve transit and to ensure coherence and co-ordination between the actions taken in the various international fora dealing with transit related matters." (G/C/W/422)

The EC has proposed a broadening of national treatment ("NT") on modes of transport to include new modes of carriage e.g. of oil and gas and other products via pipelines or other means, which may also fall within the scope of transit.[235] The EC has also called for an examination of the reality of applying national treatment between individual carriers and between types of consignment. However, the EC is quick to point out that any discussion relating to the services provided by carriers is best undertaken within the GATS negotiations.

The EC has also made some constructive suggestions regarding implementation for developing countries. Rather than just promising technical assistance and capacity building, the EC has gone one step further by suggesting the following amendments to support special and differential treatment for least-developed countries and developing countries:

- "Possible differentiation in commitments, particularly for least developed countries, but also possibly for other developing country Members with specific needs or facing specific difficulties in implementing commitments which may carry appreciable resource implications;
- The use of transitional periods to enable progressive implementation of the results, at a pace and in a manner suited to the needs of developing country Members; and
- Action to improve the quality, quantity and co-ordination of technical assistance, aimed at improving the conditions of transit for developing countries, including through more systematic co-operation between donor bodies and recipient Members, while involving as appropriate the private sector." (Ibid.)

ii) Canada

Canada argues for greater clarification of Article V in light of the changes in transit and customs procedures since the drafting of the original article. Though not as ambitious as the proposals made by the EC, the Canadian proposal still aims to improve the Article and to strengthen commitments. Canada maintains "We agree that the provisions of Article V are, in some instances, lacking in specificity and that clarifications and improvements are warranted…The purpose of these suggestions is to highlight areas where the provisions of Article V might be improved, notably by taking account of international developments in the transit field. We believe that ease of transit is a matter of interest to all WTO Members since its impediment results in considerable inconvenience and extra and unnecessary cost burdens that ultimately affect everyone." (G/C/W/424)

Canada's proposals regarding Article V also include an extension of NT but only regarding internal taxation and regulation on goods. Canada also proposes the possible use of 'surety' bonds and risk management principles, and the promotion of accession to various transit agreements. These will be discussed further in relation to Article VIII.

With respect to technical assistance and capacity building, Canada does not go very far in suggesting practical means of implementation. Their position states that they support the integration of development assistance with the potential future multilateral commitments: "In the specific case of Article V, we would want to look to a wider discussion that might better place proposals for technical assistance and capacity building into an

[235] The EC claims "GATT Art.V specifies that there should be no discrimination in treatment of traffic in transit via whatever mode (road, rail, inland waterway, air etc)". The EC's interpretation of Art. V (2) is that the words "No distinction shall be made which is based on … any circumstances relating to the ownership of goods, of vessels or of other means of transport" is national treatment on modes of transport. However, since there is no jurisprudence, it could be interpreted to mean no other type of sea-transport, in line with the use of the word vessels. This ambiguity is cause for greater clarification in the article.

appropriate context that could link with more specific proposals resulting from earlier discussions on Articles VIII and X. We believe this is best pursued through Member discussion on how best to identify, coordinate and deliver technical assistance in the context of implementing future commitments in trade facilitation. In this regard, Canada continues to support fully the integrated approach of developing WTO commitments and ensuring technical assistance and capacity building where required to assist in implementing such commitments." (Ibid.)

iii) Korea

Like the EC, Korea believes that "Article V of the GATT sets out basic principles regarding transit traffic, but it does not provide detailed guidelines for applying these principles in practice. Furthermore, it does not give due consideration to the different risk levels involved in transit traffic, in particular, between transit with and without transshipment." (G/C/W/423)

Korea stresses cooperation and sharing of information among customs authorities, harmonisation of policies, standardisation and uniformity of data sets, and transparency. The Korean submission also suggests "Existing international agreements or studies such as the Kyoto Convention and the ASEAN Framework Agreement on the Facilitation of Goods in Transit can be good starting points for future discussion." (Ibid.)

With respect to special measures for developing and least-developed countries, Korea sets out some practical ways of updating the technical capacity of these countries: "Technical assistance can be provided through various means such as workshops, training programs, or direct financial assistance to install electronic data systems. Such technical assistance can substantially improve the capacity of developing countries to expedite the processing of goods in transit." (Ibid.)

### III.2.2 Article VIII: Fees and Formalities

Many countries seem to favour the 'single-window' approach at border points and the simplification, reduction and standardisation of documentation and data requirements and procedures. Once again, technical cooperation and capacity building initiatives are called for in conjunction with reforms. Specifically:

i) European Communities

The EC maintains that Article VIII is not fully operational and lacks specificity. The EC states: "In particular, Article VIII merely 'recognises the **need for** reducing the incidence and complexity of import and export formalities to the minimum' but neither **requires** any such reduction nor indicates how to achieve it. Similarly, it also 'recognises the **need** for reducing the number and diversity of fees and charges' but again does **not create any commitment** actually to do so. The absence of any operational WTO requirements to simplify or reduce fees and formalities - notably unduly cumbersome border formalities - remains a significant weakness in the WTO rule book which, as tariffs are progressively reduced, has become more and more in need of attention." (G/C/W/394)[236]

The EC stresses clarification regarding fees and charges and a uniform customs code. Here again, the EC favours non-discrimination in modes of transport and supports initiatives in automation and risk assessments. The EC also proposes the standardisation of import and export procedures, based on international standards and instruments (e.g. adopting the WCOs Kyoto Convention). The Kyoto convention has been adopted and ratified by few nations despite the lobbying by the EC.

In line with previous suggestions in Article V, the EC has taken greater steps to accommodate the concerns of developing countries: "Taking in account the views expressed on this issue over the last three years, the EC suggests that any future WTO provisions should therefore include a range of special and differential treatment provisions, including less onerous initial commitments for poorer developing countries, transitional periods for the assumption of commitments, and more stable provisions regarding the supply of technical assistance." (Ibid.)

[236] Emphasis in original document.

ii) Canada

Canada's proposal for improving Article VIII is quite broad in scope. Through the introduction of business and user-friendly amendments to trade procedures (in this case fees and charges), countries will become more competitive in the international trading system. Canada's aim is to close existing gaps between industrialised and developing countries in their proposal: "In consideration of the existing and significant technology gap that currently exists in the trading environment, the proposals for simplification and for effective procedures should be applicable and useable in either a non-automated or a technology based environment. In both cases, these can serve to promote efficiencies, enhance transparency and minimize procedural delays with the primary difference being the degree of change that is achieved." (G/C/W/397)

In view of achieving this objective, Canada recommends the standardisation and compatibility of data sets and proposes the possibility of agreements on the coordination of procedures and formalities between agencies. Canada also supports the use of risk assessment principles and the provision of collateral and monetary security (i.e. surety bonds). This would, it is argued, create an enhanced clearing system that ensures obligations to customs divisions on imports, exports, warehouse operations, or international transporters of goods, are discharged. Surety bonds shift the credit exposure from the company to the surety bank. This gives traders added flexibility in the import process and gives certainty to the government that trader obligations will be met. This would help with predictability and reliability needed for new commercial transactions.

With respect to proposals for technical assistance and capacity building, Canada again goes no further than the following statement: "Canada continues to support fully the integrated approach of developing WTO commitments and ensuring technical assistance and capacity building where required to assist in implementing such commitments. We believe this is best pursued through Member discussion on how best to identify, coordinate and deliver technical assistance in the context of implementing future commitments in trade facilitation." (Ibid.) Canada offers to share its knowledge and experience in areas where it has had success in improving efficiency, i.e. use of surety bonds.

iii) Columbia

Columbia supports the WTO's role in reforming trade facilitation and in particular, the improvement of Article V in order to avoid protectionism and improve competitiveness: "Within the framework of the multilateral trading system, the headway made with regard to disciplines in trade policy and transparency of national legislation is clear. There is, however, a large grey area as regards streamlining the handling of some trade-related requirements and administrative procedures, which continue to be dealt with as a matter of autonomous policy. Agreements on technical standards and sanitary measures, for example, provide for a number of criteria for adopting standards and regulations, but no progress has been made as regards the requirements and costs involved in obtaining registration, certification or recognition." (G/C/W/425)

Columbia's proposal suggests the possibility of accession to various international agreements, namely the Kyoto Convention and the Istanbul Convention. Columbia also stresses work programmes and a multilateral agreement on Article VIII that includes special and differential treatment for developing countries.

iv) Japan

Japan's proposal emphasises coordination, simplification, and automation of procedures. The suggestions for reforming the agreement are consistent with those of the other Members who have submitted proposals. With respect to developing countries, Japan suggests, "For some countries that lack adequate capacity, appropriate technical cooperation is an effective tool for introducing and implementing trade facilitation measures smoothly. To this end, when considering efficient resource allocation, the expertise and work of specialized international organizations, such as the WCO, shall be fully taken into account. In order to make technical cooperation programmes more effective, it is important to create targeting goals for technical cooperation. Japan believes that the best process for achieving such goals would be through constructive WTO negotiations." (G/C/W/401)

v) Korea

Korea stresses the need for multilateral cooperation with respect to reforming key areas of Article VIII: "Korea is of the view that WTO Members should now refine the time-honored principles into more concrete disciplines which reflect the changes in the trading environment. Some countries are introducing voluntary measures, but only concerted efforts by all Members can deliver substantial improvement." (G/C/W/403)

Korea's submission stresses the need for a proper IT structure to ensure implementation of modern customs techniques. Korea points out the distinction between what is needed and what is feasible. Rather than commit to technical assistance and capacity building, Korea suggests that some key changes carry a light burden of implementation. Others that do not (including those which require IT systems), should be discussed further with other Members.

### III.2.3 Article X: Publication and Administration of Trade Regulations

The EC, Japan, Korea, and Canada argue that this article needs to be updated to reflect the importance of transparency and predictability in determining trade flows. This includes widening the scope of information to be published, enquiry points, and the establishment of a prior consultation mechanism. These Members also agree on the permissibility of advance rulings and a non-discriminatory, legal right of appeal. Technical cooperation and capacity building initiatives are also proposed. Each of these submissions is surveyed in turn.

i) European Communities

The EC has submitted the most ambitious proposal for improving Article X. The EC suggests that since transparency and predictability are cornerstones of WTO agreements, changes need to be made to Article X in order for countries to fully realise the benefits of trade liberalisation and to properly exercise their rights and commitments: The EC implies that "[t]his Article has stood unchanged since the 1940's, but some of its concepts – concerning for example transparency, advance notice of proposed trade rules, and right of appeal against administrative decisions have since been developed further in the national regimes of some Members, in specific Marrakech Agreements on trade in goods, or in other international instruments. Modern principles of sound and transparent public administration have, in other words, overtaken GATT Article X since it was first negotiated." (G/C/W/363)

The EC emphasises the commitment to transparency, through the publication and availability of all relevant information. The EC also suggests the establishment of enquiry points or trade desks to facilitate this as well as advance rulings to speed up the process. The EC proposes, in line with its transparency requirements, that governments should set up consultative or feedback mechanisms and appeal procedures to ensure non-discriminatory and fair treatment.

The EC also makes the following statement about special and differential treatment under Article X: "[For these reasons] it is important that Members provide **Technical Assistance** to assist developing countries, especially least developed, to establish requisite information platforms, particularly in electronic format, in order to fulfil transparency requirements. Where necessary, assistance may also be provided to support the implementation of other commitments that Members may enter into based on the above proposals. The possible scope and nature of, special and differential treatment provisions for, in particular, the least developed countries, also needs further discussion." (Ibid.)[237] Moreover, the EC proposes to undertake bilateral technical assistance programmes stating that: "*Assistance to transparency is often provided through the creation of databases and enquiry points for traders, in particular SMEs. Many Members already operate specific systems, such as trade points, or investment desks, which demonstrate the feasibility of introducing such facilities. The EC regards this as a useful component of trade related assistance in the short to medium term and will endeavour to address this in its bilateral technical assistance programmes.*" (Ibid.)[238]

ii) Canada

[237] Emphasis in original document.
[238] Italics in original document.

Canada's submission is consistent with the EC's. The intention is to promote the WTO principles of transparency, due process, integrity, efficiency, simplification, and consultation. Also, Canada echoes the call for trade facilitation reform in order for countries to take advantage of new trading strategies: "With the expansion and diversification of trade over the last fifty-five years, there are significant potential benefits from further enhancing transparency of border rules and procedures, promoting more advance notice of and opportunities to comment on proposed trade rules, ensuring right of appeal against administrative decisions and providing advance rulings. These potential benefits of increased trade, investment, economic growth and development are even greater if such improvements and clarifications are based on multilateral commitments applied by all trading partners, based on the principles already encompassed by GATT Article X" (G/C/W/379).

With respect to developing countries, Canada again offers knowledge and experience sharing with developing countries. Canada also suggests that "Members will need to discuss in greater detail how best to identify, coordinate and deliver technical assistance where and when it is needed to implement future commitments on trade facilitation" (Ibid.).

iii) Japan

Japan concurs with most of these above proposals and advocates clarification with respect to the publication and accessibility of all laws and regulations to identify the elements that should be provided, as well as the means by which countries can publicise this information. Japan also points out that cooperation with other international organisations is important: "There are certain international organizations which have the expertise in the area of trade facilitation, for example, the WCO in the field of customs procedures. Any existing work done by such international organizations should be taken into account in order to ensure technical assistance in this area and to avoid any unnecessary duplication from the viewpoint of work efficiency" (G/C/W/376).

Japan mentions technical assistance as an issue for discussion but does not make any concrete contributions.

iv) Korea

Korea reiterates its suggestion that countries must focus on what is most needed and what is feasible: "In examining various ideas, Korea finds it important to consider two basic criteria: (1) the level of contribution in facilitating trade, and (2) feasibility. Any proposal or idea should be evaluated and prioritized according to how much it can contribute and how easily it can be drawn into relevant WTO rules and be eventually implemented. What S&D [Special and Differential Treatment] or TA/CB [Technical assistance/capacity building] package it offers should also be taken into account in assessing the feasibility" (G/C/W/377).

Korea's proposal is also close to that of the EC's and Canada's, though it focuses more on improving the technical capabilities of countries. It also stresses the need for a single national focal point, notification of core measures, and the liaison between other authorities.

With respect to specific capacity building initiatives, Korea suggests, "As a [CB] package, the donor Members can support the provision of translation services to the developing country Members. Or as an [S&D] package, the period for notification can be relaxed for developing countries" (Ibid.).

## Part IV

# WHAT IS THE CASE FOR INTERNATIONAL COLLECTIVE ACTION TO IMPROVE TRADE FACILITATION?

Despite the expected benefits of improving trade facilitation for consumers, exporters, and parts and components importers, many national policies effectively treat cross-border transactions in an inefficient, expensive, and unpredictable manner. Corruption in customhouses also frustrates cross-border trade. This speaks to the difficulty of unilaterally improving trade facilitation; an outcome that may reflect two distinct pressures. Just as in tariff reform, import-competing interests have a strong incentive to ensure that the cost of cross-border transactions remains high. Unlike tariff reform, however, inefficient or corrupt government officials may have a stake in opposing improvements in trade facilitation; an important part given the fact that any such reform will have to be implemented by these very officials. This latter source of opposition to reform may account for why tariff reform appears to precede reform to trade facilitation measures. Export interests may support unilateral reform of trade facilitation but their willingness to do so is likely to be conditional on having access to foreign markets in the first place. For any one of these reasons, unilateral reforms are unlikely to reach their full potential.

Can the simultaneous reform at home and abroad overcome the impediments to unilateral reform? To the extent that negotiations on trade facilitation are coupled with generalised measures to improve overseas market access, then a nation's exporters are more likely to support reform initiatives. Even some exporters, who are not currently facing delays at domestic ports, may support improving trade facilitation at home if it is seen as the 'price' in multilateral negotiations for concessions in other areas. All in all, the pro-reform forces are strengthened by international measures on improving trade facilitation.

There is a distinct argument that entry into an international accord on trade facilitation is likely to follow prior reduction in tariffs. This explanation might be termed the 'preservation of the existing bargain.' It is well known that governments can substitute tariff barriers for non-tariff barriers, of which customs delays, excessive paperwork, and over-zealous customs inspectors and requirements are examples. A government that is not committed to implementing a previously agreed reduction in tariffs – or finds itself under (perhaps unexpected) protectionist pressure not to do so – may in fact choose to lower its tariffs but, at the same time, slow down its investments in trade facilitation; potentially limiting the capacity of customhouses to process additional exports. The country in question's trading partner would be understandably concerned about this development, and to reduce the likelihood of this happening, may insist on negotiating an international accord on trade facilitation measures.

The case for international collective action on trade facilitation is changing in line with recent developments in global trading patterns. The spread of regional and global supply chains imply that there are now firms with a keen interest in seeing part, components, and semi-finished goods imported and exported expeditiously, predictably, and at low cost. These firms will support both unilateral and multilateral reform initiatives, especially to the extent that the latter results in improvements in trade facilitation abroad as well as at home. Exporters of time-sensitive goods, that need not be parts etc., are even more likely to support unilateral and multilateral reform than before; especially if rival firms located abroad face fewer impediments to exporting. Overall, the support for unilateral reform is strengthened, raising the possibility that support for international collective action will follow. However, it is worth pointing out that exporters will still have an interest in seeing reform to trade facilitation abroad and the need to 'preserve the original bargain' will provide strong motivation for international accords that seek to improve trade facilitation.

# Part V

## DOES TRADE FACILITATION BELONG IN THE WTO?

Now that the case has been made for collective action, why is the WTO the right forum in which to undertake multilateral reforms? Other international organisations are already involved so why strengthen the role played by the WTO? International agreements on trade facilitation abound and countries seem interested in reforming trade facilitation through international means, judging by the number of countries who have signed agreements. However, even though existing international measures may result in improvements, the effects are probably limited and certainly piecemeal. Overlaps in obligations and commitments, specifically in the areas of work programmes, customs procedures, regulatory reform, and e-commerce all point to a failure in coordination. As Wilson *et al.* (2002) confirm, "There are only limited coordination mechanisms to ensure consistency of programmatic objectives" (85). Consolidation is essential if the rules and obligations are to be consistent and fair.

Some parties have argued that the WCO's Kyoto Convention provides the regulatory framework for trade facilitation. Proponents of the adoption of the Kyoto Convention at the WTO, argue that a multilateral agreement already exists. In reality, there are only 10 Contracting Parties[239] who have ratified or acceded and 6 Contracting Parties who have signed it. Van Bodegraven (1999) argues that though the Kyoto Convention is an important step in the right direction, it is "not a panacea for all problems related to customs that some people believe it to be. For example the Kyoto Convention will not solve existing inefficiencies in the organization of customs administrations, rivalry between official control agencies, or problems of integrity. Only a well-balanced reform and modernization program, together with the necessary funds to implement the recommendations, will solve these more fundamental problems" (45). In addition, evidence from the EC[240] suggests that a firm political will is needed to reduce this type of barrier to trade.

For some, multilateral agreements do exist but it is an open question as to how much compliance there is. Is it the case that without binding and enforceable rules, countries are unlikely to meet their obligations? The ICC suggests signatories do not: "The World Customs Organisation has proposed remedies that include adequate remuneration for customs officials, internal and external auditing and fair rules for appointments and promotion. But the question remains: how are these and other recommendations to be translated into effective action? The WCO is an irreplaceable source of detailed expertise, but lacks the power to put a political head of steam behind its proposals. That must be remedied" (Cattaui, 1998). This suggests that in addition to the lack in coordination, these current international initiatives are not universally adoptable or enforceable.

Since all parties gain from improvements in a nation's trade facilitation efforts, commitments should be made multilaterally and bound at the WTO. In principle, multilateral agreements already exist but the advantages to making commitments at the WTO are four-fold: 1) Large, established membership; 2) Scope for improvement is large; and 3) Binding nature of the agreement; and 4) Synergies with other issues.

The WTO already has a large membership of countries who have chosen to join the WTO in hopes of increasing trade and prosperity. The WTO offers the same possibilities for scope and reduced overlap but with stronger internal and external incentives for compliance. The ICC states in support of this proposition that "Political commitment to multilaterally binding rules on trade facilitation, administered by the WTO, would steer reform in a consistent direction and benefit all parties in international transactions." [241] These rules would build upon the existing WTO principles of non-discrimination, transparency, and least-trade restrictiveness and draw upon the existing work and results of other international institutions and regional groupings. The WTO could provide a framework for intergovernmental organisations (European Bank for Reconstruction and Development "EBRD", UNCTAD, World Bank) to provide funds and training to improve

[239] Algeria, Australia, Canada, China, Czech Republic, Japan, Latvia, Lesotho, Morocco and New Zealand have ratified or acceded to the Convention. Six of the current Contracting Parties – Democratic Republic of Congo, Slovakia, Sri Lanka, Switzerland, Zambia and Zimbabwe – have signed the convention subject to ratification, as of January 2003.

[240] In 1986, there existed over 400 legislative or regulatory differences between EU Member states. The European Council's firm resolve to eliminate these differences ended successfully by 1993.

[241] http://www.iccwbo.org/home/statements_rules/statements/2001/wto_members_on_trade.asp

trade facilitation. In addition, since trade facilitation improvements touch so many different areas (including competition policy, government procurement of goods, technical barriers, trade remedies), the synergies between these different areas can be fully exploited during negotiations.

Regional initiatives and other international institutions should play a supporting role in achieving real progress in trade facilitation at the WTO. Three institutions that could provide an advisory role on technical matters are the WCO, APEC and UN/CEFACT. Together, they deal with facilitation of customs procedures, transport and administration issues. APEC, in particular, believes it can play a coordinating role between other organisations both in the area of developing multilateral trade policy reform measures and of developing technical assistance and capacity building programmes.

# Part VI

## RECOMMENDATIONS FOR POLICYMAKERS AT CANCUN

At the WTO Ministerial Meeting in Cancun, Ministers will have to decide whether, and upon what terms, further multilateral negotiations on disciplines on trade facilitation will take place. WTO Members have long recognised the importance of cutting red tape at customhouses, improving efficiency, and the need to reduce unnecessary delays on cross-border commerce. Of equal concern is that a nation could effectively renege on its prior commitments to liberalise by using customs measures to discriminate against foreign goods. The evidence presented in this chapter has echoed the traditional motivation for negotiating multilateral disciplines on trade facilitation.

This motivation, however, has been strengthened by developments in trading patterns and the emergence of international production that necessitates the predictable, fast, and cheap transit across borders of goods along the production chain. These factors are critically important to developing countries that are interested in their firms joining global or regional production networks, perhaps with the eventual goal of climbing up the value chain to more sophisticated and higher priced products. The phenomenal growth of trade in parts and components is indicative of the strength of MNCs; the concern has been raised that without improvements in trade facilitation, firms in developing countries will not be able to take advantage of some of the key opportunities presented by recent changes in the global commercial landscape.

One response to the greater imperative for reform to trade facilitation is to extend and elaborate upon existing regional agreements and upon non-binding international initiatives. This chapter has highlighted the drawbacks associated with either of these options. Regional initiatives, by default, do not have a pan-global membership, and differ markedly in the disciplines on signatories and the degree of compliance. That is not to say that regional initiatives are ineffective or counter-productive, but that they do not offer a comprehensive solution to the challenge at hand.

As to existing non-binding international initiatives, as was observed earlier in this chapter, a complex web of overlapping and, at the same time, piecemeal obligations have emerged. Worse still, ratification and implementation of obligations have fallen short. These considerations, plus the well-established bottlenecks to unilateral reform, provide the rationale for an international accord on trade facilitation that has enough teeth to encourage compliance. Moreover, with improvements in trade facilitation requiring initiatives in more and more areas of government policy, negotiations under the WTO umbrella offer the greatest potential for making connections across trade-related policy matters. In principle, complementarities can be identified and taken advantage of.

The growing range of measures that support trade facilitation, as well as the need to buttress compliance with the WTOs DSU, also highlight a critical challenge facing policymakers at Cancun. Even though the benefits of improving trade facilitation are sizeable, the implementation and institutional costs of improvements may be considerable. Finger and Schuler (2000) estimate that the 16 areas of custom reform will cost $2.5 million each to improve. Moreover, the expertise needed to implement these measures may well be in short supply. No doubt one response to these observations is to argue that any WTO negotiations on trade facilitation be conducted on a plurilateral basis, whose signatories would only include those nations that feel they are capable of implementing new commitments. However, a plurilateral agreement will do nothing to help those non-signatories seize the new opportunities for international commerce presented by regional and global production networks. Worse still, to the extent that a plurilateral agreement introduces *de facto* or *de jure* conditional discrimination against non-members, these non-signatories may find themselves even worse off.

A preferable response to the implementation costs that further multilateral disciplines on trade facilitation might bring is to introduce realistic phase-in times for commitments. Moreover, commitments for capacity building and technical assistance could be introduced into any multilateral agreements. Indeed, negotiations on new rules on trade facilitation might allow an opportunity to consolidate the numerous regional and international programmes on trade facilitation into a coherent framework that establishes clear priorities

(which may differ across countries according to their stage of development), foster the creation of much needed expertise, and transfer of best practices. Furthermore, the programmes of the regional and international development banks on trade facilitation-related issues should be aligned with any new negotiated mandate and multilateral disciplines.

Another option available to negotiators is to consider differential obligations on distinct trade facilitation-related matters. For example, any disciplines on the publication of trade regulations may involve few exceptions and faster implementation periods than disciplines on freedom of transit.

In sum, changing production, communication, and transportation technologies have markedly expanded the number of government policies that bear upon trade facilitation. This, in turn, has altered the patterns of production within and across national borders, of tradeable goods. These changes call for a comprehensive response by policymakers in a number of policy areas, all of which could be integrated - at some future point – into a coherent multilateral framework on trade facilitation. WTO rules on trade facilitation, however, seek to extend existing commitments in a number of prevailing multilateral agreements rather than develop such a framework. Nevertheless, the current proposals do constitute an important and realistic step in the right direction.

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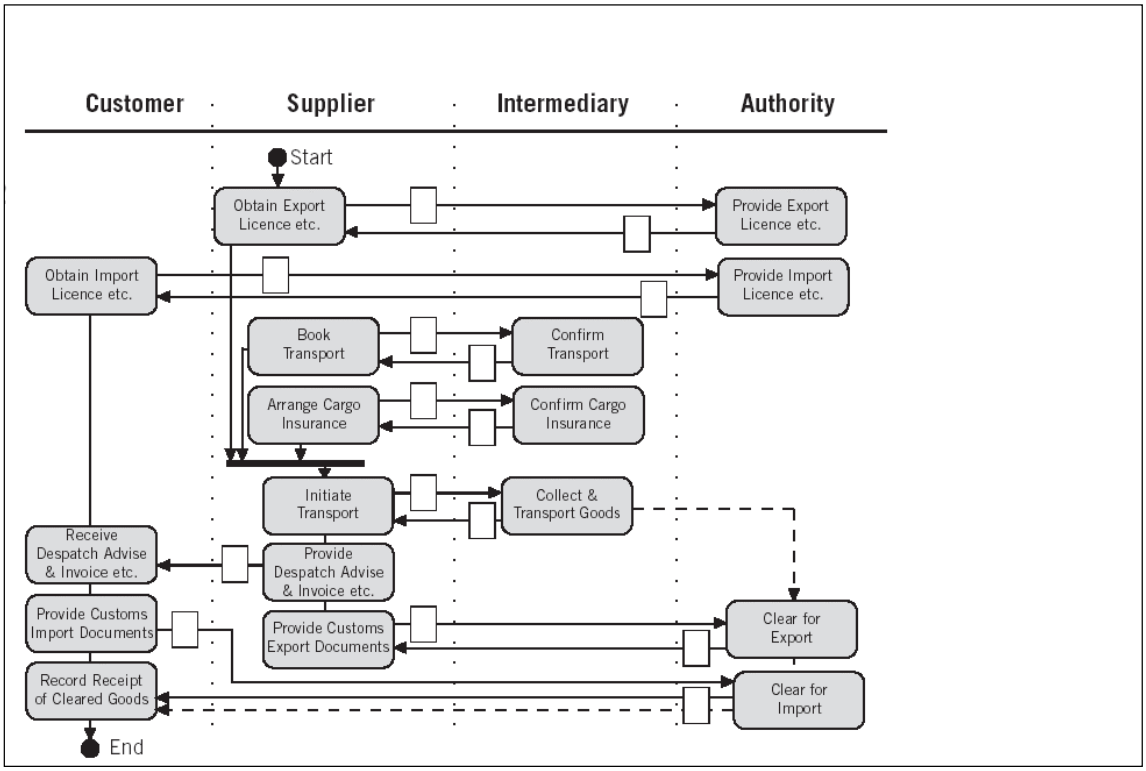
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## APPENDICES

### Figure Appendix I - Activity Diagram for the Shipment of Goods




*Source*: SWEPRO, 2002. www.kommers.se

## APPENDIX II

## LIST OF TRADE FACILITATION RECOMMENDATIONS

Brief descriptions of the recommendations contained in this ***Compendium*** have been grouped under the following headings:

A. General provisions to facilitate trade
B. Provisions relating to official procedures and controls
C. Provisions relating to transport and transport equipment
D. Provisions relating to the movement of persons
E. Provisions relating to the management of dangerous goods and harmful substances
F. Provisions relating to payment procedures
G. Provisions relating to the use of Information and Communications Technology (ICT)
H. Provisions relating to commercial practices and the use of international standards
I. Legal aspects for trade facilitation

### A. General provisions to facilitate trade

#### A.1. Trade

| | |
|---|---|
| General bonds to cover Customs, immigration and health obligations | ICAO |
| Facilitation of clearance of cargo, passengers, crew and baggage | IMO |
| Establishment of a national focal point for trade facilitation | UN/CEFACT, IMO |
| Limitation on requests for copies of documents | UN/CEFACT |
| Use of Facilitation Measures related to International Trade Procedures | UN/CEFACT |
| Preshipment Inspection not a regulatory requirement | UN/CEFACT |
| Use of Preshipment Inspection as an interim recourse | UN/CEFACT |
| Use of Preshipment Inspection to carry out Customs related activities | UN/CEFACT |
| Agreement on Preshipment Inspection | WTO |
| Procedures to be as simple as possible | WTO |
| Agreement on Rules of Origin | WTO |
| Agreement on Technical Barriers to Trade (TBT Agreement) | WTO |
| Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) | WTO |

#### A.2. Customs and other regulatory bodies

| | |
|---|---|
| Co-ordination and harmonization of controls | ICAO, UN/ECE, WCO |
| Information on veterinary inspection requirements | ICAO, UN/ECE |
| Sanitary certificates and other documents to be simple and standardized | IMO |
| Adequate resources for control services | UN/ECE |
| Coordinated and joint controls between adjacent countries | UN/ECE, WCO |
| Information on medicosanitary inspection requirements | UN/ECE |
| Information on phytosanitary inspection requirements | UN/ECE |
| Information on technical standards requirements | UN/ECE |
| Information on quality controls | UN/ECE |
| Coordinate working hours at borders | UN/ECE, WCO |
| Publicity for official tariff, information on clearance procedures, etc. | WCO |
| Provision by Customs of information of a specific nature | WCO |
| Customs to give information on duties and taxes, valuation and procedures | WCO |
| No penalty for inadvertent declaration errors | WCO |
| Designated offices for Customs clearance | WCO |
| Person to make declaration | WCO |

## B. Provisions relating to official procedures and controls

### B.1 Provisions relating to exports

| | |
|---|---|
| ***B.1.1. General*** | |
| Fees charged to be commensurate with work involved | WTO |
| Export procedures to be as simple as possible | WTO |
| Publication of export regulations | WTO |
| Impartial Application of Export Regulations | WTO |
| Preshipment Inspection to be non-discriminatory | WTO |
| Agreement on Technical Barriers to Trade | WTO |
| ***B.1.2. Customs*** | |
| Certified Cargo Manifest not to be evidence of arrival abroad | ICAO |
| Clearance at any approved Customs office | ICAO |
| Whenever possible, no physical export examination | ICAO |
| Examination of exports with minimal handling of cargo | ICAO, WCO |
| Loading up to time of aircraft departure | ICAO |
| Waive presentation of individual documents | ICAO |
| Evidence of arrival abroad not normally required | WCO |
| Acceptance of goods declarations at inland offices | WCO |
| Periodic export declarations | WCO |
| No export delay for minor information omission | WCO |
| ***B.1.3. Official documents*** | |
| Simple formalities for goods permits and licences | ICAO |
| Alignment of documents with United Nations Layout Key (ISO 6422) | ICAO |
| Limitation of documents to simple export declaration | ICAO |
| Number of copies of export declaration | WCO |

### B.2. Provisions relating to imports

| | |
|---|---|
| ***B.2.1. General*** | |
| National legislation to cater for computerized procedures | UN/CEFACT |
| Fees charged to be commensurate with work involved | WTO |
| Agreement on Import Licensing Procedures | WTO |
| ***B.2.2. Customs*** | |
| Airfreight consignments of low value to be exempted from import duties | ICAO |
| Acceptance of declaration before arrival of goods | ICAO, WCO |
| Abolition of consular invoices and fees | ICAO |
| Priority examination of live animals, perishables, etc. | ICAO, WCO |
| Selective examination of goods | ICAO |
| Reduce documentary requirements | ICAO |
| Simplified Customs documentation for air cargo up to specified value or weight | ICAO |
| Commercial invoice the basic document | ICAO |
| Provisional declaration if all data not available | ICAO |
| Customs or other official information not to be required on air waybill | ICAO |
| Expeditious clearance of goods | UN/CEFACT |
| Immediate release to importer's premises | UN/CEFACT, WCO |
| Customs to give information on clearance procedure | WCO |
| Customs to supply information to assist completion of goods declaration | WCO |
| Inward processing use of equivalent domestic goods | WCO |
| Temporary importation of special handling equipment | WCO |
| Limited Customs control of imported goods | WCO |
| General security for goods in temporary store | WCO |
| No security if Customs control temporary store | WCO |
| No duty on goods destroyed in temporary store | WCO |

| | |
|---|---|
| Limit for temporary storage | WCO |
| Responsibilities and rights of declarant | WCO |
| Customs to give information on clearance procedure | WCO |
| No separate declaration for samples taken | WCO |
| Periodic home use declarations | WCO |
| Prompt examination of goods | WCO |
| Limited Customs control | WCO |
| Clearance by summary examination whenever possible | WCO |
| Detailed examination by selective methods | WCO |
| Provisional declaration if all data not available | WCO |
| ***B.2.3. Official documents*** | |
| Simple formalities for goods permits and licenses | ICAO |
| Alignment of Customs import goods declarations | ICAO, WCO |
| Number of copies of goods declaration | WCO |
| No unnecessary certification of origin | WCO |
| Acceptance of declaration of origin | WCO |
| Information on origin requirements | WCO |
| Alignment of certificates of origin | WCO |

**B.3. Provisions relating to transit**

| | |
|---|---|
| ***B.3.1. General*** | |
| Normally no technical standards control | UN/ECE |
| Normally no quality control | UN/ECE |
| Freedom of transit to be allowed | WTO |
| No distinction based on flag, origin, ownership, etc. | WTO |
| No unnecessary delays or restrictions | WTO |
| ***B.3.2. Customs*** | |
| Limitation of inspection | UN/ECE |
| Exemption from Customs duties | UN/ECE, WCO |
| Flat rate bonds for transit goods | UN/ECE |
| No routine calculation of duty on transit goods | UN/ECE |
| TIR transit regime valid for all modes of transport | UN/ECE |
| Normally no escort of goods | UN/ECE |
| No duty on transit goods accidentally lost or destroyed | WCO |
| No escort of goods in transit or itinerary | WCO |
| Commercial or transport document as descriptive part of transit declaration | WCO |
| No unnecessary delays or restrictions | WTO |
| ***B.3.3. Health and Safety*** | |
| No medicosanitary inspection for goods in transit if no contamination risk | UN/ECE |
| No veterinary inspection for animal products in transit if no contamination risk | UN/ECE |
| No phytosanitary inspection for goods in transit if no contamination risk | UN/ECE |
| ***B.3.4. Security*** | |
| Declarant to choose form of security | WCO |
| General security for several transit operations | WCO |
| On completion, discharge of security without delay | WCO |

**B.4. Measures relating to transshipment of goods**

| | |
|---|---|
| ***B.4.1. Customs*** | |
| No duty on transhipped goods | WCO |
| No duty on destroyed transshipment goods | WCO |
| Reduced duty if goods damaged and not exported | WCO |
| Normally no examination of transshipments | WCO |

| | |
|---|---|
| Normally no escort of transshipments | WCO |
| ***B.4.2. Security*** | |
| Declarant to choose form of security | WCO |
| General security for regular transshipments | WCO |

**C. Provisions relating to transport and transport equipment**

**C.1. Air transport**

| | |
|---|---|
| Minimization of dwell-time of air cargo | ICAO |
| No General Declaration for air transport | ICAO |
| Use of ICAO standard General Declaration if one required | ICAO |
| Agent or pilot may sign declaration | ICAO |
| Standard Manifest for air cargo | ICAO |
| Nature of goods not to be shown on Standard Manifest | ICAO |
| Minimum documentation for aircraft arrival/departure<br><br>ICAO | |
| Arrival/departure documents not required for internal stops, only on arrival from and departure to abroad | ICAO |
| No duty on air transport ground equipment | ICAO |
| No duty on air transport training equipment | ICAO |

**C.2. Sea transport**

| | |
|---|---|
| Acceptance of standard manifest | ICS |
| Use of Standard Bill of Lading | ICS |
| Single comprehensive security for shipowners | IMO |
| No prior authentication of ship and cargo documents | IMO |
| Minimum formalities at second port call | INTO |
| Grant of practique by radio | IMO |
| Limited documents required on ship's arrival | IMO |
| Use of General Declaration | IMO |
| Same form of General Declaration for arrival | IMO |
| Information required on General Declaration | IMO |
| Authentication of General Declaration | IMO |
| Use of Cargo Declaration for arrival and departure | IMO |
| Information required on Cargo Declaration | IMO |
| Limited information about cargo remaining on board | IMO |
| Number of copies of documents | IMO |
| Authentication of Cargo Declaration | IMO, ICAO |
| Manifest in lieu of Cargo Declaration | IMO |
| Separate advice of unmanifested parcels | IMO |
| Acceptance of Bill of Lading as alternative to Cargo Declaration | IMO |
| No departure Cargo Declaration for cargo remaining on board | IMO |
| Correction of inadvertent errors without delay to ship | IMO |
| Use of model arrival forms | IMO |
| No penalties for inadvertent errors | IMO |
| Issue of single original Bill of Lading | UN/CEFACT |
| Use of Sea Waybill in preference to Bill of Lading | UN/CEFACT |
| Simpler Shipping Marks | UN/CEFACT |

**C.3. Multimodal transport**

| | |
|---|---|
| Use of blank-back forms | UN/CEFACT |
| Use of codes for modes of transport | UN/CEFACT |
| Layout Key for Standard Consignment Instructions | UN/CEFACT |

| | |
|---|---|
| Undocumented temporary importation of vehicles or containers containing goods under TIR | UN/ECE |
| Acceptance of foreign Customs seals on containers | UN/ECE, WCO |
| Minimum Customs formalities for means of transport | WCO |
| Temporary importation of means of transport | WCO |
| Duty on destroyed or damaged means of transport | WCO |
| No prior authentication of means of transport documents | WCO |
| Reduced number of copies of declaration of arrival | WCO |
| Use of foreign containers in internal traffic | WCO |
| Acceptance of foreign containers for temporary admission | WCO |
| Temporary admission for replacement parts for containers | WCO |
| Temporary admission for accessories and equipment for containers | WCO |
| Undocumented temporary importation of foreign containers | WCO |
| Acceptance of approved foreign containers | WCO |

**D. Provisions relating to the movement of persons**

| | |
|---|---|
| No passenger manifest to be required for air transport | ICAO |
| Use of Standard Passenger Manifest if one required | ICAO |

**E. Provisions relating to the management of dangerous goods and harmful substances**

| | |
|---|---|
| Separate advice of dangerous goods | IMO |
| Information relating to dangerous goods | UN/CEFACT |
| Use of dangerous goods declaration | UN/CEFACT |

**F. Provisions relating to payment procedures**

| | |
|---|---|
| Use of abbreviations for PAYTERMS | UN/CEFACT |
| Duty payment by means other than cash | WCO |
| Deferred duty payments | WCO |
| Proof of duty payment to be issued | WCO |
| Refund of overpayments | WCO |

**G. Provisions relating to the use of Information and Communications Technology (ICT)**

| | |
|---|---|
| Basic principles for the introduction of EDI | ICAO |
| Participation by operators to be optional | ICAO |
| Study use of information technology to facilitate airfreight | ICAO |
| Encouragement of use of EDI | ICAO |
| Customs to provide data interchange with trade users | ICAO |
| Acceptance of information technology prepared Cargo Manifest | ICAO |
| Electronic data-processing techniques for facilitation of ships clearance | IMO |
| Acceptance of authentication without signature | UN/CEFACT |
| Use of UN/EDIFACT including use of UN Trade Data Interchange Directory (TDID) (syntax : 1509735) | UN/ECE |
| National legislation to cater for computerized procedures | WCO |
| Continuous liaison Customs - national information technology services | WCO |
| Customs administrations to exchange information technology information | WCO |
| Customs to maximize use of information technology techniques | WCO |
| Customs computer systems to use international standards | WCO |
| Review Customs manual procedures before computerizing | WCO |
| Customs to provide data interchange with trade users | WCO |
| Customs to use information technology criteria | WCO |

| | |
|---|---|
| Exchange of information technology information between Customs administrations | WCO |
| Exchange of information technology information between Customs and other parties | WCO |

**H. Provisions relating to commercial practices and the use of international standards**

| | |
|---|---|
| Avoidance of excessive detail in credits | ICC |
| Authenticated teletransmission deemed operative credit/amendment unless qualified | ICC |
| Despatch of operative credit/amendment without delay after qualified teletransmission | ICC |
| Bank acceptance of photocopied, carbon copies and information technology produced documents | ICC |
| Copies do not need to be signed | ICC |
| Acceptance of alternative documents when credit calls for Bill of Lading | ICC |
| Limited acceptance of transshipment when credit prohibits | ICC |
| Acceptance of alternative documents when credit calls for non-negotiable waybill | ICC |
| Acceptance of alternative documents when credit calls for charter party Bill of Lading | ICC |
| Acceptance of alternative documents when credit calls for multimodal transport document | ICC |
| Acceptance of alternative documents when credit calls for an air transport document | ICC |
| Acceptance of alternative documents when credit calls for road, rail or inland waterway transport document | ICC |
| Acceptance of post receipt or certificate of posting (conditions) | ICC |
| Acceptance of courier receipt (conditions) | ICC |
| Limited acceptance of freight forwarder issued transport document | ICC |
| Commercial invoices need not be signed | ICC |
| Acceptance of weight certificate on transport document | ICC |
| Acceptance of goods description in general terms | ICC |
| Use of aligned trade documents | UN/CEFACT |
| Use of country codes | UN/CEFACT |
| Use of INCOTERMS abbreviations | UN/CEFACT |
| Use of Aligned Invoice Layout Key | UN/CEFACT |
| Use of codes for dates, times, periods of time | UN/CEFACT |
| Use of a Unique Identification Code (UNIC) | UN/CEFACT |
| Use of International Currency Codes | UN/CEFACT |
| Use of codes for the Identification of ships | UN/CEFACT |
| Official adoption of agreed location codes (UN/LOCODE) | UN/CEFACT |
| Use of codes for Units of Measure | UN/CEFACT |
| Use of Packaging Codes | UN/CEFACT |
| Use of Standard Consignment Instructions | UN/CEFACT |
| Use of Freight Codes | UN/CEFACT |
| Use of Trade and Transport Status Codes | UN/CEFACT |
| Use of the EDI standard | UN/CEFACT |
| The commercial use of Interchange Agreements for Electronic Data Interchange | UN/CEFACT |
| Use of trade data elements internationally (ISO 7372) | UN/ECE |
| Standards and certification systems should not create obstacles to trade | WTO |
| Use of International Standards | WTO |

**I. Legal aspects of trade facilitation**

| | |
|---|---|
| Use of Uniform Rules of conduct for Interchange of Trade Data by Teletransmission (UNCID) | ICC |
| Electronic Commerce Agreement | UN/CEFACT |

*Source*: UN/CEFACT, "Compendium of Trade Facilitation Recommendations", 2001.

**APPENDIX III**

LIST OF COUNTRIES OR TERRITORIES HAVING ACCEPTED OR ACCEDED TO TRADE FACILITATION INSTRUMENTS

| **Country / Territory** | **Trade Facilitation instruments** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | IMO | UN/ECE | | | ICC | ICAO | WCO | | |
| | FAL (1) | TIR (2) | HAR (3) | UN//CEFACT | UCP 500 (5) | (6) | CCO (7) | KC (8) | HS (10) |
| Afghanistan | | + | | | | + | | | |
| Albania. | | + | | + | | | | | |
| Algeria | + | + | | | + | + | + | + | + |
| Antigua and Barbuda | | | | | + | + | | | |
| Argentina | + | | | | + | + | | | + |
| Armenia | | + | + | | | | | | |
| Aruba (Netherlands) | + | | + | | + | | | | |
| Australia | + | | | + | + | + | + | + | + |
| Austria | + | + | + | + | + | + | + | + | + |
| Azerbaijan | | + | + | + | | + | | | |
| Azores (Portugal) | | | | | + | | | | |
| Bahamas | + | | | | + | | | | |
| Bahrain | | | | | + | + | | | |
| Bangladesh | | | | | + | + | | | + |
| Barbados | + | | | | + | + | | | |
| Belarus | | + | + | + | | + | + | | + |
| Belgium | + | + | + | + | + | + | | + | + |
| Belize | | | | | | + | | | |
| Benin | + | | | | | | | | |
| Bermuda (United Kingdom) | | | | | | | | | |
| Bolivia | | | | | + | | | | |
| Bosnia and Herzegovina | | + | + | | | + | | | |
| Botswana | | | | | | | | + | + |
| Brazil | + | | | | + | + | | | + |
| Brunei Darussalam | | | | | | + | | | |
| Bulgaria | + | + | + | + | + | + | + | + | + |
| Burkina Faso | | | | | | + | | | + |
| Burundi | + | | | | | + | | + | |
| Cameroon | + | | | | | | | + | + |
| Canada | + | + | | + | + | + | + | + | + |
| Cape Verde | + | | | | | | | | |
| Cayman Islands (United Kingdom) | | | | | + | | | | |
| Central African Republic | | | | | | | | | + |
| Chad | | | | | | | | | + |
| Channel Islands (United Kingdom) | | | | | + | | | | |
| Chile | + | + | | + | + | | | | |
| China | + | | | | + | + | + | + | + |
| Colombia | + | | | | + | | | | |

| | IMO | UN/ECE | | | ICC | ICAO | WCO | | |
|---|---|---|---|---|---|---|---|---|---|
| | FAL (1) | TIR (2) | HAR (3) | UN//CEFACT | UCP 500 (5) | (6) | CCO (7) | KC (8) | HS (10) |
| Comoros | | | | | | | | | |
| Cook Islands | | | | | + | | | | |
| Costa Rica | | | | | + | | | | |
| Cote d'Ivoire | + | | | | | | | + | + |
| Croatia | + | + | + | + | + | + | | + | + |
| Cuba | + | | + | + | | + | + | + | + |
| Cyprus | | + | | | + | + | | + | + |
| Czech Republic | + | + | + | + | + | + | + | + | + |
| Democratic People's Republic of Korea | + | | | | + | | | | + |
| Democratic People's Republic of the Congo | | | | | | | | + | + |
| Denmark | + | + | + | + | + | + | | + | + |
| Djibouti | | | | | | | | | |
| Dominica | | | | | + | | | | |
| Dominican Republic | + | | | | + | | | | |
| Ecuador | + | | | | + | + | | | |
| Egypt | + | | | + | | | | | + |
| El Salvador | | | | | | | | | |
| Equatorial Guinea | + | | | | | | | | |
| Eritrea | | | | | | + | | | |
| Estonia | | + | + | | | + | | | + |
| Ethiopia | | | | | | + | | | + |
| Fiji | + | | | | + | | | | + |
| Finland | + | + | + | + | + | + | + | + | + |
| France | + | + | + | + | + | + | | + | + |
| French Polynesia | | | | | + | | | | |
| Gabon | | | | + | | | | | |
| Gambia | + | | | | | + | | + | |
| Georgia | + | + | + | | | | | | |
| Germany | + | + | + | + | + | + | | + | + |
| Ghana | + | | | | + | + | | | |
| Gibraltar (United Kingdom) | | | + | | + | | | | |
| Greece | + | + | + | | + | + | + | + | + |
| Grenada | | | | | | | | | |
| Guam (USA) | + | | | | | | | | |
| Guatemala | | | | + | + | + | | | |
| Guinea | + | | | | | | | | + |
| Guyana | + | | | | | + | | | |
| Haiti | | | | | | + | | | |
| Honduras | | | | | | | | | |
| Hong Kong | + | | | | + | | | | |
| Hungary | + | + | + | + | + | + | + | + | + |
| Iceland | + | | | + | + | + | | | + |
| India | + | | | + | + | + | | + | + |
| Indonesia | | + | | | + | + | + | | + |
| Iran (Islamic Republic of) | + | + | | + | + | + | | | + |
| Iraq | + | | | | | + | | | |
| Ireland | + | + | + | + | + | | | + | + |

| | IMO | UN/ECE | | | ICC | ICAO | WCO | | |
|---|---|---|---|---|---|---|---|---|---|
| | FAL (1) | TIR (2) | HAR (3) | UN//CEFACT | UCP 500 (5) | (6) | CCO (7) | KC (8) | HS (10) |
| Israel | + | + | | + | + | + | | + | + |
| Italy | + | + | + | + | + | + | | + | + |
| Jamaica | | | | | + | | | | |
| Japan | | | | + | + | | | + | + |
| Jordan | + | + | | | + | + | | | + |
| Kazakhstan | | + | | | | | | | |
| Kenya | | | | + | + | | | + | + |
| Kiribati | | | | | + | | | | |
| Kyrgyzstan | | + | + | + | | | | | |
| Kuwait | | + | | | | + | | | |
| Latvia | + | + | | | | + | | + | + |
| Lebanon | | + | | | + | + | | | + |
| Lesotho | | | + | | | + | | + | + |
| Liberia | + | | | | | | | | |
| Libyan Arab Jamahiriya | | | | | | + | | | + |
| Liechtenstein | + | + | + | + | + | + | + | + | + |
| Lithuania | + | + | + | + | | | | | + |
| Luxembourg | + | + | + | + | + | + | | + | + |
| Macao (China) | | | | | + | | | | |
| Madagascar | + | | | | | | | | |
| Madeira (Portugal) | | | | | + | | | | |
| Malawi | | | | | | + | | + | + |
| Malaysia | | | | + | + | + | | + | + |
| Mali | | | | | + | | | | + |
| Malta | | + | | + | + | + | | | + |
| Marshall Islands (the) | + | | | | | | | | |
| Mauritius | + | | | | | + | | | + |
| Mexico | + | | | | + | + | | | + |
| Monaco | + | | | | | + | | | |
| Mongolia | | | | + | | | | | + |
| Montserrat(United Kingdom) | | | + | | + | | | | |
| Morocco | | + | | | + | | + | + | + |
| Mozambique | | | | | | | | | |
| Myanmar | | | | | | | | | + |
| Namibia | | | | | + | | | | |
| Nepal | | | | + | | + | | | |
| Netherlands Antilles | + | | + | | + | | | | |
| Netherlands | + | + | + | + | + | + | | + | + |
| New Caledonia (France) | | | | | + | + | | | |
| New Zealand | + | | | + | + | | + | + | + |
| Nicaragua | | | | | + | | | | |
| Nigeria | + | | | + | + | | | + | + |
| Niger | | | | + | | + | | | + |
| Niue Island | | | | | + | | | | |
| Norway | + | + | + | | + | + | | + | + |
| Oman | | | | | + | + | | + | + |
| Pakistan | | | | | | + | | | |
| Panama | | | | | + | + | | | + |
| Papua New Guinea | | | | | + | | | | |
| Paraguay | | | | | + | | | | |

| | IMO | UN/ECE | | | ICC | ICAO | WCO | | |
|---|---|---|---|---|---|---|---|---|---|
| | FAL (1) | TIR (2) | HAR (3) | UN//CEFACT | UCP 500 (5) | (6) | CCO (7) | KC (8) | HS (10) |
| Peru | + | | | | + | | | | + |
| Philippines | | | | + | + | | | | |
| Poland | + | + | + | + | + | + | + | + | + |
| Polynesia | | | | | | | | | |
| Portugal | + | + | + | | + | | | + | + |
| Puerto Rico | + | | | | + | | | | |
| Qatar | | | | | | | | | |
| Republic of Korea | | + | | + | + | + | + | + | + |
| Republic of Moldova | | + | | | | + | | | |
| Romania | | + | | + | + | + | + | | + |
| Russian Federation | + | | + | + | + | + | + | | + |
| Rwanda | | | | | + | | | + | + |
| Saint Kitts and Nevis | | | | | + | | | | |
| Saint Lucia | | | | | + | | | | |
| Saint Pierre and Miquelon | | | | | | | | | |
| Saint Vincent and the Grenadines | | | | | + | | | | |
| Samoa | | | | | + | | | | |
| San Marino | | | | | | + | | | |
| Saudi Arabia | | | | | + | + | | + | + |
| Senegal | + | | | + | | + | | + | + |
| Seychelles | + | | | | | + | | | |
| Sierra Leone | | | | | | | | | |
| Singapore | + | | | + | + | + | | | |
| Slovakia | + | + | + | + | + | | + | + | + |
| Slovenia | + | + | + | + | + | + | | + | + |
| Solomon Islands | | | | | + | | | | |
| South Africa | | | + | + | + | | | + | + |
| Spain | + | + | + | + | + | + | + | + | + |
| Sri Lanka | + | | | | + | + | | + | + |
| Sudan | | | | | | | | | + |
| Suriname | + | | | | + | | | | |
| Swaziland | | | | | | | | | + |
| Sweden | + | + | + | + | + | + | | + | + |
| Switzerland | + | + | + | + | + | + | + | + | + |
| Syrian Arab Republic | + | + | | + | | + | | | |
| Taiwan (Province of China) | | | | | + | | | | |
| Tajikistan | | + | | | | + | | | |
| Tanzania | | | | | | | | | |
| Thailand | + | | | | + | + | | | + |
| The former Yugoslav Republic of Macedonia | | + | + | + | | + | | | + |
| Togo | | | | | | | | | + |
| Tonga | | | | | + | + | | | |
| Trinidad and Tobago | + | | | | + | | + | | |
| Tunisia | + | + | | | + | | | | + |
| Turkey | | + | | + | + | + | + | + | + |
| Turkmenistan | | + | | | | + | | | |
| Tuvalu | | | | | + | | | | |
| Uganda | | | | | + | + | | + | + |

| | IMO | UN/ECE | | | ICC | ICAO | WCO | | |
|---|---|---|---|---|---|---|---|---|---|
| | FAL (1) | TIR (2) | HAR (3) | UN//CEFACT | UCP 500 (5) | (6) | CCO (7) | KC (8) | HS (10) |
| Ukraine | + | + | | + | + | | + | | |
| United Arab Emirates | | | | | + | + | | | |
| United Kingdom of Great Britain and Northern Ireland | + | + | + | + | + | + | | + | + |
| United States of America | + | + | | + | + | + | + | + | + |
| Uruguay | + | + | | | + | + | | | |
| Uzbekistan | | + | + | | | + | + | | + |
| Vanuatu | + | | | | + | + | | | |
| Venezuela | | | | | + | | | | + |
| Vietnam | | | | | + | + | | + | + |
| Wallis and Futuna (France) | | | | | | | | | |
| Yemen | + | | | | | + | | | |
| Yugoslavia | + | + | + | | + | | | | |
| Zambia | + | | | | | + | | + | + |
| Zimbabwe | | | | | + | | | + | + |

Notes:

(1) Contracting Governments as at 26 January 2000
(2).Contracting Parties to the TIR Convention, 1975
(3) Contracting Parties to the HAR Convention, 1985
(4) Countries participating in the work of UN/CEFACT
(5) Adherence list
(6) Contracting States as at 30 August 2000
(7) Signatures, ratifications and accesions as at 30 June 1999
(8) Ratifications and accesions as at 30 June 1999
(9).Contracting Parties as at 30 June 1999

***Source*: UN/CEFACT, "Compendium of Trade Facilitation Recommendations", 2001.**

## APPENDIX IV: COUNTRY SUBMISSIONS TO THE WTO ON PROPOSALS TO REFORM TRADE FACILITATION

*A) Country Submissions: Proposals for reform*

| Country, Doc. No., Date of Submission | Proposed changes | Reasons stipulated for Proposal | References cited |
|---|---|---|---|
| | | | |
| **Australia**<br>**G/C/W/443 5**<br>**December 2002**<br>**General Proposals** | 1. The following principles should be Incorporated into the existing WTO articles:<br>• The application of procedures and practices that are predictable, consistent and transparent;<br>• The provision to interested parties of all the necessary information regarding laws, regulations, administrative guidelines, procedures and practices;<br>• The adoption of modern techniques such as risk management and audit-based controls, and the maximum practicable use of information technology;<br>• Cooperation wherever appropriate with other national authorities, other administrations and the trading communities; and<br>• The provision of easily accessible processes for administrative and judicial review.<br>2. Technical assistance which includes a range of special and differential treatment provisions including:<br>• Less onerous initial commitments for developing countries,<br>• Transitional periods for the assumption of commitments, and<br>• More stable provisions regarding the supply of technical assistance.<br>3. Adoption of the Kyoto Convention | Develop measures to improve import and export measures<br><br>Implementation of fair and modern procedures<br><br>Creation of a consistent, transparent and predictable environment for trade | Kyoto Convention |
| **Canada**<br>**G/C/W/424**<br>**1 October 2002**<br>**Art. V: Freedom of Transit** | 1. Limitation, simplification, standardization of customs procedures and documentation requirements<br>• Limit undue documentation on goods in transit<br>• Limit customs formalities on arrival<br>• Use of 'surety bonds', securities<br>• Use of risk management principles for established traders<br>• Include a provision to promote "the simplification of customs regulations concerning traffic in transit" as in the Havana Charter<br>2. Promotion of use of transit instruments<br>• Promote the accession to various Customs' Transit agreements.<br>3. Issues related to non-discrimination (MFN,NT) | To increase the multilateral trading system's effectiveness in addressing freedom of transit issues; furthering the capacity of land-locked countries. | Barcelona Convention<br>Havana Charter |

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| | • Extension of NT to Art.V; limited to taxation and regulations on transit of goods.<br>4. Clarification of fees and clearer definition of terms<br>5. Technical assistance, Capacity Building | | |
| **Canada**<br>**G/C/W/397**<br>**17 July 2002**<br>**Art. VIII: Fees and Formalities** | 1. Simplification, reduction and standardisation of documentation and data requirements and procedures<br>• To create standard, international compatible data sets<br>• Increased use of information and communication technologies<br>2. Border Agency Coordination<br>• Simplified clearance procedures<br>• Establishment of a 'single window' at border points<br>• Possible agreements on the coordination of procedures and formalities between agencies.<br>3. Streamlined procedures, fast-track clearance and risk assessments for established/authorized traders<br>4. Provision of collateral or monetary security<br>• Use of surety bonds<br>5. Use of risk assessment principles and /or advanced control techniques; post-entry audits<br>6. Technical Assistance and capacity building | Addition of business and user-friendly improvements to the core international trade procedures; furthering the capacity of countries through technical assistance | Agreement on Rules of Origin and the Agreement on Implementation of Article VII of the GATT. Our ideas also draw upon the National Experience papers on trade facilitation submitted to the Council for Trade in Goods by various Members. |
| **Canada**<br>**G/C/W/379**<br>**30 May 2002**<br>**Art. X: Publication and Administration of Trade Regulations** | 1. Publication and Accessibility of all information regarding border rules and procedures to all interested parties through an accessible medium (electronic if feasible); technical assistance provided.<br>2. Consultative/Feedback Mechanisms for all stakeholders/interested parties before the proposed rules or procedures are formally adopted or implemented<br>• Publication of reasoned motivations for a proposed measure<br>3. Non-Discriminatory, legal right of review and appeal<br>• Consideration could be given to developing and extending a provision similar to that of Art. 13 of the Customs Valuation Agreement<br>4. Advance Rulings covering the main elements of import requirements<br>• Provision of binding rulings on tariff classification, applicable duties, taxes and import licensing requirements<br>• Specifications regarding means/modalities<br>• Close alignment of the text with that in the Agreement on Rules of Origin, Part 11, | To promote the trade facilitation principles of transparency, due process, integrity, efficiency and simplification, and consultation | Agreement on Rules of Origin and the Agreement on Implementation of Article VII of the GATT. Our ideas also draw upon the National Experience papers on trade facilitation submitted to the |

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| | Article 3 (f)<br>5. Mechanism for goods to be released and possibility for duty payment to be left in abeyance in certain situations<br>6. Technical assistance and capacity building | | Council for Trade in Goods by various Members. |
| Columbia<br>G/C/W/425<br><br>1 October 2002<br><br>Art. VIII: Fees and Formalities | • Simplification, reduction and standardisation of documentation and data requirements and procedures<br>• The establishment of a single-window facility at border points<br>• Simplified clearance procedures<br>• Possibility of accession to the Kyoto Convention, Istanbul Convention and the Brussels, *inter alia*, which include mechanisms for the progressive adoption of commitments, selectivity as regards the inclusion of regulations and the possibility of reservations.<br>• The adoption of international standards on the harmonization and simplification of customs procedures<br>• Automation<br>• Streamlining of operations and enhancement of transparency<br>• Border agency coordination<br>• Multilateral agreement on Art.VIII with Special and Differential Treatment, technical assistance<br>• Work Programmes | Adopt international standards that ensure simplification, predictability, transparency, non-discrimination and foreign trade support, in particular in developing countries.<br><br>Reiterate the importance of both technical assistance and time to move ahead with the planned programmes and actions. | Kyoto Convention<br>Istanbul Convention<br>Brussels convention |
| **European Communities**<br>**G/C/W/422**<br>**30 September 2002**<br>**Art. V: Freedom of Transit** | 1. Non Discrimination in modes of transport<br>2. Non Discrimination between Individual Carriers<br>3. Non-discrimination between types of consignment<br>4. Limitation, simplification, standardization of customs procedures and documentation requirements<br>• Based on international standards where they exist<br>5. Clarification of Fees and Charges<br>• Introduce disciplines on securities<br>6. Promotion of use of transit instruments<br>• Establishment of regional transit instruments or arrangements<br>7. Review and removal of unnecessary or overburdensome procedures<br>8. Special and Differential Treatment, technical assistance, capacity building. | Real freedom of transit is often absent or compromised. The conditions of international trade and the requirements for transit have changed since Article V was originally formulated in the late 1940s. The provisions of Art. V should be clarified and strengthened. | |

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| **European Communities G/C/W/394 12 July 2002 Art. VIII: Fees and Formalities** | 1. General Commitments<br>• Scope and coverage<br>• Geographical coverage<br>• Non discrimination<br>• Transparency and predictability<br>• Avoidance of unnecessary procedural barriers<br>• A commitment to regularly review regulations and working procedures with a view to introducing better and less burdensome practices<br>2. Specific Provisions on Fees and Charges<br>• Clarification regarding the service provided, the fee levied, ad valorem calculation, and non-related operational costs (interpretation of para.1(a) and commitment regarding para.1(b)).<br>• Consolidate or reduce the number and diversity of their fees and charges<br>3. Specific Provisions on Data and Documentary Requirements and Procedures<br>• Acceptance of relevant commercially available information and documents<br>• Simplification, reduction and standardisation of documentation and data requirements and procedures<br>• Uniform domestic customs code<br>• Single window facility<br>4. Customs and Related Import and Export Procedures<br>• Simplified and standardised import and export procedures, based on international standards and instruments (e.g. the WCO's Kyoto Convention)<br>• Non-discrimination in modes of transport<br>• Introduction of simplified release and clearance procedures<br>• Risk assessment<br>• Special procedures for authorized traders<br>• Automation<br>5. Cooperation and coordination among different authorities; communication with traders<br>• Convergence of official controls<br>6. Special and Differential Treatment<br>• Differentiation in Commitments<br>• Transitional periods<br>• Technical Assistance and Capacity Building Measures | To clarify and improve its provisions in a way that would, indeed, reduce the incidence and complexity of import and export procedures and formalities, and fees and charges. | UNCTAD Columbus declaration of 1994<br>Bilateral or regional agreements<br>TBT Agreement<br>Kyoto Convention |

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| **European Communities**<br>**G/C/W/363**<br>**12 April 2002**<br>**Art. X: Publication and Administration of Trade Regulations** | 1. Publication and Availability of Information of all relevant laws, regulations, administrative guidelines regarding border crossing trade to all interested parties through an accessible medium (electronic if feasible)<br>• Advance rulings, notably binding rulings on classification and origin; Specifications regarding means/modalities<br>• Fees charged for the provision of information<br>• Guidelines should be simple<br>• Establishment of Enquiry points or trade desks<br>• Legal basis for administrative actions, decisions or rulings<br>2. Predictability via Prior Consultation & Minimum Time Periods before entry into force etc<br>• Consultative/Feedback Mechanisms for all stakeholders/interested parties before the proposed rules or procedures are formally adopted or implemented<br>• Standard, and adequate time, to allow trade to adjust<br>• Adequate time periods for such comment and for reasonable time periods between adoption and entry into force of regulations<br>• Publication of the reasoned motivations for a proposed measure<br>• Review and update of primary legislation<br>3. Appeal Procedures and Due Process<br>• Non discriminatory, legal right of appeal<br>4. Mechanism for goods to be released and possibility for duty payment to be left in abeyance in certain situations<br>5. Special and Differential Treatment, including technical assistance | Commitment to transparency for the benefit of all Members | |
| **Hong Kong**<br>**G/C/W/398**<br>**18 July 2002**<br>**Art. VIII: Fees and Formalities** | • Simplification, reduction and standardisation of documentation and data requirements and procedures<br>• Introduction of a standard of review<br>• Introduction of a necessity test (Commitment regarding para.1 (b)).<br>• Formalities and documentation requirements<br>• Simplicity/modernization in the formulation of guidelines, regulations and procedures<br>• Use of International Standards/Harmonization<br>• Introduction of Neutrality into the agreement<br>• Clarity in fees and charges<br>• Technical Assistance | Necessary import and export formalities and fees maintained should be administered in a neutral, transparent, consistent and predictable manner so as to ensure a smooth and efficient functioning of the international trading system | TBT Agreement, SPS Agreement, and IL Agreement |

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| **Japan G/C/W/401**<br>**22 July 2002**<br>**Art. VIII: Fees and Formalities** | • Simplification/standardization of trade and/or clearance procedures<br>• Risk Assessment and/or advanced control techniques<br>• Automation<br>• Border agency coordination<br>• User-agency communication<br>• Single-window facility<br>• Technical cooperation | Trade and investment promotion | |
| **Japan G/C/W/376**<br>**22 May 2002**<br>**Art. X: Publication and Administration of Trade Regulations** | • Identification of elements that should be provided in laws and regulations<br>• Identification of the means to publicize the laws and regulations<br>• Formulation and publication of administrative guidelines<br>• Establishment of inquiry points and an advance ruling system<br>• Advance Rulings<br>• Non discriminatory, legal right of appeal<br>• Technical Assistance<br>• Coordination with other international organisations | Transparency, predictability and uniformity are the principle elements that are stipulated in GATT Article X. Further improvement of these elements would lead to the facilitation of trade and investment, and thus economic development. | |
| **Korea G/C/W/423**<br>**1 October 2002**<br>**Art. V: Freedom of Transit** | • Cooperation among customs authorities<br>• Harmonization of transit policies<br>• Sharing of information among customs authorities<br>• Limitation, simplification, standardization of customs procedures and documentation requirements<br>• Standardization and uniformity of data sets<br>• Transparency<br>• Notification of fees and charges<br>• Differentiation of Transhipment and Non-Transhipment<br>• Technical assistance and capacity building measures | Improving Art.V so that it not only sets out basic principles regarding transit traffic, but also provides guidelines for applying these principles in practice. | Kyoto Convention and the ASEAN Framework Agreement on the Facilitation of Goods in Transit (as starting points for discussion) |
| **Korea G/C/W/403**<br>**25 July 2002**<br>**Art. VIII: Fees and Formalities** | • Acceptance of commercially available information and copies<br>• Risk assessment and/or advanced control techniques; Pre-arrival processing, post-auditing<br>• Proper IT infrastructure to ensure implementation of modern customs techniques and EDI<br>• Use accepted GATT/WTO principles as reference for legal interpretation and guideline for matters not specifically covered by Art. VIII's provisions<br>• Institutional reform and human training | Refine the time-honoured principles (Non-Discrimination, Transparency, Predictability, Simplicity and Reasonableness) into more concrete disciplines. Only multilateral efforts can | |

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| | • Technical Assistance | deliver substantial improvement. | |
| **Korea G/C/W/377 22 May 2002 Art. X: Publication and Administration of Trade Regulations** | • Single National Focal Point, liaison with other authorities; flexible implementation period<br>• Notification of Core Measures as in the SPS and TBT Agreements; translation services.<br>• Immediate publication of all rulings, laws, procedures and regulations regarding international trade and customs administration; translation services and electronic media assistance<br>• Predictability<br>• Consultative/Feedback Mechanisms for all stakeholders/interested parties before the proposed rules or procedures are formally adopted or implemented<br>• Adequate time periods between adoption and entry into force of regulations<br>• Advance Rulings; translations services<br>• Non discriminatory, legal right of appeal<br>• Qualified technical assistance, special and differential treatment, capacity building | To promote and enhance transparency. Any proposal or idea should be evaluated and prioritised according to how much it can contribute and how easily it can be drawn into relevant WTO rules and be eventually implemented | SPS and TBT Agreements |
| **United States G/C/W/400 19 July 2002 Art. VIII: Fees and Formalities** | No proposals.<br>Questions raised in the areas of fees, formalities and requirements, penalties, and scope of coverage | To ensure that Members' regulatory infrastructure keeps pace with advancements in commercial logistical practices | |

*Source*: Derived from WTO Submissions by Australia, Canada, Columbia, European Communities, Hong Kong, Japan, Korea, and the United States. Additional information supplied by the Secretariat's "Review, Clarification and Improvement of GATT Articles V, VII and X. Proposals made by Delegations", 15 November 2002, G/C/W/434. www.wto.org

**APPENDIX IV (CONTINUED): COUNTRY SUBMISSIONS TO THE WTO ON NATIONAL EXPERIENCE**

**Reprinted from www.wto.org[242]**

***B) National experience papers***

A total of 16 national experience papers have been submitted by the following 10 delegations: Australia (2), Canada (1), Chile (1), Costa Rica (1), Czech Republic (1), Guatemala (1), Hong Kong China (2), Korea (4), Maldives (1), Norway (1) and Switzerland. Most of them present experiences in introducing measures to facilitate trade. References to trade facilitation needs have been mostly taken from what delegations described as the main problems in this area. Indications of priorities are based on the presentation of key trade facilitation measures undertaken by delegations.

| Member | Document number | Main points related to trade facilitation needs and priorities |
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| Australia | G/C/W/233 | Key expectations: (i) government intervention by exception in customs clearance; (ii) customs information requirements kept to the minimum necessary for risk management and statistical purposes; (iii) fast, reliable, adaptable, flexible, paperless, cost-efficient best practice processes, including risk management, post-transaction auditing, pre-arrival reporting and the use of information technology; (iv) transparency, predictability and consistency in procedures developed and adopted by governments in consultation with traders. Future directions: a) cargo management re-engineering; b) business partnerships; Recognition of importance of capacity building and technical assistance; |
| Australia | G/C/W/263 | Delivery of technical assistance and capacity building to modernize and reform customs processes and procedures in less developed countries whilst ensuring consistency with WTO and WCO conventions and principles; Importance of simplifying, harmonizing and improving customs procedures; Need for a strategic and planned approach to improve the delivery of technical assistance, consistent with existing international conventions; |
| Canada | G/C/W/238 | Demand for fast and predictable release of goods and measures to facilitate the flow of services and travelers across national borders; Need to undertake modernization of border management process and customs practices; Need for reform of import and export procedures, including elimination of unnecessary processing steps, simplification and elimination of certain forms, streamlining of document processing flow and adoption of international codes. Importance of more appropriately applied enforcement tools and for greater coordination among the various stakeholders. Examples of trade facilitation measures implemented: (i) innovative customs line release systems, (ii) use of e-commerce and electronic interfaces, (iii) low-value shipment program, (iv) Accelerated Customs Release Operations Support System, (vi) single window, (vii) binding advance rulings, (viii) right of appeal, and (ix) risk assessment approach; |

[242] WTO, Trade Facilitation Needs and Priorities of Members: Compilation of Existing Material by the Secretariat, 11 July 2002, G/C/W/393

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| Chile | G/C/W/239 | Need to modernize and streamline customs administrations based on the use of information technology; Implementation of Electronic Data Interchange system in order to have (i) less paper-based inputs to the customs process, (ii) longer opening hours, (iii) shorter processing times, (iv) release of staff from repetitive duties, (v) better inspection and control capacity, (vi) shorter time of goods in warehouses and (vii) interconnection of organizations involved in foreign trade; Expected benefits from new technological developments such as a) improvement in the logistical chain, improved transparency in customs operations, costs savings and release of staff engaged in administrative duties; |
| Costa Rica | G/C/W/265 | Need to reform and modernize customs; Adoption of reforms by setting measures in the area of a) organizational restructuring b) inspection and automation c) customs procedures and d) legislation; Implementation of measures like (i) risk-assessment and control techniques; (ii) processing prior to arrival or advance goods clearance; (iii) in-works and commercial clearance; (iv) automation of customs clearance procedures; (v) establishment of Users' Committee; and of (vi) National Deregulation Commission; (vii) Single Window for Foreign Trade; (viii) enhancement of transparency and predictability; (ix) creation of investors' manual; |
| Czech Republic | G/C/W/247 | Need to establish modern and effective customs service, ensure training, establish good communications between customs offices, modernize and computerize customs procedures as well as to create appropriate environment for development. Objective of enhancing the effectiveness of customs and performing tasks more quickly, reliably and in a less costly way; Measures implemented: (i) Digitalization of data submissions; (ii) new customs transit system, (iii) simplified procedures, (iv) electronic customs clearance; |
| Guatemala | G/C/W/248 | Importance of simplification and harmonization of international trade procedures to facilitate trade flows and reduce obstacles to international trade. Setting up of Tax Administration Office as one of the most important domestic measures to modernize trade procedures in customs administration and bring them into conformity. Objectives of new customs model to facilitate trade: (i) update and systematization of customs legislation; (ii) establishment of flexible, secure and automated procedures for foreign trade; (iii) introduction of computer system capable of processing information related to customs procedures in a timely, reliable and automated way; (iv) remodeling and building up of customs infrastructure adapted to the new procedures; and (v)coordination and setting up of technical assistance mechanisms with other countries and international organizations for transmission of information and training; |
| Hong Kong, China | G/C/W/125 | Trade facilitation measures adopted: (i) conduct of performance pledges and establishment of customer liaison groups to improve quality of services to traders; (ii) simplification of licensing procedures and requirements; (iii) introduction of Interactive Voice Response System and creation of a Homepage for public access to information in order to enhance transparency in licensing procedures; (iv) increased transparency in customs procedures and requirements; (v) introduction of EDI Service for government trade documents to promote the application of electronic commerce; |

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| Hong Kong, China | G/C/W/231 | Measures implemented to facilitate trade: (i) improved quality of services to traders; (ii) enhanced transparency in licensing and customs procedure and requirements; (iii) simplified licensing procedures and requirements; (iv) liberalization of trade; (v) introduction of Electronic Data Interchange Service for government trade documents; (vi) faster boundary crossings; (vii) pre-arrival clearance to enable speedy customs clearance and (viii) cooperation with other customs administrations; |
| Korea | G/C/W/123 | Importance of guaranteeing efficient trade flows through computerization and simplified work processes; Measures undertaken to simplify, harmonize and computerize customs clearance system: (i) reform of the Import Clearance System, covering the a) reforming of the Import Declaration System; b) valuations procedures; and c) post-entry investigation of imported goods; d) introduction of EDI-based Cargo Selectivity System; e) introduction of On-Dock Immediate Delivery System; and f) simplification of checklist for eligibility for importation; (ii) computerization of customs procedures; |
| Korea | G/C/W/134* | Measures related to the facilitation of cargo movement such as (i) bonded transportation; (ii) surveillance and control of cargoes entered, covering both prevention and exposure of customs offences; (iii) post-entry investigations of goods imported, by measures such as on-the-spot investigation into contracts, invoices, account books, records, and any other books relating to the transaction at the importer's office; |
| Korea | G/C/W/146 | Importance of reforming customs administration and customs procedures in order to (i) induce foreign direct investment, (ii) enhance the competitiveness of domestic enterprises, reach a level of transparency and rationality compatible with international standards in customs administration. Measures undertaken: a) Introduction of the Omnibus Bonded Area System; b) introduction of immediate release system; c) implementation of paperless import customs clearance system; d) extension of the duration of storage of goods for transit cargoes; |
| Korea | G/C/W/212* | Simplifying customs clearance procedures and harmonizing international standards as essential means to facilitate trade flows. Efforts made to facilitate trade: (i) implementation of paperless import clearance system with the aim to simplify import clearance procedures and expedite logistics flows; (ii) extended implementation of the On-Dock Immediate Delivery System; |
| Maldives | G/C/W/232* | Measures taken by the Customs Service to simplify customs procedures and documentation by streamlining the system (i) introduction of Electronic Data Interchange Service, Direct Trader Input and Wide Area Network, leading to more efficient use of human resources, strengthening of customs procedures; easier and faster clearance, facilitation of clients' submissions and of generation of timely and up-to-date statistics for customs; (ii) implementation of the HS Tariff Nomenclature; (iii) launching of Customs Website, providing access to information regarding external trade regulations and the customs service; |

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| Norway | G/C/W/221+ Add.1 | Importance of simplifying import and export procedures as well as other customs related procedures to lower costs and enhance benefits of trade for national authorities, traders and society at large. Introduction of measures on customs facilitation in the areas of electronic customs procedures and the development of a computerized transit system such as (i) implementation of electronic customs clearance system, leading to paperless goods transit and electronic communication, and of a (ii) computerized transit system. Need to modernize transit procedures through computerization to make exchange of information more secure and information more reliable; Implementation and monitoring of security measures of vital importance to achieve and maintain reliable and secure operation of transit; |
| Switzerland | G/C/W/234 | Need to achieve coherence between simplifying customs procedures and internal administrative provisions; measures introduced to achieve this goal: introduction of (i) new computerized transit system; (ii) common transit zone; (iii) stepped-up procedures; (iv) better co-ordination of procedures; (v) more liberal and transparent legislation; (vi) client orientation; Importance of a) transparency; b) necessity to improve co-ordination between customs and administrative bodies; c) recourse to international standards or equal recognition of national standards in their absence; d) harmonization of technical regulations, recognition of conformity assessment procedures and e) mutual acknowledgement of documents and data contained therein, in combination with advances in electronic data processing; |

Note: Documents marked with an * refer to submissions dealing with trade facilitation programs and related experiences without being explicitly labelled as "experience papers".

## APPENDIX IV (CONTINUED): OTHER RELEVANT SUBMISSIONS TO THE WTO

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*C) Other submissions by Members of relevance*

Communications listed under this category contain mainly proposals for future work. Like in the previous section, references to trade facilitation needs are mostly based on what Members present as main problems in the facilitation of trade. Indications of priorities have been taken from proposed measures to facilitate trade.

| Member | Document number | Main points related to trade facilitation needs and priorities |
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| Australia | G/C/W/152 | Importance of electronic reporting in trade facilitation; need to reduce or eliminate the requirement for paper documentation for customs and other cross-border trade administration as well as other documents for international trade; importance of removing unnecessary or inefficient government data requirements; need for fast, reliable, flexible, harmonized, cost-efficient and largely paperless systems; need to raise the level of use of IT systems for communicating to regulatory bodies; Necessity to consider the whole trade transaction process from the point of quotation to the point of payment with both official procedures and commercial practices included; |
| Canada | G/C/W/126 | Suggestions for specific trade facilitation measures: (i) quick release of goods; (ii) use of risk assessment principles for border inspections and post-entry verification, (iii) border agency coordination; (iv), harmonization of import documents and data required for the release of merchandise using existing international standards where appropriate; (v) simplified and streamlined clearance requirements and procedures for commercial samples and goods for exhibition; (vi) express consignment clearance; (vii) simplified procedures for low value shipments; (viii) use of compatible Electronic Data Interchange (EDI) systems; (ix) use of advance rulings; (x) access to unbiased administrative appeal process; (xi) making national laws, regulations, administrative policies and guidelines readily available to the international trading community; |
| Costa Rica | G/C/W/240 | Objectives for defining specific trade facilitation measures: (i) efficiency, simplification and facilitation of trade procedures; (ii) harmonization and consistency of requirements and formalities; (iii) transparency and predictability regarding trade procedures; (iv) integrity; (v) cooperation; (vi) modern and flexible customs control systems based on risk evaluation techniques; (vii) modernization of national customs and technical training services; (viii) customs cooperation and technical assistance; (ix) publication of advance requirements by customs authorities; |
| European Communities | G/C/W/85 | International trade transaction process should be as simple as that required for domestic sale; Exporters should be able to expect solid but simple and transparent procedures for trading; Onerous formalities should be reduced; Customs procedures should be reviewed and adapted over time to reflect changes in trade patterns, introduction of information technologies; Specific areas of work should be: (i) alignment of customs procedures; (ii) modernize customs procedures and make them more transparent; (iii) standardize information and use of electronic |

[243] WTO, Trade Facilitation Needs and Priorities of Members: Compilation of Existing Material by the Secretariat, 11 July 2002, G/C/W/393

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| | | transmissions; |
| European Communities | G/C/W/122 | Suggested measures related to documentation and information requirements at import and export: (i) avoidance of unnecessary procedural obstacles; (ii) adoption of international standards; (iii) reduction and harmonization of data sets and messages; (iv)adoption of harmonized documentation format; (v) single window submission of information; (vi) seamless integrated transaction; Suggested measures related to customs and border crossing procedures: (i) introduction of automated customs clearance; (ii) pre-arrival processing, post- clearance controls and audit; (iii) develop system of "authorized traders"; (iv) one stop clearance; (v) remote filing and simplified clearance procedures; (vi) time-limit for routine customs clearance; (vii) co-operation between trade and customs/other agencies; (viii) judicial or administrative redress; (ix) enhancement of transparency; (x) tackle corruption and integrity issues; |
| European Communities | G/C/W/133 | In the area of transport and transit, proposal to reduce excessive and unharmonized documentation and data requirements at import and export and promote their electronic submission, minimize date requirements, introduce modern customs methods, provide for advance clearance of consignments, post-clearance controls and audit, for transparency and the avoidance of sudden changes in documentation and other requirements, as well as for progressive convergence of official controls on the international movement of goods; Need to tackle problem of lack of uniform, harmonized intermodal transportation régime of goods; Regarding payment, insurance and other questions affecting cross-border trade in goods, suggestion to pay attention to (i) electronic payment systems, (ii) banking settlement delays, (iii) non–payment and credit worthiness and (iv) late payment in commercial transactions; |
| European Communities | G/C/W/138 | Need for automation in trade administration; proposed action: (i) establishing customs acceptance of electronic documents and data, processing and release by electronic means; (ii) computerization preceded by reduction, simplification and harmonization of data and documentation requirements, as part of a package of modern techniques such as pre-arrival processing, risk assessment, post-release payment of duties, and remote filing of declarations; (ii) systematic improvements to customs practices and management; (iii) use of EDI by other agencies; (iv) use of international standards; (v) public and private sector cooperation; (vi) capacity building; |
| European Communities | WT/GC/W/190 | Development of framework of WTO commitments to simplify and harmonize trade procedures, encompassing, among others, the (i) harmonization and simplification of trade and transport documents and data, drawing on international standards, and relying on commercial information; (ii) progressive introduction of modern customs techniques designed to strengthen compliance and control while speeding release of legitimate goods; (iii) progressive automation and EDI at the level of customs and other agencies to replace paper procedures for export and import; (iv) development of measures to facilitate convergence of official controls on border crossing goods; (v) capacity building to strengthen human and physical infrastructure and improve import/export management; (vi) consideration of scope for provision to ensure smooth conduct of banking and payment transactions; |
| Japan | G/C/W/151 | Need to streamline the entire importation procedures, starting from the arrival of cargo at the border to its receipt by the resident; Essential to apply electronic processing and EDI to enable smoother and faster trade procedures; Importance of securing transparency in trade procedures, of reducing the number of offices exporters and |

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| | | importers need to deal with by establishing a single agency to deal with the entire trade procedures and, even more essential, of simplifying procedures by electronic processing; Importance of technical co-operation; Proposal to establish database on procedural requirements to increase transparency; |
| Japan | G/C/W/236 | Importance of (i) increasing transparency and predictability of procedures; (ii) reducing excessive documentation requirements; (iii) reducing physical examination, (iv) introducing EDI systems; (v) addressing problems related to customs valuation, (vi) facilitating customs formalities other than customs clearance procedures, such as procedures for the exemption or reduction of import taxes and repayment. Examples of possible measures mentioned in this context: Making a clear official announcement and publication of the relevant laws, regulations and procedures, establish detailed administrative rules for each operation, simplify and harmonize rules compatible with international standards, establish a system for advance ruling on classification, timely public announcement of changes in regulations, share information among sections of the customs authority, increase communication between relevant departments, decrease and simplify documentation, adopt risk management techniques, introduce automated clearance systems achieving seamless and paperless trade procedures. |
| Japan | WT/GC/W/257 | Need to implement the existing WTO Agreements; Necessity to facilitate the entire sequential procedures from the arrival of goods at the border to free circulation in the domestic market; advance automation of procedures and EDI by (i) simplifying measures such as by automation, introduction of EDI and harmonization of requested formats; (ii) realizing appropriate and quick clearance by substantive single window; (iii) establishing necessary framework for technical cooperation; Importance of human resource development; Need to enhance transparency; |
| Korea | G/C/W/150 | Need to institutionalize a single window for information regarding trade and importation; Suggestion to work on automation and modernization of customs administration by (i) allowing the private sector to use electronic means of data exchange designed for an integrated management of documentation and data with a view to ensuring seamless commercial transactions; (ii) establishing customs acceptance of electronic documents and data as well as processing and release of goods by electronic means; (iii) using open, interoperable and internationally recognized standards and codes as a basis for harmonized, simplified data and documentary requirements; (iv) greater international cooperation and assistance to developing countries to help them build infrastructure and expertise necessary to reach higher level of automation and modernization in the field of customs and export/import administration. Importance of enhancing transparency of laws, regulations and administrative guidelines governing foreign trade; |
| Paraguay | G/C/W/237 | Need to address problems of land-locked countries, going beyond the areas of transport and transit to include also issues such as financing for infrastructure, cost of freight or other facilities, inclusion of land-locked countries in globalization. Need to substantially upgrade infrastructure of highways, waterways and communications as well as need for more flexible rules on funding, simpler administrative arrangements and the application of rules governing the use of all modes of transport, need to provide landlocked countries with facilities to counterbalance their disadvantage and place them on an equal footing; |
| Switzerland | G/C/W/92 | Trade facilitation areas where action should be taken: (i) pre-arrival processing by, for example, electronic processing or "one stop" facilities; (ii) combat of customs irregularities such as corruption and malpractice by |

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| | | customs authorities; (iii) facilitation of anti-fraud measures by improvements in pre-arrival processing; (iv) harmonization of customs procedures and establishment of risk assessment and management procedures; (v) standardization of information and use of electronic transmissions; |
| Switzerland | G/C/W/137 | Techniques that could be used to facilitate trade: (i) gradual liberalization; (ii) simplification of documents, formalities and regulations governing the import and export of goods, covering not only the customs aspects but also the forms of transport, insurance and payment related to such transactions; (iii) harmonization; (iv) mutual recognition; (v) enhanced cooperation through the exchange of information and the principle of "single window"; Promoting the use of electronic media; |
| Switzerland | WT/GC/W/264 | Need to simplify and harmonize customs procedures and regulations applied at importation and exportation as well as in the areas of transport, insurance, and payment modalities linked with trade transactions in order to make trade transactions more efficient and less expensive; need to facilitate international trade transactions; |
| United States | WT/GC/W/254 | Need to strengthen and expand existing rights and obligations and to simplify and streamline the trade facilitation environment through: (i) clarifying and making more transparent the procedural requirements necessary for trade under the covered Agreements; (ii) enhancing efficiencies, including through the rapid release of goods from the custody of government authorities such as customs administrations; Necessity to have transparent and efficient trade transaction environment; |