STUDIES IN TRADE AND INVESTMENT
61

FUTURE TRADE RESEARCH AREAS THAT MATTER TO DEVELOPING COUNTRY POLICYMAKERS

A regional perspective on the Doha Development Agenda and beyond

ESCAP
1947-2007

ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC

STUDIES IN TRADE AND INVESTMENT
61

FUTURE TRADE RESEARCH AREAS THAT MATTER TO DEVELOPING COUNTRY POLICYMAKERS

A regional perspective on the Doha Development Agenda and beyond

United Nations
New York, 2007

STUDIES IN TRADE AND INVESTMENT 61

FUTURE TRADE RESEARCH AREAS THAT MATTER TO DEVELOPING COUNTRY POLICYMAKERS

A regional perspective on the Doha Development Agenda and beyond

United Nations publication
Sales No. E.08.II.F.3

Manufactured in Thailand
ISBN: 978-92-1-120533-6
ISSN: 1020-3516
ST/ESCAP/2467

The opinions, figures and estimates set forth in this publication are the responsibility of the authors and should not necessarily be considered as reflecting the views or carrying the endorsement of the United Nations, or institutions with which the authors are affiliated. The papers in this publication were presented at the WTO/ESCAP/ARTNeT workshop, Post-Doha Research Agenda for Developing Countries , held in Macao, China, on 30 and 31 October 2006. Financial support for the workshop provided by the government of Macao, China under the Macao Regional Knowledge Hub project is gratefully acknowledged.

Preface

This volume is a collection of papers and commentaries presented at the Post-Doha Research Agenda for Developing Countries Workshop in October 2006. The workshop was organized collaboratively by ESCAP and WTO as one of the first activities under the new project, the Macao Regional Knowledge Hub in Support of Sustainable Trade and Development (MARKHUB) sponsored by the government of Macao, China.

MARKHUB was established as part of the ESCAP response to demands by stakeholders in the region for more locally generated knowledge in the area of trade and trade policy. The project is underpinned by two types of activities:

(a) Capacity-building in research, delivery of research outputs and their dissemination through a newly established Macao Working Paper Series (MARKePAPERS), in collaboration with WTO and other institutions participating in the Asia-Pacific Research and Training Network on Trade (ARTNeT), a joint initiative of ESCAP and IDRC, Canada.

(b) Capacity-building in the area of trade policy formulation, monitoring and evaluation through the convening of regional policy consultations and workshops.

The workshop was held during the period of formal suspension of the Doha Development Agenda (DDA) negotiations. The objective of the workshop was to identify important areas for trade policymaking in developing and least developed countries, independently of the actual outcome of the Doha Round. This does not reflect any pessimism or skepticism about the continuation of the DDA negotiations on the part of the organizers and participants. On the contrary, the workshop stressed that the conclusion of the Doha Round was the single most important element in making trade fully development-friendly for the countries of the region. Thus, the topics of the workshop focused on current and upcoming research questions on trade policy reforms, including services trade, non-tariff barriers, competition and behind-the-border measures, preferential trade and trade impacts on poverty.

Several months after the workshop was held, DDA negotiations were restarted, but their outcome remains uncertain. What is certain, however, is that trade remains the driving force behind growth and development in Asia and the Pacific, and that policymakers must continue doing their job regardless of the global environment in which they find themselves. In an environment where trading rules might become less stable and predictable without the DDA conclusion, policymakers will have to depend even more on high-quality inputs from analysts and researchers. In these circumstances, homegrown research becomes as important as the ability to draw from the experiences of, and lessons learnt by other countries. Therefore, the establishment of MARKHUB is particularly timely as it provides a specific forum for the exchange of research findings and stakeholders opinions on good practices in sustainable trade and development policies.

The following chapters offer some new ideas for addressing current problems faced by policymakers. Concern is also raised regarding some areas that might become problematic, such as preferential rules of origin, non-tariff barriers and behind-the border barriers. This publication does not exhaust the number of areas of interest to policymakers or the public, nor is it intended to be a manual for good policymaking. Nevertheless, it is hoped that the following pages will provide some useful insights into ways of coping with the current and emerging trading environments.

Acknowledgments

This collection of papers and commentaries is the first publication resulting from the MARKHUB project generously sponsored by the government of Macao, China. The project also has benefited from the contribution of other dedicated partners: the World Trade Organization, Macao University of Science and Technology, and the International Development Research Centre, Canada.

The project is implemented by Ms. Mia Mikic, under the overall supervision of Mr. Xuan Zengpei, Director, Trade and Investment Division, and Ms. Tiziana Bonapace, Chief, Trade Policy Section of ESCAP. Mr. Robert Oliver edited this volume, while Ms. Tavitra Ruyaphorn had the task of formatting the text. Much advice and support was received from Mr. Patrick Low, Director, Research and Statistics Division of WTO for which the ESCAP secretariat expresses its appreciation.

The most profound gratitude is due to the authors who contributed papers and commentaries, and who patiently revised them in order to meet editorial consistency. Although much care was taken in removing obvious differences in the style and presentation of contributions, the volume was not edited with the aim of presenting the papers as a homogeneous manuscript. Therefore, the secretariat offers apologies to the readers who will find it necessary, when proceeding from chapter to chapter, to adapt to variations in expositions.

Contents

List of Tables

List of figures

List of contributors

Florian A. Alburo is Professor of Economics, University of the Philippines, a Fellow of the Institute for International Policy, University of Washington in Seattle, Washington, United States, and President of the Centre for the Advancement of Trade Integration and Facilitation. He formerly held positions in the Government of the Philippines (Deputy Minister of Socio-Economic Planning), and in international organizations (Asian Development Bank, World Bank, World Trade Organization and ESCAP). E-mail: florian.alburo@up.edu.ph.

Myrna S. Austria is Dean, College of Business and Economics, Associate Professor, Economics Department, De La Salle University, Manila, Philippines. She obtained her PhD from the Australian National University. Her areas of academic specialization are in trade and investment policy, development economics and international trade. E-mail: austriam@dlsu.edu.ph.

John Cockburn is co-Director of the Poverty and Economic Policy (PEP) research network and professor at Laval University in Qu bec. He completed a PhD at Oxford University (Nuffield College and the Centre for the Study of African Economies) in September 2001 on child labour and schooling in rural Ethiopia and CGE-based micro-simulation analysis of trade liberalization in Nepal. His areas of specialization include child poverty, macro-micro poverty modelling, trade policy analysis and manufacturing competitiveness. He has been active in providing training and technical support to developing country researchers throughout the developing world since 1990. E-mail: jcoc@ecn.ulaval.ca.

Bernard Decaluw is a full professor and a network leader in the Poverty and Economic Policy (PEP) research network at Laval University in Qu bec. He completed a Doctorat en Sciences Economiques at Universit de Louvain Belgique on exchange rates, balance of payments and economic policy. His areas of specialization include trade analysis and policy, macro-micro poverty modelling and development economics. He has published several books and articles, and has been invited as a speaker or teacher by numerous universities and institutions. E-mail: bdec@ecn.ulaval.ca.

Biswajit Dhar is professor and Head of the Centre for WTO Studies in the Indian Institute of Foreign Trade, New Delhi. For more than a decade and a half, he has been involved in trade policy issues, particularly in the context of the multilateral trading system, both as a researcher and a policy adviser to the Government of India. He has been a member of the Indian delegation to the Ministerial Conferences of the World Trade Organization. He has also been associated with several intergovernmental organizations, taking up issues related to the functioning of the global trading system. E-mail: bdhar97@gmail.com.

Evan Due is Senior Program Specialist responsible for economic and trade programs at the International Development Research Centre (IDRC) Regional Office for Southeast and East Asia in Singapore. Prior to joining IDRC in 2003, he worked for the Government of Canada in various positions with the Canadian International Development Agency, including diplomatic assignments in Pakistan, Afghanistan, and India, as well as serving as representative to the OECD/DAC working parties on Financial Aspects and Poverty Reduction. His interests include public policy, institutional economics, and poverty analysis. He obtained his doctorate from the University of Sussex. E-mail: Edue@idrc.org.sg.

Yann Duval is an Economic Affairs Officer in the Trade and Investment Division, Economic and Social Commission for Asia and the Pacific (ESCAP). Since joining ESCAP in 2002, he has designed and delivered training and advisory services on trade facilitation in at least 12 countries in the ESCAP region. He has authored various publications in this area and has been instrumental in the creation and development of the Asia-Pacific Research and Training Network on Trade (ARTNeT), a network of research and academic institutions aiming at building regional capacity in trade and investment policy and facilitation research. Prior to joining the United Nations, Yann Duval was Assistant Professor of International Business at the Asian Institute of Technology and Assistant Professor of Agricultural Economics at Washington State University. E-mail: duvaly@un.org.

Simon J. Evenett is Professor of International Trade and Economic Development, University of St. Gallen, Switzerland. Since receiving his PhD in economics 10 years ago, he has held fellowships at the Brookings Institution and the World Bank, both in Washington, D.C. He has acted as rapporteur at numerous events of the Organisation for Economic Co-operation and Development, and World Trade Organization. He has published a variety of policy-relevant writings and edited volumes. For more information on recent papers, please consult www.evenett.com. E-mail: simon.evenett@unisg.ch.

Christopher Findlay is Professor of Economics and head of the School of Economics at the University of Adelaide. Prior to that, he was Professor of Economics at the Australian National University. Australia s economic relations with Asia are the theme of his research. He has a special interest in developments of regional trade in services, as well as the nature and effects of impediments to trade and investment in services. E-mail: christopher.findlay@adelaide.edu.au.

K.C. Fung is Professor of Economics at the University of California, Santa Cruz and a visiting professor at the University of Hong Kong. His research interests include international trade, the World Trade Organization (WTO) and Asian economies. He was a senior staff economist at the United States White House Council of Economic Advisers, a consultant for WTO, the World Bank and the United States International Trade Commission. He has previously taught at Stanford University, the University of Wisconsin-Madison, Mount Holyoke College and the University of Hong Kong. E-mail: kcfung@ucsc.edu.

Murali Kallummal is Consultant, Centre for WTO Studies, Indian Institute of Foreign Trade (IIFT), New Delhi. He is currently working on market access-related issues, particularly in the context of the ongoing Doha Round negotiations under WTO. He has written a number of publications that address issues of governance and the challenges faced by national governments in developing countries in an era when economies are becoming increasingly integrated. In addition, his research interests include the working of global financial markets. E-mail: muralikallummal@gmail.com.

April Lacson is research assistant at the Philippine Institute for Development Studies. She recently graduated from the University of Asia and the Pacific, with a major in Political Economy (Magna Cum Laude). She is currently pursuing a degree in law at the University of the Philippines. E-mail: lapril@pids.gov.ph; aplacson@yahoo.com.

Donald J. Lewis is Associate Professor and Director, East Asian International Economic Law and Policy Programme in the Faculty of Law, The University of Hong Kong, Hong Kong, China. He was academic coordinator of the first official WTO Regional Trade Policy Course (RTPC) for the Asia-Pacific region and currently serves as UNESCAP consultant, ARTNeT external advisor and AusAID trainer/mentor on trade policy issues for the governments of Indochina. His teaching/research interests comprise international trade law, WTO law and policy and Chinese trade and investment law. Among his recent publications is *China s Participation in the WTO* (Cameron & May, 2005). He has been a visiting scholar at Harvard Law School, East Asian Legal Studies Program, United States; visiting professor at University of Wisconsin-Madison School of Law, United States; and visiting lecturer at University of Zurich Faculty of Law, Switzerland. E-mail: lewlaw@hkucc.hku.hk.

Mia Mikic is an Economic Affairs Officer in the Trade and Investment Division, Economic and Social Commission for Asia and the Pacific. Previously, she was Professor of International Economics at the University of Zagreb, Senior Lecturer at the University of Auckland, Research Associate at the University of Canterbury and a visiting fellow at the Universite Lumiere, Lyon, and Oxford University. She is the author of *International Trade* (Macmillan, 1998), has contributed chapters to several edited volumes and published a number of journal articles and other papers. Her current work focuses on the impacts of preferential and multilateral trade liberalization. E-mail: mikic@un.org.

Gloria O. Pasadilla is Senior Research Fellow at the Philippine Institute for Development Studies (PIDS). She is currently the Convener for the APEC Group on Services sub-forum, and the Philippine lead negotiator for services in the ASEAN-Australia-New Zealand FTA negotiations. She has been a professor at the University of Asia and the Pacific, consultant for various international organizations including ADB and ADB Institute (Tokyo), a visiting scholar at the South-East Asian Central Bank Centre (SEACEN) in Kuala Lumpur and the World Trade Organization in Geneva, and worked as research associate in Goldman Sachs, Hong Kong. She edited *Asia: Responding to Crisis* (1998) and *The Global Challenge in Services Trade: A Look at Philippine Competitiveness* (PIDS/GTZ 2006). She regularly contributes to the PIDS research working paper series, a number of which have been published as chapters of edited volumes. Her current research interest is in services trade liberalization and non-tariff measures as well as bankruptcy and insolvency procedures affecting financial services. E-mail: gpasadilla@mail.pids.gov.ph.

Mustafizur Rahman is Research Director at the Centre for Policy Dialogue (CPD), a leading civil society think-tank in Bangladesh. He also teaches at the University of Dhaka where he is a professor. He received his PhD from Moscow State University. He subsequently carried out research at Oxford University, United Kingdom, Yale University, United States and the University of Warwick, United Kingdom. He has published widely in professional journals, both in Bangladesh and abroad, and has authored a number of books. He has collaborated with various international organizations including ESCAP, UNCTAD, UNDP, the World Bank, ADB and the Commonwealth Secretariat. His current research interests include issues related to external sector competitiveness, regional cooperation and globalization. E-mail: mustafiz@cpd-bangladesh.org.

V ronique Robichaud completed a Bachelor s Degree (1992) and a Master s Degree in Economics (1994) at Laval University in Qu bec. Her graduate studies together with her ongoing research activities at the Centre interuniversitaire sur le risque, les politiques conomiques et l emploi (CIRP E) have contributed to the development of strong analytical capacities. Over the years, she has been involved in the development of analytical tools, such as computable general equilibrium models, for CIRP E, Finance Canada, the Department of Finance of Qu bec and other research centres. Given her strong academic background and her communication skills, she has been involved in many training sessions, and acts as a lecturer at the HEC. She has participated in numerous research projects related to regional and international agreements, aboriginal issues, international development and the environment. She has also been responsible for the economic impact assessment of several projects such as the construction and operation of a liquefied natural gas in Gros Cacouna, the expenditures of Laval University in the Quebec region, changes in the Inuit traditional diet, the construction of marine infrastructure in native villages and the feasibility studies for hydroelectric projects in Nunavik. E-mail: vrob@videotron.ca.

Alan Siu is an associate professor at the School of Economics and Finance and an associate dean of the Faculty of Business and Economics at the University of Hong Kong. He is the Deputy Director of the Hong Kong Institute and Business Strategy and the Executive Director of the Hong Kong Centre for Economic Research. He obtained his PhD from Harvard University in 1984. His research interests are the economics of research and development, productivity growth, technical change and statistical computation. E-mail: hrnekfs@econ1.hku.hk.

Yumiko Yamamoto is a Gender and Trade Programme Advisor at the Asia-Pacific Trade and Investment Initiative, UNDP Regional Centre. She is currently working in the areas of trade, gender and human development including human development impact assessment of the expiry of quotas in textiles and clothing, and Trade-Related Intellectual Property Rights and its impacts on women health. She is also a PhD candidate in economics. E-mail: yumiko.yamamoto@undp.org.

Abbreviations and Acronyms

AFAS	ASEAN Framework Agreement on Services
AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Area
AoA	Agreement on Agriculture
APEC	Asia-Pacific Economic Cooperation
APTA	Asia-Pacific Trade Agreement
APTIAD	Asia-Pacific Preferential Trade and Investment Agreements Database
ASEAN	Association of Southeast Asian Nations
BTAs	bilateral trade agreements
CBTA	cross-border transport of people and goods
CEFTA	Central European Free Trade Agreement
CGE	computable general equilibrium
C-NTBs	WTO-compatible barriers
CTE	Committee on Trade and the Environment
CU	customs union
DDA	Doha Development Agenda
DSU	Dispute Settlement Understanding
EMC	electromagnetic compatibility
EMI	electromagnetic interface
EV	equivalent variation
EVSL	early voluntary sectoral liberalization
FDI	foreign direct investment
FGT	Foster-Greer Thorbecke
FTAs	free trade areas
FY	financial year
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GMS	Greater Mekong Subregion
GPN	global production network
GSP	Generalized System of Preferences
GSTP	Global System of Trade Preferences among Developing Countries
ILD	international long-distance services
IMF	International Monetary Fund
IPRs	intellectual property rights
ITO	International Trade Organization

LDCs	least developed countries
MDG	Millennium Development Goal
MFN	Most Favoured Nation
MNCs	multinational companies
NAFTA	North American Free Trade Agreement
NAMA	non-agricultural market access
NC-NTBs	WTO non-compatible barriers
NGMA	Negotiating Group on Market Access
NGOs	non-governmental organizations
NGTF	Negotiating Group on Trade Facilitation
NTBs	non-tariff barriers
NTMs	non-tariff measures
OECD	Organisation for Economic Co-operation and Development
PAFTA	Pan-Asian Free Trade Area
PEP	poverty and economic policy
PTAs	preferential trade agreements
QRs	quantitative restrictions
RBI	regional bias index
RMG	ready made garments
RTAs	regional trade areas
SCM	subsidies and countervailing measures
SDT	special and differential treatment
SPS	sanitary and phytosanitary
TBT	technical barrier to trade
TDI	trade dependence index
TRAINS	Trade Analysis and Information System
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
VERs	voluntary export restraints
WITS	World Integrated Trade Solution
WTO	World Trade Organization

Part I

Multilateral governance of global trade and sustainable development: whither the WTO system?

Chapter I

WHAT CAN RESEARCHERS LEARN FROM THE SUSPENSION OF THE DOHA ROUND NEGOTIATIONS IN 2006?

By Simon J. Evenett

Introduction

Multilateral trade rounds have afforded scholars opportunities to learn more about the politics and economics of reciprocal trade liberalization. The Uruguay Round, for example, is of particular interest as it saw a broadening of corporate support within industrialized countries for multilateral trade reform (with the inclusion of binding disciplines on services and intellectual property rights drawing in support of financial, telecommunications and pharmaceutical companies for this Round) as well as agreement by developing countries to take on greater multilateral disciplines as part of the Single Undertaking. Understanding how and why both of these outcomes occurred has provided plenty of grist for the academic mill. Looking over the events of recent years, a similar question arises as to what can be learnt about the political economy of reciprocal trade reform from the Doha Round of multilateral trade negotiations.

This chapter focuses specifically on the events leading up to, and the aftermath of the formal suspension of the Doha Round in July 2006. As is well known, once it became clear in late July 2006 that trade ministers from Australia, Brazil, the European Union, India, Japan and the United States were unable to agree on a framework for agricultural trade reforms in the context of the Doha Round, WTO Director-General Mr. Pascal Lamy suspended negotiations and all associated work on the Doha Round.

A number of rationales were advanced for the suspension. For some it was hoped that a pause or “breathing space” might allow negotiators time to reassess their positions. For others, the suspension raised the prospect of outright failure that, it was thought, might jolt the most senior national policymakers (not necessarily trade ministers, who were probably well aware of the seriousness of the negotiating impasse, but their bosses – prime ministers and presidents) into action. Peering over the cliff might provide a rude shock to those complacent about the likelihood and consequences of outright failure, or so the argument went. Advocates of the latter position were soon to be disappointed and, by the fourth quarter of 2006, there was considerable unease among trade negotiators in Geneva. “Not talking is getting us nowhere”, was how one ambassador to WTO put it. Informal consultations restarted and the suspension was formally declared at an end in December 2006.

More generally, the fortunes of the Doha Round have oscillated since its formal launch in November 2001. (Arguably, this leaves aside the pre-launch dramas at Seattle in 1999.) The desire by nations to demonstrate an enhanced commitment to cross-border cooperation in the aftermath of the 11 September 2001 attacks on the United States is widely credited with providing the necessary impetus behind the launch of the Doha Round. Unfortunately, the goodwill did not last long and was certainly perceptibly elusive at the next Ministerial Conference, held at Cancun, Mexico, in September 2003. That conference, like many of its predecessors, collapsed without agreement. A course correction, in the form of the so-called July 2004 package, was subsequently agreed, which provided some structure and a plan for completing the Round. Since then, each major deadline has been missed, and attempts to finalize sufficient specifics for a deal on any of the major negotiating items (agriculture, industrial goods and services) has proved impossible.

One factor that has injected a sense of urgency into the negotiations is the imminent expiration of the United States President's Trade Promotion Authority, which enables the President to submit to Congress trade agreements that, by and large, must be voted up or down without amendment. It is thought by many knowledgeable observers that it would be impossible for the United States to seek congressional ratification of any multilateral trade agreement without this procedure (the fear being that individual elected representatives would seek amendments to the enacting legislation that might effectively call for the renegotiation of the agreement with trading partners.) Given that the current Trade Promotion Authority expires on 30 June 2007,[1] and the impending United States presidential election in 2008, many trade negotiators and officials appear to be currently operating on the assumption that any Doha Round agreement reached by mid-2007 could form the basis of a United States Government request to Congress to extend Trade Promotion Authority for six months. This would allow a formal ratification vote on the Doha Round agreement to take place well before the 2008 election cycle intensifies. (It is taken as a given that trade reforms are not a vote winner in the United States, a presumption reinforced in the mid-term congressional elections of 2006.)

Failure to complete the Doha Round by mid-2007 will have a number of consequences. First, given the United States' presidential election cycle and the time taken to assemble a new American administration, the Doha Round could not be completed before mid-2009 at the earliest. A completion date of 2010 or 2011 is more realistic, especially since Congress will probably have to approve an extension of Trade Promotion Authority for the new president. (The conditions that Congress may attach to such an extension could also complicate any completion of the Doha Round.) Second, it is unclear how this two-to-four year delay will be used. Will the absence of any deadlines reduce the pressure on

[1] During 2006, the approaching expiration of Trade Promotion Authority was a reason given by many senior trade negotiators for making progress before the Hong Kong Ministerial Conference in December of 2005. As 2006 progressed, the expected date of a "breakthrough" slipped further and further back. When no such breakthrough transpired at the Hong Kong Ministerial Conference, negotiators then began hoping for a deal before the end of March 2007. When that proved impossible, negotiators began discussing the need for a short extension of Trade Promotion Authority in 2007 in order to ratify an agreement they expect to complete in mid-2007.

negotiators to come to an agreement, or can negotiating scenarios and options be fruitfully explored in a less heightened atmosphere? Perhaps more importantly, will the priorities of WTO members change much in the next two to three years? If so, how? If not, will the impasse continue or will flexibility emerge? Indeed, one might ask what the tangible difference is between several years of drifting and declaring outright failure, especially as many senior political leaders will probably equate one with the other. Fortunately, the lot of a researcher is not to confront these difficult policymaking questions; even so, it is worth bearing them in mind as one considers what lessons can be learned from the suspension of the Doha Round. As is often the case, tomorrow's decisions and turn of events are often influenced by today's circumstances.

A few other preliminary comments are in order before proceeding further. First, it will be necessary to draw on the events from the launch of the Doha Round in November 2001 until the end of the suspension of the Round in December 2006. Second, specific focus will be on the factors leading to the suspension of the Doha Round in July 2006. In this regard, four non-mutually exclusive hypotheses are stated and examined. Third, it must be noted that opinions have inevitably differed sharply as to whom or what was responsible for the negotiating impasse in July 2006, just as there was considerable acrimony after the collapse of the Cancun Ministerial Conference in 2003.

Fourth, the four hypotheses advanced here have been presented by the author at conferences and workshops in East Asia, North America, and Europe and, for what it is worth, a number of participants (many of whom are much closer than the author to the trade negotiations) have argued that they contain several kernels of truth. Therefore, it is hoped that by probing a little deeper into each of these four hypotheses in this chapter, some of the assumptions made by scholars in thinking through the politics and economics of reciprocal trade liberalization will be called into question and that in rethinking them, our understanding of the associated matters might improve.

Section A of this chapter describes some of the distinctive features of the Doha Round, whose relevance will become clearer as the argument progresses. The four hypotheses concerning the suspension of the Doha Round are described in section B together with some of the implications raised by them. Section C probes some of the research questions raised by the four hypotheses and section D offers some concluding remarks.

A. Some distinctive features of the Doha Round

Although the introduction to this chapter contains some remarks on the sequence of negotiations in the Doha Round, this multilateral trade round has a number of other distinctive features that are likely to be of some relevance to discussions on the political economy of reciprocal trade reform. Having said that, it should be noted that the length of the Doha Round, the propensity to miss deadlines, and failed ministerial meetings are not unique to this multilateral trade round. It is other aspects of the Doha Round that are discussed below.

First, the prominence given to development matters in this multilateral trade round is distinctive. Previous rounds have sought "only" to liberalize trade barriers, enhance transparency and the like – all of which may, in fact, facilitate development. However, never before have development considerations been so centrally placed in a multilateral trade round. It may well be that the rationale for this move was to secure support from developing countries for launching the Doha Round in 2001. Whatever the rationale, the form of the development mandate, as it is so often described, has never been precisely defined. Does it refer to a set of principles, means or ends? Certainly, diplomats and others can point to documents that refer to development-related aspects of the Doha Round, but it is not clear whether these documents really summarize a consensus view as to what constitutes the development mandate. Arguably not. Indeed, one might argue that the development mandate has deliberately been kept sufficiently ambiguous to allow its beneficiaries (developing countries) to redefine it at will as well as to suit whatever matter is at hand. One important consequence of the adoption of this mandate is that it has called into question exactly whose interests are served, and how, by the Doha Round negotiations. One traditional direct beneficiary, export interests, may now wonder what their stake has become in a development-oriented WTO. (Indeed, some leading lobbyists have noted a reluctance of senior corporate executives to attend recent WTO Ministerial Conferences, apparently because of confusion created by the development label of the Round.)

On the other hand, more developing country governments, non-governmental organizations, and other institutions may feel they have a greater stake in a round with a development mandate, which could be healthy for the long-term reputation and functioning of WTO. In short, the articulated goals of the Doha Round are likely to influence those who have a stake in the negotiations as well as the intensity with which they pursue their interests, factors that any political economy analysis of reciprocal trade liberalization should take into account.

The second distinctive feature has been the demise of what might be termed the bipolar WTO and its replacement by a multipolar alternative. A recent paper (Evenett, 2007) describes the factors that led to the end of United States and European domination of the multilateral trading system and the determination of Brazil, China and India (admittedly, in different ways) to influence the evolution of WTO. The associated transition is by no means complete; even so, some elements of the new WTO landscape can be clearly discerned. The United States and the European Union may no longer be able to present proposals *fait accompli* to the rest of the WTO membership, but they are still large enough to veto proposals. The implications of a multipolar WTO for agenda setting, coalition formation, securing agreement and enforcement of accords have yet to be fully considered, and may come to occupy the time of many researchers in the years to come.

The third development in the Doha Round was the repudiation by many WTO members, principally the developing countries, of proposals for new multilateral rules or disciplines in a number of regulatory areas. Even though negotiations on further rules concerning trade facilitation were to begin later, it is worth bearing in mind that the African bloc of developing countries objected to launching negotiations on all four of the so-called Singapore issues. (The four matters being the relationship between trade and competition law and policy, investment policy disciplines, transparency in public procurement practices, and trade facilitation.)

A number of interesting questions were raised by this third development. However, in order not to drift too far from the theme of this chapter, the focus here is on only a few of them. Much turns on how to interpret this rejection to negotiate on Singapore issues. Was it a step taken to trim the negotiating agenda of items thought likely to divert developing country energies from pursuing their true interests? Or did the rejection reflect careful consideration of each of the four Singapore issues and the conclusion that none was appropriate for multilateral disciplines? From the perspective of the political economy support for trade reform, questions arose as to which interests might be served by multilateral initiatives in these areas and whether they could effectively organize themselves nationally and internationally. Although consumers, for example, may well benefit from certain multilateral disciplines on competition law, will they bear the costs of collective action? If they do not, who, if anyone, will do so? Moreover, is the political economy of implementing a rule or law – which can be a discrete, irreversible act – the same as liberalizing a trade barrier, which can take many values and be reduced in stages? The final point to be made in connection with the Singapore issues is that, having swept three of them off the negotiating table in 2004, they cannot be held responsible for the impasse that followed.[2] Instead, the impasse arose over what might be called the traditional liberalization function of WTO, particularly in this case as it refers to agricultural trade reform.

The sustained focus by many WTO members, both developing and industrialized, on agricultural trade reform (in all of its forms[3]) is the fourth distinctive feature of the Doha Round. Certainly, an Agreement on Agriculture was negotiated during the Uruguay Round, but this was regarded as a prelude to something more – the more being the next multilateral trade negotiation, the Doha Round. There are, without doubt, some (but not very many) WTO members for whom existing trade-distorting agricultural policies significantly harm their economies or their export interests, a fact that may account for the attention given by those WTO members to this matter. However, it must also be said that a balanced assessment must point out two countervailing factors.

The first factor is that some WTO members' consumers (particularly those in North Africa and the Middle East, it seems) benefit from the agricultural subsidies that depress the world prices of certain foodstuffs. Many studies have found that eliminating agricultural export subsidies would have a small net effect on the world economy, which in turn raises

---

[2] There are two quite different caveats here. For completeness sake, they are stated by the author without endorsement. The first is that one could argue that by serving as a distraction for almost eight years, the Singapore issues used up time and energy that could been used productively elsewhere. The second is that, without the Singapore issues, the European Union would have little to show for any concessions that it might make on agricultural trade reforms and other matters.

[3] Market access, export subsidies and domestic support payments.

the question of whether any measures to reduce agricultural export subsidies ought to be coupled with transfers to those harmed by this initiative.

The second factor is that the overall benefits of agricultural trade reform are typically found to be a fraction of those associated with liberalization of national service sectors. A better understanding of the factors responsible for the prominence given to agriculture, and the reluctance of many WTO members to seriously discuss service sector liberalization, would shed light on one important aspect of the trajectory followed during the Doha Round. If it is the case that the reluctance to liberalize service sectors, in the context of WTO, is the result of (a) prior adverse experiences with unilateral service sector reform, or (b) such reforms being a condition of IMF or World Bank “rescue” packages, then we might learn something about the spillovers from development policymaking to WTO.

More generally, whether it be with regard to the Singapore issues, agricultural trade reform or the service sector negotiations, more light could be shed on the influencing factors and the processes used by countries in determining national negotiating priorities.

The legacy of the Uruguay Round, both good and bad, provides the final distinctive feature of the Doha Round. On (at least what at first appears to be) the positive side, the Marrakech Agreement clarified and distinguished between the different functions of WTO. These functions include, among others, negotiation and dispute settlement. These two functions can, in principle, operate independently of one another.[4] This separation of functions does not appear to be lost on those WTO members who are not keen on further multilateral trade reform (at least on the terms offered by their trading partners.) To some, this may have raised the possibility that a failed Doha Round negotiation need not necessarily imply the end of WTO. Based on this logic, the prevailing WTO agreements and the Dispute Settlement Understanding would remain in place even if the Doha Round negotiations fail to reach a successful conclusion. As argued in section B, this factor may have influenced the calculations by key actors as to the cost of suspension and failure of the Doha Round.

The negative legacy of the Uruguay Round is the enduring perception among many developing country delegations that at Marrakech they agreed to a one-sided deal. Fears have been expressed that the cost of implementing certain Uruguay Round agreements cut too much into any gains for developing countries.[5] Moreover, some of the high-profile benefits of the Uruguay Round for developing countries, such as the liberalization of trade in textiles and clothing, were backloaded and did not occur until almost 10 years after WTO came into being. An imbalance between the timing of costs and benefits, then, is said to have occurred. The perceived inequity of the Uruguay Round is very much an empirical question, and 13 years after the signing of the Marrakech Agreement one would have thought plenty of data would be available for conducting serious ex post assessments of the Uruguay Round.

---

[4] Whether this is desirable, however, is another matter.

[5] This view is stated without the endorsement of the author who, like many other experts, remains sceptical of the evidence presented in support of this argument.

Whatever the merits of received wisdom, the perceived inequity appears to have coloured the negotiating strategies of many developing countries, particularly the least developed countries (LDCs) and the lower-income developing countries. For example, it is not surprising that some developing countries opposed the Singapore issues because of fears over their implementation costs, especially as certain international organizations – including the World Bank, the United Nations Conference on Trade and Development (UNCTAD) and the United Nations Development Programme (UNDP) – were fostering these fears at the time. More generally, some Geneva-based trade observers have argued that 90-100 WTO members, principally poorer developing countries, would be delighted to see the Doha Round fail. Accounting for this level of disenchantment with the multilateral trade reform ought to be a priority for research over the years to come, especially for an institution such as WTO, where each member has, in principle, a veto.

The purpose of this section has been to identify five distinctive features of the Doha Round of multilateral trade negotiations and some of the research questions that they raise. Raising them should not been viewed as a suggestion that no one else has thought about these matters; rather, the objective has been to identify areas where additional research would possibly be especially helpful. These five factors provide much of the context for the following account of the four potential hypotheses accounting for the suspension of the Doha Round in 2006.

B. Four working hypotheses on the suspension of the Doha Round

To fix ideas as to what research questions arise from the suspension of the Doha Round of multilateral trade negotiations, it may be useful to posit four working hypotheses. This will make it possible to take into account several different aspects of the political economy and the mechanics of multilateral trade reform, and, hopefully, will help the reader assess the pros and cons of each hypothesis. It should also be noted that these four hypotheses are not necessarily mutually exclusive and that a combination of them, plus other factors, may well best account for the suspension of the Doha Round in July 2006. The four working hypotheses, which are subsequently discussed, are:

(a) Perceived low costs of suspension – even of outright failure – of the Doha Round;

(b) Domestic political constraints in certain leading WTO members lead to incompatible levels of ambition in liberalizing agricultural trade;

(c) The organization and procedures used during the negotiations among the WTO membership were flawed;

(d) Negotiating miscalculations were responsible for the impasse.

Four somewhat related factors underlie the first hypothesis. The fact that there has been so much unilateral liberalization of trade barriers by developing countries and, to a lesser extent, of agricultural policies by certain industrialized countries (in particular, the European Union), plus the fact that more such liberalization is either planned or likely to occur, may well have led to the impression that national commercial interests will be well served in the years to come, even without a Doha Round deal. The wave of regional trade agreements signed in recent years also reinforces the impression that there is a trade liberalization alternative to WTO. Perhaps unsurprisingly, then, according the WTO statistics on national exports, every major player (with the exception of Japan and the United States) or group of players (such as LDCs) in the Doha Round has seen its exports grow by approximately 10 per cent or more per annum since 2000.

The final factor in support of the first hypothesis, which was mentioned in the previous section, is that WTO members appear to have differentiated between the liberalization function of WTO and the existing WTO agreements, and the Dispute Settlement Understanding, which, in principle, exists to encourage compliance with the latter. Taken together, these factors suggest that the prospects for export growth will continue to be good and that the threat to existing privileges of a Doha Round suspension or even failure is limited. Moreover, to the extent that concluding the Doha Round on relatively unambitious terms means export growth would accelerate by a mere 1 or 2 percentage points per annum, given the high levels of existing export growth one can imagine a jaded and mercantilistic trade minister asking whether the incremental payoff from concluding the Doha Round would be large enough. (Of course, the retort should be that the minister needs to negotiate a more ambitious deal.)

Whether the costs of outright failure of the Doha Round are as low as suspension is another matter.[6] Much presumably turns on the metrics employed and the timeframe. From a longer-term systemic perspective, it is difficult to see how an acknowledged failure to complete the Doha Round would be a plus for the reputation of WTO.[7] However, much depends on the alternative. If it is a never-ending acrimonious negotiation that saps the will of all concerned, thus perpetuating and adding to a negative impression of the world trading system, then calls to halt the Doha Round negotiations might not look so unappealing. In these circumstances, damage limitation may become the primary consideration rather than potential for liberalizing progress. The prospect of continuing buoyant export growth may also cushion the downside of any decision to abandon the Doha Round negotiations.

The second hypothesis relates, superficially at least, to the subject over which the impasse was reached in July 2006, namely, agriculture. No overlap was found in the acceptable levels of ambition for liberalizing the various policies that support and protect farmers. The European Union trade negotiators clung tenaciously to the 10-year programme

---

6 Indeed, whether the costs of suspension have been accurately assessed is another matter which is considered further in section C of this chapter.

7 However, the argument exists that by acknowledging failure, the decks can be cleared, so to speak, and any future multilateral negotiation may be less encumbered with the baggage of the Doha Round. Whether every WTO member will see the matter that way, should these events come to pass, is probably doubtful. Will every WTO member resist the temptation to claim that they have unaddressed grievances from the Doha Round and that certain “promises” made to them were broken etc.?

of reforms that its member States agreed to in 2003 and refused to cut, among other policies, its agricultural tariffs at a faster pace. Demands that the United States cut its financial support to farmers were rebuffed unless greater market access improvements in agriculture were offered by the trading partners of the United States. In fact, the United States proposed a very ambitious liberalization package for agriculture precisely to balance what it perceived as its losses on domestic support with gains on foreign market access.[8] India and China both argued that they had little or no room to cut farm tariffs, lest they jeopardize the wellbeing of their rural populations, which are numbered in the hundreds of millions. The preconditions for a standoff were in place, with the United States eventually being isolated as the party making the least mainstream demands.

The mismatch in ambition begs the following question: why was domestic opposition to further agricultural concessions hard to overcome? Was it because political leaders saw few competing domestic interests clamouring for trade reforms to economies abroad and, therefore, in political terms saw little to offset the "pain" of agricultural trade reform? This, of course, pushes the question back further. What accounts for the limited support for further foreign market opening? Here the answer could be a combination of factors, including some of those mentioned above (such as already buoyant levels of export growth as well as plenty of ongoing unilateral and regional trade reforms.) Other contributing factors might be that:

(a) The quality of offers to liberalize national service sectors was generally poor;

(b) The terms upon which trade in goods was to be liberalized remained unclear, especially as it related to the exemption to be allowed; and

(c) Corporate interests may well have factored in any planned liberalization by trading partners and may not see any Doha Round reforms going beyond the planned liberalization.

With regard to factor (c), there appears to be a marked reluctance by trading partners to "pay" for agricultural reforms that jurisdictions, such as the European Union, are undertaking. These trading partners may have decided to wait for better commercial opportunities in agriculture to unfold as reforms abroad are implemented. This discussion will return later to the complications created by unilateral liberalization when negotiating reciprocal cuts in bound tariffs and other policy instruments. Implicit in the argument above, of course, is that actual, and not bound, market access improvements are what appear to galvanize export interests.

The third hypothesis refers to the terms upon which the recent negotiations were conducted among the WTO membership. As is well known, the conundrum faced is as

---

[8] The United States sought to balance its losses in agriculture within the same sector – and not across sectors. It may be recalled that it is precisely the willingness of nations to make intersectoral trade-offs that many argue is one of the advantages of reciprocal trade liberalization. The fact that the United States' agricultural interests consistently insisted on intrasectoral benefits for any losses is somewhat revealing.

follows. Each WTO member has, in principle, a veto over the outcome of any negotiation – but with 150 members and at least three substantive areas of negotiation to consider (goods, agricultural and service sector matters) it is impossible for everyone to negotiate all three matters together. Inevitably, some classification or segmentation of WTO membership into groups (even groups of one) occurs. Moreover, some WTO members may take the lead in negotiating the parameters of an agreement that could then be presented to the other members. This raises concerns about inclusivism and suspicions that subsets of the WTO membership will make deals among each other at the expense of other members. Given the negative view that some have of the Uruguay Round agreement, these concerns are not to be underestimated.

In the run-up to the July 2006 suspension, the following formulation was adopted to advance the negotiations: six significant WTO members (Australia, Brazil, the European Union, India, Japan and the United States), each represented by their trade ministers or equivalent, attempted to negotiate the parameters of the overall package of agricultural, non-agricultural and service sector reforms. Typically, each of the three main topics for negotiation were taken in turn, but it was understood that "nothing was decided until everything was decided" (a consequence of adhering to the Single Undertaking). WTO Director-General Mr. Lamy floated the so-called 20-20-20 proposal in the first half of 2006 as a possible set of parameters around which a final Doha Round agreement might coalesce. This involved a cap of US$ 20 billion on direct agricultural subsidies by the United States, acceptance of the G20 proposal for cutting agricultural tariffs (which envisaged approximately a 54 per cent cut in tariffs on imported agricultural products), and a maximum ad valorem tariff of 20 per cent on imports of goods by developing countries.

As we now know, this scheme for organizing the negotiations did not bear fruit and, of course, the question is why? Perhaps even with only six parties, as opposed to the two parties that essentially negotiated the central elements of the Uruguay Round, it was feared that each concession was likely to be "pocketed" and, therefore, not reciprocated by the other five members of this inner group. There may also have been idiosyncratic factors that slowed this process down, such as the appointment of a new United States Trade Representative in early 2006. (Realistically, new United States Trade Representatives cannot be seen at home to be making concessions during their first meeting with foreign counterparts.) Even so, once it became clear that not enough movement was forthcoming, negotiating positions hardened.

The extent to which the negotiating procedure was really at fault can be questioned, especially if one believes the second hypothesis outlined above and that, on agricultural matters, some leading WTO members had little room to make further concessions. Even so, questions still arise as to whether the 20-20-20 package was the right formulation, whether that process and package took sufficient account of the concerns of other WTO members (especially the poorer and smaller developing countries), and whether more progress could have been made at the level of ambassadors in Geneva before the matters were taken up by trade ministers? It is not being suggested here that there are straightforward answers to these questions; the intention is merely to highlight the fact that there were alternatives to what some have dubbed the “Masters of the Universe” model of multilateral trade negotiations.

The fourth hypothesis points to the role of negotiating miscalculations, if not necessarily as a reason for the ultimate impasse but at least as an explanation as to why precious time was lost. Throughout the Doha Round, much has been made of the need to keep pressure on the United States and the European Union to make more concessions, in particular on agricultural policies, as if it were just a matter of persistence before the supporters of those policies in the West would throw in the towel. This is not a matter of whether the European Union or the United States should make more concessions (in fact, they should). It is whether influential domestic interests in these jurisdictions will let their trade negotiators move and whether enough pressure could sway the influence of those interests. Presumably, senior trade negotiators have to judge how far their foreign counterparts can feasibly go, given domestic political constraints, and what, if anything, foreign offers of market access and the like can do to bolster opponents to import-competing sectors in trading partners. Elsewhere (Evenett, 2006), the author argued, on the basis of specialized press reports at the time, that in 2005 some of the European Union’s trading partners underestimated the strength of the opposition among European Union member States to further agricultural concessions. That opposition was led by France and included a majority of the then 25 European Union member States.

Likewise, the level of support in the United States Congress for the current set of United States farm subsidies is very high, reflecting their popularity among United States farmers and ranchers. This is despite a concerted effort by the United States Administration to persuade the country’s farmers and elected officials that the current farm subsidies are financially unsustainable and likely to be challenged as WTO-illegal. In the light of these considerations, one has to wonder if the European Union and United States trading partners applied the right level and right form of pressure. Perhaps less emphasis on moral suasion and more on signals to move further on goods and service sector reforms might have galvanized wider export interests in these industrialized countries. One way or the other, individually and collectively, the negotiating offers did not trigger enough support to overcome entrenched supporters of the status quo.

Another factor that may have reduced the incentive to accurately assess each trading partner’s so-called bottom lines for these negotiations is the view, voiced by a number of supporters of WTO, that somehow “everything will be all right on the night” and that enough WTO members care about “saving the system”. These are two different views, the first appealing to luck perhaps, and the second to basic instincts to support multilateral rules. Both views, however, may well have accentuated the negotiating miscalculations associated with the fourth hypothesis, and overlooked the hard-nosed calculations associated with the first and second hypotheses described above.

The four hypotheses described in this section could, individually or combined, partly account for the suspension of the Doha Round of multilateral trade negotiations. The objective of section C is to describe a number of research questions raised by these four hypotheses and the suspension itself.

C. Research questions arising from suspension of the Doha Round in 2006

One approach to assessing the suspension of the Doha Round is to ask whether it raises any fundamental questions about our current understanding of the politics and economics of trade policy formation and reciprocal trade liberalization. Implicitly or explicitly, most economic analyses of trade policy formation have self-interested political leaders aggregate (in some fashion) the preferences of various organized and unorganized groups of society, typically with the former getting a larger weight than the latter.[9] The willingness of those groups to lobby their governments depends on a number of factors, including the perceived gains or losses from various choices, the lobbying efforts of others and the costs of collective action. The beauty of this approach to studying trade policy formation is that it neatly identifies and clarifies some of the trade-offs facing self-interested politicians. What is interesting here is how applicable this conception of trade policy formation is when applied to the specific circumstances of reciprocal trade liberalization in the context of WTO. The fact that this conception may not be entirely accurate does not imply that it should be rejected out of hand, but rather that refinements and reformulations may be in order.

The first hypothesis described in the previous section essentially argues that the perceived cost of the Doha Round suspension is low. This raises questions as to how self-interested politicians assess the costs to their national interests of a suspension of the Round and whether that assessment is accurate. Have all of the relevant costs been identified, especially if there is the belief that the end of negotiations will be followed by more dispute settlement cases and by more trade remedy actions (such as antidumping, countervailing duties and safeguard measures)? By what process are these costs identified and assessed? To what extent are these costs discounted by the fact that they might not, in fact, happen? Here, both empirical and qualitative research might shed light on the restraining effect, if any, that ongoing multilateral trade talks have on international trade disputes as well as identify errors in decision-making that do not consider the absence of this restraint. Of course, the explanation for the perceived costs being seen as so low is that the political costs are likely to be faced by the successor to a current trade minister. Even so, it would be useful to test this simple hypothesis against more sophisticated alternatives, taking into account any international differences in the tenures of trade ministers or other relevant senior decision-makers.[10]

Perhaps far more under-appreciated is the possible impact that sustained unilateral and preferential trade liberalization might have had on the costs of suspension or failure of the multilateral trade negotiations. During the past 20 years, many developing countries (and some industrialized countries) have liberalized their trade regimes significantly, resulting

---

9 An example of this approach is the much studied paper by G. Grossman and E. Helpman, 1994.

10 To the extent that average tenure of a minister is an endogenous variable, the slow-changing or never-changing institutional features that partially determine tenure may be more useful in identifying variables.

in a growing gap between the measures bound in the relevant WTO agreements and the measures applied. It is argued here that this growing gap might have implications for the political economy of reciprocal trade liberalization at WTO and which require more thought and attention.

The bound level of a trade measure is, of course, the currency of WTO trade negotiations; this is because such bindings are thought to provide certainty concerning the nature of the (most adverse) treatment of a foreign product, service or supplier. Reductions in bound rates, therefore, are said to have value to foreign firms in so far as they reduce uncertainty about their potential treatment. When bound tariffs equal or just exceed applied tariff rates, a multilateral trade agreement to cut bound tariff rates is almost certain to also require cuts in applied tariff rates; the latter reduces the cost of supplying a given market, thereby creating commercial opportunities for foreign firms. It is precisely the quest for those commercial opportunities that encourages foreign trade partners to offer reciprocal concessions of their own. The question posed here is whether private parties do, in fact, view the benefits of cutting bound tariff rates in the manner described above.

First, the value of a bound tariff rate depends in large part on the probability that foreign private parties place on the liberalizing government reversing its reforms. Much, of course, depends on the political economy of the liberalization programme in the reforming country. If this probability is thought by foreign firms to be low, then the value of lowering a binding on tariffs that does not result in cuts in applied rates is likely to be low as well. This implies that, as time passes and the gap between bound and applied rates grows because of unilateral trade reforms, only larger and larger cuts in bound rates (necessary to cut the applied rates in foreign markets) will be enough to encourage exporters to actively support their government’s negotiating position at WTO.

Following this argument, the degree of exporter support for multilateral trade reform is a function of the prior extent of unilateral trade reform abroad; where the latter has been extensive, a minimum level of bound tariff rate reduction may be necessary to garner any active corporate support at all. These are (hopefully intelligent) conjectures and it would be useful to understand better the factors that determine the value, if any, that firms attach to tariff bindings.

One reason why WTO members may be unwilling to “pay” for the unilateral reforms or each other’s agricultural policies is the presumption that it is irreversible budgetary pressures that are driving reforms and, therefore, backsliding is very unlikely. Whether or not this argument is true depends very much on the context and countries being considered; yet, it does suggest that bindings may have less of a role in certain situations – in which case, the balance of concessions and even the content[11] of a multilateral deal will have to reflect this.

A third reason why bindings might be less important than is typically thought is because there are number of WTO-legal measures for effectively circumventing them

[11] That is, the desirability of including agricultural trade reforms at all.

(and thereby imposing higher tariffs on imports). Exporters know this, and thus discount promises to cut bindings accordingly. For example, anti-dumping measures can be applied on top of most favoured nation (MFN) tariffs. As far as the calculus facing the exporter is concerned, much would depend on the difference in the magnitude of the MFN tariff and the expected antidumping tariffs[12] and the likelihood of the latter being imposed. To the extent that the enforcement of unfair trade laws is expected to become more rigorous after a multilateral trade deal is concluded (for some this is the quid pro quo for MFN tariff reduction in the first place), this will erode the net benefits to exporters with consequences for the overall level of support for the associated multilateral trade agreement. It would be useful to learn more about the potential dampening effect of the widespread use of trade remedy laws on corporate support for the reciprocal liberalization of trade in goods.

Examining the true value of cutting bindings, especially to exporters of manufactured goods, may go some way to understanding what many perceive to be a low level of business support for the current trade round. Other factors could also be relevant, including any confusion created by the adoption of the development mandate. Moreover, the greater propensity of service sector firms to engage in high-profile lobbying during the Doha Round is worth exploring; however, the explanation here may well be that opposition to reforming their service sectors is so intense in many WTO members that an additional lobbying effort was thought necessary.

Implicit in the second hypothesis is a statement about how national political systems aggregate across different corporate interests and the apparently substantial influence of defensive agricultural interests on national trade negotiating strategies. The explanation for this may be, as argued above, that many non-agricultural corporate interests see little benefit in the Doha Round's completion, at least on the terms being offered at present, and they do not lobby in the first place.

However, there are perhaps alternative explanations. For example, do agricultural interests have a far more effective lobby because they focus on a smaller number of policy matters before politicians, and so can concentrate their lobbying efforts? Alternatively, is there something about the nature of the policy instruments being negotiated in agriculture that generates more intense lobbying pressure? For example, does the expected gain in overseas market access, necessary to compensate a farmer for a certain reduction in domestic support payments, have to be so much larger precisely because the former is speculative and the latter loss is certain? Finally, the allocation of seats in certain legislatures on a geographical, rather than a population basis may well reinforce the strength of the agricultural lobby (and, in fact, is said to do so precisely for this reason in the United States Senate.) These matters, and no doubt others, need further consideration if we are to understand better:

---

[12] Given that average MFN tariff rates in many industrialized countries are a fifth or even a tenth of the height of the anti-dumping duties imposed, it therefore does not take a large increase in the probability of anti-dumping duties being imposed to overturn the benefit of any MFN tariff reduction.

(a) The political economy of agricultural trade liberalization;

(b) The extent to which agricultural trade liberalization should be thought of in the same way as the liberalization of trade in goods; and, perhaps most importantly of all;

(c) Whether serious agricultural trade reform is possible within the context of multilateral trade agreements.[13]

The third hypothesis mentioned in the previous section, i.e., that the procedures and organization of the Doha Round negotiations were flawed, raises important questions about the nature of multilateral trade agreements and the mechanisms used to secure accords. At present, the challenge is to secure the agreement of all 150 WTO members, each of whom has a veto, on a Single Undertaking covering a diverse range of topics recognizing that, practically speaking, progress is likely to be made (at least, initially) among smaller groups of WTO members. The latter point implies the existence of a second stage to what might be termed the negotiating game, in which the whole WTO membership accepts, rejects or modifies any proposals negotiated in the first stage. Undoubtedly, those involved in the smaller group – or first stage – negotiations will take this second stage into account, a fact that may also have adverse implications.

Given that concessions are associated with political "pain", once a concession is offered it signals a willingness to accept a higher level of pain to secure an agreement. Even if a concession is subsequently withdrawn, the willingness and ability to go further is not forgotten. Perhaps as a result of this, but more generally because of the multi-step nature of the negotiation, WTO members will be reluctant to move first, as any overtures that they make may be rejected. However, the information revealed by the overture remains. These preliminary lines of argument suggest that, if WTO is effectively stuck with using multi-step negotiations, then we need to better understand the incentives created by the multiple steps. Here, game theory approaches to bargaining and the findings of studies of similar decision-making challenges in organizations with large memberships might be of use.

Alternatives to the current negotiating modalities could be considered further, which opens both narrow- and wide-ranging possibilities. Among the latter, the pros and cons of the Single Undertaking comprise a venerable research topic that still requires further attention. On what basis could different groups of WTO members proceed at different speeds without creating further discrimination within the multilateral trade system? In addition, to what extent does the answer to that question depend on the trade regulations being considered? Perhaps, more narrowly, we might ask whether there was an alternative to the "top down" negotiation of the framework of an agreement in 2006, which could have been pursued? Given the desire of many WTO members to secure exceptions from any framework agreement, to what extent can the parameters of such an accord be agreed

[13] Perhaps the question could be put pointedly, thus: What is likely to lead to more agricultural reform – recurring domestic budgetary pressures or multilateral trade negotiations?

upon without knowing the specifics of which exemptions are to be allowed?[14] Must uncertainty over the average level of cuts in tariffs (say) be resolved at the same time as the exceptions negotiated, or is a sequential approach possible? The pros and cons of the different alternatives to organizing negotiations and the incentives that they create for countries to liberalize their economies arguably need further thought. Certainly, this is an area where the professors need to catch up with the steps taken by the practitioners.

Implied in the fourth hypothesis is the following question: how do trade ministers and ambassadors learn about the real underlying determinants of their trading partners' negotiating positions and the changes in them? A related question, borne more out of the author's own suspicions than anything else, is whether there has been an over-reliance on face-to-face impressions gained between trade ministers, with insufficient attention being paid to the reports from officers or diplomats working in embassies and missions to foreign trading partners.

For example, it would be interesting to understand why so many WTO members felt the European Union was able to give more concessions on agriculture in 2005, when a French-led coalition of the majority of European Union member States was firmly in place and which was publicly and repeatedly resisting attempts by the European Commission to offer more to trading partners. Interestingly, sometime towards the end of 2005 or during 2006, this point appears to have been absorbed by Europe's trading partners; according to press reports, those trading partners had, by early 2007, apparently taken account of this coalition and had begun working with more reform-oriented European Union member States to persuade Germany to break with France on this matter (the ultimate goal being to isolate France and some other hold outs.) Whether this strategy was particularly well-timed in the run-up to the French presidential election is another matter (a point that was unlikely to have been missed by the German Government), and may well account for little apparently coming of this particular initiative. The thinking, strategy and tactics employed, plus what they reveal about each major player's understanding of other nations' trade policy formation processes, are worthy of much more attention (although these matters may well appeal more to political scientists and international relations specialists than to economists).

This section describes a number of research questions and problems that have arisen from the suspension of the Doha Round negotiations in July 2006. The sole purpose has been to emphasize that, in the light of relatively recent events, these questions and problems merit further attention, and not to suggest that no one has ever worked on these matters. Indeed, by answering these questions, we might gain a fuller picture of the political, economic and diplomatic determinants of WTO-led reciprocal trade liberalization.

---

[14] In this regard, it is telling that during 2007, trade negotiators in Geneva began a "bottom up" assessment of each negotiating topic in order to establish the possible implications of the exemptions being sought. Surely, however, the number and nature of the exemptions sought will depend on the overall depth of liberalization, which are precisely the parameters that the "top down" approach, pursued in 2006, sought to establish.

D. Conclusion

At present, the most optimistic predictions concerning the conclusion of the Doha Round point to the adoption of a modest package of trade reforms that will, to a large degree, consolidate prior trade reforms in a number of significant WTO members. It seems unlikely, then, that any Doha Round accord will be seen as a watershed agreement, as were the Uruguay Round accords. The question posed in this chapter concerns what we can learn from this latest attempt at multilateral trade liberalization and, in particular, in what ways will our understanding of the process of reciprocal trade liberalization need to be revised. The goal of this chapter is to sketch out what political, economic and diplomatic factors may need additional thought by researchers.

In summary, this chapter argues that the following matters needed further consideration. Perhaps the most important question from the perspective of policy relevance is why do policymakers apparently perceive the cost of a suspended and possibly failed Doha Round to be so low? Questions have been raised with regard to how much value corporate interests actually place on bindings of tariffs etc., especially in an era when unilateral trade reforms have reduced applied tariff rates well below bound rates in many WTO member States. What factors account for the weight given to agricultural interests in the current trade round? What incentives are created by different negotiating procedures and which, if any, procedures are less susceptible to deadlock?

Finally, in what ways and how effectively do the national trade policymakers learn about the factors underlying the negotiating positions of their trading partners? Each of these questions has a normative as well as a positive component and, in principle, could have implications for policymaking as well as for the design of institutions and initiatives supportive of reciprocal trade liberalization.

References

Evenett, S.J., 2006. "The WTO Ministerial Meeting in Hong Kong: What Next?" *Journal of World Trade*, vol. 40, No. 2, pp. 221-238.

______, 2007. "EU commercial policy in a multipolar trading system", forthcoming in *Intereconomics*. (Revised April 2007; mimeograph.).

Grossman G. and E. Helpman, 1994. "Protection for sale", *American Economic Review,* vol. 84, No. 4, pp. 833-850.

Comments

ON MULTILATERAL GOVERNANCE AND SUSTAINABLE DEVELOPMENT

By Donald J. Lewis

The Director-General of the World Trade Organization, Mr. Pascal Lamy, recently intimated that there had been no collapse in the Doha negotiations. Instead, he characterized the current state of play, or rather non-play, as a suspension or timeout. From the viewpoint of Mr. Lamy, the Doha negotiations are deadlocked not because of structural or functional issues, but because of the inability of the main players (e.g., the United States, European Union, Brazil and India) to unblock a deal on agricultural subsidies and agricultural tariffs.

Consequently, the "Lamy Cathedral" is still under construction. The cathedral consists of the "Single Undertaking", comprising a package of some 20 negotiation areas. The cathedral has three central pillars: (a) agricultural subsidies; (b) agricultural tariffs; and (c) industrial tariffs. Unfortunately, in July 2006, the cathedral builders could not put in place pillars (a) and (b); as a result, the rest of the building, which apparently is ready, cannot be installed. The cathedral, apart from agriculture, includes the key negotiating areas of non-agricultural market access, services, rules (anti-dumping, subsidies, including fisheries subsidies), trade facilitation and the trade and development negotiations.

When and how can the cathedral be completed? In other words, when will the Doha Round be (successfully) concluded? What will be the outcomes of the Round? At this stage, all seems conjecture. Can a "Single Undertaking" realistically be achieved? On the other hand, is WTO reverting to its pre-Uruguay GATT antecedents, with the looming prospect of a fractured plurilateral global trading system in the post-Doha era – a plurilateral system made even more complicated, inefficient and costly by the proliferation of the "noodle bowl" of PTAs.

Putting aside such momentous questions, at least for the time being, I would like to provide a few comments on some potentially useful research avenues for the developing countries of Asia and the Pacific in the post-Doha era.

First, we should conduct a stocktaking exercise. In the Asia-Pacific region, several ARTNeT studies and projects have been undertaken since the inception of ARTNeT in April 2004. Those studies concerned a range of trade themes that typically included both a WTO and regional or national regulatory aspect. Study areas have tended, understandably, to deal with current WTO-related issues, such as trade facilitation, services liberalization and trade preferences. What then is the "way forward" from a post-Doha perspective?

Indications of present and future WTO research directions may be gleaned from a number of sources: WTO's own research programme, headed by Mr. Patrick Low, the proceedings of the current WTO negotiating groups and committees as well as the work of the Task Force on Aid for Trade and that of the Integrated Framework for LDCs. Other indications can be surmised by looking at developments here in this region, particularly the present and future work programmes of the Asia-Pacific Economic Cooperation (APEC) group and the Association of Southeast Asian Nations (ASEAN). My current interactions with trade and other officials of the governments of Indochina (all of whom are ASEAN members) make clear certain priorities, at least in terms of their own national economic development strategies.

A. Agriculture

There is a strong pre-occupation with increasing market access for key agricultural products, both among the developing and the LDC economies in the region. At the same time, technical understanding of the WTO Agreement on Agriculture (AoA) and the various coloured boxes is quite limited. This would suggest that a major focus of research going forward should be on WTO agricultural issues, the current (and future) negotiations, and how to increase effective market access to a range of markets for key agricultural exports of the developing countries. Linked to this is the whole area of special and differential treatment (SDT) generally, and trade preferences (e.g., GSP systems and "Everything but Arms") and preferential trading arrangements, more specifically. Impaired market access for primary and processed agricultural products of developing countries of the region, on account of SPS and TBT barriers in developed country markets (particularly the European Communities), could additionally feature as an independent, but related, study.

B. Supply-side constraints

The concerns of many developing countries, particularly LDCs, in the Asia-Pacific region currently do not appear to concentrate on direct trade measures – rather, their immediate concerns are more about "behind the borders" supply-side constraints. To some extent, this is recognized both by the Aid for Trade Task Force and the Integrated Framework for LDCs. Therefore, future studies could be directed, and in fact already have been to some extent by ARTNeT, at how such constraints may be alleviated or overcome. They could, with regard to agriculture, include issues related to the organization of domestic production and post-harvest processing, marketing and distribution as well as the development of external marketing networks. Trade preferences mean very little if such constraints are not addressed.

C. Trade and investment

A concomitant here is the expressed desire to attract greater foreign direct investment to the developing economies of the Asia-Pacific region, not just in industrial manufacturing, but also in agriculture and related food industries. Such evident interest could provide an impetus for reopening multilateral negotiations on that neglected Singapore issue of "trade and investment". In any case, this is an area that should probably form an important element of post-Doha research. Here I have in mind the formulation of a more "development-friendly" approach to trade and investment, involving perhaps:

(a) A targeted set of investment incentives for developing countries;

(b) A possible further relaxation or revisiting of export subsidization rules under the Subsidies and Countervailing Measures (SCM) Agreement; and

(c) A more widely disseminated recognition and tolerance for infant industry protection for developing countries pursuant to Article XVIII, GATT.

Moreover, PTA experiences with trade and investment issues should be considered in any such future ARTNeT studies, with a view to reaching a broader, ultimately multilateral consensus on what a "development-friendly" trade and investment package would include. Trade, finance and development intersections should also be explored more deeply.

D. National competitiveness

It should be noted that Australia will assume the chairmanship of APEC in 2007 and is likely to steer APEC along a similar "behind the borders" path to sustainable economic growth and development. What this will entail is a focus on issues of "national competitiveness"; in other words, on the elements and strategies that are the key to raising economic productivity. Following the approach of the Harvard Institute for Strategy and Competition, the future APEC work programme could conceivably concentrate on: (a) competition and economic development; (b) competition and firm strategy; and (c) competition and society.

E. Sustainable development/competition policy

Competition and society, in particular, could be a valuable field for future ARTNeT and post-Doha research as it brings into play a range of sustainable development issues, most notably environmental quality and protection. Such research might link up with the current work programme of the WTO Committee on Trade and the Environment (CTE). From a purely trade angle, the CTE work programme includes, inter alia, environmentally-related standards, TBT and labelling issues – some of which may constitute NTMs – and could be factored into future ARTNeT studies in this field.

At the same time, competition and society typically address issues of competition law and policy, which could be a means of reviving general interest in competition policy – another of the neglected Singapore issues. This renewed interest in competition policy, situated within the larger context of national competitiveness, should at the same time yield up valuable interdisciplinary law and economics studies.

F. Interdisciplinary studies/WTO-related law research

The foregoing observations lead me to my last set of research comments. If one considers the ARTNeT studies to date, it is evident that almost all ARTNeT WTO-related research to date has been the exclusive province of economists. There is a need to broaden the scope of participation in ARTNeT research to include others, including trade lawyers, political scientists and government officials. In other words, what I am recommending is, first, a commitment to interdisciplinary law and economics studies. I am also advocating specific ARTNeT trade law/regulatory studies. There is an extreme dearth of understanding in the Asia-Pacific region of the WTO legal texts – the WTO “Bible” as Gabrielle Marceau puts it.

Having said that, a regional WTO law association already exists that could be included in future ARTNeT consultative meetings and studies. The need for a greater understanding of WTO law and trade regulation generally extends not only to the “covered agreements”, but also to an appreciation of rapidly expanding WTO jurisprudence that provides in-depth interpretation of the WTO agreements. Such proposed ARTNeT legal studies would also provide a fulcrum for the drafting of WTO-consistent national legislation by developing countries. Importantly, ARTNeT legal studies would be a springboard for developing countries to acquire needed expertise to participate meaningfully and effectively in WTO dispute settlement proceedings.

As Joseph Stiglitz has rightly observed, WTO dispute settlement is an objective, adjudicatory process that levels the playing field and makes it possible for developing and perhaps even small and vulnerable economies to prevail over developed countries on major trade policy issues. This was witnessed recently in the victories of Brazil over the United States and the European Communities in the cotton and sugar cases, respectively. At the same time, we may appreciate that WTO adjudication is likely to be of increasing relative importance within the WTO system as the potential for further significant most favoured nation (MFN) trade liberalization diminishes.

Finally, I would note that WTO dispute settlement procedures, namely the Dispute Settlement Understanding, can play a very instructive role as a model for regional PTA dispute settlements, such as in the case of the emerging ASEAN Dispute Settlement Mechanism.

A NOTE ON THE FUTURE OF MULTILATERAL GOVERNANCE OF GLOBAL TRADE

By Florian A. Alburo

In a September 2006 Project Syndicate article, entitled *Time to Get Back to Business*, Mr. Rodrigo de Rato and Mr. Paul Wolfowitz, the heads of IMF and the World Bank, respectively, argued that the suspension of the Doha Round was bad for the world. Citing now all-too-familiar reasons, they laid out what would need to be done to put the Round on track again and get back to business. The missing byline to the piece was WTO Director-General Mr. Pascal Lamy.

Although stoking the dangers of repeating the protectionism and competitive devaluations of the 1930s, they pointed out that the more serious threat to multilateralism was the shift towards regional trade agreements (RTAs) and bilateral trade agreements (BTAs). Since the multilateral trading system had a similar challenge before during the Uruguay Round, Mr. de Rato and Mr. Wolfowitz believed it was still possible to achieve a conclusion of the Doha Round.

Two observations are in order here. First, while it is true that the Uruguay Round did face a serious threat then, it was more of another "multilateral-like" alternative. A common story often heard is that the APEC process was foisted (during the Leaders' Meeting, Blake Island, Washington) in the case of the Uruguay Round failure (being "open regionalism"), which drove the negotiators to cut a deal. There were no new regional initiatives then other than the North American Free Trade Agreement (NAFTA). The other observation is the current proliferation of bilateral trade arrangements and regional groupings that countries see as equal alternatives to a multilateral trading system. In the Asia-Pacific region, in 2007 the average number of agreements per country was 5.6 (APTIAD); while many have not been notified to WTO, thus violating the provisions of GATT Article XXIV, they have remained in existence for some time.

The call by Mr. de Rato and Mr. Wolfowitz appears to have been ignored. Contextually, IMF and the World Bank do not really have direct constituencies. Their stakeholder is the world, which is good for rhetoric and platitudes but not for actual country positions. The same can be said of WTO itself, even if trading countries constitute its members. The real action and deliberations on whether nations redouble efforts to break the Doha Round impasse is within the regions themselves. This means the United Nations regional commissions (Africa, Asia, Western Asia, Europe, Latin America and the Caribbean) and regional development banks (Africa, Asia and Inter-American) as one group. The other group is the bilateral donor agencies and organizations that provide official development assistance to developing countries, including even non-governmental organizations (NGOs) and civil society groups. The United Nations regional commissions, development banks and bilateral agencies deal with individual countries in the field, and they are often consulted on questions of policy, development agenda and government positions. The question is what messages are below the global context?

On the other hand, numerous sound bites have been heard on restarting the talks after some progress was achieved from the July 2004 “renewal” and, of course, the reaffirmation to conclude talks from the Hong Kong Ministerial Meeting – only to be stalled once again. If only to show that the (trade) dominant WTO members still swear by a global multilateral system, the Round has again been given a new boost by virtue of their collective resolve to work towards some agreement on all fronts and meet the lofty goals of the Doha Round. In the same vein, new bilateral agreements have been concluded, newer ones negotiated and regional arrangements lined up.

There seems to be some ambivalence in the regions about the importance of multilateral governance of trade, the issues raised by Mr. de Rato and Mr. Wolfowitz and a fuller appreciation of completing new disciplines in the multilateral trading system. This is contributed in part by the behaviour of regional and bilateral institutions. All of them have voiced concern about the suspension of the Doha Round, advocated a multilateral trade system and echoed the need to go back to the negotiating table, but what actually has happened appears to have given mixed signals to the countries.

For example, while announcing the need for multilateral trade, some development banks and bilateral agencies have gone ahead and supported countries in designing FTAs. AusAID, for example, has produced a manual for FTAs and the Asian Development Bank conducts training in FTAs for ASEAN trade officials (see W. Goode, 2005, *Negotiating a Free Trade Agreement: a Guide,* Government of Australia, Department of Foreign Affairs and Trade). The implied rationale appears to be that if FTAs are going to be part of the trade landscape, they at least should be designed better. Moreover, there is no doubt that regionalism has many things going for it – FTAs, BTAs and the like. There are many references to the issues of whether these are “building blocks” or “stumbling blocks”. Yet, if this is not counter-productive, it certainly diminishes the importance of multilateral governance of trade and of aiming for a breakthrough by efforts from all sides.

Can something be done to counterbalance this ambivalence and convince countries to invest more effort in multilateral trade governance? Several directions are worth considering:

(a) Let the trade champions speak – international traders, manufacturers and assemblers who rely on global production networks and make business decisions based on global trade conditions. These are hard-nosed subscribers to multilateral trade who understand what is at stake when countries resort to FTAs. Victor Fung (of Li and Fung, a multinational Hong Kong supply chain management and trading company) argues “...that multilateral solutions will help us optimize the efficiency of the complex cross-border flows generated by dispersed manufacturing. Non-tariff barriers become more challenging when production is fragmented, and they have proven particularly thorny to resolve on a bilateral basis...,” and conversely “...that the proliferation of bilateral agreements is forcing businesses to sub-optimize". (See Victor Fung, 2005, "Luncheon address on business perceptions and expectations regarding the WTO Doha negotiations" in *Studies in Trade and Investment No. 56: Delivering on the WTO Round: a High-level Government-Business Dialogue,* ESCAP, Bangkok). There should be some response to his challenge: "...to advocates of bilateral agreements, I say the following: 'Please show me how a series of bilateral agreements, as they proliferate, somehow merge into a coherent multilateral system.' The truth is that they cannot. Instead, they make it harder for business to create value and hence economies to create jobs";

(b) Promote policy dialogues within and among countries – government policymakers, advisers and senior technical staff who matter in decisions concerning trade. They are the ones who need to connect with broader views, be able to understand what is at stake and be willing to adjust policies. The drawback here is that these important personages are few, over-extended in bilateral and regional negotiations and agreements (diversion of negotiating resources), and unlikely to put discussions of these sort on their priorities, given the limited 24-hour day;

(c) Support dissemination of trade research findings. Networking as well as debates among academics, research institutions, advocacy groups and NGOs, government policy establishments and the public should be supported in translating and spreading analyses in order to build a multilateral constituency. Indeed, there may be an adequate knowledge base for arriving at a more-or-less emerging picture of the superiority of multilateralism;

(d) Lay out alternatives to FTAs that may fall short of multilateralism, but which can be building blocks. For example, acceding to the Asia-Pacific Trade Agreement (APTA), formerly known as the "Bangkok Agreement", would give analogous benefits but would not confine countries to following the more rigid rules of FTAs.

Part II

Regionalism and multilateralism – friends or foes?

Chapter II

PREFERENTIAL TRADE IN ASIA AND THE PACIFIC: TRENDS AND PROSPECTS FOR MULTILATERALIZATION

By Mia Mikic

Introduction

There are two broad sources of preferential trade. It can be based on trade concessions extended unilaterally to selected trading partners without any expectations of reciprocity. Generalized System of Preferences (GSP) schemes for developing countries belong to this type of preferential trade. Another source arises from the reciprocal preferential trade agreements also known as regional trade agreements (RTAs).[1] The use of trade by most Asian economies as a means of achieving fast growth and development has been achieved with little reliance on preferential trade. Participation by the Asia-Pacific economies (members of ESCAP)[2] in the global (GATT/WTO) trading system from 1948 to 2007 is illustrated in figure 1. Membership in GATT/WTO grew slowly from the initial six to the current 31 members over several decades.[3] On the other hand, the number of preferential trade agreements (PTAs) established by those countries exploded in a relatively short period, from less than five in the late 1970s to more than 100 effective agreements in mid-2007.

As figure 2 shows, the proliferation of regionalism among the Asia-Pacific countries did not adversely affect exports of the Asia-Pacific GATT/WTO members, which make up a (slowly) growing share of total GATT/WTO exports to the world. However, figure 3

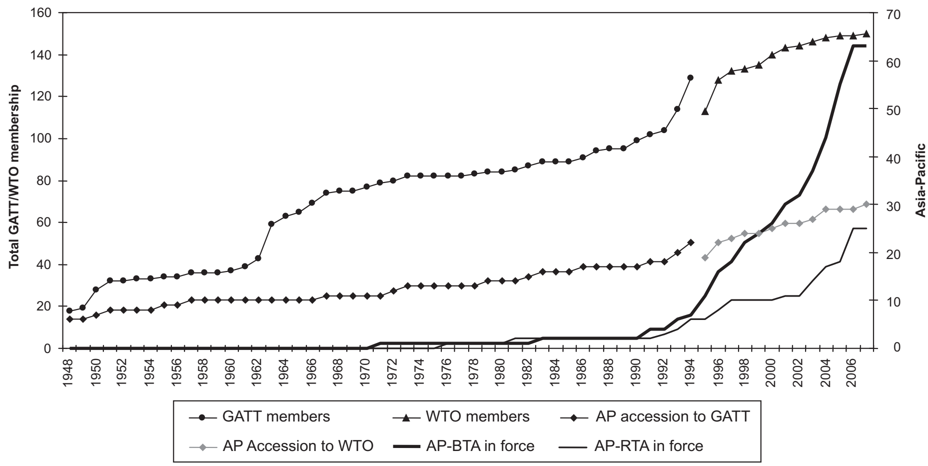
---

[1] The terms “preferential trade agreements” (PTAs), “preferential trade” and “preferential trade liberalization” are loosely used to refer to a wide variety of agreements that are also classed as “regional trade agreements” (RTAs). It should be noted that members of RTAs are not always in geographical proximity. The term “regional integration” is used in this chapter as a synonym for RTAs or PTAs.

[2] ESCAP has 62 members and associate members, 58 of which are regional and four of which are non-regional (France, the Netherlands, the United Kingdom of Great Britain and Northern Ireland, and the United States of America). In this chapter, “Asia-Pacific” refers to the regional members. More information on ESCAP membership is available at <http://www.unescap.org/about/member.asp>.

[3] When GATT was officially born in 1947, it had 23 founding members (“contracting parties”). The group included Australia, Belgium, Brazil, Burma (Myanmar), Canada, Ceylon, Chile, the former Republic of China, Cuba, Czechoslovakia, France, India, Lebanon, Luxembourg, Netherlands, New Zealand, Norway, Pakistan, Southern Rhodesia, Syrian Arab Republic, South Africa, the United Kingdom and the United States. The countries from the Asia-Pacific region that have most recently acceded to GATT are Tonga and Viet Nam.

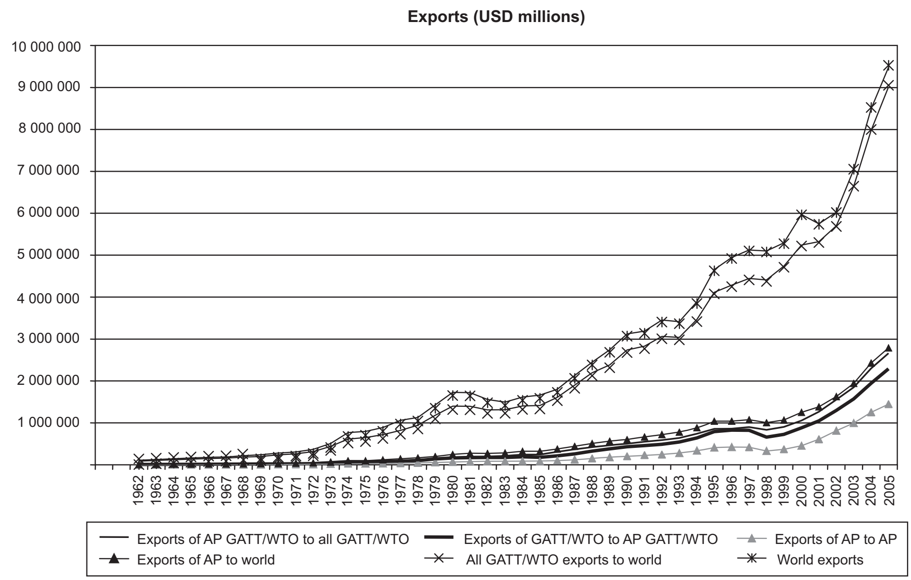
Figure 1. Participation by Asia-Pacific economies in GATT/WTO and PTAs



Source: Membership in GATT/WTO extracted from information provided on the WTO website (http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm); membership in PTAs is taken from APTIAD (http://www.unescap.org/tid/aptiad/).

Note: AP = Asia-Pacific.

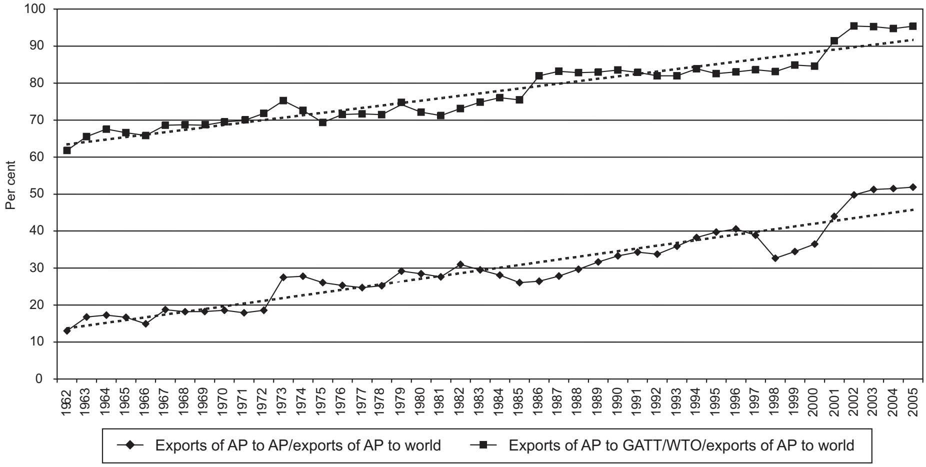
Figure 2. Exports by world, GATT/WTO and Asia-Pacific GATT/WTO members



Source: Calculated based on COMTRADE data downloaded from WITS, and membership from WTO.

Note: Asia-Pacific (AP) GATT/WTO include only regional members of ESCAP with full membership in GATT or WTO in the observed years.

Figure 3. Asia-Pacific exports – looking more towards the region



Source: Calculated based on COMTRADE data downloaded from WITS.

shows that exports from the Asia-Pacific GATT/WTO members to all GATT/WTO members and to the region, as a share of their exports to the world, is rising although not at the same pace. It appears that intraregional exports have been growing slightly faster than exports to WTO members since the establishment of WTO. Although this difference is very small, it coincides with the obvious shift in their policies towards PTAs (which is captured by exponential increase in the number of PTAs shown in figure 1). It cannot be denied that since 1995 the Asia-Pacific economies, traditionally supporters of multilateralism, have embraced PTAs as a basic trade policy option. According to data in the Asia-Pacific Preferential Trade and Investment Agreements Database (APTIAD), in 2005-2006 alone, these economies signed or opened official negotiations on more than 40 various agreements.

This chapter assesses various dimensions of preferential trade in the region. Section A first offers some facts and figures on regionalism in Asia and the Pacific. Section B provides more detail on the architecture of PTAs. In particular, it examines the scheduling approach, the extent of liberalization, types of barriers tackled, rules of origin and sectoral coverage. As one and perhaps most feasible ways of moving towards multilateralization of PTAs, section C considers the possibility of the geographical consolidation of many Asian PTAs into the so-called "Pan-Asian Free Trade Area" (PAFTA). Finally, section D closes with a non-exhaustive list of directions of policy research that might offer useful guidance to policymakers in this area.

A. Facts and figures on PTAs in Asia and the Pacific

The status of regionalism, including the number of agreements under implementation and their notification, is given in table 1. As of mid-2007, 91 trade agreements that include at least one member from Asia-Pacific (ESCAP region) were in force, and a further 11

Table 1. Status of regionalism in Asia and the Pacific

	Total	BTA total	BTA	BTA x-cont	BTA c-b	RTA total	RTA	RTA x-cont	RTA b-b	Other
In force	**91**	**64**	50	14	**13**	**14**	11	2	0	1
Pending ratification	**11**	**7**	5	2	**2**	**2**	0	2	0	0
Under negotiation	**31**	**28**	19	9	**2**	**1**	0	1	0	0
Total notified	**62**	**47**	39	8	**6**	**9**	7	0	1	1
Art. XXIV GATT	**31**	**27**	25	2	**2**	**2**	2	0	0	0
Art. XXIV GATT and/or Art. V GATS	**20**	**17**	11	6	**2**	**1**	0	0	1	0
Enabling Clause	**11**	**3**	3	0	**2**	**6**	5	0	0	1

Source: APTIAD, 2007 (July).

were waiting for the completion of the ratification process to become effective. At the same time, the number of agreements under negotiation in APTIAD amounts to just over 30 because the database tracks only agreements with officially opened negotiations. Most of the agreements recorded as under negotiation are also between two countries, but almost one third include a partner from another geographical region.

Most of the effective agreements (as of September 2007) and those pending ratification (64) are of bilateral scope,[4] either between two countries in the region or globally. The group of agreements between a country and another regional trade agreement is relatively large but mostly based on activities of the ASEAN Free Trade Area (AFTA) as the trading bloc (13 effective agreements in this group). There is one other agreement, the Global System of Trade Preferences among Developing Countries (GSTP). This leaves 13 regional trade agreements, two of which include members outside the region.

The WTO discipline on RTAs (and previously GATT) requires members to be transparent about their use of trade preferences and thus they are required to notify trade agreements they negotiate. The WTO notification process recognizes free trade areas and customs unions as types of regional trade agreements that qualify under Article XXIV of GATT. All other agreements that do not qualify for notification under Article XXIV of GATT fall into "partial scope agreements" in the area of goods liberalization and can be notified only under legal cover of the Enabling Clause, paragraph 2(c). The fourth type, economic integration agreements, is reserved for liberalization in services area, to be

[4] Zhai (2006) commented that bilateral trade agreements (BTAs) were preferred because of their lesser costs in terms of negotiation and enforcement efforts. While this might hold true for every individual member of BTAs, the resulting costs of all BTAs might easily be higher compared with all RTAs. Bonapace (oral communication) argues that this could be because of the lack of "peer pressure" as well as institutional framework that is often missing from BTAs but built into many RTAs. Feridhanusetyawan (2005) held that the faster rate of increase in BTAs than in RTAs (plurilateral agreements) contributed to a complexity of the picture, as many of those BTAs arose "within and across different regional agreements".

Table 2. Structure in terms of types of agreements

	BTA	BTA x-cont	BTA c-b	RTA	RTA x-cont	Other	Total
Free trade agreement	44	8	4	4	1	0	**61**
Customs union	0	0	1	1	0	0	**2**
Preferential trade agreement	3	2	0	4	0	1	**10**
Framework agreement	3	4	8	2	1	0	**18**
Total	**50**	**14**	**13**	**11**	**2**	**1**	**91**

Source: APTIAD, 2007.

Notes: x-cont = cross-continental
c-b = country-bloc

notified under Article V of General Agreement on Trade in Services (GATS). Since, in practice, the taxonomy of trade agreements still needs to be harmonized with the one adopted by WTO (see table 2), the record of notification in APTIAD jointly presents notifications under Article XXIV of GATT and Article V of GATS for the agreements that are notified separately under each. Thus, in total, 62 agreements are registered as notified, with only 11 of them coming under the Enabling Clause. From a cursory inspection of the agreements that are not notified, it appears that they too will ultimately be notified under this category.

As mentioned above, a harmonized taxonomy of trade agreements is yet to be universally applied and, in many cases, the textbook taxonomy of PTAs is not followed in work of policymakers and/or researchers and analysts. Various databases also use different approaches. Table 2 includes types of agreements reflecting titles used to describe the agreements by countries themselves. Two thirds of the effective agreements in the Asian and Pacific region belong to the free trade area (FTA) category. They also include agreements in the area of trade in services, as APTIAD still does not record them separately. There are only two customs unions and 10 preferential trade agreements that are agreements of “partial scope” in WTO classification. A large number of the agreements (18) are classified as framework agreements. In the understanding of the WTO RTA disciplines, these should not be implementable as trade liberalization agreements. Rather, they should serve to guide negotiations on the “proper” type of the agreement. However, in Asia and the Pacific, some of these framework agreements contain an “early harvest programme”. As such, they should be notified as “partial scope agreements”, which is not often the case.[5]

The fast multiplication of agreements shown in figure 1 resulted in an increasing density of the “noodle bowl”[6] phenomenon associated with preferential trade. The “noodle

---

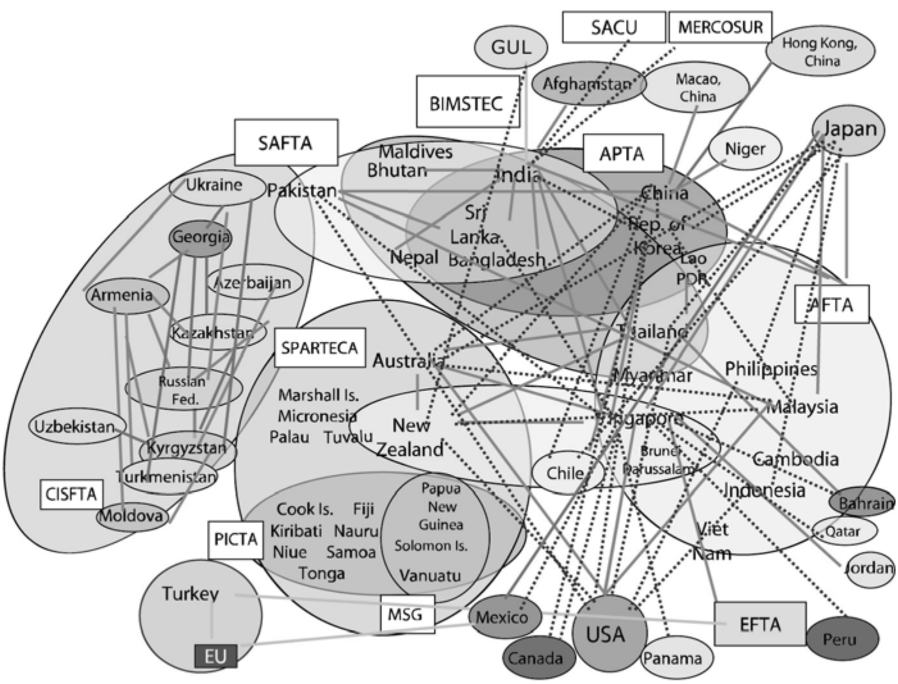
5 Of these, only the ASEAN-China Framework Agreement, in force since 2003, was notified in 2004.

6 See Bhagwati, 1992, who is credited with introducing the original term, “spaghetti bowl”. “Noodle” was apparently introduced to the RTA vocabulary by Findlay and Pangestu (2001). Cf. Mikic, 2002.

bowl" of preferential trade refers to the entanglement of bilateral and regional free trade and other types of agreements that are in force as well as those that are in various stages of negotiations (figure 4). It is quite appropriate to describe this state of affairs as a "motley assortment" (Baldwin, 2006) that is working against trade creation rather than for it. With conflicting rules, these preferential agreements tend to fragment markets and increase trade costs, thus adversely affecting trade volumes as well as global and national welfare. For example, figure 4 illustrates how current regionalism results in the fragmented Asia-Pacific market, with no established trade agreements between Central Asia and rest of Asia and the Pacific. Likewise, the Pacific is far from being well integrated into Asian regionalism, while links between South Asia and the rest of the region are just emerging. It appears that only the Asia-Pacific Trade Agreement (APTA) links South Asia, North Asia and Southeast Asia, as well as high- and low-income developing countries. Therefore, in terms of promoting south-south cooperation, this agreement has a desirable scope.

The previous analysis reveals that from 1994 to the present, the number of all agreements in force expanded from 10 to 91, a more-than-eightfold increase. Of the total 58 ESCAP regional members, those involved in this proliferation of agreements increased

Figure 4. Noodle bowl effect in Asia and the Pacific



Source: APTIAD, Feb 2007, some PTAs not shown.

from 41 to 50 during the same period.[7] Only one ESCAP-cum-WTO member remains unattached to any of the trading blocs. In contrast, most ESCAP members who are not WTO members are members of at least one and up to 11 PTAs. The average number of agreements in force per ESCAP member, not counting those countries without any agreements, is 5.6. This indicates multiple memberships and a significant overlap in the membership of agreements.

Overlapping memberships arise from parallel BTAs and RTAs for the same set of economies. One country ends up negotiating with another under several unrelated framework agreements. Multiple and overlapping membership is spread across this region. Only eight ESCAP members and associate members are not involved in PTAs. The maximum number of agreements implemented by a country belongs to Singapore (19), followed by Thailand (15), India (13), Malaysia (12) and Turkey (12).

The issue, however, is that with multiple agreements it is not known which particular set of rules drives trade growth or which set might act as an obstacle. The question should also be asked whether an even larger effect on trade could have been achieved with fewer agreements and, arguably, lower costs. Finally, the impact of unilateral liberalization processes in countries that are party to such agreements should not be ignored.

The total trade of ESCAP members has increased in absolute terms, and in 2005 accounted for almost 30 per cent of world exports and imports. The value of their intraregional trade also increased dramatically from 1980 to 2005 in absolute terms. Starting with a slightly smaller value of intraregional trade than the North American Free Trade Agreement (NAFTA) in 1980, by 2005 the intraregional trade of Asian and Pacific region had surpassed NAFTA and had closed the gap with the European Union (15) from four-fifths to one-third. As a share in total world trade, this intraregional trade grew only slightly faster than the share of total Asia-Pacific trade in world trade (coefficient 1.36 compared with 1.29 – rows 1 and 3 in table 3).

This information on growth in intraregional trade can be combined with an indicator of trade dependence to tell us more about the "fortress building" attitude of trade agreements. As table 3 shows, total trade dependence,[8] which is a contribution of total trade to the region's collective gross domestic product, increased by coefficient 1.5 over this period. As trade can be split into intraregional and extraregional categories, it is helpful to track intraregional and extraregional trade dependence as separate indicators. Thus, an indicator showing only the contribution of extraregional trade to the region's gross domestic product

---

[7] Agreements of non-regional members are not covered in the analysis unless signed with one or more regional members (e.g., the United States–Singapore FTA is included, while the United States-Jordan FTA is not). This currently leaves only three ESCAP members (Mongolia, Palau and Timor-Leste) and five ESCAP associate members (American Samoa, French Polynesia, Guam, New Caledonia and Northern Mariana Islands) not involved in preferential trade. Of those countries, only Mongolia is also a WTO member.

[8] This indicator is often interpreted as "trade openness". See Bowen, Hollander and Viaene, 1998, pp. 12-15.

Table 3. ESCAP trade performance basics

(Unit: %)

Category	1996	1998	2000	2002	2004	2005
Total ESCAP trade/world trade	22.7	23.4	26.3	26.3	28.2	29.4
Total intra-ESCAP trade/world trade	10.7	10.3	12.4	12.7	14.0	14.6
Total intra-ESCAP/total ESCAP trade	47.3	44.0	47.2	48.4	49.6	49.8
Total trade dependence	33.1	35.3	39.4	38.8	46.6	50.0
Intra-ESCAP trade dependence	19.0	18.1	20.1	18.8	23.1	24.9
Extra-ESCAP trade dependence	14.1	17.2	19.3	20.0	23.5	25.1
Marginal propensity to trade (total)[a]	...	-0.29	0.68	-0.17	0.71	0.85
Marginal propensity to intra-ESCAP trade[a]	...	-0.08	0.38	-0.25	0.37	0.43
Total number of BTAs in force	**17**	**22**	**26**	**30**	**46**	**63**
Total number of RTAs in force	**5**	**6**	**6**	**6**	**8**	**11**
Members with WTO status	22	24	25	26	29	29[b]
Members with PTA status	44	44	44	45	49	50

Source: Compiled by the author from APTIAD, WITS and WDI, May 2007.

[a] Marginal propensity to trade = change in trade value/change in GDP value (ranges from 0 to 1).

[b] 31 in 2007 (e.g., Viet Nam and Tonga became members on 11 January 2007 and 27 July 2007, respectively).

grew more than the total trade dependence (coefficient of 1.8 during the same 10 years), while intraregional trade dependence grew by less – coefficient 1.3. Despite relatively small differences in these coefficients, they point to a lack of a significant increase in the reliance on intraregional trade by ESCAP economies, giving no strong support to a claim of the “appearance of the third mega trading bloc” to join the European Union and NAFTA. Thus, even though intraregional trade is growing in both the absolute and relative sense, it is difficult to identify this trend as trade diversion.

Furthermore, a reliable measure of a link between the increase in intraregional trade and the existence of preferential trade (i.e., BTAs and RTAs) is still lacking. In addition, does trade growth among members of the agreements precede or follow preferential agreements? These questions remain high on the list of future empirical research topics.[9] Identification of the share of trade associated with the establishment of the preferential trade area is still one of the most tedious forms of empirical trade research (cf. Mayda and Steinberg, 2007 and DeRosa, 2007).

[9] See Mayda and Steinberg, 2007 on the lack of evidence for across-the-board new trade creation in response to the Common Market for Eastern and Southern Africa, and DeRosa, 2007 for slightly different arguments.

In 2005, slightly less than 30 per cent of total ESCAP trade was associated with members of BTAs and RTAs (table 4) even though intraregional trade amounted to almost 50 per cent of total ESCAP trade with the world (see table 3). This trade among the BTA/RTA members amounted to less than 9 per cent of world trade.[10] While close to 60 per cent of PTA-linked intraregional trade was done by members of BTAs, more than half of that was linked to BTAs that had one extraregional member (e.g., the United States, European Union/EFTA). This could indicate that there is still a great deal of untapped potential for developing intraregional trade linkages among ESCAP members.

Table 4. Trade of BTAs and RTAs in force, 2005*

	Share in total ESCAP trade (%)	Share in total world trade (%)
BTAs (61)	**16.2**	**4.7**
– Regional (33 BTAs)	6.6	1.9
– Other (28 BTAs)	9.6	2.8
RTAs (11)	**13.2**	**3.9**
– Regional (6 RTAs)	10.2	3.0
Total preferential trade	**29.4**	**8.6**
Total ESCAP trade		**29.2**
Memorandum items:		
– Total ESCAP trade (US$ billion)	5 764	
– Total world trade (US$ billion)		19 585

Source: Computed using APTIAD and COMTRADE data, May 2007.

* Where 2005 trade data are unavailable, data from the most recent available year are used.

B. Architecture

In this section,[11] the architectural characteristics of the Asia-Pacific preferential agreements are assessed. The scheduling approach in terms of tariff liberalization, extent of liberalization, types of trade barriers tackled by agreements, rules of origin and sectoral coverage is examined.

10 Note that table 1 shows intra-ESCAP trade as 14.6 per cent of world trade in 2005. Intra-ESCAP trade is larger than the sum of trade by members of BTAs and RTAs under implementation (which makes up 8.6 per cent of world trade).

11 This section borrows heavily from Mikic, 2007.

1. Approaches to tariff reductions in PTAs

How important is the contribution of preferential trade liberalization to the opening of a country? As noted above, declarative aspirations of all agreements are to transform trade among partners into duty-free trade. In many agreements, in fact, this is expressed as an ultimate goal; however, partners are taking many different routes to achieve this end. Table 5 summarizes the difference in approaches to tariff reduction in the enforced agreements that provide this information. A positive list approach is considered, in principle, as less liberalizing; it consists of members agreeing to the products on the (positive) list whose tariffs will be reduced or eliminated. A negative list approach assumes the reduction/ elimination of tariffs on all products except those that are included in the negative list. This approach is closer to the spirit of GATT, even though it may often include a long list of excluded products.

Another important factor is the determination of a base tariff rate as a benchmark for reduction. In most cases, the MFN-applied rates are used for this purpose (cf. Feridhanusetyawan, 2005). In an effort to comply with WTO rules on regional agreements, most contain an intention to eliminate tariffs within what is considered a reasonable period. When an LDC is involved, it is provided either with longer transition periods (e.g., AFTA) or lesser or no reduction commitments (e.g., APTA). Another interesting feature, and one that supports previous claims about “made-to-measure” agreements, refers to asymmetrical reciprocity in tariff reduction even when there is no LDC involved. Feridhanusetyawan (2005) described how, in the Singapore-United States FTA (which follows the “negative list approach”), the United States kept tariffs on about 8 per cent of products during the transition period of eight years while Singapore eliminated all tariffs immediately, binding them to zero. In the Singapore-Japan FTA (which follows a positive list approach), Singapore again reduced all tariffs to zero immediately while Japan committed to eliminating its tariffs gradually over a 10-year period.

Table 5. Tariff reduction approaches

PTAs	Positive list	Negative list
All agreements in force (that provide information)	31	33
Bilateral trade agreements	22	25
Cross-continental plurilateral	0	1
Country-blocs	3	2
Regional trade agreements	5	5
Global	1	0
Free trade agreements	20	29
Framework agreements	4	1
Preferential trading agreements	6	2
Customs unions	0	1
Non-reciprocal arrangements	1	0

Source: Compiled by the author from APTIAD, February 2007.

2. Rules of origin

The current proliferation of agreements has spun a complex web of rules of origin (table 6). In addition to each agreement having its own rules of origin, a bewildering array of product-specific rules of origin is emerging. Adopting the less restrictive rules of origin could result in significant trade deflection and redundancy of a trade agreement, while adopting the most restrictive rules of origin may result in no trade taking place under the agreement. Several chances have been missed, at both the WTO and regional levels, to bring some uniformity to the formulation of preferential rules of origin. GATT Article XXIV, quite remarkably, is silent on the use of preferential rules of origin. Should rules of origin not be viewed as just "other regulations of commerce" (referred to in Article XXIV of GATT), in that they should not raise barriers to third countries any higher than the level existing prior to the formation of PTAs? The most that is said is embodied in a non-binding common declaration on principles.

Table 6. Rules of origin provisions in selected trade agreements

PTA	Change in tariff class.	Specific man. process	Local value addition	Cumulation
BTAs				
ASEAN-China	Yes	...	40%	Full
ASEAN-Republic of Korea	Yes	...	40%	Full
Australia-New Zealand	...	...	50%	Bilateral
India-Thailand	Yes (or VA) 4, 6 digit level product specific	...	20-40% product specific F.O.B. value	Bilateral
India-Sri Lanka	Yes (or VA) 4 digit level	...	35% F.O.B. value	Bilateral
Japan-Mexico	...	No specific process required	50% with some exception F.O.B. value	Bilateral
Republic of Korea-Chile	...	No specific process required	45% build down method calculation, 30% build up method calculation	Bilateral
Malaysia-Japan	Yes (product specific)	...	40% (product specific)	Bilateral
Singapore-Republic of Korea	Yes	...	45-55%	Bilateral
Singapore-Japan	Yes (or VA) 4 digit level	Yes	60% F.O.B. value	Bilateral
Singapore-USA	Yes (or VA) 2, 4, 6 digit level	Yes	30-60% product specific	Bilateral

Table 6. *(continued)*

PTA	Change in tariff class.	Specific man. process	Local value addition	Comulation
Singapore-New Zealand	...	...	40% Factory cost	Bilateral
Singapore-Australia	...	...	30-50% product specific factory cost	Bilateral
Thailand-Australia	Yes (and/or VA) 4, 6 digit level product specific	Yes	40-55% product specific F.O.B. value	Bilateral
Thailand-New Zealand	Yes (product specific)	Yes		Bilateral
RTAs				
Asia-Pacific Trade Agreement	No tariff beading change necessary	No specific process required	45% (35% for LDC)	Full
ASEAN Free Trade Agreement	No tariff beading change necessary	No specific process specified	40% F.O.B. value	Full
Trans-Pacific Strategic Economic Partnership TRANSPACSEP	Yes	Yes	45-55%	Diagonal (bilateral)

Source: Compiled from table 2 in Bonapace and Mikic (2006); and APTIAD.

This increases the urgency for establishing an overarching, region-wide, common framework of principles, guidelines and procedures to which BTAs and RTAs would be anchored. Notwithstanding its non-binding nature, the point of departure should be the WTO common declaration. Ongoing work, notably in APEC, and other useful trade and development elements found in other agreements should be built upon with this need in mind. For example, APTA recently agreed to common rules of origin (representing a wide spectrum of industrial development among the members) that are relatively simple, general and liberal, that is:

(a) A flat rate of a minimum 45 per cent of local value content (35 per cent for LDCs) in bilateral rules of origin; and

(b) At least 60 per cent (50 per cent for LDCs) of regional content with full cumulation (cf. Baldwin, 2006).

Section C of this chapter discusses prospects for multilateralization of Asia-Pacific PTAs in terms of geographical consolidation. However, it is possible to approach multilateralization through the functional consolidation in different areas, such as rules of origin. Consolidation of multiple membership agreements around more liberal rules of origin will serve as a tool for diminishing noodle bowl-related costs of trading under preferential regimes. One such example is provided by the recent consolidation of bilateral trade agreements among the southern European countries and a replacement by the common rules as part of an amended Central European Free Trade Agreement (CEFTA) deal. The new CEFTA consolidates 32 bilateral trade agreements into a single regional trade agreement. The free trade area will be established for a transitional period ending, at the latest, on 31 December 2010. The new consolidated agreement replaces the network ("spaghetti bowl") of bilateral trade agreements in order to improve conditions for promoting trade and investment by means of fair, clear, stable and predictable rules.

The agreement consolidates and modernizes the region's "rule book" on trade, and includes modern trade provisions on issues such as competition, government procurement and protection of intellectual property. It facilitates the convergence of relevant trade-related rules, notably with regard to industrial and sanitary-phytosanitary rules. A simplified single system of rules of origin (and other rules) makes it easier to trade within the region. Increased trade is necessary to promote growth, job creation and a reduction in youth unemployment. It is the foundation for stability and peace. Such harmonization and simplification of rules of origin in the subregions of Asia could contribute to a deepening of integration, as the rules are associated with an increase in "seamless production".

3. Going beyond the goods trade[12]

Many of the newer initiatives declare the intention to go well beyond the reduction/elimination of tariffs and NTBs, including anti-dumping and safeguards, harmonization of competition policies and standards, and customs. However, a large number just remain a collection of aspirations towards liberalization that tend to be associated with a longer negotiation process. In addition, despite these intentions to go deeper than trade integration, there is only an occasional mention of the formation of a CU or a common market in the Asia-Pacific region.[13]

Furthermore, in the context of multilateral liberalization, a number of countries strongly argue for more freedom in movements of labour (referring to Mode 4 liberalization) when it comes to BTAs and RTAs, as only a few cover this area. A comparison of BTAs/RTAs of the Asia-Pacific region with existing deals in the Americas also illustrates a type of reluctance to negotiate all-inclusive comprehensive agreements. Instead, trade agreements are often accompanied by separate agreements on services, investments, intellectual property protection, customs procedures etc. Most of the new agreements cover trade in services. (However, pre-GATS agreements still have separate agreements on trade in services, such as the ASEAN FAS).

---

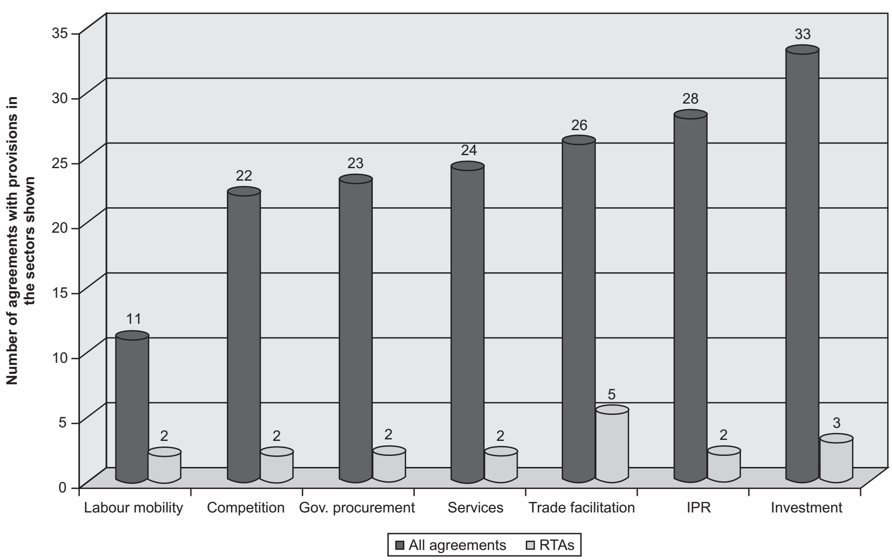
[12] Some of the agreements do not have legal texts either publicly available in English or at all, and therefore might not have been captured properly in counting the sectors covered.

[13] One such example is that of the already cited "single economic market" of Australia and New Zealand. At the zenith of the 1997 Asian economic crisis, there were also calls for the establishment of a currency union. They were later merged into proposals for an East Asian Community.

Most of the newer agreements could be described as WTO-plus agreements as they extend concessionary coverage beyond multilaterally agreed disciplines to areas such as government procurement, competition policy and the environment. This is true for trade agreements between developed economies, and between developed and developing economies (Lesher and Miroudot, 2006). It is important to note that most agreements mention a number of WTO-plus sectors when describing the objectives of the agreement (typically in the preamble of the agreement text). However, a significant number of agreements only include a statement of intention to negotiate liberalization in certain areas. These agreements have been excluded from the scope of this study because they do not count for "substantive commitments".

The overview that is provided in figure 5 only shows whether a concessionary commitment has been made in a particular sector or not. In order to provide a better assessment of the beyond-the-goods commitments, a more detailed analysis of the legal texts of the agreements is required. The most frequently covered area is that of investment provisions followed by IPRs and trade facilitation. Other areas that also receive some coverage are government procurement, competition policies and labour mobility. Services are only covered in 24 agreements, including separate agreements for some parties. Table 7 provides a summary of treatments of four sectors (investment, IPR, labour mobility and services) with a view to differentiating between BTAs and other agreements in terms of the coverage of these sectors.

Figure 5. Overview of sectoral coverage by PTAs



Source: Compiled by the author from APTIAD, February 2007.

Table 7. Summary of treatments of selected sectors in preferential trade agreements in Asia and the Pacific

	Total	Type of agreement				Notified to WTO
		FTA	FA	CU	Other	
Intellectual property protection						
BTA	19 [a]	16 (7)				17 (7)
Country-bloc	6 [b]		2	(1)	–	5 (3)
RTA	2	1	–	–	1	2
Other	1	1	–	–	–	–
Total	**28 (9)**	**21 (8)**	**3**	**(1)**	**3**	**24 (10)**
Investment						
BTA	23 [c]	17 (4)	5	–	1	17 (4)
Country-bloc	6	2	4	–	–	3
RTA	3	2	1	–	–	1
Other	1		1	–	–	–
Total	**33[a] (4)**	**21 (4)**	**11**	**–**	**1**	**21 (4)**
Mobility of labour						
BTA	8	7	1	–	–	7
Country-bloc	1	–	1	–	–	–
RTA	2	1	1	–	–	–
Other	1	1	–	–	–	–
Total	**12**	**9**	**3**	**–**	**–**	**7**
Services						
BTA	18	17	1	–	–	14
Country-bloc	3	2	1	–	–	3
RTA	2	–	2	–	–	–
Other	1	1	–	–	–	–
Total	**24**	**20**	**4**	**–**	**–**	**17**

Source: APTIAD; annex tables 2-5 in Mikic, 2007.

Note: Figures in parentheses are the number of agreements involving Turkey.

[a] Includes seven BTAs between Turkey and Bosnia and Herzegovina, Bulgaria, Croatia, Former Yugoslav Republic of Macedonia, Israel, Romania and Tunisia.

[b] Includes one agreement between Turkey and EFTA, and one between Turkey and the European Union.

[c] Includes four BTAs between Turkey and Bulgaria, Former Yugoslav Republic of Macedonia, Romania and Tunisia.

In terms of scope of agreement, it is obvious that the "beyond-the-goods" sectors are captured more often by agreements that are bilateral, i.e., between two countries or between an established bloc and a country. It is mostly FTAs that venture beyond goods liberalization, except in the case of investment where FAs also feature. It also appears that BTAs-FTAs are notified to WTO more quickly than other agreements, thus contributing towards transparency of trading rules at the global level.

C. Towards multilateralization: How?

Arguably, regionalism practiced by countries of Asia and the Pacific does not facilitate trade effectively. There is a need to start managing this process sooner rather than later, but the best approach has not yet been identified (cf. Baldwin, 2006; Zhai, 2006; Bonapace and Mikic, 2007). In principle, multilateralization can be pursued after agreements become closer in similarity and have more commonalities in terms of disciplines adopted and extent of liberalization. First, therefore, some progress needs to be made in terms of "harmonization" of relevant areas in the agreements (e.g., rules of origin) before they can be "multilateralized".

One approach to consolidation that can serve as a handmaiden to multilateralization is through geographical widening of current agreements or the consolidation of several agreements into one; this would apply to both widening the geographical area and replacing what would be a series of bilateral agreements in one region-wide trade agreement.

Amid uncertainties on the closure of the Doha Round negotiations, and the renewal of a number of stalled talks on bilateral and regional FTAs, a proposal to negotiate the so-called Pan-Asian Free Trade Area (PAFTA) is explored here as one possible vehicle of consolidation (WTO, 2006). This agreement is looking towards bringing together 16 members including Australia, China, India, Japan, New Zealand, the Republic of Korea and members of ASEAN (Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam). In terms of collective GDP, PAFTA would become the third largest trading bloc in the world after NAFTA and European Union, based on data for 2004.

Among the three, only PAFTA would include non-WTO members (such as Brunei Darussalam, and the Lao People's Democratic Republic). All three blocs declare "free trade" as their objective. However, exports and imports of the two existing blocs and the new proposed PAFTA differ (table 8). More than half of the European Union's trade consists of intraregional trade while NAFTA and PAFTA still rely on extraregional partners for their trade. Similarly, figure 6 shows the value of trade among the three blocs in 2005. It is obvious that PAFTA is the "largest" trader, exporting more than US$ 500 billion to each of the other blocs, and importing close to that amount from both of them, thus creating a substantial trade surplus in this tripartite trade.

In evaluating the potentials of trade agreements, it is useful to use so-called trade performance indicators. In fact, APTIAD features such indicators for the number of agreements

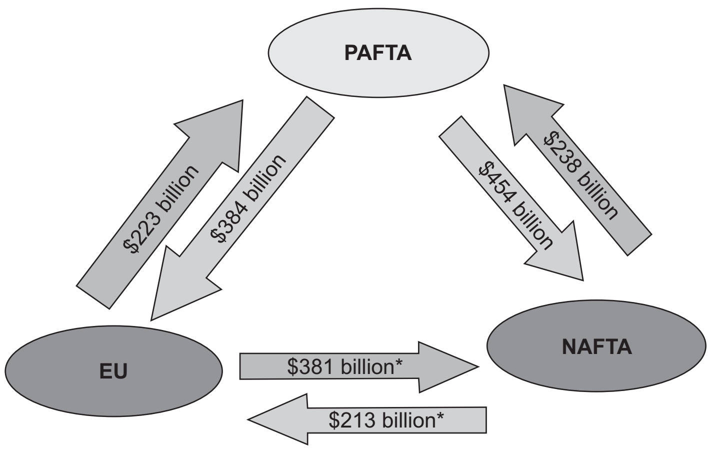
Table 8. Sizing up three hemispheric blocs, 2004

Category	European Union	NAFTA	PAFTA	Memo item: ESCAP
Population	**458**	**429**	**3 121**	**3 855**
GDP	**12 804 020**	**13 366 295**	**9 443 842**	**10 952 556**
Total exports	**3 598 526**	**1 315 025**	**2 108 411**	**2 478 486**
Total imports	**3 583 461**	**1 990 202**	**1 907 263**	**2 417 024**
Intraregional exports	**2 387 270**	**736 366**	**801 166**	**1 146 555**
Intraregional imports	**2 239 240**	**702 589**	**890 276**	**1 277 805**

Sources: Calculated from WDI and WITS, World Bank.

Note: Trade covers merchandise trade; all values are in millions (people or US dollars).

Figure 6. Tripartite merchandise trade



Source: Calculated from WITS data for 2005.

* EU as a reporting country.

that are already in force in Asia and the Pacific. Indicators can be used ex post to evaluate performance of a free trade or other type of trade agreement after it has been implemented or in some cases ex ante to try to infer economic impact from forming an agreement. Here we use the trade dependence index (TDI) and regional bias index (RBI).[14] These indices are summarized in table 9.

[14] Technical notes on these and other indices and the glossary of terms are available on the APTIAD website at http://www.unescap.org/tid/aptiad.

Table 9. Open – but towards whom?

Index	Agreement	2000	2001	2002	2003	2004
TDI	PAFTA	20.53	20.43	20.55	22.72	24.61
	European Union	20.75	20.51	19.56	19.15	19.96
	NAFTA	13.96	12.81	12.38	12.77	13.96
RBI	PAFTA	1.89	1.97	1.98	1.90	1.83
	European Union	1.71	1.65	1.61	1.58	1.56
	NAFTA	2.03	2.07	2.10	2.26	2.29

Source: Calculated from COMTRADE data downloaded from WITS.

Note: TDI = trade dependence index; RBI = regional bias index.

The TDI is a standard measure of the ratio of GDP contributed by international trade with the rest of the world. In literature, it is also called the “openness index”. By this measure, it appears that PAFTA is the most trade dependent on extraregional trade (or most open) of the three blocs, since close to 25 per cent of its GDP is generated by trade with others. This overall index, although higher compared to the European Union (just below 20 per cent) and NAFTA (close to 14 per cent) is, however, low compared with those of individual countries of PAFTA, especially small trading economies with extensive re-exporting, where this ratio rises above 100 per cent of GDP.[15] The overall index for PAFTA, being an average, thus obscures significant variations of national indices and underestimates real trade dependence due to the impact of large countries such as Japan, China and India, which contribute more to PAFTA’s GDP than to its trade. Notwithstanding this fact, the TDI for the European Union and NAFTA falls over time, signalling more reliance on trade with in region. In the proposed PAFTA area, the opposite trend can be observed – the TDI with the rest of the world increases, indicating relatively less reliance on intraregional trade compared to the other two blocs.[16]

The RBI for member countries in a preferential trade agreement shows a level of bias towards intraregional trade relative to trade with countries outside the agreement area. When the index is equal to 1, the region is neutral in its geographical trade pattern. This means that the share of intraregional trade in its total trade is the same as the region’s total trade in world trade. For the three blocs, the RBI values are larger than 1 over the whole period from 2000 to 2004, indicating a bias towards trading with itself.[17]

Because the RBI is calculated without adjusting the values of exports and imports to take into account price effects (such as a rise in oil prices) and exchange rates, care

---

[15] This is also true for smaller economies in the European Union, such as Belgium or Denmark.

[16] Table 3 provides figures for ESCAP-wide trade dependence (25 per cent in 2005) which follows the same trend as trade dependence for PAFTA.

[17] This index normalizes the intra-regional trade share of a regional trading bloc for group size in world trade as it is expected that a larger group would have a larger share of world and intra-regional trade.

should be taken in the interpretation of these values. As the European Union already has a very high proportion of intraregional trade, it is difficult to envisage further increases in the RBI for that region. NAFTA is similar, but PAFTA should differ as many border and non-border barriers still restrict trade among proposed members. This is despite the existence of bilateral trade agreements among most of the members of the proposed PAFTA (see figure 4). Replacing multiple agreements that are not fully effective in liberalizing trade with one trade liberalizing agreement could help to de-fragment markets and allow faster growth of trade, not the least among developing countries in the bloc. In doing so, progress made by existent preferential agreements in the region should be taken into account in order to combine this geographical consolidation with the functional one. More specifically, simple and regionally cumulative rules of origin as embraced by APTA should be adopted by PAFTA,[18] while full coverage and elimination of tariffs on goods from a number of bilateral agreements in the region should be the goal of PAFTA within a reasonable period (not longer than 10 years).

Regional integration initiatives are often associated with the occurrence of one “domineering” economy (in PTA parlance, a “hub”) that is not only the key player in multiple trade agreements in a region, but also the main driver of regional trade. In this sense, it is useful to compare the country market shares of these three blocs in intraregional exports and imports in 2004. In the European Union, the largest three suppliers to the integrated market are Germany (24 per cent), France (12 per cent) and the United Kingdom (9 per cent). In NAFTA, about 40 per cent of intraregional exports originate from the United States. In PAFTA, Japan contributes 26 per cent of intraregional exports, followed by China (20 per cent) and the Republic of Korea (13 per cent).

At the same time, these countries absorb most of the intraregional imports. In the European Union, Germany, France and the United Kingdom buy 19 per cent, 12 per cent and 12 per cent of total intraregional imports, respectively. The United States is even more dominant as an importer in NAFTA, absorbing 59 per cent of intraregional imports. In PAFTA, China buys 27 per cent, followed by Japan (24 per cent) and the Republic of Korea (12 per cent). Extending supply chains in order to integrate other developing countries, and particularly LDCs, into intraregional exports and imports would be one potential benefit from the establishment of PAFTA.

D. Impacts and future research directions

Are these mushrooming PTAs in Asia and the Pacific a healthy development, or do they make “a noodle bowl” increasingly less palatable? What is their true impact on economies taking part in the process and on the rest of the world? There are different ways in which we can shed some light on these questions. There is, of course, the usual “stumbling vs. building” block type of arguments seeking to assess the impact on the parallel process of multilateral liberalization as well as on multilateralism as an institution (embodied in the form of WTO).

---

18 Cf. Richard Baldwin, 2006.

Although this issue has been heavily researched and debated by many, the gap between the proponents of either view is not any narrower today – 300 PTAs later – than it was when the debate started.[19] Proponents of the "stumbling blocks" view still hold that the proliferation of preferential trade, because of its discriminatory nature, weakens the fundamentals of multilateralism and, indirectly, the case of free trade. They also argue that spreading "negotiating (and political) capital" across multilateral and preferential negotiations leaves developing countries in an inferior position compared to developed countries, thus weakening the former group's chances for modifying the global system according to their developmental needs.

Advocates of the "building blocs" view, in contrast, put forward positive experiences stemming from the process of PTA proliferation, such as:

(a) Gaining negotiation experience;

(b) Obtaining deeper openings in selected sectors/markets, and facing lesser resistance to the opening of domestic markets;

(c) Allowing firms to learn how to export to friendlier markets;

(d) Removing divergences in harmonization or mutual recognition areas faster;

(e) Creating competitive liberalization and thus widening free(r) trade; and

(f) Providing the possibility of revenue compensation within the preferential bloc.

A relatively new contribution to the "building vs. stumbling blocks" literature (Limao, 2006, among others) indicates that the United States and European Union types of preferential trade have had a negative impact on multilateral liberalization. This impact should be looked at from the perspective of the impact on the governance of global trade (functioning of WTO), and the level of protectionism in global trade. When focusing on the impact made by PTAs in the Asia-Pacific region, it appears that so far they have hindered the operation of WTO in terms of its "rule-making" capacity, even though they have not resulted in any obvious direct trade-diverting costs (Pomfret, 2007).

However, the proliferation of RTAs should be seen as a threat to the business community as well as the global production system, as this regulatory complexity raises the costs or production (for example, see Fung, 2005). It can easily cause production to move from being comparative advantage-based to competitive liberalization-based (cf. World Trade Organization, 2007). This limits the potential of trade to serve as an engine of growth and thus limits the choices of policymakers in the medium to long term.

WTO, which is the main pillar of the multilateral trading system, responded to this RTA proliferation on two fronts. Firstly, it continued to motivate all stakeholders to increase efforts to conclude the DDA successfully (cf. Evenett, this publication). The DDA has pro-development potentials. It can provide market access, which is important to developing country producers. It allows for policy space, which is necessary to the

[19] See Bhagwati, 1992 for early discussions and Baldwin, 2006 for a summary of more recent debate.

protection of development interests, and not just the narrow interests of a select few. Because it is global, there is scope for delivering trade concessions across more sectors and disciplines than that permitted by many bilateral agreements. Furthermore, it incorporates the use of “Aid for Trade” as an instrument for delivering development through assistance in achieving deeper and wider liberalization of trade, as it can soften trade adjustment shocks. It thus helps trade negotiations to maintain their role of “reform anchors”, as it provides countries with external incentives to implement difficult and costly, yet desirable policy changes that they would otherwise be unable to achieve politically.

Second, WTO members have made progress in their attempt to improve disciplines related to RTAs. A draft decision on a Transparency Mechanism for Regional Trade Agreements awaits conclusion of the DDA to become permanent discipline. Preferential and multilateral liberalization share the objective of liberalizing trade but differ significantly in the approach; RTAs are discriminatory while multilateral liberalization is intended to be non-discriminatory (its principle of non-discrimination or MFN is weakened by various exemptions and exceptions that members permit). This tension between the approaches, among other things, resulted in the move by the WTO members to improve disciplines in the multilateral system on RTAs.

Research in area of trade and investment liberalization and its impact on development need to focus on providing comparative analyses of impacts of alternative path to liberalization from various perspectives (economic, social, developmental and institutional) with direct bearing on policymaking in the region. Objectives of so focused a research programme would include, inter alia:

(a) The identification of institutional differences in trade policymaking, relevant to engagement in regionalism, and assessment of how differences in the level of “social inclusiveness” between countries influence the choice of liberalization path;

(b) Estimating direct and indirect costs of engagement in the regionalism path;

(c) Analyzing the impacts of RTAs in the region and outside it, in terms of trade-creating and trade-diverting effects, and the effects on poverty. It would include various dimensions of impacts (gender, environment, labour standards, democratization and security) in addition to standard economic dimensions of welfare changes (cf. Oxfam, 2007);

(d) An assessment of how the new “transparency mechanism” adds to the WTO disciplines on RTAs and whether it can improve the quality of RTAs negotiated in the region;

(e) The identification of possible frameworks and paths for RTA consolidation and the study of possibilities for multilateralization of regional preferences.

It is necessary to stress that both regional and multilateral paths to liberalization will continue to exercise a strong impact on trade and trade policy in the Asia-Pacific region and the world. Notwithstanding the fact that PTAs may be completely “appropriate solutions to national policy needs, they may confer credibility on policy regimes, [and] help to solve political problems or increase competition" (Schiff and Winters, 2003), there are many other situations where PTAs unnecessarily increase the economic price for non-economic (and uncertain) gains and/or increase cost of an inappropriately chosen trade liberalization path. It is true, therefore, that for many developing countries in the region, the key to development lies in improving overall economic policies, including trade policy. Whether a country follows the regional or multilateral path, domestic economic reform is imperative in order to maximize the gains from trade (and investment) liberalization.

Meantime, both policymakers and researchers have attempted to identify common good policies and practices, and are packaging them in forms of "manuals" or "do/do not" guides (cf. Goode, 2005). Policymakers are advised to consult such manuals with the caveat that good and evidence-based policymaking is definitely helped by tapping into the experience of others while remembering that solid analytical assessment of policy alternatives is required. Furthermore, it is evident that "one size does NOT fit all" and that these collections of good practices and policies can serve only as frameworks for assisting policymakers to identify the appropriate approach for a case at hand.

E. Conclusion

This chapter clarifies what types of preferential trade agreements are emerging in Asia and the Pacific, and it establishes the fact that they vary widely in motivation, form, coverage and content. Bilateral agreements are much preferred to plurilateral or regional ones, while "free" trade areas/agreements are the most frequent form. However, in most cases, they push achievement of "free" trade several years into the future. Increasingly, countries are opting for a partnership or framework agreement – in principle, to signal that either they mean much more than trade integration or that they really do not mean serious trade integration, but are using the format to put together a framework of cooperation in several (non-trade-related) areas. More often, the latter is the case. This probably explains to some degree why a number of countries sign multiple agreements with the same partners.

Analysis has also discovered a reluctance to commit to full and quick liberalization in merchandise trade and to expose "other than goods" trade areas (including WTO-plus) to preferential liberalization. In summary, regionalism in Asia and the Pacific has not, so far, resulted in significant trade-diverting effects for the rest of the world. This also means that it has not succeeded in increasing intraregional trading linkages in terms of enhancing south-south cooperation or region-wide trade. Thus, as one possible approach, the creation of a large trading bloc(s) through policy-led consolidation of binding rules for series of PTAs (currently with heterogeneous rules), without trade-diverting effects for those economies left outside, could be considered.

A necessary next step in research is to establish conceptual frameworks for the consolidation of multiple PTAs, and to determine empirically if and by how much such consolidation of existing preferential deals will improve welfare and reduce poverty compared with the current situation.

References

Baldwin, R.E., 2006. “Multilateralising regionalism: Spaghetti bowls as building blocs on the path to global free trade”, CEPR Discussion Paper Series, No. 5775.

Bhagwati, J., 1992. “Regionalism versus multilateralism,” *World Economy*, vol. 15, No. 5; pp. 535-555.

Bonapace, T. and M. Mikic, 2007. “Regionalism quo vadis? Charting the territory for new integration routes”, chapter 5 in P. De Lombaerde (eds.), *Multilateralism, Regionalism and Bilateralism in Trade and Investment*, 2006 World Report on Regional Integration, Springer, Dordrecht, pp. 75-98.

Bonapace, T. and M. Mikic, 2006. “Freeing trade in Asia-Pacific: Comparative analysis of bilateral and regional trade agreements”, presentation for ESCAP Development Seminar, 28 October 2006 (mimeograph). Bangkok.

Bonapace, T. and M. Mikic, 2005. “Multilateralizing regionalism: Towards an integrated and outward-oriented Asia-Pacific economic area”, in *Delivering of the WTO Round: A High-level Government Business Dialogue*, Studies in Trade and Investment No. 56, ESCAP, Bangkok; pp. 85-111.

Bowen, H., A. Hollander and J-M. Viaene, 1998. *Applied International Trade Analysis*, Basingstoke, Macmillan Press Ltd.

DeRosa, D.A., 2007. “The Trade Effects of Preferential Arrangements: New Evidence from the Australia Productivity Commission," Peterson Institute Working Paper Series WP07-1, Peterson Institute for International Economics.

Feridhanusetyawan, T., 2005. “Preferential trade agreements in the Asia-Pacific region”, International Monetary Fund Working Paper, WP/05/149, Washington, D.C.

Findlay, C. and M. Pangestu, 2001. “Regional trade arrangements in Asia-Pacific: Where are they taking us?” Paper presented at the Trade Policy Forum on Regional Trading Arrangements: Stock taking and Next Steps, Bangkok, 12-13 June 2001.

Fung, V., 2005. “Business perceptions and expectations regarding the WTO Doha negotiations”, in *Delivering of the WTO Round: A High-level Government Business Dialogue*, Studies in Trade and Investment No. 56, ESCAP, Bangkok; pp. 10-15.

Goode, W., 2005. “Negotiating a free trade agreement: a guide”, APEC. http://www.apec.org/apec/enewsletter/jul_vol6/publication.primarycontentparagraph.0001.LinkURL.Download.ver5.1.9.

Lesher, M. and S. Miroudot, 2006. “Analysis of the economic impact of investment provisions in regional trade agreements”. Organisation for Economic Co-operation and Development, Trade Policy Working Paper No. 36 [TD/TC/WP(2005)/40/FINAL], Paris.

Limão, N., 2006. “Preferential trade agreements as stumbling blocks for multilateral trade liberalization: Evidence for the United States,” in *American Economic Review*, vol. 96, No. 3, June; pp. 896-914.

Mayda, A.M. and C. Steinberg, 2007. "Do south-south trade agreements increase trade? Commodity-level evidence from COMESA", IMF Working Paper (WP/07/40), Washington, D.C.

Mikic, M., 2007. "Trends in preferential trade liberalization in Asia and the Pacific", chapter I, in *Agricultural Trade: Planting the Seeds of Regional Liberalization in Asia*, Studies in Trade and Investment No. 60, ESCAP and ARTNeT, Bangkok.

Mikic, M., 2002. "Preferential trading agreements: Adding spices and noodles to a spaghetti bowl", *Cahiers de Commerce International,* No. 3, November, Universite Lumiere Lyon 2.

Oxfam, 2007. "Signing away the future", Oxfam Briefing Paper, Oxfam International.

Pomfret, R. 2007. "Asian regionalism: threat to the WTO-based trading system or paper tiger?," http://www.voxeu.com/index.php?q=node/309, 22 June

Schiff, M. and L.A. Winters, 2003. *Regional Integration and Development*, World Bank, Washington, D.C.

World Trade Organization, 2007. "The Changing Landscape of Regional Trade Agreements", WTO Discussion Paper No. 12.

World Trade Organization, 2006. World Trade News, No. 1466, 2 August, page 2.

World Trade Organization, 2004. "The future of the WTO: Addressing institutional challenges in the new millennium (The Sutherland Report)", WTO Consultative Board, Geneva.

Zhai, F., 2006. "Preferential trade agreements in Asia: Alternative scenarios of 'Hub and Spoke'", ERD Working Paper Series No. 83, Asian Development Bank, Manila.

Comment

REGIONALISM AND MULTILATERALISM: A FORCED MARRIAGE?

By Myrna S. Austria

The proliferation of regional trade agreements (RTAs) and bilateral trade agreements is the most significant trend in international trade policy since the 1990s. Most members of WTO are party to at least one RTA. This is happening even while the world is becoming increasingly integrated because of the intensive trade liberalization around the globe. By its nature, such arrangements discriminate against non-members. Parties to the agreements grant each other preferential treatment on a reciprocal basis. Likewise, as one country can be a member of more than one RTA, the overlapping RTAs can increase the risk of inconsistencies in trading rules among RTAs, which in turn can lead to implementation problems. Such inconsistencies can cause systemic risks on the functioning of WTO by rendering future efforts to develop multilateral rules difficult, if not impossible (Austria, 2003). All these factors have raised concerns over their effects on the trade environment as well as the trading system. Yet, the trend is expected to continue.

A. Forces driving bilateralism and regionalism

Several factors have been seen as contributing to this continuing phenomenon. First, there is now less incentive for countries to engage in WTO, given the extensive tariff liberalization over the past decades. WTO continues to focus on tariffs in manufacturing and less on agricultural products, which is of interest to developing member countries.

Second, tariffs are no longer seen as the most important obstacle to international trade. Non-tariff and non-border issues are increasingly becoming more important in the improvement of international exchange, including trade and investment facilitation, competition policy, government procurement, and intellectual property rights. However, these issues are difficult for WTO to handle because of political sensitivity, since they affect national sovereignty. Nonetheless, many consider these issues easier to negotiate bilaterally or by like-minded countries compared to the diverse WTO membership.

Third, the aftermath of the Asian financial crisis during 1997–1998 has demonstrated the need for cooperation in managing the existing integration. The crisis spread quickly around the region, with little regard to differences in the fundamentals of the economies (Tay, 2001). The kind of integration that already existed in the region was of no help to the economies in doing anything to prevent the contagion (Austria, 2003). This realization increased the awareness of the affected economies that they should do something by themselves as a region.

Fourth, APEC lost its momentum for trade liberalization as manifested by the failure of the Early Voluntary Sectoral Liberalization (EVSL). The disappointing outcome of EVSL shows that moving beyond the voluntary approach for liberalization to binding commitments may not be relied upon as an instrument for regional liberalization in APEC. The experience also showed that not all members of APEC, particularly Japan and the United States (the two leading economic powers in the world and in Asia and the Pacific), are willing to take active participation in APEC's concerted unilateral approach to liberalization. They are, in fact, more likely to deliver their APEC commitments through the negotiated process of WTO (Scollay and Gilbert, 2001). Hence, formation of sub-RTAs within APEC could be regarded as an instrument for expediting liberalization among "like-minded" economies in the region that are willing to proceed with liberalization ahead of the others.

Finally, in the case of the ASEAN, there is the increasing pressure to stay competitive, including the rapid emergence of China as an economic power and the growing attraction of India among foreign investors. The high level of economic growth of China is disruptive to some sectors in ASEAN, especially in labour-intensive industries. Rising wages and costs in ASEAN are reducing its comparative advantage under the current industrial structure and shifting the balance to China and India (Austria, 2003 and 2005). The presence of global production networks (GPNs) among multinational companies (MNCs) in ASEAN creates an incentive for it to reduce transaction costs through the progressive elimination of rules of origin requirements, reduced trade barriers, and greater capital and labour mobility. Otherwise, an increase in production and administrative costs of these MNCs will force them to move out of the ASEAN region.

However, such an environment for GPNs requires an economic integration that is far deeper and more comprehensive than that currently aimed at by the ASEAN Free Trade Area (AFTA), the ASEAN Framework Agreement on Services (AFAS) and the ASEAN Investment Area (AIA). Thus, given the current resistance to further economic policy reforms in the region, especially from those still recovering from the Asian financial crisis, ASEAN's extraregional linkages provide an opportunity to push the needed reforms that otherwise would have been more difficult, if not impossible, without triggering national and regional sensitivities (Austria, 2006). Most of these reforms are in the areas of deregulation and structural reforms to further promote economic growth (Urata, 2004).

Furthermore, the proliferation of bilateral agreements and RTAs in North America and Europe, and recently in East Asia, has created many new competitors for ASEAN, for both export markets and sources of foreign direct investment (FDI). ASEAN members know that they face discriminatory deals from arrangements in which they are not members. This is particularly relevant to ASEAN-5 who are hosts to a critical mass of global electronics players from the United States, Europe, Japan, the Republic of Korea and Taiwan Province of China (Austria, 2005). Since RTAs/FTAs are characterized by lower barriers to trade and investment, reduced transaction costs, harmonized standards and legal norms, GPNs would prefer to locate their subsidiaries or outsource their production to economies with which their own economies are linked through FTAs (Stein and Daude, 2001).

In addition, the rules of origin in FTAs and RTAs encourage MNCs to locate in economies that belong to the same RTA/FTA as their source economies in order to overcome such rules of origin. In short, RTAs/FTAs in which an economy is not a member may displace that economy's exports. Thus, ASEAN's extraregional linkages provide a way out from the differential treatment and trade diversion. Effectively, the ASEAN economies are now competing as hosts to GPN-related foreign investment with other developing economies that belong to the same RTAs/FTAs as the economies of the United States, Japan and Europe (Austria, 2005).

Still related to the issue of the proliferation of FTAs/RTAs, ASEAN's extraregional linkages increase its leverage in trade negotiations and discussions, particularly in WTO (Munakata, 2002), and amplifies its voice in regional issues given its increased stakes in regional developments (Soesastro, 2003).

B. Making regionalism work

The proliferation of RTAs has raised concern over the effects on the trade environment as well as on the trading system. The usual question of whether RTAs are building blocks or stumbling blocks for the rules-based multilateral trading system under WTO has been greatly debated in the literature. Whether an RTA brings about a gain in welfare or not depends on the balance between trade diversion and trade creation. Trade diversion occurs when an inefficient company inside an RTA is able to gain market access, because of the preferential agreement, at the expense of an efficient firm in a non-member of that RTA. On the other hand, trade is created when efficient firms within an RTA are able to expand their market shares at the expense of inefficient firms in non-members. The overall impact depends on the net effect of trade creation and trade diversion.

Since regionalism is expected to continue, making it work in favour of global free trade has become a challenge to policymakers, the academia and international development agencies. Possible areas in which this could be attained are:

(a) Strict enforcement by WTO of Article XXIV of GATT, which allows the formation of RTAs. Article XXIV has not been binding. Thus, all RTAs and bilateral agreements should be subject to (i) a WTO-consistency test, such as the adoption of liberal rules of origin, (ii) ensuring broad product coverage, including sensitive sectors and minimizing exclusions, and (iii) the provision of clear phase-outs of exclusions;

(b) A frank assessment of RTAs, taking into account their stated motivations and whether those stated motivations are best met by using RTAs; and

(c) A successful conclusion of the Doha Round, which is still the best solution to possible adverse effects arising from the proliferation of RTAs.

C. Possible areas of research

1. Investment issues as they relate to RTAs/FTAs

Much of the discussion and research concerning the effects of RTAs has been focused more on trade and less on investment. The implications of RTAs with regard to possible investment diversion should be examined and measured, and particularly the effects on technology transfers and increased productivity and efficiency of domestic firms.

2. Reforms at WTO

The Doha Round should review the relevance and applicability of Article XXIV, given the proliferation of RTAs. WTO should formulate a framework for regionalism to make it work in favour of global trade.

3. Common framework for bilateralism/regionalism in ASEAN

ASEAN is proceeding with an ad hoc approach in dealing with its extraregional linkages, without the guidance of a single common framework. This is also true even among the individual members who are pursuing bilateral trade agreements. The absence of a single common framework makes the building block process more complicated than it appears, if not impossible (Austria, 2006). In fact, it endangers the whole building block process as it could lead to a series of agreements that differ greatly from each other. This could give rise to the "spaghetti bowl" effects, where each agreement will have different scope and tariff reduction schedules, different rules of origin etc. Thus, instead of becoming building blocks, the bilateral initiatives become stumbling blocks.

4. Ex-post empirical work on the impact of trade liberalization

Much of the empirical work on trade liberalization has been ex ante. Usually, computable general equilibrium (CGE) analyses show the positive benefits of trade liberalization. However, some developing countries that have opened up their economies have not experienced the promised benefits of trade liberalization. This has become a question and a puzzle to many. On the other hand, the dynamic effects of trade liberalization on the economy (such as increased productivity, technology transfer, macroeconomic stability etc.) are not captured by standard CGE models. Thus, the effects of trade liberalization could have been understated.

The above issues call for an ex-post evaluation of the impact of trade liberalization. The ex-post evaluation could be a combination of a general equilibrium analysis as well as industrial or sectoral studies. However, the latter has been less studied.

5. Impact of non-tariff and non-border issues on growth

The impact of trade and investment facilitation, competition policy, intellectual property rights, government procurement and other non-border issues on economic growth has received less attention in empirical work. However, since these issues are increasingly becoming the primary factors affecting international exchanges of goods and services, research activities should focus on them.

References

Austria, M., 2003. "ASEAN Free Trade Area: Lessons learned and the challenges ahead" in Sa-Myung Park and Supachai Yavaprabhas (eds.), *Regional Cooperation and Identity Building in East Asia in the Age of Post-Cold War Globalization*. Seoul, Korea Association of Southeast Asian Studies.

______, 2005. "Recent developments in the electronics production networks in Southeast Asia", paper prepared for the Canada-ASEAN Trade and Investment Analytical Study. (Accessed at http://www.asiapacificresearch.ca/caprn/as_project/index.cfm on 15 September 2005).

______, 2006. "ASEAN extraregional linkages: Implications for an East Asian Community", in Ping, Siew Yian and Yu (eds.), *The East Emerging East Asian Community: Security and Economic Issues.* Universiti Kebangsaan Malaysia.

Munakata, N., 2002. *Whither East Asian Economic Integration?,* RIETI Discussion Paper Series 02-E-007.

Scollay, R. and J. Gilbert, 2001. *New Regional Trading Arrangements in the Asia-Pacific.* Washington, D.C., Institute for International Economics.

Soesastro, H., 2003. Building an East Asian Community through Trade and Investment Integration. Economics Working Paper Series No. 067, Center for Strategic and International Studies, Jakarta.

Stein, E. and D. Christian, 2001. "Institutions, integration, and the location of foreign direct investment", paper presented during the 2001 Annual Meeting of the Boards of Governors, Inter-American Development Bank and Inter-American Investment Corporation, Santiago, Chile.

Tay, Simeon, S.C., 2001. "ASEAN Plus 3: Challenges and cautions about a new regionalism", paper prepared for the Asia-Pacific Roundtable, June 2001, Kuala Lumpur.

Urata, S., 2004. "The emergence and proliferation of FTAs in East Asia", in Proceedings of the International Conference on Creating an East Asian Community: Prospects and Challenges for Fresh Regional Cooperation, organized by the National University of Singapore, 8-10 January 2004, Singapore.

Part III

Services liberalization as a development opportunity

Chapter III

SERVICE TRADE LIBERALIZATION AS A DEVELOPMENT OPPORTUNITY: THE ROLE OF THE WORLD TRADE ORGANIZATION*

By K.C. Fung and Alan Siu

Introduction

Service trade liberalization is one of the most important areas of negotiations in the Doha agenda. Given the complexities involved in this topic, it is safe to assume that service liberalization will remain an important negotiation and research topic beyond the completion of the Doha Round, which at this moment is indefinitely suspended. The “concession demanders” in the area of service trade liberalization are the rich, industrialized countries; partly because of this fact, trade liberalization in services is almost universally believed to be against the trade interests of the developing countries. To some degree, this belief is justified, but only in a technical, negotiation sense.[1]

It is widely known that the other major areas of negotiations for the Doha Round of trade talks are cuts in agricultural subsidies and protection as well as the reduction of industrial tariffs. The implicit “grand bargain” is for industrialized countries such as the United States, France and other European Union members to provide deep cuts in subsidies and protection in the agriculture sector and, in return, developing countries such as Brazil and India will open up their service industries (Financial Times, 2005). This highlights the view that at the general political level, the implicit negotiation linkage for developing countries is to give up service sector and industrial sector protection in exchange for agricultural sector liberalization in the industrialized economies.[2]

However, while this grand vision of a comprehensive exchange of concessions implies that developing countries lose from giving up too much in service liberalization, there are many reasons to believe that even without significant reciprocal concessions in return, developing countries may well benefit from their own liberalization of their service sectors. Service industries, such as finance, act as important intermediates for other

* This project is partly supported by a grant from the University Grants Committee, Hong Kong, China (Project No. AoE/H-05/99).

1 Negotiation interests and unilateral economic interests can be quite different. For a discussion of this aspect, see K.C. Fung and others, 2005.

2 In some cases, the service sectors of some developing countries may be too small to be considered significant reciprocal concessions. However, these concessions can be seen as long-term gains for the industrialized countries. As developing economies grow, their service sectors will expand. The concessions in the service sectors are locked in.

sectors. Their liberalization (together with judicious regulations and monitoring) can significantly improve the productivity of other industries in the economy. Indeed, the malfunctioning of certain service industries can create economic chaos, as was clearly highlighted by the 1997 Asian financial crisis.

Intellectually, at least in the Asia-Pacific region, the idea that service liberalization can enhance economic development is not totally alien. Given the painful experience of the Asian financial crisis, and the decade-long slow growth in Japan that was at least partly induced by its banking problems, many policymakers are aware of the need to carry out reforms and liberalization in the financial sector. So why is it so difficult to accept service sector liberalization, even though such a policy is expected to foster economic development? For anyone who has any practical policy experience, the answer, at least in part, lies in the political economy of such liberalization. Service trade liberalization has winners and losers. The losers will always attempt to block these policies. Some of the existing domestic regulations exist because of such lobbying in the first place.

Section A of this chapter discusses service trade liberalization as an opportunity for economic development. This discussion is couched in the context of the literature on the so-called East Asian miracle or, from another viewpoint, the literature on the myth of the East Asian miracle. Section B argues that in order to realize this opportunity, it is necessary to understand fully the political economy of such liberalization. A particular approach is taken and a political economy model of service trade restrictions is created. The model is then used to highlight what can be done to relax the political-economic constraints in order to further service trade liberalization and thus economic development. In particular, the role of WTO in fostering such liberalization, and thus development, is highlighted. Section C discusses the growth-accounting literature as applied to East Asia and Southeast Asia, examines the role of services in creating further economic growth, and then focuses on the political difficulty and potential solutions to fostering service trade liberalization. Section D provides an overview of the discussion.

A. Economic growth and service trade liberalization

In a very simple sense, the growth-accounting literature proposes that there exists an economy-wide production function, linking aggregate output to its inputs such as labour and capital.[3] Translating output levels into growth rates of outputs, the growth rate of an economy can easily be translated to the growth rates of its inputs, plus a residual that researchers attribute to technical progress. Using an extremely simplified example, it can be postulated that the economy-wide production function is of the Cobb-Douglas type:[4]

$$Y = AK^{a}L^{1-a} \tag{1}$$

[3] Some of the materials used in this section are taken from K.C. Fung, 2006.

[4] The aggregate production function does not need to be Cobb-Douglas, which is used here as an illustrative example only.

where Y is the aggregate output, A is the level of technology, K is capital, L is labour and "a" is the national income share of capital owners. It is clear that economic growth of output can be decomposed into the growth of the inputs and the change of the state of technology:

$$dY/Y = dA/A + a(dK/K) + (1-a)\,(dL/L) \qquad (2)$$

Technical progress can be measured as the "Solow residual", or the residual from the difference between growth of output and growth of inputs. The analysis can be made more complex by incorporating human capital or intangible capital (such as research and development spending) as a third or fourth input. However, the essential analysis remains the same.

Empirically, there has been a very lively debate among prominent researchers such as Young (1995), Lau and Park (2003), Krugman (1994) and Hsieh (2002), who applied this growth-accounting framework to the case of East Asia and Southeast Asia. To summarize their findings, they found that there had been no technical progress in China, the Asian newly industrialized economies (NIEs) and the ASEAN-4 (Indonesia, Malaysia, the Philippines and Thailand) prior to 1985. There was some evidence that after 1985, in the case of most of the Asian economies studied, there was some technical progress.[5] Tables 1 and 2 highlight some results from this literature.

Tables 1 and 2 show that after 1985, even if human capital is included as an input, most Asian economies (except China and the Philippines) exhibited some technical progress. Naturally, Japan has always been an exception. Its growth is propelled by a sizeable degree of technical progress, both before and after 1985.

Table 1. Sources of economic growth in East Asia and Southeast Asia, pre-1985

Country/area	Physical capital	Labour	Technical progress
Hong Kong, China	74.61	25.39	0.00
Republic of Korea	82.95	17.05	0.00
Singapore	63.41	36.59	0.00
Taiwan Province of China	86.60	13.40	0.00
Indonesia	88.79	11.21	0.00
Malaysia	66.68	33.32	0.00
Philippines	66.10	33.90	0.00
Thailand	83.73	16.27	0.00
China	94.84	5.16	0.00
Japan	55.01	3.70	41.29

Source: Lau and Park, 2003.

[5] Using different data, some technical progress for selective economies was found by Chang-Tai Hsieh, 2002.

Table 2. Sources of economic growth in East Asia and Southeast Asia, post-1985

Country/area	Physical capital	Labour	Human capital	Technical progress
Hong Kong, China	41.81	6.46	1.58	50.14
Republic of Korea	44.54	14.98	1.75	38.73
Singapore	37.01	31.30	1.52	30.17
Taiwan Province of China	43.00	10.46	1.38	45.16
Indonesia	62.79	15.91	5.69	15.61
Malaysia	42.87	33.41	3.25	20.47
Philippines	52.18	41.63	6.23	-0.03
Thailand	51.01	13.32	2.36	33.31
China	86.39	10.37	3.27	0.00
Japan	38.21	2.47	1.17	58.14

Source: Lau and Park, 2003.

However, even if research and development spending is included as an additional input, the researchers found that there had been no technical progress for East Asian and Southeast Asian economies, pre- or post-1985.[6] Thus, economic growth in much of post-1985 Asia can be attributed to human capital, and research and development spending. These observations about the sources of economic growth do not imply the absence of sizeable technical progress at a sectoral level (e.g., Korean cell phones or Taiwanese laptop manufacturing). However, for the economy as a whole, technical progress did not show up in growth accounting. In general terms, therefore, before 1985 economic growth in Asia was due exclusively to growth in traditional inputs (physical capital and labour). After 1985, some growth was propelled by non-traditional inputs such as human capital, and research and development.

At the policy level, it appears that Asian and other developing economies should continue to invest in education (to enhance human capital) and increase spending on research and development. The problems with these sources of growth are two-fold. First, they are costly, particularly spending on research. Second, the results may take a long time to realize. Despite these problems, in the longer term there are no good alternatives to making investments in intangible capital and human capital.

Service sector liberalization can be a complementary policy to investment in these other forms of capital. Service sectors such as finance, distribution, logistics, transport and telecommunications act like infrastructure and lubricants for other industries in the economy. They can be viewed in a variety of ways in the context of growth accounting. One simple way is to think of them as another form of intangible capital, so that the growth of output of a developing country can be seen as:

---

6 For more details, see L.J. Lau and J.S. Park, 2003.

$$dY/Y = dA/A + a(dK/K) + b(dL/L) + (1\text{-}a\text{-}b)\ (dS/S) \quad (3)$$

where S is the amount of service output available for production and "b" is the labour share of national income. A more subtle way to incorporate service into the aggregate production function is additionally to allow a separate amount of service-enhanced amount of physical capital (much like human capital) in the production function. With gradual liberalization of services over time, the growth rate of the national output increases while other factors remained constant. A third way to incorporate service liberalization in the growth-accounting framework is to assume that service sector liberalization will increase A, or the level of technology. While it is necessary to perform the actual empirical work to see how much services can contribute to development, the important basic conceptual point is:

> Service trade liberalization constitutes an important channel for economic growth, in addition to investment in education and spending on research and development.

B. Political economy of service trade liberalization

If indeed service trade liberalization is a new channel for economic development, and one that growth accounting may not have taken into account, then why is service trade liberalization so difficult to achieve? The basic answer lies in the political economy aspects of such liberalization. There has been extensive literature on trade liberalization associated with WTO. On liberalization of selective service sectors, many influential and insightful papers have also been written (Sapir, 1998, Hoekman and Messerlin, 2000, and Hoekman and Braga, 1997, among others). However, in terms of theoretical research work focusing on the political economy of liberalizing trade in services, the literature has been minimal by comparison.[7]

This section aims to provide a simple, tractable model of the political economy of service sector liberalization in order to illustrate some possibilities for research in this area. The model, while simple, will allow the capture of some of the important stylized features of the service sector that are often alluded to in the literature (see, for example, Hoekman and Messerlin, 2000, Warner, 2000, and Sauve and Wilkie, 2000). Furthermore, the model will also permit consideration of the links between the liberalization of a developing country's service industry and liberalization in the agricultural sector of industrialized countries. In addition, it highlights how, despite the fact that liberalizing the service sectors improves the welfare and growth prospects of the developing countries, political economy considerations can still hinder economic development. The model further highlights how multilateral trade negotiations sponsored by WTO can help the liberalization process.

According to the General Agreement on Trade in Services (GATS), there are four types of trade in services. Karsenty (2000), and Ito and Krueger (2003) discussed these modes extensively. They are:

---

[7] Some recent exceptions include K.C. Fung and A. Siu, 2006, and some related theoretical modelling work by J. Francois and I. Wooton, 2001.

(a) Cross-border trade in which services can be produced in one country and delivered to another economy (for example, banking services that are provided to foreigners via mail or telephone, which are counted as exports of service);

(b) Trade in which consumption occurred abroad, i.e., domestic residents go abroad to consume the products (for example, tourism);

(c) Services provided via foreign direct investment. That is, sales provided to foreign nationals by foreign branches and subsidiaries of the home entities (for example, foreign subsidiaries of insurance companies or hotel chains);

(d) Services are provided by movement of natural persons. This category includes people such as consultants, accountants, doctors, etc. moving from the home country to the foreign country to deliver the services.

In addition, several stylized economic characteristics of the service industries affect trade liberalization in the sector (see, for example, Feketekuty, 2000, Francois and Wooton, 2001). This section considers the following aspects:

(a) The frequent perception of service trade barriers as qualitatively different from trade barriers in goods.[8] Instead of tariffs and quotas, trade barriers in services are often closer to regulatory barriers (e.g., regulations in telecommunication) and entry barriers (e.g., restrictions against entry by foreign banks);

(b) Due to barriers to entry and other inherent economic characteristics, service industries often exercise various degrees of market power. In other words, they are quite often imperfectly competitive;

(c) The use of service industries, and particularly producer services as "lubricants" for other industries (e.g., in trade-related services, finance, distribution, etc.)

Aspect (c), the intermediate roles of some services, often leads observers to call on the governments of the developing countries to recognize the virtues of unilateral liberalization, and to proceed with domestic reforms in the service industries without regard for global negotiations. While this is eminently reasonable – and a fair amount of reforms have actually taken place, particularly in East Asia – it may appear unrealistic, given that most governments (particularly those of developing countries) will be subject to influences from special interests. This section shows that WTO, with its sponsoring of multilateral trade negotiations, can help relax the political-economic constraints and allow a greater degree of service sector liberalization.

1. An illustrative political-economic approach

To start the model, consider an open economy (a developing country) with two sectors: a formal sector that is open to international liberalization negotiations and an

---

[8] For attempts to measure trade barriers in the service sectors, see P. Dee and K. Hanslow, 2001.

informal sector that is not open to trade. The formal sector comprises three industries – the service industry, the manufacturing industry and the agricultural business (agribusiness) industry. The producer service industry is government-regulated, so trade barriers exist in the form of entry barriers against foreign affiliates. The manufacturing industry is also competing with imports. However, the agribusiness industry is producing for home consumption as well as for exports. An attempt is made here to depict a situation of a developing economy that may be involved in the Doha Round of trade talks (e.g., Brazil). It is exporting agricultural products while importing manufacturing goods and services.

The informal sector produces the numeraire good *N* using mobile homogenous labour only. The technology for the numeraire good is constant return to scale. The mobile factor is supplied inelastically to the developing country's economy. As long as the informal sector is active, the constant marginal product of the mobile factor fixes its economy-wide return to unity.

Total population in the economy is normalized to one. A fraction α^s of the population are the owners of capital in the service industry, a fraction α^m of the population are the owners of capital the manufacturing industry, and α^a is the fraction of the population who are capital owners in the agricultural business. The remaining $1\text{-}\alpha^s\text{-}\alpha^m\text{-}\alpha^a$ (hereafter, α^w) individuals are the owners of the mobile factor (labour), which is used in both the formal and informal sectors, and earn a fixed return normalized to one. The owners of the mobile factor are assumed to be politically inactive. The owners of capital organize as interest groups for political activities.

The service industry has *n* identical domestic firms,[9] each producing a homogenous service output *s* at a price $P^s(S)$, where $S = ns$. Each firm in the industry produces its service output *s* with an identical production function *f,* using capital and the mobile factor labour. With the standard properties of the production function,[10] we can generate the dual cost function C^s, which depends on the quantity of the producer service output *s* and the factor prices *r* and *w.*[11] As discussed above, one important characteristic of service industries is that they tend to have market power, so it is assumed that these firms are Cournot-Nash oligopolists. Each firm's profit function π^s is:

$$\pi^s = sP^s(S) - C^s(s, w, r) \tag{4}$$

It is assumed that these service providers are shielded from foreign competition. An increase in *n* will denote foreign entry and a liberalization of service trade.[12]

$$S_n > 0 \tag{5}$$

$$\pi^s_n < 0 \tag{6}$$

---

9 The industry can also be allowed to contain some foreign firms. The results will not be altered.

10 *f* is continuous from above, quasi-concave and non-decreasing.

11 The wage rate is actually fixed at one.

12 We have thus focused on a particular mode of service trade, namely trade via the movement of foreign firms to the domestic market.

where the subscripts n denotes partial derivatives.[13] A reduction of the trade barriers in the service industry will thus increase the total volume of services (which, in turn, will reduce the price of providing the service). However, foreign entry will also lead to a reduction in the profits of the incumbent domestic service firms. Here, the losers from service trade liberalization (the incumbent service providers in the developing countries) are identified.

Next, we turn to the manufacturing firms and the agribusinesses. The profit functions of each can be represented by:[14]

$$\Pi^m = mP^m(M) - C^m(m, w, r, P^s) \tag{7}$$

$$\Pi^a = aP^a(S) - C^a(a, w, r) \tag{8}$$

Note that the price of the service output is used as an input to the manufacturing industry in equation (7). This captures a second feature of the service industry, in which services such as distribution and trade-related services are used as “lubricants” for other industries.

Next, the political-economy side of the model is developed, which will allow discussion of trade liberalization in the service industry in a more realistic setting. The model is similar in structure to Grossman and Helpman (1994), Rama and Tabellini (1998), and Fung and Lin (2001). To do this, we first turn to the demand side of the economy. All individuals in this developing economy are assumed to have the same preferences. The indirect utility function of each individual in group i has the form:

$$V^i = I^i + CS^i(P^m, P^a) \tag{9}$$

where CS = consumer surplus derived from consumption of the manufacturing good and the agricultural product. It is assumed that the producer service output is not directly consumed by individual consumers.

The gross indirect utility functions for each individual in each group are: $V^s = n\pi^s/\alpha^s + CS^s$, $V^m = \pi^m/\alpha^m + CS^m$, $V^a = I^a + CS^a$, $V^w = I^w + CS^w$, where I^a is the return to the specific capital in the agricultural sector and I^w is the fixed return to the mobile factor.

With no lobbying, it is assumed that the policymakers can choose an appropriate level of n to maximize social welfare. The government’s objective function is given by:

$$Max_n\, W = \alpha^s V^s + \alpha^m V^m + \alpha^a V^a + \alpha^w V^w \tag{10}$$

[13] The derivations of these partials are available upon request.

[14] It can be assumed that the capital owners in the manufacturing industry are earning rents in an imperfectly competitive environment and that the capital owners in the agribusiness are owners of the specific factor – capital – in each industry. An expansion of trade due to trade liberalization in European Union or the United States agriculture will allow the capital owners in this industry to earn a higher real rate of return.

where W is the social welfare level that can be attained in the absence of any political contributions to the government. The socially optimal n is then given by $n^w = arg\ max\ W$.

The lobbying structure follows the Grossman and Helpman (1994) framework, which applies the Bernheim and Whinston (1986) study on menu-auctions and common agency. The various interest groups, as bidders, offer various contribution schedules corresponding to different entry barriers to the government at the first stage. The government, as the auctioneer, sets n by evaluating the weighted sum of contributions and aggregate social welfare at the second stage. An equilibrium is a set of contribution schedules and the politically determined number of producer service providers.

The equilibrium contribution schedules imply that the interest groups contribute up to the point where the marginal benefit from the resulting change in the number of providers exactly equals to the marginal contribution costs. In equilibrium, the contribution schedules of each interest group are given by:

$$\alpha^i V^i_n = \lambda^i_n (n) \tag{11}$$

where i is the lobby group, $\lambda^i_n (n)$ is the contribution schedule provided by interest group i.

2. Lobbying by producer service providers

First, it is assumed that only the producer service providers will lobby to restrict entry to their own industry. The government's objective is to maximize the possibility of being re-elected. With lobbying, other than providing a high standard of living to the public, the government has another resource to enhance its possibility of being re-elected, i.e., contributions provided by the interest groups. With lobbying, the government's objective function contains not only the aggregate social welfare, but also the total level of political contributions. The objective function can be written as:

$$Max_n\ V^G + (\beta^s - 1)\left[\lambda^s(\mathrm{n})\right] + W \tag{12}$$

where $\beta^s > 1$ represents the weight that the government puts on the contributions provided by the interest groups.[15]

Using equations (13) and (14), the first order condition of the government's optimization problem is:

$$V^G_n = \beta^s \alpha^s V^s_n + \alpha^a V^a_n + \alpha^m V^m_n + \alpha^w V^w_n = 0 \tag{13}$$

The politically determined number of providers is given as $n^p = arg\ max\ V^G$. By totally differentiating equation (16) with respect to n and β (and evaluating β at 1), it is shown that lobbying by the service providers will lead to entry barriers.

[15] $\beta > 1$ implies that the government values a US dollar offered by the interest groups more than a US dollar in the hands of the public.

By restricting entry, the economic rents of the incumbent service providers are increased. In the context of the Doha Round, it is assumed that the any relaxation of the entry barriers will lead to entries by foreign firms. These entry barriers thus constitute trade barriers. So far, it has been shown that lobbying by the service providers leads to trade restrictions in services.

C. Liberalizing producer service trade restrictions

1. Cross-cutting lobbying

Given that trade restrictions are the result of explicit lobbying by the insiders of the service industries, and that the economic rents are captured by these incumbents, what can be done to try to relax these politically determined trade barriers? If it is now assumed that the manufacturing firms are also allowed to lobby, the objective function of the government becomes:

$$Max_n \; V^G = (\beta^s - 1)[\lambda^s(n)] + (\beta^m - 1)[\lambda^m(n)] + W \tag{14}$$

where $\beta^m > 1$ is the weight attached by policymakers to the contributions made by the manufacturing capital owners. The first order condition for maximization of this modified objective function is:

$$V_n^G = \beta^s \alpha^s V_n^s + \alpha^a V_n^a + \beta^m \alpha^m V_n^m + \alpha^w V_n^w = 0 \tag{15}$$

Essentially, the government places more weight on the interests of the incumbent service providers as well as the manufacturing capital owners because they provide funds to the government. What are the effects of allowing an industry to lobby for the entry and trade policy in another industry? That is, what are the effects of allowing cross-cutting lobbying? It results can be seen by totally differentiating equation (12) with respect to n and β^m. The resulting politically determined number of producer-service providers will be larger than when only the service providers are allowed to lobby. Intuitively, this is precisely because producer services are used as lubricants in other industries. The manufacturing capital owners lobby to relax the trade and regulation barriers in order to allow foreign affiliates to enter the service industry. With a larger number of providers, the price of the service output declines, which, in turn, raises the profits of the owners of manufacturing firms.

In reality, existing regulations in the service industries are often opaque, complex and convoluted. For example, information and specific knowledge about the financial industry or telecommunications industry are difficult to master. That is why rents in services are often captured by insiders. To facilitate cross-cutting lobbying, these regulations should be made more transparent and consistent. The process of government policymaking should also be made more transparent; however, this is not always the case, particularly in developing economies. Thus:

Allowing cross-cutting lobbying by the manufacturing industry will enhance trade liberalization in the service industry. In general, more transparency in policymaking and regulations in the service sector will facilitate service trade liberalization.

2. State-owned service providers

In many service industries of developing economies, the provision of services is often done by state-owned enterprises. Suppose we assume that $\theta < n$ is the number of incumbent service providers in the economy. Bureaucrats and government ministries directly own these entities, and the economic profits of the state-owned firms go directly to the treasury of the government. Both the government bureaucrats and ministries derive explicit and implicit income from the state ownership of these service providers. The maximization of the government objective function becomes:

$$V_n^G = \beta^s \alpha^s V_n^s + \alpha^a V_n^a + \beta^m \alpha^m V_n^m + \alpha^w V_n^w + \alpha^b V_n^b = 0 \tag{16}$$

where V_n^b is the impact of a relaxation of the trade restriction in the service industry on the utility of the government bureaucrats in control of the state-owner service providers, and α^b is the fraction of the population that comprise government bureaucrats who control these state-owned service providers. By differentiating equation (13) with respect to n and α^b, we can easily see that reducing the number of government-owned service providers will lead to a more relaxed policy towards service trade. The reason is simple: trade restrictions allow government bureaucrats to capture some of the economic rents in the service industry. These rents are proportional to the number of service firms under government control. Thus, we have:

Reducing the number of state-owned service providers will enhance trade liberalization in the service industry.

3. Multilateral cross-sectoral negotiations

In the literature, there has always been a notion that cross-sectoral negotiations will enhance liberalizations across the board. For the current proposed cuts in subsidies and tariffs in the European Union farm sector, it is clear that these cuts are contingent on “satisfactory” openings in the service industries in the developing countries. In our model, this feature can be seen by incorporating lobbying by the agribusinesses, with the first order condition of the government objective function being:

$$V_n^G = \beta^s \alpha^s V_n^s + \beta^a \alpha^a V_n^a(\mathrm{t}) + \beta^m \alpha^m V_n^m + \alpha^w V_n^w + \alpha^b V_n^b = 0 \tag{17}$$

where β^a is the weight attached by the policymakers on the contributions provided by farmers and t is the farm tariff rate imposed by the European Union. Without cross-sectoral negotiations, the impact of liberalizing the service industry on domestic farmers is only through their consumption of the lower-priced manufacturing goods. With linked negotiations, a larger n will also lead to a lower t, which raises the returns to the specific capital owned by the lobbyists from the domestic farm sector. By differentiating equation (14) with regard to *n* and *t*, it can be seen that linked negotiations will lead to an easing of the trade barriers in the service sector. Thus:

> Cross-sectoral negotiations will enhance trade liberalization in the service sector. Multilateral trade negotiations sponsored by WTO relax the political-economic constraints and can lead to more liberalization in the service sectors.

D. Conclusion

Service trade liberalization is an important component of the now stalled Doha Round of multilateral trade talks. Viewed from the perspective of the literature of Asian growth accounting, we can easily conceptualize service liberalization as an additional important channel for economic development. While it is true that the East Asian and Southeast Asian economies need to continue investing in human capital as well as research and development, it is also safe to say that service trade liberalization can be a powerful ingredient in fostering more economic growth. In order to gauge the quantitative importance of service trade liberalization for growth rates, actual empirical research needs to be conducted in this area in the future.

While it is relatively easy to think of service trade liberalization as a positive force for economic development, it is also not difficult to see that reforms and liberalization in services have not been sufficient. To understand such contradictions further, a simple theoretical model has been constructed in this chapter that depicts the various political-economic facets of trade liberalization in the service sector in the context of the Doha Round trade talks. First, a model was built that incorporates three stylized features of the service sector:

(a) Trade barriers often occur in the form of entry barriers;

(b) Producer service providers are used as lubricants in other industries; and

(c) Service firms often have market power.

To discuss liberalizing the service sector, it is the authors' opinion that an explicitly political-economy model along the lines pioneered by Grossman and Helpman is more appropriate than the depiction of a welfare-maximizing government. By using this simple formal model, it has been shown that lobbying by the service providers leads to trade restrictions in the service industry.

This model has then been used in discussing several interesting issues in the context of global trade negotiations. First, allowing cross-industry lobbying (in the sense of allowing the manufacturing capital owners to lobby for influences in the service industry's entry restrictions) will enhance trade liberalization in the service sector. Next, it was noted that in many developing economies, service providers are often owned by the State. By using this model, it has also been shown that reducing the number of state-owned service providers will ease trade restrictions in the service industry. Finally, the issue of cross-sectoral negotiations has been considered. Proposed liberalization by the European Union and the United States is contingent upon "satisfactory" openings in the service sectors of the developing countries. This model has shown that such linked negotiations would indeed lead to greater trade liberalization in the service sector.

It has been argued here that multilateral trade talks sponsored by WTO would help relax political-economic constraints and push service trade liberalization further along. Future research will be needed in examining the institutional details of the political-economic forces in various developing countries in order to develop this line of inquiry.

This chapter has provided a general framework that lays out the theoretical aspects that would liberate economies from their political constraints and allow developing countries to engage in service sector liberalization. Overall, it has been shown that institutions such as WTO, which will eventually facilitate service sector liberalization, will (at least indirectly) go a long way towards enhancing economic development in developing countries.

Annex

Structure of the political-economy model of service trade liberalization

The structure of the political-economy model of service trade liberalization is:

$$\pi^s = sP^s(S) - C^s(s, w, r) \qquad (1)$$

The first and second order conditions are:

$$d\,\pi^s/ds = \pi^s_s = P + sP' - C^s_s = 0 \qquad (2)$$

$$d\,\pi^{s2}/d^2 s = \pi^s_{ss} = 2P' + sP'' - C^s_{ss} < 0 \qquad (3)$$

For the liberalization experiments that we want to study, we assume that a stable Nash equilibrium is holding:

$$D = P'n + sP''n - C^s_{ss} < 0 \qquad (4)$$

$$K = P' - C^s_{ss} < 0 \qquad (5)$$

These stability conditions are derived formally in Seade (1980). It is assumed that these service providers are shielded from foreign competition. An increase in *n* will denote foreign entry and a liberalization of service trade. Using (1) to (5), it is shown that:

$$S_n = s(P' - C^s_{ss})/D > 0 \qquad (6)$$

$$\pi^s_n = -s(P - C^s_{ss})\,\pi^s_{ss}/D < 0 \qquad (7)$$

where the subscripts *n* denotes partial derivatives. A reduction of the trade barriers in the service industry will thus increase the total volume of services (which, in turn, will reduce the price of providing the service). However, foreign entry will also lead to a reduction of the incumbent domestic service firms' profits.

Next, turn to the demand side of the economy, all individuals in this developing economy are assumed to have the same preferences, and they maximize the utility function:

$$U^i(N, m, a) = N^i + u^i(m, a) \qquad (8)$$

where $i = s, m, a$ and w (individuals in each of the four groups); N^i is the consumption of the numeraire good. The function $U(\cdot)$ is differentiable, increasing and strictly concave in all arguments. Utility is maximized, subject to the budget constraint:

$$I^i \geq N^i + P^s s + P^m m + P^a a \qquad (9)$$

where I^i is the net income of individual *I* in each group.

For all other details of the model, see Fung and Siu (2005).

References

Bernheim, D. and M. Whinston, 1986, “Menu auctions, resource allocation and economic influence,” *Quarterly Journal of Economics*, February, vol. 101, No. 1; pp. 1-31.

Dee, P. and K. Hanslow, 2001. “Multilateral Liberalization of Services Trade,” in R. Stern (ed.), *Services in the International Economy*; pp. 117-139. University of Michigan Press.

Feketekuty, G., 2000. “Assessing and improving the architecture of GATS,” in P. Suave and R. Stern (eds.), *GATS 2000: New Directions in Service Trade Liberalization*; pp. 487-508. Washington, D.C., Brookings Institution.

Financial Times, 2005. “US calls for larger EU farm tariff cuts to aid trade talks,” 2 December.

Francois, J. and I. Wooton, 2001. “Imperfect competition and trade liberalization under the GATS,” in R. Stern (ed.), *Services in the International Economy*; pp. 140-156. University of Michigan Press.

Fung, K.C., 2006. “Lecture notes for WTO regional trade policy course: Trade and development”. WTO and University of Hong Kong.

Fung, K.C., H. Iizaka, C. Lin and F. Ng, 2005. “Multilateral trade negotiations under the GATT and the WTO: Lessons for Asia,” *Asian Economic Papers*, vol. 3, No. 2; pp. 79-96.

Fung, K.C. and A. Siu, 2005. “Political economy of service trade liberalization and the Doha Round,” *Pacific Economic Review*, forthcoming.

Fung, K.C. and C. Lin, 2001. “Rent-shifting trade policies for sale,” working paper, University of California, Santa Cruz.

Grossman G. and E. Helpman, 1994. “Protection for Sale”, *American Economic Review*, vol. 84, No. 4; pp. 833-850.

Hoekman, B. and P. Messerlin, 2000. “Liberalizing trade in services: Reciprocal negotiations and regulatory reform”, in P. Suave and R. Stern (eds.), *GATS 2000: New Directions in Service Trade Liberalization*, pp. 487-508. Washington, D.C., Brookings Institution.

Hoekman, B. and C.P. Braga, 1997. “Protection and trade in services: A survey,” CEPR Discussion Paper 1705, London, Centre for Economic Policy Research.

Hsieh, Chang-Tai, 2002. “What explains the industrial revolution in East Asia? Evidence from the factors markets”, *American Economic Review*, vol. 92, No. 3; pp. 502-526.

Ito, T. and A. Krueger, 2003. “Introduction”, in T. Ito and A. Krueger (eds.), *Trade in Services in the Asia-Pacific Region*, 1-9, University of Chicago Press.

Karsenty, G., 2000. “Assessing trade in services by mode of supply,” in P. Suave and R. Stern (eds.), *GATS 2000: New Directions in Service Trade Liberalization;* pp. 487-508. Washington, D.C., Brookings Institution.

Krugman, P., 1994. "The myth of Asia's miracle," *Foreign Affairs*, November/December 1994.

Lau, L.J. and J.S. Park, 2003. "The sources of East Asian economic growth revisited", (mimeograph), Stanford University.

Rama, M. and G. Tabellini, 1998. "Lobbying by capital and labor over trade and labor market policies," *European Economic Review*, 42; pp. 1295-1316.

Sapir, A., 1998. "GATS 1994-2000", *Journal of World Trade*, 33; pp. 51-66.

Sauve, P. and C. Wilkie, 2000. "Investment liberalization in GATS", in P. Suave and R. Stern (eds.), *GATS 2000: New Directions in Service Trade Liberalization*; pp. 331-363. Washington, D.C., Brookings Institution.

Seade, J., 1980. "On the effects of entry", *Econometrica*, 48; pp. 479-489.

Young, A., 1995. "The tyranny of numbers: Confronting the statistical realities of the East Asian growth experience", *Quarterly Journal of Economics*, vol. 110, No. 3; pp. 641-680.

Warner, M., 2000. "Competition policy and GATS," in P. Suave and R. Stern (eds.), *GATS 2000: New Directions in Service Trade Liberalization;* pp. 364-398. Washington, D.C., Brookings Institution.

Comments

DEVELOPMENT DIMENSION OF SERVICES LIBERALIZATION

By Gloria O. Pasadilla and April Lacson

Fung and Siu (2006) argued that the level of services liberalization could be explained in the context of a power play between domestic liberal and protectionist forces. More specifically, they argued that the presence of domestic interest groups for or against liberalization influences policymakers through lobbying activities to pursue or block liberalization of sectors. Most of their arguments rely on the premise that either domestic service providers or the manufacturing industries are concentrated enough to allow cooperation between players in launching an effective lobby. The problem of collective action is that no single player, unless deeply invested in the interests of the services sector such as a state-owned monopoly, will take on the costs of lobbying when the resulting benefits will accrue to everyone in the industry.

Their model can be one plausible explanation for the slowness of services liberalization in WTO, but other explanations may hold as well. Various country experiences (some examples of which are described below) show that liberalization or continued protection of services do not occur as a result of lobbying. The Czech Republic, for example, pursued liberalization as part of its transition from communism while Turkey liberalized financial services as part of its structural adjustment programme. The same holds true for the experiences of other countries, where no significant lobbies or parliamentary debates ruled the day, but through economic restructuring pressure from without.

Especially when it comes to WTO, various concerns colour the negotiations on services liberalization through GATS. These include the concern of government officials over the national ability to cope with a liberalized market, worries over having the necessary regulatory institution and resources to manage liberalization, uncertainty as regards the effect of liberalization on employment and domestic industry as well as future policy flexibility, and inadequacy of data and research on the effects of service liberalization. Of course, that concern is somehow related to the prevailing political economy that is partly explained by Fung and Siu (2006), but the model does not completely determine a government’s position.

Another reason for the hesitation over liberalization comes from a perception that services liberalization is primarily a developed country agenda. To some extent, the assumption is valid. In 2003, developed country share of total world exports of services was as high as 75.8 per cent (Findlay and Sidorenko, 2005) while developing countries generally remained net importers (UNCTAD, 2005). Developed country economies also rely more heavily on services than developing countries. As much as 71 per cent of developed country GDP comes from services whereas for least developed countries, services only account for about 46 per cent of GDP (Findlay and Sidorenko, 2005).

Yet, just as trade is not a zero-sum game, neither is services liberalization. In fact, estimates suggest that merely halving the amount of protection in the sector promises to bring an increase in income five times greater than that brought by liberalization in the trade in goods (World Bank, 2003). Theoretically, liberalization brings with it a number of benefits such as "improved allocative efficiency, access to superior technology and intermediate inputs, greater variety of goods, advantages of economies of scale and scope, increased domestic competition and creation of growth externalities through knowledge transfers" (Dornbusch, 1992 in Findlay and Sidorenko, 2005). Further, Nielson and Taglioni (2004) argued that because developing countries had more barriers to services trade than developed ones, gains from liberalization from the sector would be greater for the former than for the latter. Finally, while export-related gains may be substantial, they argued that greater benefits from liberalization would come from increased competitiveness and efficiency of domestic markets than from acquiring more market access and capturing market share abroad (Dornbusch, 1992, in Findlay and Sidorenko, 2005). However, despite the theorized benefits, developing countries remain hesitant over liberalizing services, especially since, as far as the Doha Round is concerned, developed countries appear intent on acquiring concessions on market access for the sector while apparently little progress has been achieved in agriculture.

Country experiences of services sector liberalization

It is an incontrovertible fact that developed countries have a comparative advantage in exporting services, because major financial, telecommunication, shipping, air transportation and other services are mostly owned by businesses headquartered in rich countries. The question is whether the opening of the services sector is only one-sided; that is, whether developing countries do not, themselves, benefit from it. What are developing country experiences of liberalization of services?

Although anecdotal in nature, country experiences show that services liberalization does have its benefits to the liberalizing country itself. First, lifting restrictions on market entry allows new players, both foreign and domestic, to challenge existing monopolies and promote a more competitive environment. Competition, in turn, spurs efficiency gains as erstwhile monopolies strive to improve productivity and avoid loss of market share. New entrants, on the other hand, bring in new investment and even innovations. Foreign players, especially those from developed countries, bring in new techniques, knowledge, processes, and technology that, in turn, compel domestic competitors to adapt or innovate. This occurred in Argentina when it liberalized its energy sector, in Uganda when it liberalized its telecoms, and in the Czech Republic, where a general equilibrium analysis showed that services liberalization had positive downstream cost effects on manufacturing industries (Arnold and others, 2006).

The mere increase in the number of service providers already provides a benefit to consumers in terms of increased accessibility of services, higher penetration rates for telecoms and expanded choices for consumers. In Argentina's electricity sector and the Philippines' airline industry, a drop in the prices together with improvements in the quality of services even occurred as service providers tried to outdo each other and capture greater market shares. Privatization and removal of subsidies, on the other hand, add to the government treasury or, at least, result in a reduction in public subsidies.

The table summarizes selected country experiences in services liberalization in a variety of sectors. In all the examples, the service sector, prior to liberalization, was dominated either by a monopoly (usually state-owned) or by a small number of large conglomerates. In many cases, this led to limited service accessibility, high prices and low quality. This was the case for the Philippine air transportation industry before liberalization when Philippine Airlines (PAL) remained the country's sole carrier. As a monopoly, the company had little incentive to improve services to customers, especially since losses were offset, if not totally covered, by government subsidies. Consequently, despite the fact that PAL flights were expensive and frequently late, customers were forced to use their services. After liberalization, which involved deregulation and privatization efforts, five carriers entered the market offering variety, choice and lower airfares. The PAL administration thus had to shape up, and while PAL airfares were initially 11-34 per cent higher than those of local competitor Cebu Pacific, in recent years a degree of price convergence has been noticeable (Austria, 2000).

Argentina's electricity sector experienced a similar broad pattern as the Philippines' air transportation sector before and after liberalization. Prior to liberalization efforts, the electric sector was dominated by large monopolistic conglomerates concentrated across the different stages of energy creation, transmission and distribution. Energy transmission was inefficient and 20 per cent of energy created was left unpaid for due to illegal hook-ups. Prices were high, averaging at US$ 60/MWh, and blackouts were frequent. After liberalization, foreign entry was allowed and a number of competitors entered the sector. Eventually, the sector was producing more than enough energy to supply the entire country and even for exports. Blackouts were reduced by between 22 and 39 hours per year to 6 hours per year, while prices were reduced to US$ 27-US$ 28/MWh (Centre for Energy Economics, undated).

Of course, the amount of benefits depends on a number of factors such as the extent of liberalization, the safety nets in place and whether the nature of the business environment is conducive and facilitating or prohibitive (e.g., availability of infrastructure and the efficiency of government bureaucracy in processing new entrants). Further, not all services liberalization leads to a more competitive environment. In some cases, foreign players merely replace domestic monopolies and oligopolies while collusive practices remain (e.g., the cement industry in the Philippines). Nevertheless, although brief, the examples above show that, at the very least, services liberalization is not all pain and no gain. There are benefits to be had and, in realizing that fact, the question now becomes, why do countries still obstinately refuse to open up. Further, given the existence of the GATS framework, why not open up the services sector through the multilateral negotiations. Why not GATS?

Highlight summary of selected country experiences in services liberalization

Country/industry	Reform programme	Condition before reform	After liberalization
Uganda/telecoms	– Privatization of state monopoly – Allow foreign entry – Expansion of telecom services	– Coverage concentrated in cities and towns – Service monopolized by state-owned enterprises – Low penetration rate of fixed lines and mobile phones	– Fifty-six districts have point of presence for delivery of telecom services – A jump from 68,000 to 840,000 customers between 1998 to 2003 – Increased penetration rates from 0.24/100 to 3.5/100 inhabitants – Mobile lines increased from 12,500 in 1998 to 872,704 in 2004 – Fixed lines increased from 57,366 in 1998 to 67,234 in 2004 – Lower tariffs for end-users and a decline in rates for international calls (International Telecommunications Union, undated)
Turkey/financial services	– Relaxed rules on bank entry – Eliminated controls on interest rates and financial intermediation – Turkish residents allowed to open foreign currency accounts in banks – Capital accounts opened up	– Interest rate regulation led to non-price competition – Of 42 banks in 1980, only four were foreign – Concentrated market dominated by large public and private banks – Directed credit programmes absorbed 75 per cent of all loanable funds	– Twelve net entries of foreign banks, mostly American, European and Middle Eastern – Fees on letters of credit declined from 1.5 per cent to 0.5 per cent – Fees on letters of guarantee feel from 4 per cent to 1 per cent – Greater efficiency and resource utilization – Improved credit evaluation – Improved bank marketing – Recruitment and staff quality increased (Denizer, 2000)

Philippines/financial services	– Easing of entry restrictions	– Few, very large, expanded universal banks – Sector is dominated by the Government – High bank interest spreads and profit	– Doubling of bank branches – Ten foreign banks established in 1995 alone – The number of mergers and acquisitions increased between 1998 and 2003 – Foreign ownership increased, with less than half of the banks remaining purely Filipino-owned in 2003 – Greater bank accessibility due to an increase in bank branches – Bank spread over savings deposit was cut in half, implying greater operational efficiency and dissipation of monopoly profits (Pasadilla and Milo, 2005)
Philippines/air transport liberalization	– Privatization of state-owned monopoly – Elimination of restrictions on domestic routes, and frequencies – Deregulation of air fares	– Philippine Airlines (PAL) had no incentive to be efficient or to meet customers. demands due to monopoly situation – PAL subsidized by government and beset with losses	– Entry of five competitor airlines free to choose their routes, capacity and fares – Expanded choices for passengers – Convergence in rates of airline fares among airlines (e.g., in 1997, PAL fares were 11-34 per cent higher than local competitor Cebu Pacific, but have since declined considerably (Austria, 2000)
Argentina/electricity services	– Privatization of 25 state electric companies – Allowed entry of foreign competition	– Poor management, insufficient investment, financial and operational difficulties	– Increased generation of electricity – Country now meets demand and even exports electricity – Price declined to US$ 27-US$ 28/MWh

	– Division of electricity industry into generation (competitive), transmission (regulated monopoly), and distribution (regulated monopoly)	– Blackouts due to reliance on hydropower – A total of 20 per cent of power was going to non-paying customers (illegal hook-ups) – Electricity prices averaged US$ 60/MWh – Rates frozen in pesos for utility consumers and led to company losses due to exchange rate devaluations	– Loss of power due to illegal hook-ups decreased from 20 per cent to 7 per cent in 1999 – Northern Buenos Aires companies reduced outages from 22 hours per year in 1992 to 6 hours per year in 1995 – Southern Buenos Aires companies reduced outages from 39 hours per year in 1992 to 6 hours per year in 1995 (Centre for Energy Economics, undated)

Why not the GATS?

While unilateral liberalization has its benefits, liberalization through multilateral agreements arguably has more advantages. First, if successful, services liberalization through GATS would involve reforms across a wide array of services and countries. The sheer number of the players involved in the multilateral negotiations alone is enough to overtake gains from unilateral liberalization. Commitments made in WTO also give credibility to state policies. At the same time, GATS has flexibility provisions that allow countries greater ability to choose what sectors to liberalize and to what extent. Multilateral liberalization is also preferable to regional trade liberalization as trade diversion effects from the latter may outweigh its trade creation effects, i.e., giving preference to the less efficient service provider results in wasteful resource allocation and negative externalities to parties outside the agreement.

However, a look at the number and nature of commitments to GATS shows that little progress has been made despite the proclaimed advantages of multilateral services liberalization. Adlung and Roy (2005) found that, on average, only one-third of all services sectors of all member countries are committed to GATS; even then, as of 2005, most of the commitments are limited by exclusions, special arrangements and limitations on market access and modes of entry.

Since flexibilities in GATS allow member countries considerable leeway in deciding which sectors to liberalize and to what extent, committing a sector does not necessarily imply significant liberalization. In fact, the total ratio of limitations to commitments is 2:2, suggesting that for every commitment made there are about two limitations accompanying it (Adlung and Roy, 2005).

One explanation for the lack of progress in negotiations in GATS is that the very features that make it advantageous also weaken it. Having many members at the negotiating table slows down and complicates negotiations while policy lock-in enforced through sanctions makes the autonomy provided by unilateral liberalization more appealing. Further, while the flexibility provisions under Article XIX: 2 of GATS allow members to pace liberalization, they also encourage countries to slack off and offer limited commitments without substantially liberalizing the sector. GATS, for example, does not oblige WTO members to commit a specific number of sectors. In fact, a country need only make one commitment in a single sector to show its official acceptance of the Uruguay Round (Stephenson, 2001). Thus, partly due to this flexibility, countries have not committed more sectors, taking advantage of the leeway provided.

Another perspective involves the political economy of services liberalization. In particular, Fung and Siu (2006) argued that the level of services liberalization depended on a number of factors, particularly the presence of domestic interest groups for or against liberalization. They argued that little or no liberalization occurred in the presence of domestic service providers who, they assumed, would naturally lobby against reforms in the sector. The existence of state monopolies also hinders liberalization since, like domestic, non-state service providers, they run the risk of losing market share and facing intense competition from new entrants should the country loosen restrictions (Fung and Siu, 2006). However, as stated above, the absence of liberalization in general and commitment to GATS in particular, is explained by more than domestic lobbying efforts.

Some developing country policymakers, for example, are worried over government ability to establish and finance the necessary regulatory institutions to manage and oversee the liberalization of the sector. The World Bank estimates that the establishment of a telecom regulatory board to oversee telecom liberalization would cost about US$ 2 million per year – a sizeable sum for countries such as the Dominican Republic, for which US$ 2 million already represents 5 per cent of the government budget (World Bank, 2003).

Another concern involves access to services once subsidies are removed. While a country may benefit from competition effects and possibly lower prices, the poor may be unable to provide themselves with these services despite diminished costs (Findlay and Sidorenko, 2005; World Bank, 2003). Education and health are two sectors where removal of government subsidies and possible consequent marginalization of the poor is a crucial issue, especially since these sectors serve to build and develop a country's human capital. Thus, if left without remedy, instead of leading to development, services liberalization may actually hinder countries from achieving it. Finally, the common fear that foreign entry may crowd out domestic service providers also plagues the mind of developing country policymakers, leading to hesitancy in committing more sectors than are necessary to legitimize membership in WTO (UNCTAD, 2005).

Hesitation over making substantial commitments towards GATS may also be explained by the dearth of economic studies and statistics regarding the area, adding to the paucity of knowledge about the sector. Where statistics exist, data may be insufficient or incompatible with GATS classification. The GATS framework, for example, does not coincide with those used by statisticians (Stephenson, 2001). Countries without the resources to devote to research are thus hampered by their inability to identify which sectors will benefit from liberalization and to what extent. Further, even where a country has sufficient resources to fund such research, the impact of services liberalization is hard to quantify and establish, given the difficulty of calculating price equivalents for the sundry list of non-tariff barriers that plague the sector (Stephenson, 2001).

From a negotiator's point of view, offering new commitments within GATS also diminishes, if not totally eliminates, policy flexibility. Uncertain about the effects of liberalization, governments naturally want the option of reversing policies should opening up the sector prove disastrous due to excessive competition, a complete rout of small domestic service providers, a macroeconomic imbalance due to sudden entry of huge investment inflows or other unintended consequences.

In addition, the nature of the services sector makes liberalizing it more difficult than liberalizing trade in goods. The sector is subject to a variety of barriers to trade such as regulatory and cross-border policies restrictions. Moreover, whereas an executive order or decree may be sufficient to lower tariffs in goods, services liberalization may involve deeper legislative and even constitutional amendments to change specific regulations (Adlung and Roy, 2005).

Finally, because of the service sector's relative novelty, there is a lack of definite knowledge about which subsectors comprise services and how liberalization could possibly affect them. Some members have even added new classifications in their schedule of commitments. This multiplicity of definitions makes it difficult to determine what a country has committed (UNCTAD, 2005). While GATS does have one standard classification, countries are free to use other classifications as long as they are mentioned in the schedule of commitments, thus introducing greater complexity to the negotiations and its implementation.

Even when a country decides to commit, the novelty and complexity of services may lead to disagreements over interpretation of the extent and nature of commitments. Two landmark cases, both involving the United States, serve to highlight the problem. These are discussed below.

(a) United States-Antigua and Barbuda online gambling[1]

This case involved the small country of Antigua and Barbuda and the United States over the latter country's gambling measures. Antigua and Barbuda, a country whose economy thrives on online gambling, claimed that several of the United States' domestic laws (i.e., the Wire Act, the Travel Act, the Illegal Gambling and Business Act) and the state laws of Louisiana, Massachusetts, South Dakota and Utah were inconsistent with the United States' commitments to GATS. In particular, these laws unfairly discriminate against online gambling service providers in Antigua and Barbuda, and contradict mode 1 commitments concerning market access (World Trade Organization, undated).

The United States claimed that gambling was not included in its list of commitments and, further, that the prohibition on online gambling was allowable under the exceptions provided under GATS Article XIV (a) and (c) to "protect public morals". Antigua countered that when the United States included the liberalization of "other recreational services" in its schedule, it implicitly included gambling based on the United Nations Central Product Classification (Thayer, 2004). Clearly, depending on which interpretation is favoured, the United States either will be guilty of scrimping on its commitments or will be honouring it.

The decision of the Panel favoured Antigua and Barbuda, and it agreed that the inclusion by the United States of "other recreational activities" did include gambling and, based on the principle of technological neutrality,[2] also included online gambling. Further, the Panel found that the total prohibition of Internet gambling was in violation of Article XVI of GATS as it was tantamount to imposing a zero quota on foreign service providers.

The subsequent Appellate Body decision still favoured Antigua and Barbuda (World Trade Organization, undated). Crucially, though, the Appellate Body differed with the Panel in that it accepted the United States' defence that the measures under issue were

---

[1] The dispute between the United States and Antigua and Barbuda was the first e-commerce case to be brought before the WTO dispute settlement body.

[2] Technological neutrality was defined as non-discrimination as regards the means of delivery of service, electronic or otherwise (WTO, undated).

"necessary to protect public morals" and were thus permissible under Article XIV of GATS. As a result, the Appellate Body only found the Interstate Horse-racing Act to be in violation of the United States commitments to GATS. Despite this, some United States senators were still dismayed at the finding and reacted against what they perceived was an overstepping of jurisdiction by WTO, especially since the finding necessarily implied changing domestic law (Richtel, 2004). Despite this grievance, the United States did express its willingness to comply. However, disagreements have arisen between Antigua and Barbuda and the United States over whether the United States has indeed substantially complied with the rulings. A panel was again established to decide on the issue and its ruling has yet to be circulated (World Trade Organization, undated).

Thus, apart from the variability in the interpretation of a country's commitments, the case also emphasizes the difficulty faced by a small country in making a large major partner comply with rulings when the threat of sanctions and, given the miniscule size of Antigua and Barbuda, the actual carrying out of the threat cannot compel compliance.

(b) United States-Mexico and telecommunications[3]

As in the preceding dispute, the second case also involved the United States, but this time as a complainant against Mexico's telecommunication laws. Under the WTO Telecommunications Agreement, Mexico had committed to allowing market access and providing national treatment to foreign service providers of voice telephony, circuit-switched data transmission services, facsimile services, private leased circuit services, paging services and cellular phone services. The only limitation to market access was its provision that international traffic be routed through a company with a duly authorized concession from the Secretariat of Communications and Transport (Sherman, 2006).

The United States claimed that Mexico had failed to ensure that the major supplier with the necessary concession from the Secretariat of Communications and Transport provided interconnection on "terms, conditions...and cost-oriented rates that are...reasonable". Mexico was also committed to providing "appropriate measures" against anti-competitive practices and the United States claimed that the country was unable to provide such "appropriate measures" to prohibit anti-competitive practices by Telmex, its major telecom supplier, and to ensure non-discriminatory treatment and conditions. Clearly, several terms from the agreement was ambiguous and open to interpretation. Depending on how one defines "cost-oriented" and "appropriate", Mexico could either be in violation of, or in compliance with its GATS commitments (Sherman, 2006). Unable to agree, the two parties referred the matter to the WTO dispute settlement mechanism.

Subsequently, the Panel found in favour of the United States. Telmex, for example, was found to have imposed rates that were 75 per cent higher than demonstrated costs for domestic termination. That, the Panel decided, was clearly not "cost-oriented". Further, under Mexico's Rules for the Supply of International Long-Distance Services (ILD Rules), operators were "required to apply a uniform settlement rate" and that this rate was negotiated

---

3 The dispute between Mexico and the United States was the first case involving services.

by the supplier with the "greatest share of outgoing calls to a particular country". Thus, the ILD actually compelled Telmex, the major supplier in the country, to engage in anti-competitive prices that eliminated price competition in the market. Thus, as to whether Mexico had initiated appropriate measures[4] against anti-competitive practices, the Panel found that Mexico had failed especially since anti-competitive practices did exist and that the ILD itself compelled the major supplier, Telmex, to engage in such a practice (Ryan, 2004). As a result, Mexico was required to amend or remove several laws found to encourage or promote anti-competitive and discriminatory practices, particularly the law requiring that the carrier with the largest proportion of outgoing traffic be the sole negotiator on behalf of all Mexican service providers for international traffic (Sherman, 2006).

In sum, both cases summarized above serve to highlight how differences in the interpretation of commitments, and the key terms in these commitments, can lead to differences in the extent of actual services liberalization as opposed to that promised under a country's schedule. This highlights the necessity of care, assiduous diligence and specificity during negotiations and the drafting of schedules, so that countries do not end up either committing sectors they do not wish to liberalize in the first place or liberalizing sectors beyond the desired extent.

Conclusion

Despite the fact that services liberalization brings numerous advantages, developing countries remain diffident in opening the sector. While individual country experiences show that loosening restrictions in the sector and allowing foreign entry leads to several benefits, the continuing perception that services liberalization is primarily a developed country concern makes developing countries wary of liberalizing.

Not surprisingly, GATS has posted little progress as countries offer limited commitments watered down by numerous restrictions. The lack of agreements over substantial services liberalization stems from a number of factors. While, Fung and Siu (2006) cited the power of lobbying groups to advocate for or against liberalization, other factors appear to prove more explanatory. The paucity of data and economic research on the effects of liberalization on particular services sectors, coupled with the natural complexity of the trade barriers involved and the services sectors itself, naturally make countries hesitant over committing sectors – even more so since commitments to GATS brings sanctions if countries fail to comply.

Further, loss of policy flexibility upon committing to GATS makes unilateral liberalization more appealing. Finally, as the United States-Mexico and Antigua and Barbuda-Unites States cases show, the complexity of the sector easily lends itself to misunderstandings over the interpretation of country commitments, adding to country concerns should they find themselves forced to liberalize sectors they never intended to open in the first place.

---

4 "Appropriate measures" is taken to mean measures that are sufficient to forestall anti-competitive practices (Ryan, 2004).

References

Adlung, R. and M. Roy, 2005. "Turning hills into mountains? Current commitments under the GATS and prospects for change", http://www.wto.org/english/res_e/reser_e/ersd200501_e.doc (accessed October 2006).

Arnold, J., B. Javorcik and A. Mattoo, 2006. "The productivity effects of services liberalization: Evidence from the Czech Republic", http://ipc.umich.edu/edts/pdfs/czech_services_april25.pdf (accessed October 2006).

Austria, M., 2000. "The state of competition and market structure of the Philippine air transport industry", Philippine APEC Study Centre Network, http://pascn.pids.gov.ph DiscList/d00/s00-12.pdf (accessed October 2006).

Centre for Energy Economics, undated. "Results of energy sector restructuring in Argentina", http://www.beg.utexas.edu/energyecon/new-era/case_studies/Results_of_Electricity_Sector_Restructuring_in_Argentina.pdf (accessed October 2006).

Denizer, C., 2000. "Foreign entry in Turkey's banking sector", World Bank Policy Research Working Paper 2462. http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2000/11/17/000094946_00110805385813/Rendered/PDF/multi_page.pdf (accessed October 2006).

Dornbusch, R., 1992. "The case for trade liberalization in developing countries", *Journal of Economic Perspectives,* vol. 6, No. (1); pp. 69-85. In Findlay and Sidorenko, 2005, "Services: Importance of further liberalization for business and economic development in the region". Available at http://www.unescap.org/tid/publication/tipub2393_chap5.pdf (accessed October 2006).

Findlay and A. Sidorenko, 2005. "Services: Importance of further liberalization for business and economic development in the region", Chapter V in Delivering on the WTO Round: A High-level Government-Business Dialogue available at http://www.unescap.org/tid/publication/tipub2393_chap5.pdf (accessed October 2006).

Fung, K. and A. Siu, 2006. "Service Trade Liberalization as a Development Opportunity: The Role of the WTO", paper presented at the WTO/ESCAP/ARTNeT Workshop, Macao, China, October 2006.

German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety, 2003. "Sustainability impact assessment of transport services liberalization: Case studies from Chile and Germany", RIDES and Adelphi Research. Available at http://www.adelphi-research.de/projektberichte/SIAannex.pdf (accessed October 2006).

International Telecommunication Union, undated. "Licensing in the era of liberalization and convergence: The case study of the Republic of Uganda". Available at http://www.itu.int/ITU-D/treg/Case_Studies/Licensing/UGANDA_CS.pdf (accessed October 2006).

Nielson, J. and D. Taglioni, 2004. "Services trade liberalisation: Identifying opportunities and gains", OECD Trade Policy Working Paper No. 1, February 2004. In Findlay and Sidorenko, 2005, "Services: Importance of further liberalization for business and economic development in the region." Available at http://www.unescap.org/tid/publication/tipub2393_chap5.pdf (accessed October 2006).

Pasadilla, G. and M. Milo, 2005. "Effect of liberalization on banking competition", Philippine Institute for Development Studies Discussion Paper Series No. 2005-03. Available at http://dirp4.pids.gov.ph/ris/dps/pidsdps0503.pdf (accessed October 2006).

Richtel, M., 2004. "US online gambling policy violates law, WTO rules", *The New York Times* online at http://www.nytimes.com/2004/03/26/technology/26gamble.html?ex=1395723600&en=c8c1b6ed92e479ef&ei=5007&partner=USERLAND (accessed October 2006).

Ryan, M., 2004. "WTO panel rules on US-Mexico dispute", *European Telecoms Newsletter*. Arnold and Porter, United Kingdom.

Sherman, L., 2006. "Clarifying the meaning of WTO telecommunications obligations: Mexico – measures affecting telecommunication services". Available at www.ip3.org/pub/2006_publications_008.htm (accessed October 2006).

Stephenson, S., 2001. "The growing participation in multilateral services liberalization by Latin America and the Caribbean". Available at http://www.sice.oas.org/services/Articles/ArtSteph/Ch6Grow.doc (accessed October 2006).

Thayer, J., 2004. "The trade of cross-border gambling and betting: The WTO dispute between

Antigua and the United States", *Duke Law and Technology Review*. Available at www.law.duke.edu/journals/dltr/articles/2004dltr0013.html (accessed October 2006).

UNCTAD, 2005. "Trade in services and development implications". Available at http://www.ictsd.org/issarea/stsd/Resources/Docs/UNCTAD1.pdf (accessed October 2006).

World Bank, 2003. "Services in the Development Round". Available at http://siteresources.worldbank.org/INTRANETTRADE/Resources/Pubs/TradeNote11.pdf (accessed October 2006).

World Trade Organization, undated. "United States – measures affecting cross-border supply of gambling and betting services". Available at www.wto.org/english/tratop_e/dispu_e/cases_e/ds285_e.htm (accessed October 2006).

Wunsch-Vincent, S., 2006. "The Internet, cross-border trade in services, and the GATS: lessons from US gambling", *World Trade Review*, vol. 5, No. 3; pp. 319-355.

IMPACTS ON HUMAN DEVELOPMENT MUST ALSO BE CONSIDERED

By Yumiko Yamamoto

Although this chapter analyses the impact of service trade liberalization on economic development, this commentary is focused more on the potential impacts of trade agreements in services on human development.

This chapter assumes that economic development resulting from trade liberalization in services will benefit all; owners of the capital in the services, manufacturing industries and agricultural business as well as the owners of the mobile factor (labour). Social welfare in the model can be maximized without much increasing the benefits to labour. Moreover, the literature so far has not found sufficient supporting evidence that benefits from economic development will trickle down to all, including marginalized groups of people.

In the case of East Asia, which is discussed in this chapter, the income disparities among households remain slight compared with other regions, even after rapid economic growth. However, this is due to relatively high literacy rates supported by a universal educational system and the development of other social services that are not yet available in many parts of the Asia-Pacific region.

Benefits from economic development (e.g., GDP growth) are unlikely to be shared by the poor. In fact, trade liberalization in services has the potential to worsen people's well-being (human development) for the following reasons:

(a) The chapter focuses on the analysis of the service sectors, such as finance distribution logistics, which are used as "lubricants" for other industries. However, the direct beneficiaries from liberalization in these sectors are the owners of the capital in services, manufacturing and agricultural businesses but not labourers, and especially the marginalized groups of the populations in developing countries.

As the authors point out, these sectors are trade-related service sectors; therefore, the majority of the populations in LDCs and low-income developing countries do not have access to such services. In the financial sector, low-income household members do not have bank accounts. They mainly use public transportation or transportation provided by unorganized workers, such as three-wheelers. Therefore, trade liberalization in industry-centred businesses has little positive impacts on human development.

(b) The General Agreement on Trade in Services (GATS) and bilateral trade agreements do not limit negotiation coverage to particular sectors in services.

> This also includes human development-sensitive sectors such as health, education, sanitation and utilities (e.g., water).
>
> An analysis of mode 3 in Asia, in a forthcoming UNDP publication, has found that newly acceded countries, some of them LDCs, have been obliged to accept much more stringent commitments in their terms of accession to WTO, sometimes in human development-sensitive sectors such as health, education and environmental services.[1]

Trade liberalization in the areas of health services, education and water supply is likely to worsen human development – especially in the case of the well-being of women and their families – by decreasing access by the poor to such social services within/between nations. For example, Latin American and African experiences have shown that the liberalization of water supply (with foreign investment) leads to the introduction of expensive service fees. As a result, poor communities in those regions have not received affordable supplies of potable water and the well-being of people in low-income households is deteriorating further. Moreover, they have to walk further to fetch “free” potable water from wells, thus increasing the time spent on unpaid domestic work – a burden that tends to be borne by women and children.

In conclusion, it is hoped that the authors will subsequently (a) capture the distributional effects of gains from trade liberalization in services, and (b) suggest specific policies for compensating the losers in the liberalization of services and/or ensure equal opportunities for people to gain access to such services.

---

[1] P. Ortega, forthcoming, “Policy Space and the General Agreement on Trade in Services (GATS): Analysis of WTO Commitments by Asian Countries on Commercial Presence (Mode 3)” Discussion Paper. Colombo: UNDP RCC.

Part IV

Making trade work for poverty reduction: reality or fantasy?

Chapter IV

TRADE LIBERALIZATION AND POVERTY: LESSONS FROM ASIA AND AFRICA[1]

By John Cockburn, Bernard Decaluwé and Véronique Robichaud

Introduction

In recent years, the impacts of macroeconomic shocks, such as fiscal reform and trade liberalization, on income distribution and poverty have become the subject of intense debate. Which tax regime is most equitable? Do the poor share in the gains from freer trade? What alternative or accompanying policies could be used to ensure a more equitable distribution? What are the mechanisms linking macro policies to micro impacts, particularly with regard to poverty.

The standard story begins with the observation that initial tariff rates are generally much higher for industrial imports, so that trade liberalization leads to an expansion in the agricultural sector that provides relatively greater benefits for unskilled workers and rural households than for capital owners and urban households. The results of this study challenge the standard story in important ways. Most importantly, trade liberalization was found to favour urban households in general and actually lead to an increase in rural poverty in four of the seven countries analyzed. The explanations for these results reveal a number of unexpected channels of impact through which trade liberalization influences these economies and, ultimately, poverty.

The analyses of macroeconomic shocks and poverty are generally based on very different techniques and sources of data. Income distribution and poverty issues are generally analyzed based on household data, in recognition of the heterogeneity of these agents and the importance of capturing their full distribution. On the other hand, given its economy-wide nature and the strong general equilibrium effects they imply, macroeconomic shocks are ideally examined in the context of a computable general equilibrium (CGE) model based on national accounting data. The use of a CGE model is also justified by the complexity of the impacts of trade liberalization on households, as they involve changes in wage rates, returns to land, capital returns, consumption prices and compensatory direct and indirect taxes. Finally, CGE simulation analysis has the advantage over ex post econometric analysis of generating a counterfactual in the absence of trade liberalization as well as of allowing ex ante predictions.

[1] This paper was prepared with funding from the Poverty and Economic Policy (PEP) Research Network, financed by the International Development Research Centre (IDRC).

This study melds these two currents. Average household income variations following trade liberalization were estimated at the household category level in CGE models of seven Asian and African countries: Bangladesh, Benin, India, Nepal, Pakistan, the Philippines and Senegal. These variations were then applied to individual households within each category, using base-year income data from household surveys. These results were then contrasted with initial income values through the estimation of standard Foster-Greer-Thorbecke (FGT) poverty indicators.

Underlying individual country studies were all conducted by local researchers in the context of the PEP-MIMAP research network.[2] The differences between these countries provide a natural laboratory to understand better the impact of trade liberalization on the poor. The economy-wide modelling framework adopted in this study allows the principal channels of influence to be identified and compared. Every effort was made to ensure the comparability of the modelling frameworks in each country to ensure that all observed differences reflected actual differences rather than differences of approach.

A. Brief literature review

There have been numerous attempts to use CGE models in the analysis of income distribution and poverty issues.[3] The simplest approach is to increase the number of categories of households. In this context, it is possible to examine how different types of households (rural vs. urban, landholders vs. sharecroppers, region A vs. region B etc.) are affected by a given shock. However, nothing can be said about the relative impacts on households within any given category as the model only generates information on the representative (or "average") household. There is increasing evidence that households within a given category may be affected quite differently according to their factor endowments, location, demographics, education, consumption patterns etc. Of course, this problem of intra-category variation decreases with the degree of disaggregation of household categories. Yet even in the most disaggregate versions – Piggott and Whalley (1985) have more than 100 household categories – substantial intra-category heterogeneity in the impacts of a given shock is likely to subsist.

A popular alternative is to assume a lognormal distribution of income within each category where the variance is estimated using base year data (see De Janvry and others, 1991). In this approach, the CGE model is used to estimate the change in the average income for each household category, while the variance of this income is assumed to be fixed. Decaluwé and others (1999) argued that a beta distribution was preferable as, unlike the lognormal, it could be skewed left or right and thus better represent the different types of intra-category income distributions commonly observed. Here, no specific functional form is imposed on the distribution function. Instead, the income variation obtained for

---

[2] Poverty and Economic Policy (PEP) research network: www.pep-net.org and Micro Impacts of Macro and Adjustment Policies (MIMAP) Project: www.mimap.org.

[3] A detailed review of the CGE literature on the welfare, poverty and distributional effects of trade liberalization is provided by Cloutier, Cockburn and Decaluwé (2003).

each household category in the CGE model simulation is applied to the income of each individual household belonging to this category. This provides a vector of household incomes before and after the trade liberalization simulation on which a standard poverty analysis can be performed.

A final alternative, currently pursued by the members of this research network, is to model each household individually in a micro-simulation model. This micro-simulation model can be either linked to a CGE model (Savard, 2003) or fully integrated into a CGE model (Cockburn, 2001; Cogneau and Robilliard, 2001).

Section B tracks the effects of trade liberalization through the economies studied in order to explain the welfare poverty results. In particular, the authors trace the channels of impact on sectoral production and trade, factor prices, household income and consumer prices before revisiting the welfare and poverty analysis in the light of the preceding results. Throughout, the authors draw a series of lessons, many of which contrast with the standard trade liberalization-poverty story outlined in the introduction. Section C provides concluding remarks.

B. Simulation results

The standard expectations for the impacts of trade liberalization on poverty are as follows. First, as initial tariffs are generally higher for industrial goods, it is expected that the agricultural sector will be the main beneficiary of trade liberalization. This, in turn, raises the relative returns to factors used intensively in the agricultural sector – unskilled labour and land. Rural and poor households, which derive a relatively large share of their income from these two factors, should therefore be the "winners" from trade liberalization in income terms. On the other hand, consumer prices are expected to fall more for industrial goods, which is to the advantage of rich and urban households. The net effects on poverty will depend on the relative strength of the income and consumer price effects, although it is generally assumed that the income effect will dominate and the poor will thus benefit. The results of the authors' simulations in these seven quite different developing countries challenge these expectations in a number of important ways.

1. Welfare and poverty impacts

Lesson one: Trade liberalization increases welfare and reduces poverty marginally

The results of this study indicated that trade liberalization has positive, although generally small, aggregate welfare and poverty effects in most of the countries studied (table 1). Note that welfare indicators concern all households, whereas poverty indicators compare the income of the poorest households with a minimum income required to satisfy their basic necessities. Overall welfare effects, as measured by equivalent variations (EV), are generally small but positive, with the exception of Benin (-0.3 per cent) and India (-0.1 per cent).

Table 1. Impact on income, welfare and poverty

(Unit: %)

Country	Income	CTH	CPI	EV	P_0	P_1	P_2	Initial poverty level		
								P_0	P_1	P_2
Bangladesh	**-3.1**	**-2.7**	**-2.8**	**0.1**	**0.13**	**0.53**	**0.71**	**0.418**	**0.099**	**0.034**
Rural	-3.2	-2.9	-2.8	-0.1	0.10	0.53	0.71	0.461	0.109	0.038
Urban	-3.1	-2.5	-2.9	0.4	0.46	0.53	0.67	0.204	0.047	0.016
Benin	**-4.2**	**-3.1**	**-3.2**	**-0.3**	**-1.02**	**-1.00**	**-1.23**	**0.354**	**0.110**	**0.050**
Rural	-5.5	-5.2	-2.4	-3.0	2.38	3.12	3.76	0.389	0.109	0.043
Urban	-3.1	-1.1	-4.1	2.0	-4.92	-4.84	-4.86	0.320	0.110	0.056
India	**-9.7**	**-9.2**	**-9.1**	**-0.1**	**-0.10**	**-0.13**	**-0.16**	**0.383**	**0.133**	**0.064**
Rural	-9.8	-9.8	-9.1	-0.2	0.00	0.27	0.32	0.404	0.134	0.062
Urban	-9.5	-9.0	-9.1	0.1	-0.14	-0.27	-0.31	0.376	0.133	0.065
Nepal	**-5.9**	**-5.0**	**-5.2**	**0.0**	**-0.74**	**-0.43**	**-0.46**	**0.395**	**0.121**	**0.054**
Rural	-5.8	-5.0	-5.2	0.0	-0.83	-0.48	-0.53	0.377	0.107	0.045
Urban	-6.4	-5.0	-5.2	0.0	0.00	-0.18	-0.23	0.636	0.302	0.176
Pakistan	**-6.7**	**-5.5**	**-5.7**	**0.3**	**-0.50**	**-0.55**	**-0.89**	**0.383**	**0.086**	**0.028**
Rural	-6.8	-6.4	-5.6	-0.8	1.70	2.78	3.19	0.372	0.081	0.026
Urban	-6.6	-4.5	-5.8	1.3	-3.42	-4.64	-5.74	0.397	0.094	0.031
Philippines	**-3.0**	**-1.8**	**-2.5**	**0.8**	**-0.75**	**-1.47**	**-1.88**	**0.485**	**0.171**	**0.079**
Rural	-3.1	-2.1	-2.5	0.4	-0.56	-1.37	-1.79	0.632	0.228	0.107
Urban	-2.9	-1.7	-2.5	0.9	-1.10	-1.68	-2.06	0.337	0.112	0.051
Senegal	**-3.7**	**-2.6**	**-3.1**	**0.3**	**-0.24**	**-1.49**	**-2.19**	**0.691**	**0.284**	**0.147**
Rural	-3.8	-1.6	-3.4	1.9	-0.49	-1.80	-2.48	0.884	0.401	0.218
Urban	-3.7	-3.2	-2.9	-0.2	0.63	0.47	0.61	0.390	0.100	0.036

Notes: CTH = consumption; CPI = consumer price index; EV = equivalent variations; P_0 = headcount ratio; P_1 = poverty gap; P_2 = poverty severity.

At the same time, poverty falls in all countries but Bangladesh, regardless of the poverty indicator chosen. Headcount ratios (P_0) fall substantially in Benin (-1.02 per cent) and moderately in all other countries, except for Bangladesh (0.13 per cent). Similar, if sometimes stronger, reductions are noted in the poverty gap (P_1) and poverty severity (P_2), the latter decreasing by 2.19 per cent in Senegal. The remainder of this chapter is devoted to explaining this and the following lesson.

Lesson two: Trade liberalization is pro-urban and may increase rural poverty

Trade liberalization affects rural and urban households quite differently. In every country, apart from Nepal and Senegal, welfare increases and poverty decreases most for urban households. This contrasts with the standard story, which suggests that rural households will be the “winners” from tariff reductions. Indeed, welfare actually decreases and poverty increases in the rural areas of four (Bangladesh, Benin, India and Pakistan) of the seven countries studied. To understand these results more clearly, the impacts of trade liberalization are traced below through its effects on resource allocation, factor remuneration and the price structure.

2. Trade and output effects

Lesson three: Industrial output increases relative to agriculture due to a stronger export response and greater input cost savings

The pro-industrial nature of trade liberalization can be explained by three major factors: (a) a muted impact of import price reductions on domestic demand for local products, given their imperfect substitutability and low initial import penetration rates; (b) a stronger positive industrial export response; and (c) greater input cost savings in the industrial sector. These factors are outlined in more detail below.

The initial impact of trade liberalization is felt by imports. The elimination of tariffs directly reduces import prices (table 2). In all seven countries, import prices decline more in the industrial sector as a result of higher initial tariff rates. Consequently, the import response (a 1 per cent to 10 per cent increase) is higher among industrial imports in all the countries studied. As this response also depends on the degree to which imports and domestic goods are considered as substitutes, which varies across countries, the increases in import volumes are not necessarily proportional to the fall in import prices. The smallest import increase is observed in Nepal, where initial tariff rates are lowest. In the case of India, the strong industrial import response is also due to the elimination of quantitative restrictions, whereas these restrictions had already been removed by the mid-1990s in the other countries.

Table 2 shows that in the agricultural and industrial sectors, domestic demand for locally produced goods ("dom. sales") declines in the face of lower-priced imports. However, imports represent on average less than 20 per cent of domestic consumption in all countries and are considered imperfect substitutes for local goods; therefore, the resulting falls in the price and volume of domestic sales of local goods are quite limited. Although these impacts are strongest in the industrial sector (except in the Philippines), the differences with regard to agriculture are generally small. A particularly strong price reduction is observed in India, where quantitative imports restrictions are simultaneously removed.

With a fixed current account balance, the increase in imports following trade liberalization leads to a real exchange rate depreciation. This, in turn, stimulates exports. The strength of this export response depends on the fall in prices for domestic sales, the capacity of local producers to substitute between local and export markets, the price elasticity of world demand for these exports[4] and initial export intensities. As domestic prices fall most and initial export intensities are highest in the industrial sector, this sector generally has the strongest export response.

---

[4] World demand for exports from Benin, Nepal, the Philippines and Senegal are assumed to be perfectly elastic.

Table 2. Impact on production, trade and prices

(Unit: %)

Country	Sectoral shares*			Ratios*		Imports	Volume changes			Value added	Imports	Price changes			Value added
	Value added	Imports	Exports	Imports/ Cons'n	Exports/ Output		Dom. sales	Exports	Output			Dom. sales	Exports	Output	
Bangladesh				**9.1**	**5.0**	**10.0**	**-0.1**	**15.3**	**0.6**	**0.0**	**-13.3**	**-4.0**	**-8.2**	**-3.8**	**-3.3**
Agriculture	22.3	5.2	8.1	2.4	1.9	8.9	-0.7	6.7	-0.5	-0.6	-8.1	-3.3	-2.1	-3.2	-3.1
Industry	22.1	94.8	91.9	24.4	14.0	10.0	-0.4	16.0	1.9	1.2	-13.6	-4.7	-8.8	-4.0	-2.9
Services	55.5	0.0	0.0	0.0	0.0	–	0.2	–	0.2	-0.3	–	-3.9	–	-3.9	-3.5
Benin				**19.6**	**17.0**	**3.6**	**-1.4**	**5.0**	**-0.2**	**0.0**	**-14.9**	**-5.4**	**0.0**	**-4.4**	**-3.9**
Agriculture	36.3	3.0	6.0	2.7	3.9	3.3	-1.1	2.6	-1.0	-1.0	-9.6	-4.8	0.0	-4.6	-5.1
Industry	13.5	91.5	37.7	39.7	18.4	4.1	-3.0	2.6	-2.0	-2.2	-15.8	-5.4	0.0	-4.4	-7.1
Services	50.3	5.6	56.3	3.3	24.7	-4.6	-1.0	6.9	1.4	1.3	0.0	-5.8	0.0	-4.4	-2.2
India				**5.5**	**6.1**	**8.1**	**-0.7**	**10.3**	**-0.1**	**0.0**	**-14.6**	**-10.1**	**-3.2**	**-9.8**	**-10.0**
Agriculture	30.2	3.4	5.3	0.9	1.3	3.6	-0.1	7.3	0.0	0.0	-11.0	-9.6	-2.3	-9.5	-9.9
Industry	19.8	87.6	69.0	12.8	9.7	9.9	-1.3	11.6	0.1	0.2	-15.8	-10.8	-3.6	-10.1	-10.1
Services	50.0	8.9	25.7	1.2	4.7	-8.0	-0.4	7.2	-0.2	-0.1	0.0	-9.9	-2.3	-9.6	-10.0
Nepal				**15.4**	**15.0**	**1.0**	**-0.1**	**3.8**	**0.2**	**0.0**	**-7.9**	**-5.8**	**0.0**	**-5.5**	**-6.2**
Agriculture	57.9	15.1	8.6	5.5	1.2	1.0	0.1	3.4	0.1	0.0	-7.6	-6.0	0.0	-6.0	-6.2
Industry	6.7	84.9	62.3	54.4	28.0	1.0	0.0	3.1	0.8	0.9	-7.9	-5.9	0.0	-4.3	-6.2
Services	35.4	0.0	29.1	0.0	4.6	0.0	-0.3	5.3	0.0	-0.1	0.0	-5.6	0.0	-5.3	-6.3
Pakistan				**11.6**	**9.7**	**6.8**	**-0.8**	**10.4**	**0.1**	**0.0**	**-18.0**	**-7.9**	**0.0**	**-7.2**	**-7.3**
Agriculture	28.7	6.3	3.0	3.4	1.1	-0.2	-0.3	3.9	-0.3	-0.3	-6.4	-6.6	-1.5	-6.6	-6.7
Industry	19.5	85.4	79.6	24.3	16.3	8.7	-1.6	11.3	0.6	0.7	-20.1	-8.6	0.0	-7.2	-8.6
Services	51.9	8.3	17.4	2.5	6.5	-7.7	-0.4	7.5	-0.2	-0.2	0.0	-7.9	0.0	-7.6	-7.2
Philippines				**17.4**	**17.5**	**7.7**	**-1.1**	**6.9**	**0.3**	**0.0**	**-16.2**	**-5.2**	**0.0**	**-4.2**	**-3.1**
Agriculture	20.0	1.5	6.5	1.8	7.5	5.5	-1.6	4.7	-1.1	-1.0	-7.0	-4.1	0.0	-3.8	-4.0
Industry	23.2	87.9	59.3	33.3	25.4	9.2	-1.3	9.2	1.5	1.3	-18.0	-6.9	0.0	-5.1	-1.8
Services	56.8	10.6	34.3	4.6	13.7	-4.7	-0.8	3.3	-0.2	-0.2	0.0	-4.3	0.0	-3.7	-3.3
Senegal				**19.7**	**15.5**	**6.5**	**-2.0**	**8.8**	**-0.3**	**0.0**	**-13.6**	**-4.1**	**0.0**	**-3.4**	**-3.8**
Agriculture	19.4	14.6	0.7	14.8	0.6	3.1	-2.6	4.3	-2.6	-2.6	-11.9	-3.1	0.0	-3.1	-5.1
Industry	25.8	66.3	73.3	26.9	23.2	10.0	-3.0	8.1	-0.4	0.1	-17.2	-4.8	0.0	-3.6	-3.4
Services	54.7	19.0	26.1	11.8	10.0	-2.9	-0.3	10.8	0.9	0.9	0.0	-3.7	0.0	-3.3	-3.6

* Initial shares and ratios.

Indeed, this response is strong enough to counteract the reduction in domestic sales such that total industrial output actually rises relative to total agricultural output in all but one country (Benin). Even there, the difference in output response is much smaller than the difference in domestic sales. This pro-industrial "export-push" effect of trade liberalization is not often noted in studies of trade liberalization. However, the combined effect of fixed or falling export prices and falling prices for domestic sales is a fall in output prices that hits the industrial sector slightly harder than the agricultural sector, except in Benin and Nepal.

Given higher initial tariff rates and import penetration rates in the industrial sector, consumer prices systematically decline much more than in the agricultural sector.[5] As the industrial sector consumes a higher share of industrial inputs in most countries, it benefits most from the resulting input cost savings of trade liberalization. While industrial output prices fall relative to agricultural output prices in five of the seven countries, value added prices actually increase in the industrial sector relative to the agricultural sector in four (Bangladesh, Nepal, Philippines and Senegal) of these seven countries. This counteracting input cost effect of trade liberalization on the relative value added prices of industry and agriculture is another novel finding of this study.

This chapter now turns its attention to the impacts on the service sector. Initial tariffs on the limited or inexistent imports of services are all zero. Consequently, where there are any imports of services, their price remains constant and import values actually decrease as consumers switch to cheaper agricultural and industrial goods. Domestic sales decline nonetheless, albeit much less than in agriculture or industry, as import penetration ratios are small and real depreciation leads producers to increase their exports. However, the net impact on the output and value added of services is generally small and negative, except in Benin and Senegal, which have the two of three highest export intensities for services. Output and value added prices fall roughly in proportion with the agricultural and industrial sector.

In conclusion, in most countries a similar pattern is observed concerning the trade and output effects of trade liberalization. Higher initial tariffs on industrial imports translate into greater reductions in their import prices. However, due to their imperfect substitutability with regard to domestic goods and generally low import penetration ratios, the resulting reductions in domestic output prices and volumes are much smaller. Furthermore, due to its high export intensity, the industrial sector benefits most from the resulting export expansion, such that industrial output, with the exception of Benin, rises relative to agricultural output. This pro-industrial impact is further reinforced by industry's more substantial input cost savings. Finally, the service sector is characterized by generally small output effects, as it has no initial tariffs.

5 This result is discussed further in subsection B6.

3. Factor price effects

This subsection shows how the general fall in value added prices affects factor prices, which are the prime determinants of household income and, ultimately, poverty effects.

Lesson four: Relative wages increase, returns to capital fall

Perfect sectoral mobility of labour but no intersectoral mobility of capital is assumed.[6] Consequently, variations in capital prices differ from sector to sector, whereas variations in wage rates are uniform. The two exceptions here are Bangladesh and Benin, given that these models distinguish numerous labour categories: male and female low, medium and high-skilled workers in Bangladesh, and informal, modern and civil servants in Benin. Thus, wage rate variations are weighted averages of the variations in the corresponding wage rates of these labour categories, where the weights differ between sectors.

In general, the cost of mobile factors is expected to be less affected than the cost of fixed factors. The more rigid the market for a factor, the greater will be the price response and vice-versa. Therefore, it is not surprising if a smaller fall is recorded in wage rates than in capital prices. Although the fall in average returns to capital is relatively greater than in wages in most countries, sectoral impacts mimic changes in value added prices.

Hence, sectors within which value added prices fall more will also show a greater decline in the returns to capital. The factor share in value added will determine the degree to which the impact on value added price is transmitted to return to capital. Finally, the overall impact will depend on the sectoral share in overall factor payments.

In the models of India, Nepal and Senegal, land is distinguished. In the case of India and Nepal, constant relative agricultural prices lead to stability in the returns to land, relative to the other factors of production. In Senegal, returns to land fall relative to all other factors, reflecting the stronger fall in agricultural value added relative prices in that country. In conclusion, with the exception of Nepal and Senegal (relative gain for capital), trade liberalization leads to an increase in the relative price of labour.

4. Household income effects

Lesson five: Nominal income tends to fall most in rural areas

In the preceding subsection, nominal returns to all factors fall were seen to fall as a result of trade liberalization. Consequently, it is not surprising that nominal household income also falls in all countries (table 4). The fall is the greatest for countries where the reductions in nominal factor returns are the strongest, i.e., India (-9.7 per cent), Pakistan (-6.7 per cent) and Nepal (-5.9 per cent). Conversely, nominal incomes are least affected

---

6 The long-term effects with capital mobility are examined later in this chapter.

Table 3. Impact on factor prices

(Unit: %)

Country	Change in VA price	Change in VA	Sectoral shares in factor payments* Labour Unskilled	Labour Skilled	Capital	Land	Factor shares in value added* Labour Unskilled	Labour Skilled	Capital	Land	Change in price Labour Unskilled	Labour Skilled	Capital	Land
Bangladesh	**-3.3**	**0.0**	**100.0**	**100.0**	**100.0**	**–**	**25.2**	**21.2**	**53.7**	**–**	**-3.1**	**-3.2**	**-3.4**	**–**
Agriculture	-3.1	-0.6	30.0	10.9	23.2	–	33.9	10.4	55.8	–	-2.9	-2.9	-3.3	–
Industry	-2.9	1.2	12.9	13.6	29.8	–	14.7	13.0	72.3	–	-2.6	-3.0	-2.8	–
Services	-3.5	-0.3	57.1	75.4	47.0	–	25.8	28.8	45.4	–	-3.3	-3.3	-3.7	–
Benin	**-3.9**	**0.0**	**100.0**		**100.0**	**–**	**63.1**		**36.9**	**–**	**-2.7**		**-5.3**	**–**
Agriculture	-5.1	-1.0	33.2		41.5	–	57.8		42.2	–	-3.8		-6.9	–
Industry	-7.1	-2.2	10.6		18.3	–	49.9		50.1	–	-2.5		-10.0	–
Services	-2.2	1.3	56.1		40.3	–	70.4		29.6	–	-2.0		-1.6	–
India	**-10.0**	**0.0**	**100.0**		**100.0**	**100.0**	**48.8**		**39.2**	**12.0**	**-9.8**		**-10.0**	**-9.9**
Agriculture	-9.9	0.0	30.9		7.9	100.0	50.0		10.2	39.8	-9.8		-9.9	-9.9
Industry	-10.1	0.2	17.6		28.6	0.0	43.4		56.6	0.0	-9.8		-10.4	–
Services	-10.0	-0.1	51.5		63.5	0.0	50.2		49.8	0.0	-9.8		-9.8	–
			Unskilled	Skilled			Unskilled	Skilled			Unskilled	Skilled		
Nepal	**-6.2**	**0.0**	**100.0**	**100.0**	**100.0**	**100.0**	**24.8**	**12.3**	**64.0**	**62.9**	**-6.2**	**-6.4**	**-6.2**	**-6.2**
Agriculture	-6.2	0.0	68.7	36.4	–	100.0	29.4	7.7	–	62.9	-6.2	-6.4	–	-6.2
Industry	-6.2	0.9	2.9	6.3	19.7	0.0	10.8	11.5	77.6	–	-6.2	-6.4	-6.2	–
Services	-6.3	-0.1	28.4	57.3	80.3	0.0	19.9	19.9	60.2	–	-6.2	-6.4	-6.2	–
Pakistan	**-7.3**	**0.0**	**100.0**		**100.0**	**–**	**39.3**		**60.7**	**–**		**-6.4**	**-7.9**	**–**
Agriculture	-6.7	-0.3	44.3		18.6	–	60.7		39.3	–	-6.4		-7.2	–
Industry	-8.6	0.7	15.5		22.1	–	31.2		68.8	–	-6.4		-9.5	–
Services	-7.2	-0.2	40.2		59.4	–	30.5		69.5	–	-6.4		-7.6	–
Philippines	**-3.1**	**0.0**	**100.0**		**100.0**	**–**	**44.9**		**55.1**	**–**	**-3.0**		**-3.1**	**–**
Agriculture	-4.0	-1.0	21.2		19.0	–	47.7		52.3	–	-3.0		-4.8	–
Industry	-1.8	1.3	21.6		24.6	–	41.7		58.3	–	-3.0		-0.7	–
Services	-3.3	-0.2	57.2		56.5	–	45.2		54.8	–	-3.0		-3.5	
Senegal	**-3.8**	**0.0**	**100.0**		**100.0**	**100.0**	**62.0**		**34.2**	**3.9**	**-3.9**		**-3.4**	**-6.7**
Agriculture	-5.1	-2.6	18.2		12.5	100.0	58.1		22.0	19.9	-3.9		-6.7	-6.7
Industry	-3.4	0.1	21.1		37.4	0.0	50.6		49.4	–	-3.9		-2.9	–
Services	-3.6	0.9	60.7		50.1	0.0	68.7		31.3	–	-3.9		-2.8	–

* Initial shares.

Table 4. Impact on income

(Unit: %)

Country	Change in rate			Share in total income			Contribution to change in income		
	Rural	Urban	All	Rural	Urban	All	Rural	Urban	All
Bangladesh									
Unskilled wage	-3.1	-3.1	-3.1	36.5	12.0	24.2	-1.1	-0.4	-0.7
Skilled wage	-3.2	-3.2	-3.2	18.4	22.3	20.4	-0.6	-0.7	-0.7
Capital	-3.4	-3.4	-3.4	43.7	59.6	51.7	-1.5	-2.0	-1.7
Other income	0.0	0.0	0.0	1.5	6.0	3.8	0.0	0.0	0.0
TOTAL	–	–	–	100.0	100.0	100.0	-3.2	-3.1	-3.1
Benin									
Wage	-2.7	-2.7	-2.7	79.0	47.4	61.5	-2.1	-1.3	-1.6
Capital	-5.3	-5.3	-5.3	19.8	36.6	29.1	-1.1	-2.0	-1.5
Other income	-1.9	0.0	-0.1	1.2	16.0	9.4	-2.4	0.1	-1.0
TOTAL	–	–	–	100.0	100.0	100.0	-5.5	-3.1	-4.2
India									
Wage	-10.5	-10.5	-10.5	47.6	48.6	48.1	-4.7	-4.8	-4.7
Capital	-10.6	-10.6	-10.6	21.3	40.8	30.0	-2.1	-4.1	-3.0
Land	-10.5	-10.5	-10.5	20.4	0.3	11.5	-2.0	0.0	-1.1
Other income	0.0	0.0	0.0	10.6	10.2	10.5	-1.0	-0.6	-0.8
TOTAL	–	–	–	100.0	100.0	100.0	-9.8	-9.5	-9.7
Nepal									
Unskilled wage	-6.1	-6.8	-6.2	22.6	14.8	21.4	-1.4	-1.0	-1.3
Skilled wage	-6.1	-7.0	-6.4	8.4	23.0	10.6	-0.5	-1.6	-0.7
Capital	-5.8	-7.2	-6.2	15.1	23.8	16.4	-0.9	-1.7	-1.0
Land	-6.2	-5.9	-6.2	34.7	8.2	30.6	-2.1	-0.5	-1.9
Other income	0.0	-0.1	0.0	19.3	30.2	21.0	-0.9	-1.6	-1.0
TOTAL	–	–	–	100.0	100.0	100.0	-5.8	-6.4	-5.9
Pakistan									
Wage	-6.4	-6.4	-6.4	53.1	34.0	42.8	-3.4	-2.2	-2.7
Capital	-7.9	-7.9	-7.9	37.0	46.0	41.8	-2.9	-3.7	-3.3
Other income	-0.1	0.0	0.0	9.9	20.1	15.3	-0.5	-0.8	-0.7
TOTAL	–	–	–	100.0	100.0	100.0	-6.8	-6.6	-6.7
Philippines									
Wage	-3.0	-3.0	-3.0	48.4	53.2	51.6	-1.5	-1.6	-1.6
Capital	-3.1	-3.1	-3.1	37.2	31.0	33.0	-1.1	-1.0	-1.0
Other income	0.0	0.0	0.0	14.4	15.8	15.4	-0.5	-0.3	-0.4
TOTAL	–	–	–	100.0	100.0	100.0	-3.1	-2.9	-3.0
Senegal									
Wage	-3.9	-3.9	-3.9	22.4	55.4	48.4	-0.9	-2.1	-1.9
Capital	-3.4	-3.4	-3.4	29.0	10.5	14.4	-1.0	-0.4	-0.5
Land	-6.7	-6.7	-6.7	14.1	0.0	3.0	-1.0	0.0	-0.2
Other income	0.0	0.0	0.0	34.5	34.1	34.2	-1.0	-1.2	-1.2
Total	**–**	**–**	**–**	**100.0**	**100.0**	**100.0**	**-3.8**	**-3.7**	**-3.7**

by trade liberalization in the Philippines (-3 per cent) and Bangladesh (-3.1 per cent), where factor incomes fall the least, and in Senegal (-3.7 per cent) where fixed "other income" (inter-household transfers) is a major part of household income.

In all but Nepal, rural households experience a larger nominal income reduction than urban households. Thus, it is concluded that trade liberalization tends to be pro-urban or anti-rural. Different explanations underlie this result, depending on the country analyzed. In Bangladesh, Benin, the Philippines and Pakistan, urban households are less affected due to their greater reliance on relatively stable other (non-factor) income such as government transfers and domestic or foreign remittances. In the cases of India and Senegal, rural income losses can be traced primarily to the reduction in returns to land. Finally, in the case of Nepal, the nominal income of urban households falls more than that of their rural counterparts, as skilled wages, returns to capital and "other income" decline more for urban households than for rural households. These results follow the greater price reductions in the service sector, which uses skilled labour and capital more intensively.

Once again, the use of full-scale realistic models has led to a surprising conclusion concerning the important positive impact of non-factor income for households and the substantial negative impact of land income for rural households. These two effects outweigh the more traditional labour and capital-income share effects.

5. Consumer price effects

Lesson six: Nominal consumer prices fall more in industry than agriculture or services

The analysis in the preceding subsection suggests that trade liberalization is pro-urban in terms of its impacts on nominal income. However, by reducing import prices and local competing goods, trade liberalization may also substantially reduce consumer prices. These impacts may also differ between households according to their consumption patterns. It is the net impact of these income and consumer price effects that ultimately determines the welfare and poverty impacts of trade liberalization.

Table 5 shows that consumer prices fall by only 3.4 per cent in Senegal but by as much as 9.7 per cent in India as a result of trade liberalization. In all countries, the fall in consumer prices for industrial goods is substantially greater, 5.8 per cent to 10.9 per cent, than for the agricultural and service sectors, reflecting high initial tariff rates and/or high import penetration ratios in the industrial sector.

Lesson seven: Cost of living effects vary

In all countries but Senegal, rural households devote a larger share of their total consumption to agricultural goods than do their urban counterparts, whereas urban households consume relatively more services. It should be stressed that "industrial goods" are defined very broadly here to include very simple food processing such as milled rice (23 per cent of household consumption in Bangladesh). Consequently, in most countries, rural households benefit less than urban households do from the fall in the relative consumer prices of industrial goods, resulting in a smaller reduction in their consumer price indices. In India, Nepal and Pakistan, rural and urban households consume roughly the same share of industrial goods. Although rural households consume relatively more agricultural goods and fewer services, consumer prices in these two sectors vary in roughly the same proportion; thus, there is little urban-rural difference in the variation in consumer price indices. Thus, it can be said that trade liberalization is pro-urban in terms of income as well as consumption.

6. Welfare and poverty effects revisited

Having now followed the channels of impact of trade liberalization through these different economies, we are in a position to return to the original poverty and welfare results to understand better the underlying mechanisms. As mentioned above, there are two main channels of impact linking trade liberalization to household welfare and poverty,

Table 5. Impact on consumer prices

(Unit: %)

Country	Import share of consumption	Compensatory sales tax	Change in prices			Share in total consumption			Contribution to change in CPI		
			Imports	Dom. sales	Consumer	Rural	Urban	All	Rural	Urban	All
Bangladesh	**9.1**	**1.3**	**-13.3**	**-4.0**	**-3.7**	**100.0**	**100.0**	**100.0**	**-2.8**	**-2.9**	**-2.8**
Agriculture	2.4	1.3	-8.1	-3.3	-2.1	16.8	14.1	15.5	-1.9	-1.8	-1.9
Industry	24.4	1.3	-13.6	-4.7	-5.8	55.1	36.2	46.2	-3.3	-4.0	-3.6
Services	0.0	1.3	–	-3.9	-2.6	28.1	49.7	38.3	-2.2	-2.3	-2.3
Benin	**19.6**	**3.8**	**-14.9**	**-5.4**	**-4.3**	**100.0**	**100.0**	**100.0**	**-2.4**	**-4.1**	**-3.2**
Agriculture	2.7	3.8	-9.6	-4.8	-1.4	34.7	31.2	32.9	-1.5	-1.5	-1.5
Industry	39.7	3.8	-15.8	-5.4	-7.0	51.8	39.8	45.6	-3.1	-7.6	-5.1
Services	3.3	3.8	0.0	-5.8	-2.6	13.5	29.1	21.5	-2.0	-2.0	-2.0
India	**5.5**	**0.9**	**-14.6**	**-10.1**	**-9.7**	**100.0**	**100.0**	**100.0**	**-9.1**	**-9.1**	**-9.1**
Agriculture	0.9	0.9	-11.0	-9.6	-8.9	42.6	29.2	37.1	-8.9	-8.9	-8.9
Industry	12.8	0.9	-15.8	-10.8	-10.9	26.2	27.2	26.6	-9.9	-9.6	-9.8
Services	1.2	0.9	0.0	-9.9	-9.0	31.2	43.5	36.3	-8.9	-8.9	-8.9
Nepal	**15.4**	**1.1**	**-7.9**	**-5.8**	**-5.1**	**100.0**	**100.0**	**100.0**	**-5.2**	**-5.2**	**-5.2**
Agriculture	5.5	1.1	-7.6	-6.0	-5.1	79.3	65.3	77.3	-5.1	-5.1	-5.1
Industry	54.4	1.1	-7.9	-5.9	-6.0	14.3	19.5	15.1	-6.1	-6.1	-6.1
Services	0.0	1.1	0.0	-5.6	-4.5	6.4	15.1	7.7	-4.3	-4.3	-4.3
Pakistan	**11.6**	**2.7**	**-18.0**	**-7.9**	**-6.9**	**100.0**	**100.0**	**100.0**	**-5.6**	**-5.8**	**-5.7**
Agriculture	3.4	2.7	-6.4	-6.6	-4.1	39.7	28.0	34.0	-4.1	-4.2	-4.2
Industry	24.3	2.7	-20.1	-8.6	-9.6	39.9	39.1	39.5	-7.5	-7.6	-7.5
Services	2.5	2.7	0.0	-7.9	-5.2	20.4	32.9	26.5	-5.0	-5.1	-5.1
Philippines	**17.4**	**3.4**	**-16.2**	**-5.2**	**-4.3**	**100.0**	**100.0**	**100.0**	**-2.5**	**-2.5**	**-2.5**
Agriculture	1.8	3.4	-7.0	-4.1	-0.9	14.6	9.8	11.4	-0.9	-0.9	-0.9
Industry	33.3	3.4	-18.0	-6.9	-8.2	52.1	40.6	44.4	-4.2	-5.3	-4.9
Services	4.6	3.4	0.0	-4.3	-0.9	33.3	49.6	44.1	-0.5	-0.5	-0.5
Senegal	**19.7**	**3.1**	**-13.6**	**-4.1**	**-3.4**	**100.0**	**100.0**	**100.0**	**-3.4**	**-2.9**	**-3.1**
Agriculture	14.8	3.1	-11.9	-3.1	-1.6	17.1	20.3	19.2	-1.6	-1.6	-1.6
Industry	26.9	3.1	-17.2	-4.8	-6.0	54.3	43.3	47.1	-5.6	-5.6	-5.6
Services	11.8	3.1	0.0	-3.7	-0.3	28.6	36.4	33.7	-0.3	-0.3	-0.3

i.e., income effects and consumer price effects. To examine these effects, the income and consumer price changes discussed in the preceding two subsections are reproduced in the first two columns of table 1. Total consumption of households is also reproduced since the closure chosen in the models implies that household savings should vary to equilibrate the investment-saving condition.

It becomes clear that the generally positive welfare effects of trade liberalization can be explained by the fact that the reduction in consumer prices is greater than the fall in total consumption, which accounts for the variation in income and savings. It is also noted that the welfare effects of trade liberalization favour rural households over their urban counterparts only in Senegal. This result, which occurs despite greater nominal income reductions among rural households, can be attributed to the greater fall in total consumption for urban households. In this model, rural savings are maintained fixed. Consequently, compensation for lower governmental saving must be entirely covered by urban households. In all the other countries, the higher decline in income is mirrored by a higher decline in total consumption. Except in the Philippines and Senegal, urban households therefore gain from trade liberalization whereas rural households experience a slight reduction in welfare. Urban welfare gains can be traced primarily to their greater reliance on stable "other income" sources and their proportionately lower consumption of agricultural goods, for which prices fall least.

Poverty reductions are greatest in Benin, although overall welfare declines slightly. Gains in welfare thus principally reach the poorest households while losses are concentrated among rich households. In India, Nepal and Pakistan, poverty reductions are very small. It is quite understandable in India, where welfare slightly decreases, and in Nepal, where welfare gains are non-existent. It suggests, in the case of Pakistan, that the welfare gains from trade liberalization accrue primarily to richer households.

(a) Compensation mechanisms

Liberalizing trade implies a change (generally negative) in government revenue, since tariff revenue represents a more or less important part of it. Government income being fixed, this revenue loss must be compensated for; the adjustment variable chosen can influence the results. The simulation described previously specifies a sales compensatory tax, increasing by between 0.9 per cent in India and 3.8 per cent in Benin, which directly affects consumption prices. To understand this influence, the results of the same trade liberalization scenario are compared using another compensation mechanism – direct compensatory tax on households' income and a production tax.

(i) Direct compensatory tax

Using a direct compensatory tax does not significantly alter overall welfare, which is still marginally positive in most countries. Poverty, on the other hand, now increases – even if marginally – instead of decreasing in most countries. Moreover, rural and urban relative gains are often changed and more definite than with a sales tax, except in India where rural-urban difference in welfare variations is less important. This is as expected, since a sales tax (mostly influencing resources allocation) compared with an income tax (directly influencing household welfare) should bring more equalized results if income taxation rates are considered to be more differentiated among households than are income sources and consumption patterns.

In terms of allocation of resources, the same decrease in import prices (except in India, where quotas are present) drives a higher demand for agricultural and industrial imports (except for Benin's industrial imports) since, without the sales tax, the import price on the market is lower. Qualitative results concerning exports, output and domestic prices are unaffected by the compensation mechanism while, quantitatively, domestic and output prices often decline more in industry and less in agriculture and services, and domestic and output supplies increase more. A notable difference is Bangladesh, where domestic demand now increases by 0.7 per cent. Interestingly, Nepal and Benin are more in line with other countries in terms of agricultural vs. industrial magnitude of responses, indicating that the sales tax has a significant impact in these countries. In Nepal, this is explained by the extremely small difference between tariff rates (and thus, import price decline) in agriculture and industry while in Benin, it follows from the high level of the compensatory tax. Impacts on services go in the same direction but are generally weaker than with a sales tax.

On the factor market, while value added prices do not follow output prices as closely, in general they still decrease. Exceptions are Benin, the Philippines and Senegal, where overall and some sectoral value added prices increase. Being directly linked to value added prices, wage rates decrease in every country except Benin, the Philippines and Senegal. Capital return generally exaggerates more than mirrors value added price variation to compensate for the increase or insufficient decrease in wages, while a land return decrease is diminished. In other words, in the absence of a sales compensation tax, returns to labour and service sector capital experience a higher relative gain because of the lower decrease in value added prices. Following changes in wage and return rates, household incomes still decline (less than is the case with sales tax) in every country except in Benin, the Philippines and Senegal, where wage rates increase.

The disadvantage to rural households in India, the Philippines and Senegal is again explained by changes in other income and in land returns that largely compensate for wage rate benefits. In all the other countries, a small relative income gain by rural households is observed. In other words, before-tax income changes are more equally distributed than in the presence of a sales tax. Consumer price variations are still negative but stronger in most of the countries, as the fall in prices is not compensated by increased indirect taxes.

Even if consumer prices decline more and incomes decline less, overall welfare effect is still marginal since decline in total consumption (including changes in savings and, especially, in direct tax) is more important, showing the significance of the compensation mechanism. Income tax increases significantly in Benin, Pakistan, the Philippines and Senegal. Highly taxed urban households in Benin, Senegal and the Philippines experience an especially significant decline in total consumption compared with the increase in income. Despite this result, and mostly because of significant falls in consumer prices, urban households still benefit more from trade liberalization than do their rural counterparts in terms of welfare. Households benefiting from a rise (decline) in welfare also benefit from a decline (rise) in poverty. Overall, poverty increases compare with trade liberalization using sales tax compensation, but changes in overall poverty levels are marginal. Compared with the sales tax situation, urban-rural welfare and poverty effects are unchanged.

(ii) Production compensatory tax

When using a production tax instead of a sales tax, most results are roughly unchanged. In effect, contrary to income tax, a production tax and sales tax both affect the allocation of resources directly. Therefore, the results also look much alike.

First, the decreases in import prices being the same, import demand, domestic sales and prices as well as export and output responses are qualitatively and quantitatively quite similar, as when a sales tax is used. A pro-industry impact is maintained although Benin and Nepal are still exceptions. When using production tax, a significant difference is the much more important decrease in output price. In effect, this price includes the production tax while the sales tax affects the consumption price although its value is not included in it. The services sector reaction is similar when using a production tax in all the countries.

On the factor market, value added prices decrease roughly in the same proportion as output and therefore decrease more than with a sales tax. The industrial-agricultural is inversed in five of the seven countries.[7] Consequently, the variation in the wage rates, capital return and land return are also qualitatively similar but quantitatively more significant. The relative gain to labour is maintained, again with the exception of Senegal. This higher fall in factor return brings a higher income loss for every household. Rural-urban share of this loss is similar. The pro-urban income effect of trade liberalization, except in Nepal, is therefore maintained in the presence of a production tax. It is explained by the same factors, except in the case of Nepal where the urban loss is principally linked to skilled wages. Consumer prices also decrease more in every sector and for every household in the presence of a production tax, and the pro-rural consumption effect of trade liberalization is maintained.

Income and consumer prices both decrease more but in similar proportions as, with a sales tax compensation mechanism, impacts on welfare and poverty are quite comparable. Overall, welfare is still negligible and poverty generally falls. Urban households gain in welfare except in Nepal and Senegal. As a result, urban poverty increases in Senegal and Nepal.

---

[7] Bangladesh, Benin, Nepal, the Philippines and Senegal.

(b) Long term versus short term

Choosing to consider trade liberalization in a long- or short-term perspective can lead to different conclusions. In effect, capital mobility assumed in the long term allows firms to react more adequately and to adapt to changes in the economic environment more smoothly; capital goes where it is needed the most without creating artificial scarcity.

With this idea in mind, simulations of trade liberalization specifying capital mobility are compared with the base simulations (using the three compensatory mechanisms) where capital immobility is required. Overall welfare and poverty results are basically the same. The sole exception is Nepal, where the relative position of rural and urban households changes. With sales and production compensatory taxes, rural (urban) Nepalese households lose (gain) welfare in absolute terms while poverty decreases (increases) in relative terms, when capital is mobile; however, they gain (lose) or are unaffected when capital is sector-specific. With direct compensatory taxes, they become relative winners (losers). Therefore, in every country, welfare and poverty results are slightly pro-urban in the presence of sales and production taxes and are pro-rural in the presence of the income taxes, no matter what time frame is used.

These results follow from the fact that mobility of capital allows both consumer prices and income to decrease less than when capital is sector-specific, but in a more or less similar proportion. Income decreases less since capital is allowed to go into industry, where demand is higher and then consequently competes less intensively with labour, allowing the overall wage rate and the overall return rate on capital to drop by a smaller amount. An interesting case is Bangladesh, where both the wage rate and capital return even increase, indicating that trade liberalization affects factors considerably, especially capital demand. Consumer prices decrease less since import price changes are the same and domestic prices decrease less following the significant export push from the gain in competitiveness permitted by mobile capital.

The principal exception here is India, where both income and consumer prices decrease more than in the reference simulation, but also have no differential impact in terms of welfare and poverty. In India, land return is highly affected by trade liberalization. The positive capital return in agriculture due to the presence of land being replaced by negative return rates (the same in every sector), combined with a still negative – in two thirds of the cases, even more negative than with immobile capital – land return (land is still specific to the agricultural sector), implies a important decrease in value added, output and domestic as well as consumer prices in agriculture. Consequently, both income and consumer price index decrease more in the mobility case. This effect is not as influential in Nepal and Senegal, since the decrease in land return is not as important.

C. Conclusion

The authors note than because they are economists, it is perhaps not surprising that the main conclusion drawn from this study of the impacts of trade liberalization on poverty is that there is no general relationship between trade liberalization and poverty; rather, the conclusion is that “it depends”. As this detailed analysis based on disaggregated large-scale CGE models shows, trade liberalization is more complicated than policymakers may want to admit, with numerous complex and opposing impacts on these economies that channel through the output, factor and product markets to influence household income and consumer prices. The main contribution of this chapter is to point out some general trends as well as explain carefully on what factors the poverty impacts of trade liberalization “depend”.

Nonetheless, it does appear that trade liberalization generally increases welfare and reduces poverty marginally, although some categories of households and certainly some specific households clearly lose out. An almost clear conclusion emerges concerning the rural-urban bias in the welfare and poverty impacts: urban households gain in terms of welfare and poverty, while rural households lose from trade liberalization.

When the channels of impacts are examined, some interesting results emerge. Initial tariffs tend to be higher for industrial imports. As a result, trade liberalization generally reduces import, domestic and output prices of industrial goods with regard to their agricultural and service counterparts. The cases of Pakistan and India are interesting in this regard, as they show how trade liberalization and ensuing export expansion may lead to a greater fall in export prices where a country faces world demand that is not perfectly elastic (i.e., demand for price reductions as exports increase). However, greater export intensities in the industrial sector imply that this sector benefits more from the ensuing export expansion, such that industrial output actually increases more than output in the other two sectors in all but Benin.

Another remarkable result of the analysis is the importance of the input cost effects of trade liberalization. As each sector consumes a large share of inputs from within the sector itself, the industrial sector – where price reductions are greatest – gains the most in terms of cost reductions from trade. Indeed, these cost savings are so strong that, in most countries, value added prices actually fall less in the industrial sector than in the agriculture sector. However, it is the service sector, which is essentially cut off from international trade, which often experiences the smallest reductions in value added price following the removal of tariffs. As value added prices determine factor remunerations, these results have important welfare and poverty implications.

As labour’s principal source of income is the service sector, wage rates tend to fall less than the returns to capital and land. Conversely, the returns to land, where this factor is explicitly taken into account, fall relative to the other factors given its tight links with the agricultural sector, where value added prices decline most. Capital is assumed to be sector-specific, so that the returns to capital in the service sector fall less than in the other two sectors.

Surprisingly, it is not the differences in the returns to the two principal factors of production – labour and capital – that drive the household income results. Instead, it is the greater reliance of urban households on relatively stable non-factor income and the greater reliance of rural households on the strongly falling returns to land that explain a general pro-urban bias in the household income effects of trade liberalization.

The impacts of tariff removal on consumer prices also hold a few surprises. Although the effects are about the same for both types of households in most countries, rural households consume relatively more agricultural goods, such that they benefit less from the reduction in the prices of industrial goods than do urban households. Finally, positive welfare and poverty effects are found to be driven by consumer price reductions that outweigh the reductions in total consumption, with nominal income taking into account variation in savings. However, it should be noted that income effects may dominate consumer effects when looking at the rural-urban bias in specific countries.

References

Cloutier, M., J. Cockburn and B. Decaluwé, 2003. "Welfare, poverty and distributional effects of trade liberalization: A review of the CGE literature" (mimeograph). Université Laval, Québec.

Cockburn, J., 2001. "Trade liberalisation and poverty in Nepal: A computable general equilibrium micro simulation analysis", discussion paper 01-18. Centre de Recherche en Économie et Finance Appliquées, Université Laval, Québec.

Cogneau, D. and A. Robilliard, 2001. "Growth distribution and poverty in Madagascar: Learning from a micro-simulation model in a general equilibrium framework", TMD discussion paper 61. Washington, D.C., IFPRI.

De Janvry, A., E. Sadoulet and A. Fargeix, 1991. "Politically feasible and equitable adjustment: Some alternatives for Ecuador", *World Development*, vol. 19, No. 11; pp. 1577-1594.

Decaluwé, B., A. Patry, L. Savard and E. Thorbecke, 1999. "Poverty analysis within a general equilibrium framework", working paper 9909. Department of Economics, Université Laval, Québec.

Piggott, J. and J. Whalley, 1985. *UK Tax Policy and Applied General Equilibrium Analysis*. Cambridge, Cambridge University Press.

Savard, L., 2003. "Poverty and income distribution in a CGE-household model: A top-down/bottoms-up approach" (mimeograph). Dakar, Senegal, IDRC.

Comment

DOES TRADE MITIGATE OR ENHANCE POVERTY?

By Mustafizur Rahman

When first reading the title of this session,[1] "Making trade work for poverty reduction: Reality or fantasy?" my initial response was that the answer would lie somewhere in between. Then I remembered the words of German philosopher Hegel: "People generally tend to think that the solution to a problem lies between two extremes; but between two extremes lies not the solution, but the problem!"

Therefore, I would like to start by asking what type of trade and trading system we are considering. The answer to whether trade is poverty mitigating or poverty enhancing will critically hinge on an answer to this question.

In answering the question posed in the theme, I would like to draw insights from the Bangladesh experience. I feel strongly that Bangladesh's experience tends to epitomize the rewards and risks as well as the opportunities and challenges that LDCs, both in general and as a collective, face in the context of the multilateral trading system and WTO. The answer to the question posed in the title of this chapter will depend on how the attendant issues are addressed in the context of the multilateral trading system.

Before looking at the substantive issues, it should be recalled that global community of nations have jointly agreed to help the developing nations attain the eight MDGs, including MDG-1 which mentions halving global poverty by 2015, and MDG-8, which aspires to make trade, together with debt relief and aid, work for attaining the other seven MDGs. Therefore, it is fair to argue that all countries have promised to work towards making trade work for the advancement of the developing world.

It must also be kept in mind that the discussion of this theme is in the context of the Doha Development Round; in particular, let us not forget the middle 'D'. Thus, while discussing the power of trade to mitigate poverty and posing this issue as a question, it must be remembered that we are discussing the issue of making trade work for poverty alleviation in the context of a Round that prides itself for putting development at the centre of the multilateral trading system. Therefore, rather than asking whether making trade work for poverty alleviation is a reality or a fantasy, the question should be what measures need to be implemented in the context of the multilateral trading system in order to make trade work for poverty alleviation.

Paraphrasing Marx, who said "so far philosophers have been engaged in explaining the world; the task, however, is to change it", our task should be to design a multilateral trading system that is sensitive to the needs of poor nations and that addresses the needs of poor people.

---

[1] Refers to the "Post-Doha Research Agenda for Developing Countries" held in Macao, China on 30 and 31 October 2006.

I will attempt to offer some insights by taking the experience of Bangladesh as a test case. In 1972, immediately after Bangladesh was born, a book was written that subsequently became an important reference source. In the preface of the book, entitled *Bangladesh: a Test Case for Development,* the authors explained that the newborn country was beset with such extraordinary difficulties in managing its economy that it would perhaps continue to remain predominantly aid-dependent for years to come. Hence, if development was possible in Bangladesh, it would be possible in all developing countries; it was in that sense that Bangladesh became a test case for development.

This same Bangladesh could now be a test case, but in a context that is quite different from the one mentioned in *Bangladesh: a Test Case for Development*.

It should be noted that during the years since independence, Bangladesh has been able to achieve a very crucial graduation, from a predominantly aid-receiving nation to a trading nation. Some stylized facts will help explain this change. In early 1990s, Bangladesh's degree of openness was about 20 per cent, whereas it is now about 40 per cent. Bangladesh's export-to-aid ratio at that time was about 1:1; in financial year (FY) 2006, the ratio was 14:1. In FY 2006 Bangladesh exported US$ 10 billion worth of goods and US$ 4.2 billion worth of services (remittances). In fact, US$ 14 billion worth of exports of goods and services for a country with a GDP of about US$ 60 billion is a truly noteworthy attainment – this is especially so for a country where the per capita income is US$ 450 and the per capita export of goods and services income is about US$ 100. With export-oriented ready made garments (RMG) contributing 75 per cent of exports, Bangladesh has, so far, successfully met the challenges emanating from the phase-out of the MFA (in FY 2006, export growth of RMG was about 21 per cent).

In the decade of the 1990s, poverty was being reduced at a pace of 1 per cent per annum. The signals coming from the data generated for the past five years indicate a doubling of the pace of poverty reduction. Yet, about 40 per cent of the population in Bangladesh is living below the poverty line. There is growing inequality in income, rural-urban inequality and spatial inequality are increasing and the number of people living below the extreme poverty line is on the rise.

No doubt, income generated through export-oriented activities did have a positive impact on Bangladesh's economy and her achievements. However, whether overall trade liberalization policy has achieved a positive impact on poverty alleviation and income distribution has been questioned in the Bangladesh context.

Take the RMG sector, which accounts for 76 per cent of exports by Bangladesh. The minimum wage fixed in 1994 was equivalent to US$ 30 per month. In 2006, in the face of worker agitation, the minimum wage was increased by 70 per cent; yet, it is now actually equivalent to just US$ 27 per month and the workers are asking for US$ 40. Entrepreneurs say that if they have to pay US$ 40 per month as a minimum wage they will not survive in the global market. Therefore, an LDC such as Bangladesh is able to export to the global market only by giving less than US$ 1 a day to a worker, which is below the international poverty line. It therefore appears time to consider the way the multilateral trading system works, even for “successful” LDCs. What is happening to terms of trade? How to move up-market, ensure higher local value addition, increase productivity, enhance product diversification and strengthen trade-related capacity-building? These are the challenges that Bangladesh must meet.

It is in that context that a comprehensive aid-for-trade package in support of LDCs becomes pertinent and vital. While it cannot be denied that Bangladesh and other LDCs will need to do their own necessary homework in order to address these challenges, it is equally true that the rules of the multilateral trading system will also need to be suitably fashioned to help the LDCs in this regard. The developed countries will also need to undertake necessary obligations in this respect.

An effective aid-for-trade package and greater market access for LDC products (under a global zero tariff, zero quota market access) could be two measures for enabling LDCs to take advantage of the current phase of globalization.

In terms of market access, the major offensive interest of LDCs in the context of the Doha Development Round is the demand for duty-free-quota-free (DF-QF) access for all products from all LDCs in the markets of all developed countries. However, Annex 36(F) of the Hong Kong Declaration stipulates DF-QF access for only 97 per cent of tariff lines, leaving scope for avoiding the provision of zero tariffs on exports of virtually all products from LDCs to the United States market, which is the major market of interest to the LDCs.

In the European Union, where LDCs receive DF-QF under the “Everything but Arms” initiative, the rules of origin continue to be stringent and only about 60 per cent of Bangladesh’s exports can actually access the DF facility. “Everything but Arms” provided zero-tariff access to 919 agricultural items, but the lack of supply-side capacities means LDCs cannot reap the potential benefits.

Even though LDCs were not asked to undertake commitments at the WTO Hong Kong Ministerial Meeting, their export competitiveness will be negatively affected because of preference erosion. Market access to the United States would have positively offset the negative impact of tariff erosion; but that did not happen at the Hong Kong Ministerial Meeting. In 2005, the import duties on Bangladesh’s exports to the United States amounted to some US$ 420 million; this was several times higher than bilateral United States aid to Bangladesh. A fund created from such import duties could be used for trade-related support, including trade-related capacity-building in LDCs. Analysis indicates that zero-tariff market access is likely to increase Bangladesh’s exports to the United States by 30 per cent.

All studies, including those by the World Bank, have shown that LDCs stand to gain substantially from exports of services. An International Monetary Fund study showed that opening up even a 3 per cent labour service market in the developed countries would bring about US$ 150 billion to developing countries and LDCs in remittances. However, as is widely known, there has not been any tangible progress in the negotiations on the temporary movement of natural persons under GATS mode-4. The analysis of HIES data in Bangladesh clearly shows a high correlation between poverty alleviation and household earnings from remittances. However, some 80 per cent of such remittances to Bangladesh come from other developing countries.

The worsening terms of trade for products from Bangladesh is also not helping. Compared with the mid-1990s, Bangladesh has seen a decline in the terms of trade index from 100 to 86 in recent years.

The strengthening of S&DT provisions in WTO and more faithful implementation are needed. There is also a lack of harmonization between trade policies in WTO and aid policies of development partners at home. Even if WTO negotiations had carved out some policy space for LDCs, they had to abandon using it under aid conditionalities imposed by aid donors with negative implications for applying policy space to development objectives. LDCs demand harmonization and alignment between WTO decisions and aid conditionalities.

The discussion of an aid-for-trade package in WTO is making good progress and a number of good suggestions have been put forward. However, LDCs have concerns in that regard. Will it be new money? What will be the LDCs' share? Will conditionalities be attached? Will LDCs have a say in the allocation and use of those resources? LDCs would like to use aid-for-trade support for trade-related supply side capacity-building in upgrading the growth of productivity as well as modernizing ports and infrastructure development, for supporting trade facilitation measures.

Bangladesh as a trade dependent LDC firmly believes that if the multilateral trading system and its rules can be crafted along these lines, making trade work for poverty reduction will indeed become a reality and no longer remain a fantasy.

Some of the research questions that could be asked in this context are:

- How to identify country-specific demands for the aid-for-trade package from the perspective of poverty alleviation?
- How should trade policies be integrated in poverty reduction strategic plans of LDCs? (This will require the identification of the transmission mechanisms of the gains from trade as well as how to ensure that poor people have a share in the process.)
- Which services sector openings under node-4 will have the greatest poverty alleviating impact?
- Under the ongoing GATS negotiations, LDCs are being asked to open up services sector under offer and request modality. Liberalization of which services sectors will be beneficial from the perspective of poverty alleviation?

Part V

Can non-tariff barriers be tamed?

Chapter V

TAMING NON-TARIFF BARRIERS: CAN THE WORLD TRADE ORGANIZATION FIND A SOLUTION?

By Biswajit Dhar and Murali Kallummal

Introduction

In 1947, the multilateral trading system was established through the formalization of the General Agreement on Tariffs and Trade (GATT) with the objective of ensuring the elimination of border protection measures arising from the pursuit of discriminatory policies. The process of trade liberalization that was thus initiated has since become almost synonymous with the lowering of tariffs. Yet, the critical issue of NTBs has remained sidelined. The consideration given to this issue appeared to be just enough to protect the protagonists of trade liberalization against criticism that they were reluctant to ensure distortion-free markets were put in place. The results were along expected lines. For a number of decades, GATT had to face the criticism that it had established a regime that had worked for the lowering of tariffs while turning a blind eye to the growing incidence of NTBs.

WTO could scarcely do any better. Disciplining NTBs was included as a part of the negotiations on non-agricultural products. More importantly, the two agreements that were explicitly included in the Uruguay Round package for monitoring the growth of standards in recent decades have been questioned regarding their effectiveness, and were substantially left outside the purview of the current round.

An issue that assumes importance in the context of the handling (or non-handling) of the NTB issue by the multilateral trading system is the identification of an NTB. The assumption has been that these barriers result in distortions in the marketplace, stemming essentially from their discriminatory application. However, this is only the beginning of the problem in identifying NTBs. The policy regimes that countries have established have also spawned instruments that are aimed at addressing “market failures”. Thus, “barriers” have been put up to ensure that the markets do not result in undesirable outcomes. Analysts have tried to differentiate such “barriers”, which have been introduced as a way of addressing “market failures”, by christening them as NTMs. However, the jury is still out on whether an NTM can, under some circumstances, appear as an NTB.

This chapter is in the nature of a status report of the handling of the NTB issue by the multilateral trading system during the six decades that it has been in existence. Section A reflects on how the received literature has addressed NTBs. The focus of the analysts has largely been on NTMs, which, in the view of the authors, has shifted attention away from the NTBs and which therefore needs urgent attention at this juncture.

The handling of NTBs by the multilateral trading system is discussed in sections B and C. The main focus of this discussion is on the current round of negotiations in which WTO members are expected to provide a framework for disciplining NTBs. This discussion indicates that the identification of NTBs by WTO members has revealed that their exporters consider some of the so-called NTMs to be technical barriers, and sanitary and phytosanitary measures as NTBs.

This brings us back to the point made above – it is imperative for the WTO members to carry out a detailed review of the agreements on technical barriers to trade (TBT), and sanitary and phytosanitary (SPS) measures to ascertain whether these so-called NTMs are behaving more like NTBs. The authors believe that this review is necessary, given the high degree of proliferation of these measures since 1995. Section D makes this point while analysing the trends in the growth of TBT measures.

A. Understanding the phenomenon of NTMs

This section explores the analytical framework as well as the evidence for understanding the phenomenon of NTBs, beginning with a discussion of some of the more contemporary literature on the subject. A brief discussion follows regarding available data on NTMs, with the focus on the widely consulted UNCTAD Trade Analysis and Information System (TRAINS) database (see annex table 1).

The existing literature on NTMs covers a vast area of trade policy instruments that are beyond the simple definitions of tariffs (ad valorem and non-ad valorem). Based on two broad classifications of goods and services, these can be categorized into two groups: those that discriminate trade in goods and those that distort market access for service providers. A number of studies have been carried out on the trade distortion effect of non-tariff instruments since the 1970s, covering instruments from subsidies to trade facilitation issues. This section attempts to briefly present the broad contours of those studies, which covered the use of “regulatory protection” as a trade policy tool and looked at its trade-distorting effects.

In a seminal work in 1970, Baldwin defined non-tariff instruments as measures (public or private) that caused internationally traded goods, services, or resources devoted to the production of these goods and services, to be allocated in such a way as to reduce potential real world income. Baldwin’s classification seems to have expanded NTMs beyond the trade policy arena, covering even micro elements such as transfer pricing that fall under competition-related matters. This definition was too ambitious to apply in the real world, as concepts such as potential real world income are very fuzzy and difficult to define.

A rather simple approach was adopted by Greenway (1983, p. 132). He categorized these regulatory instruments into direct and indirect instruments, based on explicit and notional effects on trade flows. They covered a large variety of instruments belonging to quantitative, fiscal and administrative measures. Taking a similar line, Hillman (1991) provided a general definition covering all forms of restrictions, other than traditional customs duties, that act as NTMs by distorting international trade. However, it should also be noted that defining trade distortion may not be always easy, as it is often very difficult to quantify it, especially when "expectations" are taken into account.

However, the most practical approach to understanding the negative impact of NTMs was largely taken in the context of its probable effect on trade flows (Deardorff and Stern, 1998). Hence, the most common element in the definition of NTMs in a large number of studies was the negative impact on trade volumes, directly and indirectly through price effects. But as Beghin and Bureau (2001) point out, a unifying methodology for assessing the impact of NTMs does not exist given the heterogeneous nature of these regulations.

The nature of the coverage of various instruments under the WTO agreement brought some distinction to the definitional approach used in the studies on NTMs. These studies defined NTMs based on the legitimacy of certain instruments provided in the various agreements, and therefore excluded issues on negative impacts related to compliance and transparency. In their attempt to define NTBs, Hillman (1997) and Roberts and De Remer (1997) sought to distinguish between those regulations designed to protect local industry and those designed to protect consumers. Subsequently, Roberts (1998) and Roberts and others (1999) defined NTMs as a set of regulations that included many policy instruments. Accordingly, they categorized the instruments by the scope of the barrier, regulatory goal, legal discipline, type of market restriction, product category and geographical region. Again, it was a broad definition, and it clearly highlighted differences in the protectionist nature of various measures. They found an overall equilibrium impact in a sector or in the economy where the NTM was applied. The analytical framework suggested in this case is to take account of three broad effects: (a) regulatory protection effect – rent to domestic sector; (b) supply shift effect – compliance cost impact in terms of increase in domestic supply; and (c) demand shift effect – new information effect, which leads to increased demand. All these effects are analysed in a welfare-oriented approach.

The approach adopted was intended to isolate only those measures as NTMs that restrict trade alone, and it did not address some legitimate concerns of governments/countries (protection of health and the environment, and safety). The measure, which would address the legitimate concerns under TBT and SPS, would not be termed as NTMs. Hence, legitimacy of the measure becomes an important criterion for the NTM definition. Some these trends can be observed in a large number of surveys conducted on business concerns of WTO issues by United States business councils such as the United States – China Business Council (2003). This survey made clear distinctions of SPS and TBT measures (standards and regulations) from that of other NTMs such as quotas, licensing/tendering requirements, and government and industrial restrictions.

On the other hand, Maskus and others (2001) suggested a method of comparing a measure to a situation when the measure would have been implemented if it had been designed for domestic purposes. Here, the principle of national treatment is taken as a criterion for judging the measure. It would mean that if the regulation or standard is applied for both foreign and domestic products, then the measure is not trade-distorting and hence not an NTM. Maskus suggested the need for closer examination of the impact on trade and national welfare in the context of standards and technical regulations (NTMs).

The literature also identifies the effects of small and large firms on NTMs. The cost of regulations affects these two segments of an industry in different ways, thus modifying the structure of competition or the size of the relative markets affecting the profit mark-up and rents. Granslandt and Markusen (2000) also accounted for the fact that standards could impose a fixed cost of entry that would affect competition, and might also lead to multiple equilibria, an effect well known in industrial organization. The simplest approach to standards is that when they differ between countries, they constitute a real trade cost for exports trying to penetrate the foreign market. However, the study by Granslandt and Markusen (2000) suggested that incompatible standards were particularly harmful for small/poor countries who could not win a “standards war”. As there is a fixed cost of any standard, with multiple equilibrium, they suggested that the welfare differences between different players would be large, creating an important coordination role for public policy. However, the study clearly highlighted the lack of quality in empirical evidence, given that the existing data sources did not provide sufficient information regarding the various quantitative effects.

In the context of shift in supply curves, Bureau and others (1998, pp. 437-462) and Bureau and Marette (2000, pp. 170-198) argued that regulations bring information and therefore avoid or reduce the cost of assessing product quality (the “lemon problem”). Similar views can be found in Casella (1996) and Fisher and Serra (2000), who suggested that such measures would behave like a public good and would manifest similar effects. Casella concluded that standards and regulations respond to a society’s demand for specific public goods, and as such can we expect them to be shaped by preferences, endowments, and technologies – the fundamental determinants of this demand. There is no a priori reason why standards should be equal in different societies. This paper also studied the interaction between standards and international trade. It showed that although standards can be used to manipulate trade flows, there is no logical connection between standards harmonization and gains from trade. Moreover, standards themselves will be modified by the opening of trade and under reasonable assumptions; harmonization will be one of the outcomes of free trade. The empirical evidence suggests that industry groups are assuming an increasing role in shaping government regulations (Casella, 2001). In this perspective, standards need not be automatically identified with national policies, and the possibility of international alliances of industry groups must be considered. This study supports the results of the study by Milner across industries. The result of market integration is then international harmonization together with increased differentiation across industries (Casella, 1995 and 1996).

Regulations and standards can also lead to a rise in the elasticity of substitution in demand, leading to network externalities and even economies of scale, by permitting producers to settle on a limited range of products. However, the supply of a range of products that do not necessarily fit consumers, demand a variety of attributes. Such a trend could also manifest in a manner that would help technologically capable countries over those, which do not have technological capability in terms-of-trade effect (Harrison and Tar, 1996; Maskus and Wilson, 2000). Although at the micro level the results could be mixed, at the macro level technological capability and financial control can seriously influence the trading patterns in favour of the industrial countries.

Incorporating environmental factors, Blyde (2000) showed that, if a country specialized in the production of dirty goods, it did not necessarily become dirtier, as predicted by the pollution haven hypothesis. Trade equilibrium is constructed where a rich country specializes in the production of the clean good, a poor country specializes in the production of the dirty good, and both countries become cleaner after the gains from trade are internalized. The result casts serious doubts on the effectiveness of using trade restrictions to improve the environmental conditions of developing countries, as proposed by some environmental groups. From the environmental point of view, the use of restrictions can be counterproductive, not only for the poor country but also for the rich country (Blyde, 2000).

The review of literature on NTMs and their effects on trade clearly highlights an important point that there are other effects of standards and regulations that need to be addressed. Further, there is a large gap between the ambitious analytical framework and the applied estimates of the effects of NTMs. The approaches that have been adopted can be categorized as follows**:**

(a) Trade effect – mercantile measure constructing the tariff equivalent;

(b) Welfare effect – entire economy effect (global);

(c) Distribution effect – use of social account matrix;

(d) Resource cost effect – deadweight losses (administrative cost and cost of resources to rent seeking); and

(e) The impact of industrial restructuring.

To analyse the above-mentioned effects, empirical models have to analyse the effects of regulations and standards on various issues such as supply, the extra cost induced, the price differences between foreign and domestic producers, among others.[1] However, most of the studies undertaken so far have been carried out in the context of effects on developed countries, firms and markets. In terms of sectors taken up for analysis, existing studies have attempted to analyse the impact of standards and regulations for agricultural and animal products largely in the context of developed markets. Most studies have not captured the effects of the standards that are being set by the developed countries and, more recently, by the advanced developing countries, on other developing and the least developed countries. This, in the view of the authors, is a serious flaw since it does not take into consideration the fact that the least developed countries face severe

---

1 Annex table 3 provides the salient features of some of these studies.

constraints arising from their limited availability of resources and are thus unable to meet the challenges posed by the increasing proliferation of regulations and standards. As a result, the ability of those countries to enhance their market access prospects looks rather bleak.

The constraints that these countries face are epitomized by their limited technological capabilities, which have long been recognised as impediments to improving their presence in the global markets. Although the global community has been discussing this issue for a considerable period, mainly through the efforts made by UNCTAD to improve the conditions of under which developing countries can access technologies that can improve their ability to compete in the global markets, very little progress has been made in that direction. More recently, WTO also began considering this issue after the Doha Ministerial Conference mandated the establishment of the Working Group on Trade and Technology Transfer, which is expected to submit “recommendations on steps that might be taken within the mandate of WTO to increase flows of technology to developing countries”. In the light of the above-mentioned factors, addressing the differences in capabilities to meet standards and regulations (which exist globally and even between groups of countries) becomes imperative while analysing the economic effects of NTMs.

One of the major limitations in understanding the implications or the potential implications of NTMs/NTBs is the lack of a proper database that captures these measures in a comprehensive manner. This can alone lead to focused policy initiatives being taken to address the problems that are faced because of these measures. The efforts that have been made towards documenting NTMs/NTBs, most notably by UNCTAD, are discussed briefly below.

The pervasive impact of NTMs was first recognized at the international level in the 1960s after the Kennedy Round of GATT negotiations included it in its negotiating mandate.[2] Following this, UNCTAD took the lead in developing an inventory of NTMs of the participating countries.[3] In 1973, the compendium contained more than 800 NTMs. In 1986, UNCTAD conducted a comprehensive research project to identify country-by-country NTMs, which revealed many more NTMs (Laird and Yeats, 1990).

The most comprehensive compilation of publicly available information on NTBs/NTMs is contained in the UNCTAD TRAINS database, which is accessible through the World Integrated Trade Solution (WITS) software. The NTB data incorporated in TRAINS indicate the existence of categories of NTBs classified according to the UNCTAD Coding System of Trade Control Measures (TCMCS) for particular products or groups of products. Additional information such as a brief description of each NTB, an indication of affected or excluded countries, and footnotes on exact product coverage are provided, where available.

---

[2] Developments related to NTMs in GATT are discussed in greater detail in a later section.

[3] The format for this inventory is included in annex table 1.

TCMCS currently under rinsion. identifies more than 100 different types of NTBs at its most detailed level (annex table 2). This classification does not include measures applied to production or to exports. NTBs are broadly classified into six chapters, from 3 to 8 (chapters 1 and 2 are reserved for tariff and para-tariff measures, respectively), according to the intent or immediate impact of the measures:

(a) Chapter 3 – price control measures. Measures intended to control the prices of imported articles for the following reasons:

   (i) To sustain domestic prices of certain products when the import price is inferior to the sustained price;

   (ii) To establish the domestic price of certain products because of price fluctuations in the domestic market or price instability in the foreign market; and

   (iii) To counteract the damage caused by the application of unfair practices in foreign trade.

   Most of these measures affect the cost of imports to a variable degree calculated on the basis of the existing difference between two prices for the same product, compared for control purposes. The measures initially adopted can be administrative fixing of prices and voluntary restriction of the minimum price level of exports or investigation of prices to subsequently arrive at one of the following adjustment mechanisms: suspension of import licences, application of variable charges, anti-dumping measures or countervailing duties;

(b) Chapter 4 – finance measures. Measures that regulate access to, and the cost of foreign exchange for imports as well as define the terms of payment. They may increase the import costs in a fashion similar to tariff measures;

(c) Chapter 5 – automatic licensing measures. Freely granted approval of applications for imports or monitoring of import trends for specified products, sometimes through inscription in a register. They may be applied to signal concern over import surges and to persuade trading partners to reduce export growth. They may also be applied for environmental purposes. Sometimes they are a precursor to import restraints.

(d) Chapter 6 – quantity control measures. Measures intended to restrain the quantity of imports of any particular good, from all sources or from specified sources of supply, through restrictive licensing, fixing of predetermined quotas or prohibitions.

(e) Chapter 7 – monopolistic measures. Measures that create a monopolistic situation by giving exclusive rights to one economic operator or a limited group of operators for social, fiscal or economic reasons.

(f) Chapter 8 – technical measures. Measures referring to product characteristics such as quality, safety or dimensions. They include the applicable administrative provisions, terminology, symbols, testing and test methods, packaging, marking and labelling requirements as they apply to a product.

Its comprehensive coverage notwithstanding, the TRAINS database has several limitations. The first problem with this database stems from the large diversity of measures deemed to be causing the market access problems that it covers. Because these measures are so diverse and sometimes non-transparent, their trade-distorting effects are extremely difficult to assess. Except for quotas, for which tariff-equivalents can be estimated, albeit with a fair amount of statistical margin of error, for other NTMs there are no theoretically correct and empirically sound measures for the estimation of trade distorting effects (Martin, 1997). In addition, the quality of databases on NTMs has often been pointed to as an additional problem; this limitation shows up especially when NTMs are used for explaining trade distortion effects. Even the most recent NTMs database provided by WITS does not cover the latest information on new, and additions to existing standards (annex table 4).

These limitations seem ungainly when considering the fact that the TRAINS database is a combined attempt by three premier multilateral institutions (the World Bank, the United Nations Statistical System and UNCTAD). Researchers who make extensive use of the TRAINS database would perhaps be justified in expecting this database to adopt a more scientific approach in providing data that is of such prime importance. The database needs to be significantly improved in terms of the clarity it affords in respect of the various measures that it covers. However, perhaps most importantly, information on NTMs for a relatively longer period is not available for many countries.

The only available data set for across-country NTM frequency is for the case of 20 countries. Here again a two-point comparison of NTMs based on WITS for a set of 20 countries (for which two-point data on NTMs is available – 1999 and 2001) suggests that in 2001, nearly 23 per cent of products (many of which represent two-digit HS codes) did not indicate the relevant objective and the type of NTMs applied by the country concerned. In addition, while NTM details are available along national lines, NTMs for which no description was provided in 2001 headings under the respective chapters in the database. Quite clearly, it is a serious case of non-transparency, where the objective for the application of NTMs is unavailable for empirical analysis. Hence, although the missing NTM objectives across this set of 20 countries stands at 23 per cent, their exact coverage at the six-digit level may be much higher; however, these would depend on the number of subheadings under the respective chapters in the database.

It is also expected that WITS would provide a comprehensive view of the market access conditions. However, WITS has been found to provide limited coverage. The country-wise updating of the database suggests that only in the case of 22 countries, NTM data were available for two separate periods; in addition, for all those countries, the latest coverage year was 2001. Of this list, only one country belonged to the developed category. The coverage of NTMs as per the available information from WITS is better for developing countries than for developed countries. Among the QUAD (with the exception of Japan), the two largest markets – the United States and the European Union – have information up until 1999.

Information on NTMs is a critical component of trade policy formulation. Therefore, the non-availability of such information during negotiations on critical agreements, such as that on agriculture as well as non-agricultural market access (NAMA), urgently needs to be addressed. This information gap is one of the biggest constraints facing WTO negotiators, particularly those from the developing countries.

B. GATT and market access negotiations

The foregoing discussion provides a useful backdrop to understanding the manner in which the multilateral trading system has dealt with the issue of NTBs. Established in 1947 through the adoption of GATT, the multilateral trading system was expected to substantially reduce tariffs and other barriers to trade, and to eliminate discriminatory treatment in international commerce.[4] With regard to NTBs, the focus of GATT was on the most prevalent form, i.e., quantitative restrictions (QRs) that the GATT Contracting Parties had imposed for a variety of reasons, including addressing balance of payments problems. Accordingly, several articles of GATT dealt with the issue of QRs.

Evidence of a dilution in dealing with NTBs became evident as the GATT Contracting Parties provided the larger picture of their intent in the form of the Havana Charter,[5] which was to have formed the basis of the functioning of the International Trade Organization (ITO).[6] Several critical deviations were made from the expressed intent by GATT to deal with the “other barriers” to trade, and these deviations formed a part of Article 20 of the Havana Charter, which provided for general elimination of QRs. While articulating the need to eliminate the prohibitions or restrictions other than duties, Article 20 provided the prospective members of the organization with the freedom to impose restrictions necessary for the application of standards or regulations for the classification, grading or marketing of commodities in international trade.

Furthermore, Article 21 allowed any member “to restrict the quantity or value of merchandise permitted to be imported... in order to safeguard its external financial position and balance of payments”. It was clarified that such QRs could only be applied by a member to (a) forestall the imminent threat of, or to stop, a serious decline in its monetary reserves, or (b) in the case of a member with very low monetary reserves, to achieve a reasonable rate of increase in its reserves. The QRs imposed by a member were to be progressively relaxed and ultimately eliminated, as that member’s external financial position improved. This idea, mooted in the Havana Charter, was subsequently modified as GATT Article XVIII:B. This Article was designed to allow developing countries to control the general level of their imports by restricting the quantity or value of merchandise

[4] Preamble to GATT, 1947.

[5] Interim Commission for the International Trade Organization, 1948.

[6] ITO was envisaged as a part of the triumvirate of organizations that was expected to ensure the orderly conducting of business in the global economy. However, ITO was not established because of opposition by the United States.

permitted to be imported, in order to safeguard their external financial position and ensure a level of reserves adequate for the implementation of their economic development programmes.

Much of the efforts in the initial years of GATT were devoted to the elimination of QRs. During those years, notable progress was made towards the elimination of restrictions applied under Article XII (GATT, 1973). However, concerns were expressed with regard to the "residual restrictions" that were imposed on products where BOP safeguards were not warranted and no GATT justification existed (GATT, 1983).

However, while GATT appeared to have moved towards restricting the use of QRs, it had also to contend with new developments that were ostensibly aimed at restricting trade. Two developments are particularly noteworthy – not the least because the initiatives for imposing those restrictions were taken by the United States. In 1955, the United States sought a waiver of the provisions of Article II and Article XI of GATT in order to implement Section 22 of its Agricultural Adjustment Act of 1933, which allowed the farm administration to provide price support to farmers. An amendment was adopted in 1951, which stipulated that no international agreement into which that the United States had entered would be applied in a manner inconsistent with the provisions of Section 22. According to the United States, the waiver was required in order to remove any possible inconsistency between the obligations of the United States under the General Agreement and that Section to permit the fulfilment of this Congressional mandate (GATT, 1955). Although several Contracting Parties were in favour of eliminating the restrictions by a specific date, the United States maintained that such an action ran contrary to the objectives for which the waiver was being sought. The implications of this waiver granted to the United States were far-reaching – it provided carte blanche use of QRs in the agricultural sector, which was in vogue until the Uruguay Round negotiations took the decision to convert all NTBs existing in agriculture into tariffs. This point needs particular emphasis since the decision to grant the waiver did not affect the obligations of the United States under any other provisions of the Agreement, and particularly its obligations under Article XIII that did not allow discriminatory administration of quantitative restrictions.

The second major development that introduced export restrictions was the adoption in 1961 of the Short-Term Arrangement Regarding International Trade in Cotton Textiles. Major importers of cotton textiles in the developed world argued that rapid imports from the developing countries were putting their domestic industries at considerable risk. The United States pointed out that an increase in imports of cotton textiles in 1960, which reflected a growing trend over many years, raised both economic and political problems for the country. In the view of the United States, a "Short-Term Arrangement" was required to mitigate the immediate problem faced by its domestic textiles industry by imposing restraints on textiles imports and that this could be replaced later by a "Long-Term Arrangement" after giving due consideration to the interests of the parties involved in trading in cotton textiles. As in the case of agriculture, the import restrictions, accomplished in this case by using import quotas, became a permanent feature of the international trade until it was finally dismantled in 2005. Ironically, the "Short-Term Arrangement" was adopted after the Committee III, which was established to consider measures needed to promote trade of developing countries as a part of the Programme of Action Directed towards an Expansion of International Trade.

QRs, both agricultural and non-agricultural, were the subject of negotiations during the Kennedy Round (1963-1969), but little progress was made. However, an important initiative was taken during that period to develop an Inventory of Non-tariff Measures that was undertaken under the guidance of the Committee on Trade in Industrial Products.[7] It was in the area of NTMs rather than QRs that the Kennedy Round made a new beginning. This was the result of the agreement between the GATT Contracting Parties that the negotiations would deal not with only tariffs but also with NTMs. The main outcome of that effort was the development of the Anti-dumping Code in 1967.

The GATT work programme on NTMs experienced significant expansion during the Tokyo Round. In fact, six multilateral instruments on non-tariff measures were negotiated during the Tokyo Round:

(a) Agreement on Technical Barriers to Trade;

(b) Agreement on Interpretation and Application of Articles VI, XVI and XXIII;

(c) Agreement on Import Licensing Procedures;

(d) Agreement on Implementation of Article VI;

(e) Agreement on Government Procurement; and

(f) Agreement on Implementation of Article VII.

Although the Uruguay Round negotiations were formally launched in 1986, the blue-print for that eighth Round of GATT negotiations was, in effect, provided by the Declaration adopted at the end of the Ministerial Conference held in 1982. With regard to NTMs, the 1982 Ministerial Declaration took the following decision: “To review, in a group created for the purpose, existing quantitative restrictions and other non-tariff measures, the grounds on which these are maintained, and their conformity with the provisions of the General Agreement, so as to achieve the elimination of quantitative restrictions which are not in conformity with the General Agreement or their being brought into conformity with the General Agreement, and also to achieve progress in liberalizing other quantitative restrictions and non-tariff measures, adequate attention being given to the need for action on quantitative restrictions and other measures affecting products of particular export interest to developing countries”. Backed up by this elaborate statement of intent, the Uruguay Round negotiating mandate merely reiterated that the aim of the negotiations was “to reduce or eliminate non-tariff measures, including quantitative restrictions ...”

The Negotiating Group on Non-Tariff Measures established for dealing with the issues at hand had the daunting task of defining the scope of the negotiations. Some of

---

7 See annex table 5.

the delegations argued that since the Tokyo Round had taken the initiative to rein in several NTMs, the Negotiating Group should focus on the "most serious problem areas such as import prohibitions, quantitative restrictions, VERs, variable levies, MFA restrictions and non-automatic licensing". It was further suggested that in order to effectively deal with the issue of NTMs, an adequate database should be established. The need to establish a database for identifying NTMs was particularly significant, as it indicated the difficulties that the GATT Contracting Parties continued to face while dealing with this vexing issue, despite expending considerable amount of negotiating capital since the decision to prepare the NTMs inventory was taken during the Kennedy Round.

It is interesting to note that the framework and procedures for the negotiations on NTMs was not adopted until February 1990, i.e., more than three years after the launch of the Uruguay Round. In fact, the negotiating process required an additional set of guidelines from the Ministers, which was provided through the mid-term review that was undertaken in April 1989. The negotiating guidelines provided by the mid-term review included the following key elements:

(a) Various negotiating approaches can be applied to these negotiations, including multilateral, formula and request-offer approaches. However, approaches, which ensure the widest participation and broadest possible liberalization, are to be preferred;

(b) To ensure that concessions to reduce or eliminate non-tariff measures are not subsequently nullified or impaired, participants agree to explore the most appropriate measures to achieve this objective.

(c) There should be provisions for immediate or staged implementation of results over agreed time-frames.

(d) If elimination of a non-tariff measure is not possible, consideration may be given to transforming it into a tariff.

(e) Participants will receive appropriate recognition for the liberalization measures that they have adopted.

In keeping with the above-mentioned negotiating guidelines, the framework and procedures for the negotiations on NTMs proposed three sets of approaches for dealing with the issue. These were (a) multilateral rule-making approaches, (b) multilateral formula approaches, and (c) request and offer approaches.

The GATT Contracting Parties proposed multilateral rule-making approaches for a number of NTM categories. The more prominent of these were issues related to pre-shipment inspection, Rules of origin and import taxes. The focus of negotiations in that set of approaches was, however, on the issues of pre-shipment inspection and rules of origin.

Australia made a strong pitch for the formula approach, suggesting that the two most common elements of non-tariff protection, i.e., price- and quantity-based measures, could be effectively addressed by using this approach. Australia's views were based on the request lists that countries had submitted with regard to NTMs that they wanted removed. The list showed that the price- and quantity-based measures were the most numerous. The measures included in the list were licensing, price support measures, prohibitions, quantitative restrictions, tariff quotas, voluntary export restraints (VERs), export subsidies and levies.

Taking a contrary view of this issue, the European Communities (EC) opined that "it will be difficult, if not impossible, to engage in a systematic or formula-based trade negotiation to reduce or eliminate NTMs as required by the Uruguay Round Declaration". Even in the area of quantitative restrictions, which, according to the EC members, was "the most homogeneous and theoretically quantifiable NTM", the "trade-inhibiting effect of different kinds of restrictions" was very difficult to measure. The EC members were therefore of the view that it was "unrealistic to seek to establish a standard procedure for tackling trade negotiations in this or any other sector of non-tariff measures where evaluation is currently subjective or entirely lacking".

The request-and-offer approaches were expected to be bilateral consultations based on the initial request lists submitted by the Contracting Parties. At the same time, plurilateral discussions involving participants having shared interests were to be encouraged. The negotiations on NTMs indicated that some GATT Contracting Parties were interested in establishing new rules with regard to only two areas, i.e., pre-shipment inspection and rules of origin. These issues were incorporated in the Final Act of the Uruguay Round negotiations in the form of two independent agreements. However, the request-and-offer approach was backed by too few Contracting Parties for it to make a mark in the disciplining of NTMs as mandated by the Punta del Este Ministerial. While the requests were made by more than 30 countries, only two Contracting Parties (one of which was the EC members) tabled their offers.

The lack of progress in the negotiations aimed at disciplining NTMs was appropriately summed up by the Chairman of the Negotiating Group on Market Access, formed after the Brussels Ministerial Conference failed to conclude the Uruguay Round negotiations in 1990. It was stated that there was "no substantial progress in the negotiations with respect to product-specific, non-tariff measures not dealt with in other negotiating groups. This adversely affects the prospects of achieving a balanced market access package for many participants" (GATT, 1991).

This statement remains a poignant reminder of the fact that the failure to introduce disciplines on NTMs has introduced an imbalance in the multilaterally agreed set of rules. While quantitative restrictions that the GATT Contracting Parties had maintained for balance of payments reasons were subject to a "sunset clause",[8] the other restrictions on imports

---

[8] While agreeing on the "Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994" that was adopted at the end of the Uruguay Round negotiations, "members confirm their commitment to announce publicly, as soon as possible, time-schedules for the removal of restrictive import measures taken for balance-of-payments purposes" (paragraph 1).

(including those that were the result of discriminatory use of standards) were eventually not addressed as a part of the rubric of market access negotiations. With SPS measures and technical barriers to trade being addressed by stand-alone agreements, abridgement of market access conditions resulting from the use of these standards were expected to be addressed by the disciplines introduced therein.

The inclusion of NTBs in the negotiating mandate of the Doha Round once again highlights the point that effective disciplines are needed to address problems that these market access restrictions can cause. The negotiating mandate, however, kept the focus of negotiations on this issue restricted to only non-agricultural products. However, as is shown in the following discussion, this narrowly defined scope has brought forth several practical problems in making any kind of progress towards fulfilling the negotiating mandate.

C. WTO and the disciplining of NTBs

One of the most significant outcomes of the Uruguay Round negotiations was that several NTMs were brought under closer scrutiny. The agreements covering those NTMs provided an institutional mechanism for monitoring and evaluating the functioning of NTMs. At the same time, it firmly established a distinction between the “WTO-compatible” barriers (C-NTBs) and “WTO non-compatible” barriers (NC-NTBs). Although it is too early to make a clear distinction between these two categories, some preliminary judgements can be formed based on the nature of agreements. The ongoing negotiations are primarily addressing the issue of elimination and restriction of those instruments that fall into the category of NC-NTBs. However, there are those such as the Agreement on Sanitary and Phytosanitary Measures and the Agreement on Technical Barriers to Trade, which are discussed in the context of compliance and transparency with regard to making NC-NTBs compatible under the WTO framework.

The latter part of this chapter discusses C-NTBs that are covered under the SPS and TBT Agreements. It could be said that the need for such “regulatory” measures,[9] which are different from “standards”, was a direct outcome of high living standards and increased air, water and soil pollution that led to the search for environmentally-friendly products. Combined with this, the nature of international production networks and the relative advantages enjoyed by the developed countries in terms of technological superiority may also be considered as having contributed to the emergence of these measures.

---

[9] There is an important distinction between product regulation and standards. The difference between a standard and a technical regulation lies in compliance. While conformity with standards is voluntary, technical regulations are mandatory by nature. They have different implications for international trade. If an imported product does not fulfil the requirements of a technical regulation, it will not be allowed onto the market. In the case of standards, non-complying imported products will be allowed on the market, but then their market share may be affected if consumers prefer products that meet local standards (e.g., quality or colour standards for textiles and clothing).

1. 'WTO non-compatible' NTBs and non-agricultural market access negotiations

The Doha Ministerial Declaration made a major departure from the past when it mandated the market access negotiations to address the problem of "non-tariff barriers" instead of the more ubiquitous "non-tariff measures" that were included in the negotiating mandates in the past. This change in nomenclature had two significant dimensions. First, the focus on NTBs could be considered as a step towards clarifying the scope of the negotiations. As discussed above, the focus of the Uruguay Round market negotiations on NTBs created the problem in that several of the "non-tariff measures" were being discussed in other negotiating groups, and this created jurisdictional overlaps. The second dimension, and one which caused a new set of problems, was that the Declaration gave no guidance as to how NTBs would be identified. In fact, much of the negotiating capital has been devoted to defining the scope of the negotiating mandate on NTBs.

A second set of issues of critical importance from the point of view of the negotiations was the modalities/methodologies to be adopted for the conduct of the negotiations. This dimension has immense significance from the point of view of ensuring that definite outcomes, which are also practical from the point of view of implementation, are obtained at the end of the negotiations. These issues are dealt with in the following discussion.

The NTB work programme in the Doha Round was preceded by some work that the WTO members had done on this issue with regard to the IT sector. In this sector, steps have been taken towards the identification and subsequent development of a harmonized structure on NTBs under the WTO work programme. The NTB work programme, which began at the end of 2000, had three phases. In November 2000, a "Non-Tariff Measures Work Programme" was launched by the Committee of Participants on the Expansion of Trade in Information Technology Products (ITA Committee) to identify NTBs and assess their impact on IT trade.

In 11 submissions to the ITA Committee, the participating countries identified wide-ranging forms of NTBs. Although a majority of the identified NTBs fell within the standards and the conformity assessment area, customs procedures and import licensing were some of the more prominent among the other forms of NTBs. Following a Canadian proposal, the Committee took up a pilot project for specific standards-related NTBs regarding conformity assessment procedures for electromagnetic compatibility/electromagnetic interference (EMC/EMI). The EMC/EMI Pilot Project resulted in a set of "guidelines" for EMC/EMI conformity assessment procedures, prepared by the ITA Committee.

The successful completion of the EMC/EMI Pilot Project raises the substantial point of using the experience gained for addressing the issue of NTBs in the NAMA negotiations. Several participants in the ITA Committee commented on the likely linkages with the NTBs agenda being pursued by the Negotiating Group on Market Access (NGMA) (WTO, 2004 and 2005). The key issue in this regard is the whether or not the approach followed in the EMC/EMI Pilot Project could be extended to cover other areas. This point assumes importance in view of the fact that, so far, there is no agreement within the ITA

Committee to use the EMC/EMI Pilot Project experience in other areas. There seems to be some divergence of opinion in this regard, with some participating countries indicating that particular areas of concern for developing countries could be examined using the template provided by the EMC/EMI Pilot Project. It may appear that the EMC/EMI experience has limited applicability given that the progress achieved under ITA with regard to NTMs has not been satisfactory. The long list of unfinished standards under the ISO, and looking at the similar number of other formalized standards that require an understanding at the multilateral level, is testimony to this fact.

(a) Defining the scope of NTBs

In one of the early submissions to NGMA, New Zealand focused on this issue in a systematic manner, pointing out that the top seven of the so-called NTBs identified by its exporters included those that could, on examination, be found to be “WTO-legal”. They included standards and certification, customs procedures, food safety and health requirements. To obviate this problem, New Zealand suggested the scope of the negotiations on NTBs could be defined using the following classifications:

(a) Issues that might be addressed in negotiations elsewhere under the Doha mandate;

(b) Issues or proposals involving substantial change to existing WTO agreements;

(c) Proposals involving clarification of existing rules;

(d) Issues involving disputed interpretation of rules;

(e) Issues open to bilateral resolution;

(f) Products of interest to developing countries;

(g) Capacity issues;

(h) Implementation issues;

(i) Special and differential provisions (WTO, 2002a).

Canada provided similar guidance on defining the scope of the negotiations on NTBs, based on the views expressed by the country’s exporters. Canada identified four sets of so-called NTBs (WTO, 2002b). These were:

(a) Quotas;

(b) Import licensing, rules of origin, customs valuation, SPS and TBT;

(c) Tariff classification;

(d) Border-related measures including customs procedures, fees and administration.

Of these four categories, Canada’s view was that the NTB negotiations could take up only the first set of issues, since all the other sets included issues that either were a part of existing WTO agreements or were being negotiated in other negotiating groups.

Yet another suggestion, which addressed a more specific issue concerning the developing countries, was made by India. In India's view, legitimate instruments that developing countries might use under the various WTO agreements for development of their industries should not be included as NTBs. For example, export tariffs or levies are generally used to generate resources to develop an industry by diversification in the product profile and development of value-added products for export. India, therefore, suggested that "export duties be negotiated...outside the Doha mandate" (WTO, 2002c).

In their submissions, members identified three sets of NTBs that, in their view, were outside the purview of the NTB negotiations being conducted by NGMA. These were:

(a) NTBs related to existing WTO agreements (e.g., customs valuation, import licensing, PSI, SPS and TBT) that are not subject to a specific negotiating mandate;

(b) NTBs related to other WTO agreements that are also the subject of a negotiating mandate (e.g., AD and CVD);

(c) NTBs that are already part of the Doha Declaration (e.g., trade facilitation, transparency in government procurement, and services).

A parallel process for identifying NTBs that could be included in the market access negotiations was initiated by the NGMA chairman in 2002. Two letters were sent, requesting notification by members of NTBs that their exporters were facing in various markets. This, in effect, meant that the chairman was putting in place a process for the development of a database of NTBs, in a manner similar to that which had been attempted in the past. As mentioned above, an initiative was taken during the Kennedy Round (in 1968) for developing the Inventory of Non-Tariff Measures (annex table 6) in the context of the work done in the Committee on Trade in Industrial Products. The format for the submission of notifications as suggested by the Chairman was based on the structure that was used for developing the Inventory. This process resulted in the submission of a large number of notifications in which WTO members identified the NTBs that their exporters were facing (see WTO, 2003c and WTO, 2003d).

Fliess and Lejarraga (2005) provided an interesting analysis of submissions made by the WTO members in which they reported NTBs that their exporters were facing (WTO, 2006b). In those submissions, members identified the relevant GATT/WTO Articles/Agreements that could be applied to the NTBs thus identified. Fliess and Lejarraga reported that the NTB categories with the highest incidence of notifications were TBTs (530 NTB entries – almost half the total), customs and administrative procedures (380 entries) and SPS (137 entries). Quantitative restrictions, trade remedies, government participation in trade, charges on imports and barriers falling under the other groups amounted to less than 5 per cent of total NTB entries. Interestingly, the SPS Agreement was also identified as a source of NTBs. This was the case, too, when market access for non-agricultural products was under scrutiny.

Quite clearly, the SPS measures used by countries affected not only the food/feed sectors, but also the industrial sectors.[13] This finding raises the question as to whether the WTO members had used the TBT Agreement to impose trade restrictions that were not intended to "create unnecessary obstacles to international trade", but rather to develop "international standards and conformity assessment systems" that could make contributions "by improving efficiency of production and facilitating the conduct of international trade". Given that the objective of improving market access is one of the fundamental objectives of the current round of negotiations, the above-mentioned evidence with regard to NTBs raises the critical issue of whether the tendency to exclude measures taken under the TBT and SPS Agreements from the purview of NTBs can be justified in the light of the evidence presented above. The importance of the point can be better understood from the discussion later in this chapter pointing to the rapidly increasing tendencies shown by the WTO membership to use TBT and SPS measures. The authors' view is that there is merit in critically examining the TBT and SPS measures as a part of the market access negotiations, given that the Doha Ministerial Conference provided the mandate for introducing effective disciplines on NTBs.

(b) Specific modalities and methodologies

The submissions made by the participating WTO members in NGMA on the modalities/methodologies that can be adopted for dealing with NTBs can broadly be divided into five categories:

(a) Vertical or sectorial approaches;

(b) Horizontal or multilateral approaches;

(c) Requests/offers, bilateral, or plurilateral;

(d) Dispute settlement;

(e) Tariffication of NTBs.

The first three approaches were also supported by the WTO members in the July framework, which was adopted in order to put the Doha Round back on track after the failed Cancun Ministerial Conference had severely eroded confidence, particularly of the major trading nations, in the multilateral trading system.

---

[13] A careful analysis of the SPS notifications introduced by the United States and their potential coverage of the measures included in these notifications. An example in this regard will clarify this point. In 2003, the United States issued an SPS notification covering "Products that use the pesticides 1,3 benzene dicarboxylic acid etc." The scope of this SPS measure was elaborated by the Environmental Protection Agency (EPA) (Federal Register: 7 March 2003 [vol. 68, No. 45]). EPA clarified that the potentially affected entities may include, but were not limited to crop production, animal production, food manufacturing, pesticide manufacturing and antimicrobial pesticide. EPA further stated that this listing was not intended to be exhaustive, but rather to provide a guide for readers regarding entities likely to be affected by this action.

The vertical or sectorial approach found considerable support among the WTO membership in the early phase of the negotiations. The sectoral approach was often considered useful in addressing NTBs in sectors of key importance to a country or groups of countries. Support for the vertical approach is based on two sets of considerations. First, most countries feel that this approach is consistent with the overall framework of “sequenced globalization”. Countries can engage in “cherry picking”, selecting the sectors that best suit their larger economic objectives for a “fast track” removal of NTBs. The second “positive” in favour of the vertical approach, a point made by the United States, was that countries are increasingly engaging in the process of dismantling market access barriers in specific industries. While in WTO, the ITA has been witness to discussions being conducted for the reining in of NTBs, members of APEC have been dealing with similar issues in the chemicals and automobiles sectors (WTO, 2003a).

The United States, which has been the strongest supporter of the vertical approach, considers NTB packages that bundle together a number of NTB issues relevant to a single industry could be a creative new approach for dealing with NTBs (WTO, 2003b). According to the United States, this approach has practical relevance in today’s world as industries are becoming increasingly networked; intra-industry confabulations have often dealt with issues related to NTBs from the point of view of their industry.[14] Adopting this single industry, or vertical, approach as one NTB modality could, in view of the United States, lead to better management of the negotiating process.

Thus far, the option of following the sectorial approach has been explored actively in a wide variety of sectors, including marine products, textiles, pharmaceuticals and automobiles. In addition to the United States, which sponsored two meetings on NTBs in the automotive and footwear industries, the possibility of adopting the vertical approach was actively pursued by several countries. The Republic of Korea focused on the electronics industry, Canada on forestry products, New Zealand on wood products, and Switzerland on pharmaceuticals and chemicals. In July 2005, members including the United States, New Zealand and the Republic of Korea met informally to discuss common sectoral positions on forestry products (to harmonize building codes), electronics and automobiles.

However, despite the apparent advantages, particularly in terms of calibrating the process of liberalization, the negotiations on NTBs have given rise to several contentious issues. Among the more problematic proposals that have been made thus far is the one put forward by the United States on automobile NTBs. The United States has argued that the automobile industry faces a plethora of market access barriers that include:

(a) Strict and/or excessively burdensome restrictions on the ability of the private sector to offer financing, hampering the ability of consumers to purchase motor vehicles;

---

[14] Among the industries that fit the description given by the United States is the automobile industry. The Global Auto Industry Dialogue (GAID) has seen broad-based consultations between automotive industry associations in a large number of developing and developed countries. GAID has, in recent years, increasingly been calling for the introduction of enhanced disciplines on NTBs.

(b) A lack of openness in respect of distribution channels for imported products;

(c) The application of vehicle taxes based on engine displacement in a manner that burdens foreign manufacturers disproportionately because they produce vehicles with large engine sizes;

(d) Foreign equity restrictions that constrain or distort investments in automotive production;

(e) Barriers to importing and selling manufactured products.

These so-called market access restrictions mentioned by the United States deal with issues that are in no way related to the market access negotiations for the reasons indicated below. The issue pertaining to the distribution channels is currently being discussed in the services negotiations. The investment-related issue is one that members have decided not to include in the current round of negotiations, while the issue of domestic taxation is an area outside the jurisdiction of WTO. Thus, even while recognizing the utility of following the vertical approach, WTO members need to be careful not to allow non-issues to influence the negotiating process.

Although the horizontal approach did not find as much support as that given to the vertical approach, the former has one inherent advantage as WTO members have some degree of prior experience in dealing with it as a part of the negotiations on the Customs Valuation Agreement and the Agreement on Import Licensing Procedures. More importantly, they are now actively engaged in the negotiations on trade facilitation. Support for the horizontal approach has come from the EC. According to the EC, "disciplines on specific non-tariff barriers are unlikely on their own to be effective in removing all obstacles to trade, especially when some of them are immediately replaced by new barriers. For this reason, members should explore whether additional horizontal mechanisms could be useful in addressing unnecessary barriers affecting market access so that measures taken by members are not more trade-restrictive than necessary to fulfil a legitimate objective".

The request-offer approach has not been widely discussed yet, but this approach can emerge as one of the stronger options given that the WTO members have already prepared a not insignificant list of NTBs that their exporters face. However, as pointed out above, NGMA would first have to address the critical jurisdictional issue, as many NTBs that were identified by the members were essentially those that were clearly outside the purview of this negotiating group.

More recently, the NAMA-11 group of developing countries[15] and members of the EC have proposed that the NTB issue can be addressed by setting up an "NTB Resolution Mechanism" (WTO, 2006b). These countries have argued that the "NTB Resolution Mechanism" would be "guided by the principle of 'good faith' and conciliatory negotiations wherein every member would make a concerted effort to resolve the NTB at hand, under

[15] The following WTO members made the submission on behalf of the NAMA-11 group: Argentina, Venezuela (Bolivarian Republic of), Brazil, Egypt, India, Indonesia, Namibia, the Philippines, South Africa and Tunisia.

the guidance of a mutually agreed 'facilitator'. Members would be required to engage with the intention of arriving at a solution to the NTB. It would be informal, low-key and less adversarial than the Dispute Settlement Understanding (DSU), and without prejudice to the rights of members under the DSU". The key objective of the mechanism, as visualized by the NAMA-11 group would be to find pragmatic solutions to trade effects by using expert facilitators to find the "solution". An NTB (which could include sectoral/plurilateral elements) submitted to the resolution mechanism would require the facilitator to provide recommendations on the solution after establishment of facts and trade effects. It was further provided that procedure adopted would be flexible and the "facilitator" would be free to choose the preferred method. The "facilitator" would consult the involved members, either individually or collectively, the WTO Secretariat, affected industries and other experts, including from industry and non-governmental organizations.

A similar proposal has been made by the members of the EC for addressing the vexing issue of NTBs. The EC members have stressed the need to "add to existing structures a new horizontal mechanism that enhances the opportunities for members to address – in a conciliatory and expedient manner – any trade measure that affects trade with another member. This would provide a means of resolution that could make resorting to dispute settlement unnecessary in certain cases". The EC members argued that the "establishment of horizontal mechanism, in the form of a procedure for problem-solving in the area of NTBs, with short timelines as well as with the involvement of a facilitator, can assist countries in reaching mutually agreed solutions" (WTO, 2006a).

2. Trends in the use of "WTO compatible" TBT measures

Nearly four decades after the initiation of a multilateral negotiation on the reduction of NTMs for free global trade and enhancing market access, the world is now facing one of its most difficult and complex regimes. Since the establishment of WTO in 1995, both the number of TBTs and the spread of such measures across the member countries are fast outstripping and undermining the trade liberalization achieved by way of tariff reduction and elimination. As the table below clearly shows, the use of TBTs by WTO member countries has been on the rise, especially under the WTO regime. In 1995, 365 TBT notifications were issued, while in 2005, 900 notifications were issued.

As the table shows, the number of TBT notifications issued has not seen a secular increase, but has fluctuated around an increasing trend. After an initial spurt was witnessed between 1995 and 1997, when the total notification issues reached almost 850, TBT notifications fell by almost a third by 2001. This phase was followed, however, by one in which the notifications increased by nearly 60 per cent over the 2001 trough. A more noteworthy feature of the TBT notifications is the steep increase in the number of countries that have been involved in issuing notifications. In 1995, only 26 of the 123 WTO members issued TBT notifications, yet during 2005, 67 of the 148 members were active in issuing TBT notifications.

Quite obviously, the increase in the number of countries active in terms of issuing TBT notifications was because of increased interest shown by developing countries. Again,

Use of TBTs by WTO members, 1995-2005

(Unit: Number of notifications issued)

Year	OECD members	Developing countries	Former centrally planned economies	Total
1995	349	40	0	389
1996	395	105	0	500
1997	640	206	0	846
1998	445	235	0	680
1999	432	260	4	696
2000	419	188	23	630
2001	298	277	7	572
2002	308	298	14	620
2003	305	533	55	893
2004	291	398	29	718
2005	319	544	37	900

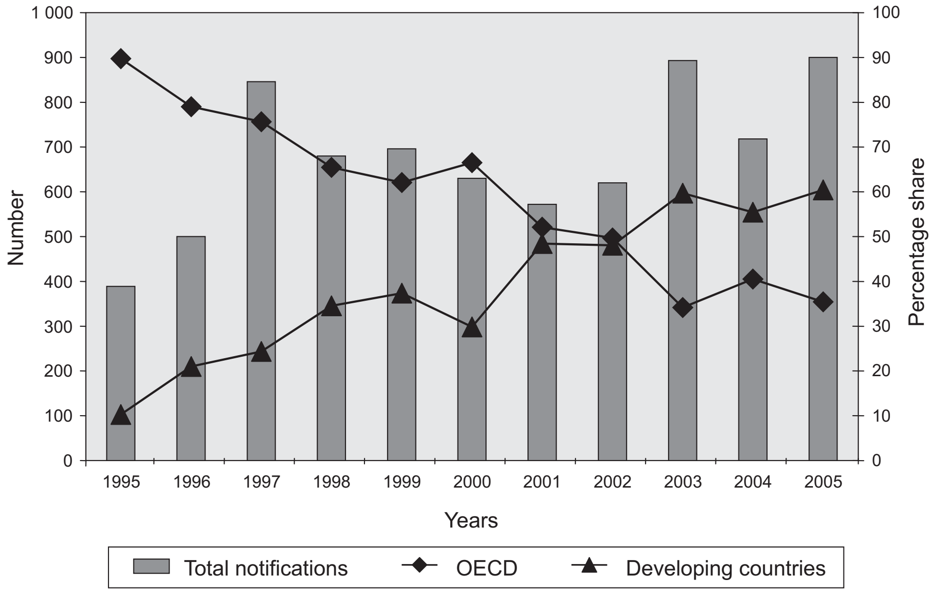
Source: Centre for WTO Studies, IIFT, New Delhi.

the number of developing countries that issued TBT notifications far outstripped the OECD member countries. This phenomenon is illustrated by the following figure showing trends in TBT notifications.

In 1995, the developing countries had a mere 10 per cent share in the total notifications issued during that year. However, in 2005, the share of those same countries had increased to more than 60 per cent. The emergence of developing countries as new players in the application of TBTs is reflected in the increased number of notifications made by them, from 40 in 1995 to almost 550 in 2005. In sharp contrast, the OECD members saw a fall in their total number of notifications, from 349 in 1995 to 319 in 2005. However, despite increasing the number of notifications issued during recent years, the share of developing countries in the total notifications issued during 1995-2005 was just over 41 per cent. In other words, the OECD member countries have continued the process of building in new standards to the already existing list of NTMs that existed even before the Uruguay Round negotiations, and developing countries appear to be in an undue hurry to catch up. However, the fact that the former group of countries will continue to have a larger number of TBTs in the foreseeable future can have significant implications for developing countries that will be seeking greater market access in the larger economies at the end of the current round of negotiations.

Yet another interesting feature of the TBT notifications observed over time is that most countries with a relatively high share of the total notifications in more recent years belong to the group of countries having relatively low tariffs. In 2005, for example, China had the largest share (13 per cent) of TBT notifications issued while Brazil had a 7 per cent share. None of the top 10 per cent countries in terms of total notifications issued in

Trends in TBT notifications across country groups



Source: Centre for WTO Studies, IIFT, New Delhi.

2005 had average industrial tariffs exceeding 10 per cent. They included OECD members belonging to the European Union as well as the United States and Japan. This observed association between tariffs and the use of NTMs such as TBTs appears to confirm the view that the focus of the multilateral trading system on tariff reduction has only resulted in a proliferation of NTBs. The authors, however, are aware that substantially more work needs to be done in this direction to allow conclusive comments to be made on this issue.

D. Conclusion

As mentioned at the start of this chapter, this discussion is in the nature of a status report on how the multilateral trading system has addressed the issue of NTBs. An attempt has been made to describe the developments in both GATT and, more recently, WTO in order to analyse this issue. Past developments have made it fairly clear that a considerable distance will have to be traversed before the multilateral trading system can put in place a meaningful set of disciplines covering NTBs.

This observation should be viewed with some concern since, in recent years, there has been a proliferation of NTBs. WTO members participating in NGMA have indicated that their exporters perceive the so-called WTO-legal NTMs, such as TBT and SPS measures, as market access barriers. The increase in the use of TBT measures, particularly by the more advanced developing countries, is contributing to the increase in complexities in what seems to be a veritable maze of NTBs.

Annex

Annex table 1. Non-tariff measures data coverage across countries: TRAINS database (as of 2005)

Sl. No.	Countries for which two years' NTM data are available	Years available
1	Algeria	2001, 1999
2	Argentina	2001, 1999
3	Bolivia	2001, 1999
4	Brazil	2001, 1999
5	Brunei Darussalam	2001, 1997
6	Chile	2001, 1999
7	China	2001, 1997
8	Colombia	2001, 1999
9	Ecuador	2001, 1999
10	Egypt	2001, 1999
11	Japan	2001, 1996
12	Mexico	2001, 1999
13	Morocco	2001, 1999
14	Nigeria	2001, 1994
15	Paraguay	2001, 1999
16	Mexico	2001, 1999
17	Morocco	2001, 1999
18	Paraguay	2001, 1999
19	Peru	2001, 1999
20	Taiwan Province of China	2001, 1999
21	Uruguay	2001, 1999
22	Venezuela (Bolivarian Republic of)	2001, 1999
Summary of WITS database		Number of countries
A	NTMs data available, of which	88
	Developed	13
	Developing	75
B	No record on NTMs	71
C	Total countries	159

Source: Collated and compiled by the authors.

Annex table 2. UNCTAD coding system on trade control measures

Code	Description
1000	Tariff measures
1100	Statutory customs duties
1200	MFN duties
1300	GATT ceiling duties
1400	Tariff quota duties
1410	Low duties
1420	High duties
1500	Seasonal duties
1510	Low duties
1520	High duties
1600	Temporary reduced duties
1700	Temporary increased duties
1710	Retaliatory duties
1720	Urgency and safeguard duties
1900	Preferential duties under trade agreements
1910	Interregional agreements
1920	Regional and subregional agreements
1930	Bilateral agreements
2000	Para-tariff measures
2100	Customs surcharges
2200	Additional taxes and charges
2210	Tax on foreign exchange transactions
2220	Stamp tax
2230	Import licence fee
2240	Consular invoice fee
2250	Statistical tax
2260	Tax on transport facilities
2270	Taxes and charges for sensitive product categories
2290	Additional charges, n.e.s.
2300	Internal taxes and charges levied on imports
2310	General sales taxes
2320	Excise taxes
2370	Taxes and charges for sensitive product categories
2390	Internal taxes and charges levied on imports, n.e.s.
2400	Decreed customs valuation
2900	Para-tariff measures, n.e.s.
3000	Price control measures

Annex table 2. ***(continued)***

3100	Administrative pricing
3110	Minimum import prices
3190	Administrative pricing, n.e.s.
3200	Voluntary export price restraint
3300	Variable charges
3310	Variable levies
3320	Variable components
3330	Compensatory elements
3340	Flexible import fees
3390	Variable charges, n.e.s.
3400	Anti-dumping measures
3410	Anti-dumping investigations
3420	Anti-dumping duties
3430	Price undertakings
3500	Countervailing measures
3510	Countervailing investigations
3520	Countervailing duties
3530	Price undertakings
3900	Price control measures, n.e.s.
4000	Finance measures
4100	Advance payment requirements
4110	Advance import deposit
4120	Cash margin requirement
4130	Advance payment of customs duties
4170	Refundable deposits for sensitive product categories
4190	Advance payment requirements, n.e.s.
4200	Multiple exchange rates
4300	Restrictive official foreign exchange allocation
4310	Prohibition of foreign exchange allocation
4320	Bank authorization
4390	Restrictive official foreign exchange allocation, n.e.s.
4500	Regulations concerning terms of payment for imports
4600	Transfer delays, queuing
4900	Finance measures, n.e.s.
5000	Automatic licensing measures
5100	Automatic licence
5200	Import monitoring
5210	Retrospective surveillance
5220	Prior surveillance

Annex table 2. ***(continued)***

5270	Prior surveillance for sensitive product categories
5700	Surrender requirement
5900	Automatic licensing measures, n.e.s.
6000	Quantity control measures
6100	Non-automatic licensing
6110	Licence with no specific ex-ante criteria
6120	Licence for selected purchasers
6130	Licence for specified use
6131	Linked with export trade
6132	For purposes other than exports
6140	Licence linked with local production
6141	Purchase of local goods
6142	Local content requirement
6143	Barter or counter trade
6150	Licence linked with non-official foreign exchange
6151	External foreign exchange
6152	Importer’s own foreign exchange
6160	Licence combined with or replaced by special import authorization
6170	Prior authorization for sensitive product categories
6190	Non-automatic licensing, n.e.s.
6200	Quotas
6210	Global quotas
6211	Unallocated
6212	Allocated to exporting countries
6220	Bilateral quotas
6230	Seasonal quotas
6240	Quotas linked with export performance
6250	Quotas linked with purchase of local goods
6270	Quotas for sensitive product categories
6290	Quotas, n.e.s.
6300	Prohibitions
6310	Total prohibition
6320	Suspension of issuance of licences
6330	Seasonal prohibition
6340	Temporary prohibition
6350	Import diversification
6360	Prohibition on the basis of origin (embargo)
6370	Prohibition for sensitive product categories
6390	Prohibition, n.e.s.

Annex table 2. ***(continued)***

6600	Export restraint arrangements
6610	Voluntary export restraint arrangements
6620	Orderly marketing arrangements
6630	Multi-fibre arrangement (MFA)
6631	Quota agreement
6632	Consultation agreement
6633	Administrative cooperation agreement
6640	Export restraint arrangements on textiles outside MFA
6641	Quota agreement
6642	Consultation agreement
6643	Administrative cooperation agreement
6690	Export restraint arrangements, n.e.s.
6700	Enterprise-specific restrictions
6710	Selective approval of importers
6720	Enterprise-specific quota
6790	Enterprise-specific restrictions, n.e.s.
6900	Quantity control measures, n.e.s.
7000	Monopolistic measures
7100	Single channel for imports
7110	State trading administration
7120	Sole importing agency
7200	Compulsory national services
7210	Compulsory national insurance
7220	Compulsory national transport
7900	Monopolistic measures, n.e.s.
8000	Technical measures
8100	Technical regulations
8110	Product characteristics requirements
8120	Marking requirements
8130	Labelling requirements
8140	Packaging requirements
8150	Testing, inspection and quarantine requirements
8190	Technical regulations, n.e.s.
8200	Pre-shipment inspection
8300	Special customs formalities
8900	Technical measures, n.e.s.

Source: UNCTAD, 1994, Directory of Import Regimes, Part I.

Annex table 3. Analytical frameworks for measurement of NTMs: A summary of existing works

S. No.	Principles	Authors/year	Sectors/markets covered	Conclusion of the study	Practical issues
A.	**Price wedge (tariff-equivalent) method**				
	1. Trade impact of NTMs 2. Impact on domestic prices 3. Provide tariff equivalents	Campbell and Gossette (1994)	Food and agriculture (apples)	Cannot provide useful information on tariff equivalent of NTMs	1. Export prices not dependable – show considerable variation 2. NTMs barrier was a residual function 3. Choice of price series would influence the results 4. Externalities like efficiency of transportation services affects results 5. Assumes perfect substitutability of exports and imports 6. Available data to aggregate to analyse; 7. It captures unwarranted effects – rents due to price discrimination and transaction cost etc. 8. Does not appear reliable for large-scale studies.
		Andriamananjara and others (2003)	Footwear, wearing apparel and processed food (CGE model)	NTM liberalization may lead to higher gains	
		USITC (1995)	Food and agriculture		
		European Commission (2001)	Agriculture (pigs, poultry, apples and tomatoes)	Pessimistic about the validity	
B.	**Inventory-based approaches**				
	• Quantitative and Qualitative assessment of domestic regulations • Three sources: *1. number of regulations;* *2. frequency of detentions; and* *3. data on complaints from industry* • Import Coverage Ratios • Complaints categorised as existence of NTMs • Trade and product coverage of NTMs	Swann and others. (1996)	British export and imports		1. When limited number of countries use regulations then they tend to be used as barriers 2. Standards vary in importance across markets 3. Cannot make distinction between those that have an impact on trade more from those that have no impact 4. International Dataset have limitation of partial coverage of countries (uneven reporting) 5. Only United States makes data on actual detentions at border available.
		Moenius (1999)	Manufacturing sector		
		Otsuki and others (2001)	Food products		
		Fontagne and others (2001)	Environmental regulations		
		Henson and others (1999, 2000, 2001)	Food sector, European Union and United States (imports of diary products)		
		Lux and Henson (2000)	European Union exports to United States		

Annex table 3. *(continued)*

S. No.	Principles	Authors/year	Sectors/markets covered	Conclusion of the study	Practical issues
C.	**Survey Based Approaches**				
	• Makes a distinction between measures in terms of intensity of trade effects • Industry specific and market-specific approach (more effective) • Based purely on Survey Method	Thornsbury (1998, 1999)	Based on USDA's survey: Agricultural Exports		1. Firms centric and biased by individual/sample specific interests – survey biased 2. Most studies done by government or institutions 3. Useful when other information is not available 4. Use to analyse hidden variable difficult to measure (administrative cost) 5. Industry concerns better captured 6. Ability to quantify NTMs is questionable 7. Cannot be used for dispute settlement procedures (Weyerbroeck and Xia (1998) and United States Government Accounting Office (1997)
		Roberts and De Remer (1997)	Based on USDA's survey: Agricultural exports		
		United States Trade Representative (various years)			
		European Commission (various years)			
		OECD (1999)	55 firms, 3 sectors, (US, EU UK, Japan and Germany): Diary products	Standards make it difficult for new firms to compete; and Bulk dealers reported few difficulties.	
		Henson and others (2000)	Survey done based on response from contact points (Codex country point in developing countries)	Animal products	
		European Commission (2001)		Administrative burden (delay and predictability) are the major issues, not tariffs and NTMs	
D.	**Gravity model-based approaches**				
	• Explaining trade flows based on relative size of economies and distances in term of location and other considerations – using the theoretical backing of imperfect substitutability between goods • Explains situation like Monopolistic competitions	Head (2000)			1. These studies does not explain NTM impact alone 2. Results sensitive to assumption of the model 3. Some standards do not show statistically significant variability
		McCallum (1995)	United States and Canada trade flows	All things equal (distance and cost) intra-Canadian trade was 22 times higher than trans-border trade	
		Anderson and Van Wincoop (2001)	Challenged the study of McCallum on United States and Canada trade flow (used dummy for local characteristics)	Introduced a concept of “multilateral resistance” (promotion of bilateral trade to protect itself from multilateralism)	

Annex table 3. ***(continued)***

S. No.	Principles	Authors/year	Sectors/markets covered	Conclusion of the study	Practical issues
	• Distinction of "hone bias" or the "border effect" in trade • Trade foregone due to "border effect" • Residual approach to explain NTMs effect on trade flows;	Cheng and Wall (1999)	Used fixed effects model to avoid heterogeneity bias.		
		Moenius (1999)	Impact of TBTs on trade flows – used "standards" (voluntary norms) rather than "regulations" due to data limitations; 471 Industries and 12 Western European countries (1980-1995)		
		Otsuki and others (2000)	European "aflatoxin standards" on African exports: fruit and nuts		
		Hillberry (2001)	Food sector		
		Burfisher and others (2001)	Food sector		
		Vido and Prenctice (2001)	Food sector		
E.	**Risk assessment-based cost-benefit measures**				
	• Used in combination with cost-benefit analysis to understand the effects of NTMs • Does not quantify the effects but helps in making a qualitative judgement based on welfare effects (welfare loss) • Low benefits from a measure would mean that it is trade distorting	Bigsby and Whyte (2000)	Pest infestation	Identified economic effects and probability aspects of risk	1. SPS Agreement pays little attention to economic analysis based on C-B approach 2. Uncertainties that surround such risks and their economic consequences; and 3. Effect of standards on consumers' willingness to pay for goods is difficult to quantify (subjective risks or ethical characteristics of the goods)
		James and Anderson (1998)	Quarantine regulations	Economic effects – asked for comprehensive economic review to determine those measures which pass C-B analysis	
		Arrow and others (1996)	Health and environment	Most systematic use can be very costly for tax payer and consumers	
		Pimentel and others (2000), and Mumford (2000)	Pest infestation	US$ 138 billion loss due to all invasive species of more than 50,000 that enter the United States.	

Annex table 3. ***(continued)***

S. No.	Principles	Authors/year	Sectors/markets covered	Conclusion of the study	Practical issues
		Orden and Romano (1996)	Pest risk (Mexico and United States done by USDA) – ban on "Mexican avocados".	Led to large transfer the United States producers compared to small potential cost of a pest infestation	
F.	**Stylised micro-economic approaches**				
	• Effect to be analysed in the context of displacement of the market equilibrium • Estimation of effects in terms of supply and demand, shadow price, price-taking firms and perfectly informed consumers • Economic mechanisms at stake rather than provide quantitative estimates of the impact of NTMs	Boom, (1995), Crampes and Hollander (1995a)	NTMs and structure of competition between firms		1. The limitation of these approaches is their robustness to the simplifying assumptions 2. Difficult to provide estimates of the various effects in empirical implementations 3. Quantification of consumer responses and maker equilibrium displacement to new NTMs is difficult
		Grossman and Horn (1988), Crampes and Hollander (1995b)	Strategic interaction between firms owing to regulations (reacting to new regulations)		
		Shapiro (1983), Donnenfeld and others (1985)	Effect of regulations based on information available to consumers		
		Marette and others (2000)	Welfare effects are different if the consumer can assess or not the quality of the products (before or after consumption)		
		Falvey (1989)	Regulation and its effect on the cost of signalling quality		
		Katz and Shapiro (1985)	Network externalities and economies to scale		
G.	**Quantification using sectoral or multi-market models**				
	• These are partial equilibrium models • Impact of regulation and welfare effects analysed • Attempt explicit summary of effects of regulation on production, consumption, trade and welfare	Orden and Romano (1996)	Cost and benefit of ban on Mexican avocados		High level of aggregation and quality of data are two important limitations
		Calvin and Krissoff (1998)	Japanese imports of apples from the United States		
		Paarlberg and Lee (1998)	Risk-based method of United States tariff protection against beef imports from countries with foot-and-mouth disease	Domestic government maximized the country's welfare	

Annex table 4. Latest year for which NTM data are available in the TRAINS database (as of 2005)

Year available	Number of countries
2001 (latest)	32
2000	2
1999	33
1998	8
1997	13
1996	8
1995	6
1994	5
1993	2
1992	1

Source: Compiled from WITS Internet version database provided by the World Bank, UNCTAD and IMF.

Annex table 5. GATT inventory of non-tariff measures

Part 1	**Government participation in trade**
A	Government aid
AA	Countervailing duties
B	Government procurement
BB	Restrictive practices
C	State trading
Part 2	**Customs and administrative entry procedures**
B	Anti-dumping duties
C	Valuation
D	Customs classification
E	Consular formalities and documentation
F	Samples
G	Repayment of duties
H	Customs formalities
Part 3	**Standards**
A	Industrial standards
B	Health and safety standards
C	Other standards concerning product content
D	Requirements concerning packaging and labelling and marks of origin

Annex table 5. *(continued)*

Part 4	Specific limitations
A	Quantitative restrictions and import licensing
B	Embargoes and other restrictions
C	Screen-time quotas and other mixing regulations
C	Exchange control
E	Discrimination resulting from bilateral agreements
F	Discriminatory sourcing
G	Export restraints
H	Measures to regulate domestic prices
I	Tariff quotas
X	Others
Part 5	**Import charges**
A	Prior import deposits
B	Surcharges, port taxes, statistical taxes
C	Discriminatory film taxes etc.
D	Discriminatory credit restrictions
E	Variable levies
F	Border tax adjustments
G	Emergency action

Source: GATT, 1973.

Annex table 6. World Trade Organization inventory of non-tariff measures

Parts and sections	Description
Part I	**Government participation in trade and restrictive practices tolerated by governments**
A	Government aids, including subsidies and tax benefits
B	Countervailing duties
C	Government procurement
D	Restrictive practices tolerated by governments
E	State trading, government monopoly practices, etc.
Part II	**Customs and administrative entry procedures**
A	Anti-dumping duties
B	Customs valuation
C	Customs classification
D	Consular formalities and documentation
E	Samples

Annex table 6. ***(continued)***

F	Rules of origin
G	Customs formalities
H	Import licensing
I	Preshipment inspection
Part III	**Barriers to trade**
A	General
B	Technical regulations and standards
C	Testing and certification arrangements
Part IV	**Sanitary and phytosanitary measures**
A	General
B	SPS measures including chemical residue limits, freedom from disease, specified product treatment etc.
C	Testing, certification and other conformity assessment
Part V	**Specific limitations**
A	Quantitative restrictions
B	Embargoes and other restrictions of similar effect
C	Screen-time quotas and other mixing regulations
D	Exchange controls
E	Discrimination resulting from bilateral agreements
F	Discriminatory sourcing
G	Export restraints
H	Measures to regulate domestic prices
I	Tariff quotas
J	Export taxes
K	Requirements concerning marking, labelling and packaging
L	Others
Part VI	**Charges on imports**
A	Prior import deposits
B	Surcharges, port taxes, statistical taxes, etc.
C	Discriminatory film taxes, use taxes, etc.
D	Discriminatory credit restrictions
E	Border tax adjustments
Part VII	**Other**
A	Intellectual property issues
B	Safeguard measures, emergency actions
C	Distribution constraints
D	Business practices or restrictions in the market
E	Other

Source: World Trade Organization, 2003e.

References

Anderson, J.E., and E. van Wincoop, 2001. "Gravity with Gravitas: A Solution to the Border Puzzle". NBER Working paper 8079, National Bureau of Economic Research, Cambridge, MA.

Andriamananjara, S., M. Ferrantino and M. Tsigas, (2003), Alternative Approaches to Estimating the Effects of Non-Tariff Measures: Results from Newly Quantified Measures, USITC Office of Economics Working Paper 03-12-C, December.

Arrow, K.J., M.L. Cropper, G.C. Eads, R.W. Hahn, L.B. Lave, R.G. Noll, P.R. Portney, M. Russell, R. Schmalensee, V.K. Smith, and R.N. Stavins, 1996. "Is there a Role for Benefit-Cost Analysis in Environmental, Health and Safety Regulation?" Science 272: 221-22.

Baldwin, R., 1970. *Non-Tariff Distortions in International Trade*, Washington, D.C., Brookings Institution.

Beghin, John C. and Jean-Christophe Bureau, 2001. Quantification of Sanitary, Phytosanitary, and Technical Barriers to Trade for Trade Policy Analysis, *Center for Agricultural and Rural Development*, Working Paper 01-WP 291, Iowa State University, December.

Bigsby, H.R., and C.F. Whyte, 2000. "Quantifying Phytosanitary Barriers to Trade." In *Interdisciplinary Food Safety Research*. edited by N. Hooker and E. Murano. Boca Raton: CRC Press.

Blyde, Juan S., 2000. "Does international trade hurt the environment? Old theory, new developments", *International Trade Journal*, vol. 14, No. 4; pp. 343-353.

Boom, A., 1995. "Asymmetric International Minimum Quality Standards and Vertical Differentiation". The Journal of Industrial Economics 43(1): 101-19.

Bureau, J.C. and S. Marette, 2000. "Accounting for consumers preferences in international trade rules", in Board of Agriculture and Resources (ed.), *Incorporating Science Economics and Sociology in Developing Sanitary and Phytosanitary Standards in International Trade*, National Research Council, National Academy Press, Washington, D.C.

______ and A. Schiavina, 1998. "Non-tariff trade barriers and consumers' in formation: The case of EU-US trade dispute over beef", *European Review of Agricultural Economics,* vol. 25, No. 4; pp. 437-462.

Burfisher, M., D. Pick, G. Pompelli, and S. Zahniser, 2001. "North American Trade in an Era of Multiple Trade Agreements: A Gravity Analysis." Paper presented at the American Agricultural Economics Association annual meeting, Chicago, August 5-8.

Calvin, L., and B. Krissoff, 1998. "Technical Barriers to Trade: A Case Study of Phytosanitary Barriers and U.S.-Japanese Apple Trade." Journal of Agricultural and Resource Economics 23(2): 351-66.

Campbell, K., and R. Gossette, 1994. "A Study of Canada's Non Tariff Trade Barriers: The Equivalents of Quantitative Import Restrictions." Research Branch, Canadian International Trade Tribunal, Ottawa, Ontario, Canada.

Casella, A., 1995. "Free trade and evolving standards". Centre for Economic Policy Research, London. Available at www.cepr.org/pubs/dps/DP1204.asp.

______, 1996. "Free trade and evolving standards", in J.N. Bhagwati and R.E. Hudec (eds.), *Fair Trade and Harmonization, Prerequisites for Free Trade?* Cambridge, MA, MIT Press.

______, 2001. "Product standards and international trade: Harmonization through private coalitions?" *Kyklos,* vol. No. 54; pp. 2-3.

Cheng, I.H., and H.J. Wall, 1999. "Controlling for Heterogeneity in Gravity Models of Trade." Working Paper No. 99-01013, March, Federal Reserve Bank of St. Louis, St. Louis, MO.

Crampes, C., and A. Hollander, 1995a. "Duopoly and Quality Standards." European Economic Review 39: 71-82.

______, 1995b. "How Many Karats is Gold: Welfare Effects of Easing a Denomination Standard." Journal of Regulatory Economics 7: 131-43.

Deardorff, A.V. and R.M. Stern, 1998. "Measurement of non-tariff barriers", *Studies in International Economics Series*, Ann Arbor, MI, University of Michigan Press.

European Commission, 2000. "Report on United States barriers to trade and investment", Brussels.

______, 2001. "A set of coordinated studies for the preparation of the next round of trade negotiations", final report, Project FAIR-97-CT3481, Task 3, Agricultural Directorate, Brussels.

Donnenfeld, S., S. Weber, and U. Ben-Zion, 1985. "Import Controls under Imperfect Information." Journal of International Economics 19: 341-54.

Fisher, R. and P. Serra, 2000. "Standards and protection", *Journal of International Economics*, vol. 52; pp. 377-400.

Fliess, B. and I. Lejarraga, 2005. "Analysis of non-tariff barriers of concern to developing countries", OECD Trade Policy Working Paper No. 16, Paris.

Falvey, R.E., 1989. "Trade, Quality Reputations and Commercial Policy." International Economic Review 30(3, August): 607-22.

Fontagné, Lionel and others, 2001. A First Assessment of Environment-Related Trade Barriers, International Trade Centre, Geneva, http://www.intracen.org/mas/pdfs/pubs/etb_english.pdf)

Granslandt, M. and J.R, Markusen, 2000. "Standards and related regulations in international trade: A modelling approach". Available at http://www.worldbank.org/research/trade/conference/markusen.pdf.

GATT, 1955. “Report of Working Party 6 on the United States waiver”, L/339.

______, 1973. “Quantitative restrictions including embargoes and export restraints: Background Note by the Secretariat”, COM.IND/W/99, Committee on Trade in Industrial Products Working Group 4.

______, 1983. “Past GATT activities relating to quantitative restrictions and other non-tariff measures: Background Note by the Secretariat”, NTM/W/2, Group on Quantitative Restrictions and Other Non-Tariff Measures.

______, 1991. Communication from the Chairman of the Negotiating Group on Market Access to the Chairman of the Trade Negotiations Committee, Group of Negotiations on Goods, GATT.

Greenway, D., 1983. *International Trade Policy: From Tariffs to the New Protectionism*, London, Macmillan Publishers Ltd.

Harrison, R. and D.G. Tarr, 1996. “Increased competition and completion of the market in the European Union: Static and steady state effects”, *Journal of Economic Integration,* vol. 11, No. 3; pp. 332-365.

Head, K., 2000. “Gravity for Beginners.” Teaching notes, Department of Economics, University of British Columbia, Vancouver.

Henson, S.J., R. Loader, A. Swinbank, M. Bredahl, and N. Lux, 2000. “Impact of Sanitary and Phytosanitary Measures on Developing Countries.” Center for Food Economics Research, University of Reading, Reading, UK. Hillman, J.S., 1991. *Technical Barriers to Agricultural Trade,* Boulder, CO, Westview Press.

Hillberry, R., 2001. “Disaggregating the ‘Border Effect’: What Can We Learn from U.S. Commodity Flow Data?” Paper presented at the American Agricultural Economics Association annual meeting, Chicago, August 5-8

Interim Commission for the International Trade Organization, 1948. “Final act and related documents (Havana Charter”, United Nations Conference on Trade and Employment, New York.

James, S., and K. Anderson, 1998. “On the Need for More Economic Assessment of Quarantine Policies.” Australian Journal of Agricultural and Resource Economics 42(4): 425-44.

Katz, M.L., and C. Shapiro, 1985. “Network Externalities, Competition and Compatibility.” American Economic Review 75(June): 424-40.

Laird, S. and A. Yeats, 1990. *Quantitative Methods for Trade-Barrier Analysis*, London, Macmillan Press.

Lux, N., and S.J. Henson, 2000. “The Impact of Food Safety and Quality Standards in EU Cheese Exports to the United States.” Working Paper, Department of Agricultural and Food Economics, The University of Reading.

Marette, S., J.C. Bureau, and E. Gozlan, 2000. “Product Safety Provision and Consumers’ Information.” Australian Economic Papers 39(4, December): 426-41.

Martin, W.J., 1997. "Measuring welfare changes with distortions", in J.F. Francois and K.A. Reinart (eds.), *Applied Methods for Trade Policy Analysis*, Cambridge, Cambridge University Press.

Maskus, K.E. and J.S. Wilson, 2000. "Quantifying the impact of technical barriers to trade: A review of past attempts and the new policy context", paper presented at the World Bank Workshop on "Quantifying the Trade Effect of Standards and Technical Barriers: Is it Possible?" 27 April 2000, Washington, D.C.

_______ and T. Otsuki, 2001. "An empirical framework for analyzing technical regulations and trade", in K.E. Maskus, and J.S. Wilson (eds.), *Quantifying the Trade Effect of Technical Barriers: Can it be Done?*, Ann Arbor, MI, University of Michigan Press.

McCallum, J., 1995. "National Borders Matter: Canada-US Regional Trade Patterns." American Economic Review 95(June, 3): 615-23.

Moenius, J., 1999. "Information versus Product Adaptation: The Role of Standards in Trade." Working paper, University of California, San Diego.

Organisation for Economic Co-operation and Development, 1999. "An assessment of the costs for international trade in meeting regulatory requirements". Paris.

Orden, D., and E. Romano, 1996. "The Avocado Dispute and Other Technical Barriers to Agricultural Trade under NAFTA." Paper presented at the conference, "NAFTA and Agriculture: Is the Experiment Working?" San Antonio, TX, November.

Otsuki, T., J.S. Wilson and M. Sewadeh, 2000. "Saving two in a billion: A case study to quantify the trade effect of European food safety standards in African exports", Working Paper, World Bank, Washington, D.C.

Paarlberg, P.L., and J.G. Lee, 1998. "Import Restrictions in the Presence of a Health Risk: An Illustration Using FMD." American Journal of Agricultural Economics 80(1): 175-83.

Pimentel, D., L. Lach, R. Zuniga, and D. Morrison, 2000. "Environmental and Economic Costs Associated with Non-indigenous Species in the United States." Working paper, College of Agriculture and Life Sciences, Cornell University. http://www.news.cornell.edu/releases/Jan99/species_costs.html

Roberts, D., and K. DeRemer, 1997. "Overview of Foreign Technical Barriers to U.S. Agricultural Exports." ERS Staff Paper No. 9705. U.S. Department of Agriculture, Economic Research Service, Washington, D.C., March.

Roberts, D., 1998, "Preliminary assessment of the effects of the WTO Agreement on Sanitary and Phytosanitary Trade Regulations", *Journal of International Economic Law,* vol. 1, No. 3; pp. 377-405.

Roberts, D., and K. DeRemer, 1997. "Overview of Foreign Technical Barriers to U.S. Agricultural Exports." ERS Staff Paper No. 9705. U.S. Department of Agriculture, Economic Research Service, Washington, D.C., March.

Roberts, D., T. Josling and D. Orden, 1999. "A framework for analyzing technical trade barriers in agricultural markets", *Technical Bulletin*, No. 1876, United States Department of Agriculture, Economic Research Service, Washington, D.C.

Shapiro, C, 1983. "Premiums for High Quality Products as Returns to Reputations." Quarterly Journal of Economics 98: 659-79.

Swann, P., P. Temple, and M. Shurmer, 1996. "Standards and Trade Performance: The UK Experience." Economic Journal 106: 1297-313.

Thornsbury, S., 1998. "Technical Regulations as Barriers to Agricultural Trade." PhD dissertation, Virginia Polytechnic Institute.

Thornsbury, S., D. Roberts, K., DeRemer, and D. Orden, 1999. "A First Step in Understanding Technical Barriers to Agricultural Trade." In Food Security, Diversification and Resource Management: Refocusing the Role of Agriculture? Edited by G.H. Peters and J. von Braun. Brookfield, VT: Ashgate.

United States Government Accounting Office, 1997. "Agricultural exports: US needs a more integrated approach to address sanitary/phytosanitary issues", report to Congressional Requesters 98-32, Washington, D.C.

United States International Trade Commission (USITC). 1995. "The Economic Effect of Significant US Import Restraints." Investigation 322-325, 2699, United States International Trade Commission, Washington, D.C.

United States – China Business Council, 2003. "Membership Priorities WTO Survey", September; pp. 1-5. Available at http://www. uschina.org.

United States Trade Representative, various years. "National trade estimate report on foreign trade barriers", Office of the United States Trade Representative, Washington, D.C. Available at http://www.ustr.gov.

Vido, E., and B. Prentice, 2001. "Methodological Issues in Gravity Model Analysis with Applications to Canadian Pork and Lentil Trade." Paper presented at American Agricultural Economics Association annual meeting, Chicago, August 5-8.

Weyerbroeck, S. and T. Xia, 1998. "Technical trade barriers in US/Europe agricultural trade", Working Paper, University of Delaware.

World Trade Organization, 2002a. "Scope of the negotiation on non-tariff barriers: Submission by New Zealand", Negotiating Group on Market Access, TN/MA/W/4. Geneva

_______, 2002b. "WTO non-agricultural market access – non-tariff barriers: Communication from Canada", Negotiating Group on Market Access, TN/MA/W/9/Add.1. Geneva.

_______, 2002c. "Market access for non-agricultural products: Submission by India", Negotiating Group on Market Access, TN/MA/W/10. Geneva.

_______, 2003a. "Modalities for non-agricultural market access – Proposal on modalities for addressing non-tariff barriers (NTBs) – Addendum", Negotiating Group on Market Access, TN/MA/W/18/Add.1. Geneva.

_______, 2003b. “Modalities For Non-Agricultural Market Access – Vertical NTB Modality: Communication from the United States – Addendum”, Negotiating Group on Market Access, TN/MA/W/18/Add.3. Geneva.

_______, 2003c. “Non-tariff barrier notification”, Negotiating Group on Market Access, TN/MA/W/25. Geneva.

_______, 2003d. “Non-tariff barrier notifications”, Negotiating Group on Market Access, TN/MA/W/46. Geneva.

_______, 2003e. “Table of contents of the Inventory of Non-Tariff Measures: Note by the Secretariat”, Negotiating Group on Market Access, TN/MA/S/5/Rev.1. Geneva.

_______, 2004. “Minutes of the meeting of 16 July 2003”, Committee of Participants on the Expansion of Trade in Information Technology Products, G/IT/M/36. Geneva.

_______, 2005. “Minutes of the meeting of 26 February 2004”, Committee of Participants on the Expansion of Trade in Information Technology Products, G/IT/M/38. Geneva.

_______, 2006a. “Negotiating proposal on WTO means to reduce the risk of future NTBs and to facilitate their resolution: Communication from the European Communities – Addendum”, Negotiating Group on Market Access, TN/MA/W/11/Add.8. Geneva.

_______, 2006b. “Resolution of NTBs through a facilitative mechanism: Submission by NAMA 11 Group of Developing Countries – Addendum”, Negotiating Group on Market Access, TN/MA/W/68/Add.1. Geneva.

Comment

TAMING NON-TARIFF BARRIERS: CONTRIBUTION OF TRADE FACILITATION

By Yann Duval

Dhar and Kallummal provide an insightful historical report in this chapter on how the multilateral trading system has attempted to address the issue of NTBs, from the Kennedy Round of GATT negotiations in the 1960s to the ongoing Doha Round of WTO negotiations. This comprehensive report suggests that, despite wide recognition of the need to tame NTBs, the multilateral trading system has throughout this extended period been unable to tackle this issue successfully.

This commentary first elaborates on some important issues raised here by Dhar and Kallummal and then briefly highlights the relevance of the ongoing trade facilitation negotiation as a small step towards taming NTBs at the multilateral level.

A. Negotiating NTBs across existing agreements

While the Doha Ministerial Conference has indeed provided a mandate for introducing effective disciplines on NTBs, what is – or is not – an NTB remains open to discussion. The legitimacy of an NTM (e.g., under an existing WTO agreement) and its compliance with key WTO principles – in particular, the principle of national treatment – appear to provide a good basis for assessing whether an NTM is, in fact, an NTB. However, this approach has the effect of restricting the scope of negotiations during the ongoing round of negotiation to a subset of potential NTBs.

Specifically, building on the Dhar and Kallummal report presented in this book, and taking the four-set classification proposed by Canada (World Trade Organization, 2002), quotas could be negotiated by the Negotiating Group on Market Access (NGMA) while border-related measures including customs procedures, fees and administration could be negotiated by the Negotiating Group on Trade Facilitation (NGTF). This leaves import licensing, rules of origin, customs valuation, SPS and TBT out of the current round of negotiations since they are part of agreements not up for negotiation in the current round. Given that many, if not most, NTMs identified as barriers to trade are related to agreements not up for negotiation in the current round, the hope for WTO to find an effective solution to tame NTBs in this round following this “legalistic” approach would seem rather dim.

As suggested here by Dhar and Kallummal, a decision by WTO members that any NTMs related to any WTO agreements may be assessed as potential NTBs could be a pre-requisite for WTO to be in a position to tame them effectively. This, however, would be a major undertaking, which could stall the Doha Round of negotiations completely if agreed to during this round.

An alternative, therefore, may be to go along with the legalistic approach and close this round quickly, following it with a new round more specifically dedicated to addressing NTBs related to all existing WTO agreements. This would have the major advantage of allowing an orderly review of all relevant agreements and their in-built mechanisms to more effectively address NTBs – as opposed to an add-on, overlapping and possibly unwieldy NTB agreement that might result from comprehensive negotiations on NTBs during this round.

B. Different modalities for different NTBs

The advantages and disadvantages of the five modalities identified by NGMA for dealing with NTBs are clearly described here by Dhar and Kallummal and do not need further elaboration. However, it is worth noting that modalities are intrinsically linked to the nature of NTBs. Since the nature of NTBs varies widely, it is likely that a combination of modalities may be needed to tackle them successfully. For example, trade facilitation-related NTBs may be best handled using a horizontal or request/offer mechanism, while many of the SPS-related and TBT-related NTBs may be best handled using vertical (i.e., sectoral) modalities.

This point again provides support for the option of reviewing NTBs under each relevant WTO agreement rather than as part of a separate agreement on NTBs, as might be envisaged under the current round, given its agreed scope.

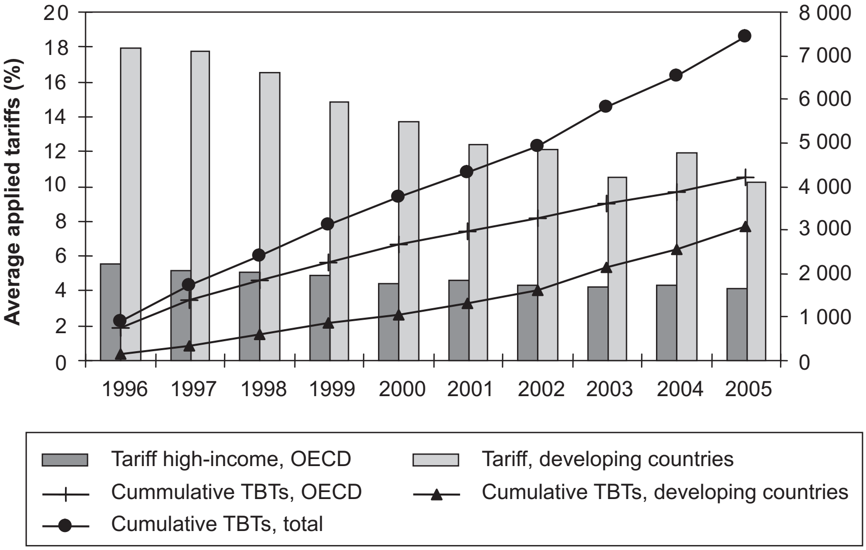
C. Have members over-negotiated on tariffs?

Dhar and Kallummal provide some evidence of a rise in the number of TBT measures since 1995, and they argue that the number and spread of the measures are “fast outstripping and undermining the trade liberalization achieved by way of tariff reduction and elimination”. While more research may be needed to support that claim, it appears increasingly evident that the apparent success of the multilateral trading system in reducing tariffs has been mitigated by a rise in “WTO-compliant” TBTs and other measures perceived by exporters as de facto NTBs (see figure).

If a negative correlation between tariff levels and the number/frequency of use of NTBs exists, the nature of the relationship remains difficult to investigate conclusively since there is no observed period during which a rise in (MFN) tariffs has led to either stabilization or a decrease in TBTs. Nonetheless, such a negative relationship may have wide-ranging implications for ongoing and future multilateral trade negotiations. For example, exporters may be reluctant to push their governments to negotiate further tariff cuts if there is a possibility that those cuts might be replaced by NTBs leading to higher overall trade costs.

Given the current relative lack of transparency of many WTO-compliant NTMs notified to the WTO Secretariat, due to the complexity of the measures or the way they are implemented, many exporters and governments might even consider higher tariffs if they

Average applied tariffs and number of TBTs, 1996-2005



Source: Ng (2006) and B. Dhar and M. Kallummal, 2007.

were compensated by removal of existing NTBs. This is something that has happened before, following the transformation of most quantitative restrictions into tariff equivalents.

That being said, the existing "water" between most favoured nation (MFN) rates and the applied rates in most WTO member countries makes it unlikely that governments would be ready to reduce or limit their use of NTBs in exchange for an opportunity to revise their bound tariffs upward. This suggests that tariff and non-tariff measures are not substitutes, making the tariffication of NTBs, other than quantitative barriers or for analytical purposes[1], a very difficult proposition. On the other hand, it suggests that even if excessive reduction in tariffs may have prompted the use of NTBs, backtracking on tariff concessions would not be a way to tame NTBs. Focusing on the simplification, standardization, harmonization and transparent implementation of NTMs may be more effective in removing the "trade protection" element embedded in some of the measures, while ensuring that the legitimate purposes of the measures are also achieved.

D. NTBs and the trade facilitation negotiation

Dhar and Kallummal provide an excellent account here of the various and evolving views on the scope of NTBs. Interestingly, no less than 95 per cent of NTBs reported by exporters relate to TBT, Customs and Administrative Procedures, and SPS (Fliess and

---

[1] See Ferrantino (2006) for a recent review of quantitative techniques for measuring effects of NTMs.

Lejarraga, 2005). Therefore, since TBTs and SPS are currently not up for negotiation, the most effective contribution of the Doha Round to taming NTBs, as perceived by exporters, may be achieved through the negotiations on trade facilitation as they cover at least some of the measures of concerns to exporters.

It must be acknowledged, however, that the negotiations on trade facilitation are limited only to GATT Article V (Freedom of Transit), Article VIII (Fees and Formalities) and Article X (Publication and Administration of Trade Regulations), such that many NTBs that fall within the "Customs and Administrative Procedures" mentioned above may not be addressed. Private sector surveys conducted by the Asia-Pacific Research and Training Network on Trade (ARTNeT) in five developing countries indeed suggest that customs valuation (i.e., GATT Article VII and the related implementation agreement) remain a primary concern of exporters, although it is outside the scope of the current negotiations (see table).

Most problematic areas in conducting trade in selected developing countries in Asia and the Pacific

	Overall ranking	Bangladesh ranking	China ranking	Fiji ranking	India ranking	Indonesia ranking	Nepal ranking
Customs valuation	1	1	2	2	1	3	2
Inspection and release of goods	2	2	6	5	2	2	1
Tariff classification	3	3	5	3	3	4	3
Technical or sanitary requirements	4	7	1	1	7	5	4
Payment of fees and penalties	5	6	4	8	6	1	n.a
Obtaining an import licence	6	5	3	7	5	6	n.a
Submission of documents for clearance	7	4	6	6	4	7	n.a
Identification of origin of the goods	8	8	8	4	8	8	n.a

Sources: *Studies in Trade and Investment* No. 57, ESCAP; and ARTNeT Working Paper No. 24.

Nevertheless, what NGTF achieves during this round may give some useful insights on what may or may not be achieved in a future round of negotiation that may be dedicated to NTBs. In that regard, recognition of the importance of capacity-building and technical assistance in ensuring satisfactory implementation of the measures negotiated, and the exploration of new, typically softer, mechanisms to monitor compliance (e.g., through peer and policy review mechanisms), may be particularly relevant to future negotiations on tackling NTBs related to TBT, SPS and other existing WTO agreements.

Considering the question addressed by Dhar and Kallummal in their paper, another question that comes to mind at a time when many countries in Asia and the Pacific region are negotiating bilateral and regional trade agreements, is whether these preferential trade agreements may also provide a solution for taming NTBs. In that context, rules of origin and their potential role as NTBs deserve particular attention (e.g., Deb, 2007).

References

Deb, U.K., 2007. "Non-Tariff Barriers in Agricultural Trade: Issues and Implications for Least Developed Countries", ARTNeT Policy Brief No. 12, May 2007.

Dhar, B. and M. Kallummal, 2007. "Taming non-tariff barriers: Can WTO find a solution?" In *Future Trade Research Areas that Matter to Developing Country Policymakers,* ESCAP, Bangkok.

ESCAP, 2006. "An exploration of the need for, and cost of selected trade facilitation measures in Asia and the Pacific in the WTO negotiations", *Studies in Trade and Investment* No. 57. Bangkok. Available at http://www.artnetontrade.org.

Ferrantino, M., 2006. "Quantifying the Trade and Economic Effects of non-tariff measures", OECD Trade Policy Working Paper No. 28, Paris.

Fliess, B. and I. Lejarraga, 2005. "Analysis of non-tariff barriers of concern to developing countries", OECD Trade Policy Working Paper No. 16, Paris.

Ng, F., 2006. *Data on Trade and Import Barriers*. Available at http://go.worldbank.org/LGOXFTV550.

Prasad, B.C., 2006. "Trade facilitation needs and customs valuation in Fiji", ARTNeT Working Paper No. 24. Available at www.artnetontrade.org.

World Trade Organization, 2002. "WTO non-agricultural market access – non-tariff barriers: Communication from Canada", Negotiating Group on Market Access, TN/MA/W/p/Add.1.

Part VI

Determining the border for trade policymaking

Chapter VI

GOING ‘BEHIND THE BORDER’

By Christopher Findlay

Introduction

Important trends in the forms of international business and in the perceptions of policy priorities are shifting the orientation of policymakers to measures, both at home and in foreign markets, that operate “behind the border”. This phrase is used here to refer to a variety of domestic regulatory practices. This shift of attention is raising questions about the role of international cooperation in managing policy reform. It is argued here that international cooperation provides options for capacity-building, mechanisms for the commitment of policy reform to avoid backsliding and for capturing spillovers between economies in regulatory reform. Consideration of these options and their application highlights the value of WTO processes in particular as well as their principles. This argument also has implications for the application of preferential trade negotiations to these issues.

A. Business and policy trends

Significant business and policy trends are leading to a redefinition of the list of priorities among policy measures relevant to international business. One of these trends is the growth of options for doing international business, particularly in the services sector. Cross-border transactions in services (which are the services transactions recorded in balance of payments data) grew as rapidly as merchandise trade (10 per cent on average during 2000-2002), then slightly lower than goods trade in the subsequent three years (15 per cent compared with 17 per cent in goods trade in 2003, 19 per cent compared with 21 per cent in 2004 and 11 per cent compared with 13 per cent in 2005).[1]

There are significant variations among countries in these growth rates, and in some developing countries services exports have increased rapidly (see table below). For example, Association of Southeast Asian Nations (ASEAN) members have recorded high growth rates in this form of cross-border services transactions that were close to world average rates. Trade in services in this form in India has grown much faster than in the rest of the world, and in China at slightly lower rates than the world as a whole, except for rapid growth in recent years.

---

[1] WTO, World Trade Report, 2006, table 3.

World trade of commercial services by region and selected countries, 2005

(Units: US$ billion and percentage)

	Exports					Imports				
	Value	Annual percentage change				Value	Annual percentage change			
	2005	2000-2005	2003	2004	2005	2005	2000-2005	2003	2004	2005
World	2 415	10	15	19	11	2 361	10	14	18	11
North America	420	5	5	11	10	373	7	8	15	10
South and Central America	68	8	10	16	20	70	5		14	22
Europe	1 233	11	19	19	7	1 119	11	19	16	8
CIS	40	18	16	23	20		20	17	24	18
Africa		13	26	20	12	66	12	16	19	15
Middle East	54	11	27	14	12	80	11	19	20	11
Asia	543	12	10	26	19	595	10	10	25	15
Japan	107	8	8	25	12	136	3	3	22	1
China	81	22	18	34	31	85	19	19	31	19
Four East Asian Economics[b]	175	8	9	18	9	165	8	8	21	10
India	68	33	21	66	76	67	29	23	53	73
ASEAN (10)	104	8	2	22	10	132	9	9	21	14

Source: World Trade Organization, *World Trade Report 2006*, appendix table 2, available at http://www.wto.org/english/news_e/pres06_e/pr437_e.htm#table2_appendix.

[a] For composition of country groups see the Technical Notes of WTO, International Trade Statistics, 2005.

[b] Taiwan province of China, Hong Kong, China, Republic of Korea and Singapore.

The types of services transactions recorded in balance of payments data are not the only form in which services can be traded. Also important is the establishment of offshore operations to deal direct with consumers in their own markets.[2] It is difficult to isolate the value of business transactions in services in this form. In its 2004 World Investment Report, UNCTAD stressed the shift to services in world foreign direct investment (FDI) flows. The report said that in the 1970s, services projects accounted for a quarter of world FDI stock and less than half by 1990; however, by 2002 the figure had risen to 60 per cent (see figure 3 of the report). Services accounted for two-thirds of FDI inflows during 2001-2002. Services investors are mainly from developed countries, but in the 1990s the developing country share of the global FDI stock in services started to grow

[2] The "movement of people" or the fourth mode of supply of services is not considered here.

and by 2002 they accounted for 10 per cent of the outward stock (they host 25 per cent of the inward stock).

A recent Australian study supported the significance of FDI in services transactions. It found that transactions from offshore establishments were significantly understated in official statistics. Balance of payments statistics might only be capturing about 36 per cent of total actual services exports (Australian Bureau of Statistics, 2004, and Australian Services Roundtable, 2005). Financial and insurance services as well as other business and professional services were the key sectors involved.

UNCTAD has suggested that the shifts towards services in FDI flows are related to the growth of the service sector in developed and developing economies (associated with growth and changes in business procurement strategies), the nature of services and the value of direct contact with consumers, and the change in policy environments. Movement offshore and outsourcing are examples of these processes at work. Another factor maybe the movement offshore of manufacturing sector clients of service sector firms, or manufactured product exporters setting up complementary services business, such as "after-sales support or repairs".

Another important trend is the decline in the importance of some policy measures affecting international business, particularly those that operate at the border. Beghin (2006), in a review of tariffs and non-tariff barriers, noted the decline in tariff rates on average and the shift in the mix of NTBs. He reported that:

(a) In 2005, the unweighted (applied) average tariff was about 3 per cent in high-income countries and 11 per cent in developing countries, compared with levels about three times as high in 1980;[3]

(b) The use of NTBs involving quantity or price controls, or financial measures, had decreased dramatically from 45 per cent of tariff lines faced by NTBs in 1990 to 15 per cent in 2004;

(c) The use of other types of NTBs had increased from 55 per cent "of all NTBs in 1994 to 85 per cent in 2004". Examples of such measures include technical barriers to trade.

However, these trends are not universal. Average tariff rates vary considerably between countries, both at applied and MFN levels (Drysdale and Findlay, 2006). In some sensitive sectors, traditional border barriers remain the priority issue, in agricultural trade, for example, and in textiles and clothing sectors in some economies. The traditional trade policy agenda continues to be worth attention (see, for example, Anderson, Martin and Valenzuela, 2005); at the same time, however, the focus of many international businesses is shifting "inland".

---

[3] Details are available from http://siteresources.worldbank.org/INTRES/Resources/tar2005.xls.

B. New policy issues

The consequence of these shifts is greater interest in behind-the-border policy. For example, consider the shift in the composition of significant NTBs to technical measures. As a consequence, there is also relatively greater interest in the administrative processes that are associated with their application, such as the design and testing of standards applied to goods and services (e.g., professional services). These processes are related to domestic procedures and practices that are linked to the way that governments operate. Business people frequently complain about the application of these measures.

These trends also combine to direct greater attention to measures affecting businesses operating in other modes (for example, businesses through establishment). That focus also directs attention to regulatory practices that operate behind the border. Examples of these policy categories include registration and licensing, rules on operations, locations and forms of establishment of offshore businesses.

A related concern is the often expressed exasperation with “red tape”. In 2006, the Australian Government set up a Taskforce on Reducing the Regulatory Burden on Business that produced a report on “Rethinking regulation”. Issues identified included excessive coverage, overlapping regulation, variation in definitions, excessive reporting and lack of justification. Costs identified including significant costs of compliance. To this might be added the costs of uncertainty associated with the outcome of any bureaucratic process.

Some of the regulatory measures of concern to business were originally introduced to solve problems of market failure. For example, standards are used to offset the lack of consumer information and manage the recognition of professional qualifications. They can, however, become barriers to international transactions. Other processes applied for the sake of consumer protection can have similar effects. Other regulatory practices for dealing with externalities might contain a bias against foreign providers (for example, rules on motor vehicle emissions to deal with urban smog). Competition policy measures, which could also fall into this category, are discussed below.

Beghin (2006) pointed out that whether a policy measure was protectionist or not was often difficult to determine. He suggested the rule that if a policy measure was “equal to the measure that a social planner would implement for domestic purposes (i.e., all firms are domestic firms or all agents belong to a single economy), the NTB is presumably non-protectionist”.

Problems could arise in these policy areas from inappropriate application of the policy measure (due to either capture or error). At one end, there is excessive regulatory activity, which adds to the costs of doing business in order to comply, restricts business development or creates barriers to entry. This could occur, for example, in the application of licensing arrangements or standards setting systems.

At the other extreme could be insufficient application of measures, such as the absence of a measure to support international business. Some concern has been voiced, for example, about the lack of a consumer protection regime to apply to cross-border financial transactions. Similarly, the absence of an access regime in critical infrastructure sectors could inhibit competition in downstream markets.

These problems in application, either to excess or to an insufficient degree, could affect both domestic and international firms. These measures are not necessarily restricted in their incidence to discrimination against foreign suppliers. They can affect market entry generally, not just the terms of foreign market entry, and they have implications for competition in the market place. Even application that does not discriminate against foreign firms could also be rent- and cost-creating.

Significant gains might be expected from reform of these sorts of measures. Beghin (2006) pointed out that most analyses of non-tariff measures identified three effects:

(a) A rent-creating effect for protected firms. (Beghin refers to “the domestic sector” as the recipient of the rents, but that sector could include firms owned by foreigners);

(b) A supply curve shift due to costs of compliance. (These costs might be incurred by both domestic and foreign firms);

(c) A demand-shift effect, when the measure enhances “demand with new information or by reducing an externality”.

Dee and others (2006) argued that “liberalization of rent-creating barriers will yield ‘triangle gains’ in producer and consumer surplus associated with improvements in allocative efficiency...but would also have redistributive effects associated with the elimination of rents to incumbents. Alternatively, liberalization of cost-escalating barriers...would be equivalent to a productivity improvement (saving in real resources), and yield ‘roughly rectangle’ gains associated with a downward shift in supply curves”. They noted that this could increase returns for the incumbent service providers as well as lower costs for users elsewhere in the economy. They observed that the aggregate welfare effect of measures that were cost-creating (for the same movement in the supply curve) would be greater than rent-creating measures, that is, the rectangle gains were likely to exceed triangle gains by a significant margin. They also noted that the differential effects on incumbent suppliers suggested the political economy of a reform programme would differ for cost-escalating measures compared to those that added to rents.

The intersectoral effects of the reforms of these measures are also significant. Consider, for example, the impact of logistics reforms on the rest of the economy – a more efficient transport sector reduces rents, lowers costs and cuts transport margins. This reduced margin is distributed between consumers, including export customers and producers. In markets where domestic prices are set by world prices, the bulk of this gain will be captured by producers (who face a close to perfectly elastic demand curve). In developing economies, these producers may be relatively poor agricultural producers.

The gains from reform of these types of measures are expected to be substantial, but capturing them is a matter of domestic policy change. It is important for domestic policy processes to respond to these issues. Another report on national regulatory reform released by the Australian Productivity Commission in February 2007 identified the productivity gains from reform in the health and education sectors. It found gains of at least 2 per cent of GDP from the reform package in these sectors.

Dee (2006) stressed the value of reform of this type to "increase the general contestability of markets", by allowing allcomers, domestic and foreign, to enter. She said reforms should "safeguard competition not particular competitors". She noted that reform was not easy because of the different players involved and their conflicting interests. Reform requires both an understanding of policy alternatives and a set of institutions for managing change. It is possible Dee was suggesting (drawing on a taxonomy provided by Ross Garnaut) that governments:

(a) Are unaware of best practice;

(b) Are aware of best practice, but face resistance to change;

(c) Themselves do not want better practice.

Dee proposed that formal, independent and public policy reviews had a key role to play in both identifying "better practice" (which may vary by stage of development) and managing the vested interests involved, including government itself.

While the focus of change is on domestic processes, international cooperation might provide some benefit. That is, it may be worthwhile for the institutions of international cooperation to explore the scope to work behind the border. The question, then, is what can international cooperation offer in this context?

C. Contribution of international cooperation

International cooperation can make contributions in three ways (the three Cs):

(a) Supporting the policy review process by providing information on options for policy reform and suggesting paths of evolution of policy (capacity-building);

(b) Adding to the credibility of reforms through commitments to policy change, (commitments);

(c) Capturing spillovers between policy reform in different countries (capturing spillovers).

With regard to capacity-building, Dee (2006)[4] noted that regional bodies could assist the policy review process by "marshalling expertise", and providing a forum for the exchange of experiences about conducting reviews. She argued, however, that if regional

[4] The paper was written with reference to APEC.

assistance was to be helpful it should not only be involved in the identification of policy options but also in “selling them”. The latter involves direct contact with local stakeholders and, she suggested, “real follow-up” by a lead minister who would be responsible for arranging consultation processes, releasing reports and prompting coordinated responses from all ministers affected. Participation by ministers distinguishes the Dee procedure from a review that is undertaken completely externally and independently of domestic stakeholders (for example, in the OECD model).

With regard to commitments, Findlay (2006), drawing on Mattoo (2002), commented on ways in which international negotiations and subsequent commitments could support domestic reform, such as the value of commitments that are binding (including those to be applied according to a schedule at a future date). The possibility that trading partners can seek compensation if policy change is not made adds to the credibility of their original commitment. Other contributions are market access, and the contribution that success makes to (a) mobilizing export interests that consequently support a domestic reform programme, and (b) guidance in the direction of regulatory reform.

In answer to the question of what has been achieved by international negotiations, Findlay (2006) noted that GATS so far “has not proved useful...as a vehicle to advance market opening in this sector”. GATS appears to have had limited impact on regulatory cooperation. Commitments in GATS have mainly reflected existing policy settings; however, there is a lack of research either in support of its role in providing credibility to those policies or to avoid backsliding. Negotiations within GATS (either across sectors or across modes of delivery) appear to be unable to overcome the domestic political hurdles to reform. Countries acceding to WTO – and China in particular – have, however, made significant commitments to reform.

Observations by Dee and others (2006) concerning trade facilitation suggest that the political economy issues to be resolved in dealing with behind-the-border issues may not be so much to do with domestic versus foreign interests, but rather incumbent versus new entrant interests. Preferential trade agreements, it might be argued, can be used to deal with behind-the-border matters. However, Dee (2005) argued that these trade agreements tended to be limited to measures that could be liberalized on a preferential basis, and tended to target only those provisions that explicitly discriminated against foreigners. These types of provisions tend to be rent-creating rather than cost-escalating. Dee and others (2006) therefore concluded that “the gains from even the ‘new age’ trade agreements are trivial, compared with the gains from comprehensive reform of non-discriminatory impediments to competition, as part of a thorough-going programme of unilateral domestic regulatory reform”.

Capturing international spillovers is the third contribution of international cooperation. Clarke and Evenett (2003) reviewed the arguments for collective action on one type of a behind-the-border policy, i.e., competition policy. They argued that political economy considerations for collective action did not provide a case for collective action; however, they identified other arguments. They discussed these issues in the context of policy on cartels. They suggested that an international agreement could strengthen the "positive spillovers" or knock-on effects in other jurisdictions from action in one economy, or that they could reduce the harm done by negative spillovers. They cited examples of spillovers related to the difficulties in obtaining evidence and cartel-related information.

Round and Findlay (2006) discussed other externalities related to the application of competition policy in the transport sector, where firms are involved in cross-border operations. Application of policy on mergers in one jurisdiction will affect consumers in others. What may improve welfare in one jurisdiction may reduce it in another; for example, one jurisdiction may endorse a merger on public interest grounds, but the result could be a reduction of competition and consumer losses in other markets. Clarke and Evenett (2003) considered issues associated with international cartels.

Conclusion

Is there a case for going behind the border in various forms of international collective action related to trade and investment policy? Yes, there clearly is a case. Contributions arise from the three Cs:

(a) The capacity to undertake and implement the recommendations of domestic policy reviews;

(b) The option to commit to the new policies and avoid backsliding; and

(c) Methods to capture the spillovers in policymaking in different countries.

The questions remain of how far and how often to go behind the border, and how to organize the work. How far and how often is difficult to say. The answer also depends on the weight given to the motivations above. The capacity-building motivation would lead to more extensive work compared to initiatives designed to deal with spillovers. The answer will also vary issue by issue and sector by sector. A set of criteria built in part on case study material might help. But the question is worth asking and the three Cs provide a framework for consideration, linking motivations for cooperation with the form of action.

The question is then how to organize the work of going behind the border. WTO offers significant capacity. For example, Clarke and Evenett (2003) considered the case for establishing minimum standards to deal with problems of non-enforcement of cartel policy. Such commitments might be made in WTO. However, it will also be important to consider the possibility of inappropriate enforcement of that policy. They pointed out that cooperation between national agencies would be important in securing the evidence to prosecute cross-border cartels, and 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". They concluded by arguing that for minimum standards to be effective, "other multilateral disciplines on voluntary cooperation and core principles (transparency, non-discrimination and procedural fairness) are required".

However, no one institution is likely to provide all the forms of international cooperation for all purposes (see Soesastro and Findlay, 2006). These contributions could be made in a variety of institutions. Each institution has different advantages, through its membership (and therefore the ability to capture policy spillovers, for example), its rules of operation and the capacity of its bureaucracy. This suggests that a portfolio approach is valuable, as is a clear view about which institute is best at which activity. APEC, as illustrated above, has strengths in the capacity-building work, and is not impeded by the ways in which it devolves responsibility for work to groups of members. For other cooperative work, a stronger secretariat may be important.[5] Commitments might better be made in organizations that are managing negotiating processes, WTO in particular, rather than making commitments in preferential trading arrangements, as is questioned above.

[5] The debate continues on the role of the APEC Secretariat. See, for example, presentations to the APEC Study Centre Network Preliminary Conference, Melbourne, December 2006, available at http://www.apec.org.au/event2.asp?event=40.

References

Anderson, K., W. Martin and E. Valenzuela, 2005. *The Relative Importance of Global Agricultural Subsidies and Market Access*, World Bank, Washington, D.C. Available at www.worldbank.org/trade/wto.

Australian Bureau of Statistics, 2004. "Australian outward foreign affiliates trade: Experimental results, 2002-2003", Cat. No. 5495.0 ABS, Canberra. Available at http://www.ausstats. abs.gov.au/ausstats/subscriber.nsf/0/17722D704FDAE92ECA256F3800756502/$File/54950_2002-03.pdf.

Australian Services Roundtable, 2005. *ASR Newsletter*, May. Available at http://www.servicesaustralia.org.au/pdfFilesNewsletters/24May2005Newsletter.pdf.

Beghin, J.C., 2006. "Non-tariff barriers", Centre for Agricultural and Rural Development Working Paper 06-WP 438, Iowa State University, Ames, Iowa. Available at http://www.econ.iastate.edu/research/webpapers/paper_12703.pdf.

Clarke, J.L. and S.J. Evenett, 2003. "A multilateral framework for competition policy", (chapter 2) in S. Evenett and the Swiss State Secretariat of Economic Affairs (eds.), *The Singapore Issues and the World Trading System: the Road to Cancun and Beyond*. Available at http://de.scientificcommons.org/2522.

Dee, P., 2005. "East Asian economic integration and its impact on future growth", Pacific Economic Papers No, 350, Australia-Japan Research Centre and the Asia-Pacific School of Economics and Government.

______, 2006. "Institutions for enhancing economic policy performance", paper prepared for the Australian National University-Ministry of Finance Conference on the Microeconomic Foundations of Economic Performance in East Asia, Manila, 23-24 November.

______, C. Findlay and R. Pomfret, 2006. "Trade facilitation: What, why, how and where?", University of Adelaide (mimeograph). Available at http://www.adelaide.edu.au/directory/christopher.findlay.

______ and A. Sidorenko, 2006. "The rise of services trade: regional initiatives and challenges for the WTO", in H. Soesastro and C. Findlay (eds.), *Reshaping the Pacific Economic Order*, London and New York, Routledge.

Drysdale, P. and C. Findlay, 2006. "US and EU trade policies and East Asia". Pacific Economics Papers, 353, Australia-Japan Research Centre, Crawford School of Economics and Government, Australian National University, Canberra. Available at http://www.crawford.anu.edu.au/pdf/pep/pep-353.pdf.

Findlay, C., 2006. "Transport Services", (chapter 9), in A. Mattoo, Robert M. Stern and G. Zanini (eds.), *A Handbook of International Trade in Services*, Oxford, United Kingdom, Oxford University Press (forthcoming).

Mattoo, A., 2002. "Negotiating improved market access commitments," in B. Hoekman, A. Mattoo and P. English (eds.), *Development, Trade and the WTO: A Handbook*. World Bank, Washington, D.C.

Round, D. and C. Findlay, 2006. “Competition policy in international airline markets: An agenda and a proposed solution”, University of Adelaide (mimeograph). Available at http://www.adelaide.edu.au/directory/christopher.findlay.

Soesastro, H. and C. Findlay (eds.), 2006. *Reshaping the Asia Pacific Economic Order*, Routledge, Taylor & Francis Group.

Taskforce on Reducing the Regulatory Burden on Business, 2006. “Rethinking regulation: final report”, Australian Government, Canberra. Available at http://www.regulationtaskforce.gov.au/finalreport/index.html.

Comment

HOW FAR SHOULD WE GO 'BEHIND THE BORDERS'?

By Evan Due

As successive rounds of multilateral trade negotiations have eroded tariffs and quotas, "behind the border" institutional and regulatory practices have come into sharp focus. These practices – from barriers around intellectual property rights, competition, logistics and service sectors to technical barriers to trade, product, labour and environmental standards – are of major concern to international businesses embedded in regional and global production networks involving frequent cross-border transactions. As shown in this chapter, while traditional border barriers continue to be prominent in some countries in the "sensitive" sectors, there has been a perceptible and real shift to "inland" domestic policy, and regulatory and public sector constraints.

Findlay succinctly highlights significant trends such as the shift towards trade in services and related processes, the shift in the composition of non-tariff barriers (e.g., away from financial to technical and domestic regulatory barriers), and the consequent policy shifts pertaining to reforms in these areas. He also underlines the significant gains to be made from domestic reforms. On these points, there is no doubt. He then goes on to emphasize an important role for "international cooperation" in facilitating such reforms through capacity-building, bolstering commitments to change, and capturing spillovers in different countries. However, precisely what is meant by international cooperation is not fully captured, and the question as to "how far to go" (and how often), is left dangling. We should therefore go a bit further.

A. Balancing business and consumer interests

There is growing evidence that policy measures at the border are of significantly less interest (and less concern) to business than those that regularly confront their various activities within borders. This is perhaps reflected in the importance that businesses place on the agreement on trade facilitation in the WTO July 2004 package. Conformity with standards and regulations, be they health and safety, environmental or commercial, is also an important domestic regulatory agenda where the interests of consumers are at play and which are unevenly represented. Confronting international businesses trying to reach consumers with services and products they desire, is the problem that different standards or specifications are often applied for the same end, resulting in huge transaction costs and uncertainty. In addition, while considerable multilateral efforts have, and are being made to encourage the adoption of internationally or mutually recognized standards, cooperation in those areas could go much further.

The political dimensions – what is seen by policymakers to be in the public interest (or worse, in their own interests) – are often not understood in the same vein, and lobbying groups have so far been weighted towards much narrower ends than the public good. In many Asian countries, this is manifested in regulatory and administrative practices that continue to be excessive, redundant and restrictive, presenting major costs (and political risk) for international business. Much has been discussed in the literature on the costs and benefits, but less attention has, until recently, been given to the political economy of domestic reform, and to the specific institutional contexts in which the various incentives are embedded and structured.

While businesses operating in Asian countries are acutely aware of the costs they incur as a result of these barriers, they have perhaps been less organized than entrenched public sector interests or other competing domestic interests. Findlay proposes in this chapter that international cooperation might be an avenue for counteracting and reducing these barriers. While important in all the ways he mentions, the motivation and forms of such cooperation also need unpacking in order to see where international business and consumer interests intersect in policy debate. For example, chambers of commerce and other business associations as well as international non-governmental organizations (NGOs) such as the Consumer Unity Trust Society[1] can (and should) significantly assist international cooperation endeavours. At the same time, they and their agents might also be targets for what Findlay identifies as capacity-building, and building commitments. International agencies with particular interests in this area (e.g., ITC, UNCTAD and WTO) as well as research institutions in Asian countries are important players in building coalitions for advocacy.

Other actors are unions, consumer groups and domestic NGOs that, although often antithetical to international business interests, can be important allies in promoting policy reforms where they recognize positive spillovers. Thus, an important process of interaction between a government, the private sector, the research community and these other actors can be facilitated through public participation and by building coalitions of interest on specific points of balance.

B. Policy and practice

A major “behind the border” barrier that international business articulates as one of the highest priorities in Asia is in the area of logistics and transportation (Duval, 2006). Modest improvements here can lead to exports worth billions of US dollars with significant positive spillover effects. This is especially so with landlocked countries where poor transportation infrastructure, coupled with weak institutions and poor coordination for trade facilitation (notably customs procedures), entail enormous costs and negative consequences for development. These conditions are evident in the countries of the Greater Mekong Subregion (GMS).

The huge investment outlays in the “economic corridors”, financed largely by assistance from ADB, are an attempt to build regional economic integration through improvements in transportation and logistics infrastructure. However, as studies have

---

1 See Consumer Unity Trust Society Institute for Regulation and Competition and its interest in promoting collective action at their research symposium in March 2007 on “Political economy constraints in regulatory regimes in developing countries”.

pointed out (Asian Development Bank Institute, 2006; ESCAP, 2006; Thailand Development Research Institute, 2007), international cooperation within Greater Mekong Subregion has been present in principle but less so in practice. Regional cooperation policies and expressions of good intent have not always permeated through to those who are tasked with implementation, resulting in confusion and continued rent-seeking behaviour.

For example, an important development in GMS market integration has been the “GMS Agreement for Facilitation of Cross-Border Transport of People and Goods” (CBTA). Although signed in 2000, a number of protocols have yet to be ratified. Implementation has been slow and many barriers continue to exist, although they are not identified or recognized by policymakers. The inexact implementation of CBTA revolves around a number of aspects, not least of which are political/institutional, and around which research and international cooperation along the lines indicated in this chapter are warranted. Studies of the economic effects of cross-border transport and logistics infrastructure in GMS demonstrate significant positive impacts for the region.

However, the lack of attention given to the institutional and public sector dimensions – the barriers to implementation that international businesses regularly confront (and pay for) – need to be better understood within their specific contexts. Corruption in public service along the logistics highway is a major concern, and research and capacity-building efforts for technical standardization (and harmonization with respect to specifications, charges etc.) would yield significant benefits. International cooperation could have an enormous impact through strong institutional arrangements embedded in agreements for facilitating trade and investment.

Another feature of increasing regional market integration has been the surge in cross-national production sharing, connected to global production networks. ASEAN and other regional groupings have placed much emphasis on promoting regional integration and supporting policies in order to encourage the building of these networks, reflecting the complementarity of trade profiles in the region. Establishments embedded in these networks have an important role, not only in addressing domestic policy reform but also in aiding their implementation, since they are on the front lines. Leading business representatives, such as Victor Fung (2005), have shown to be practical advocates for reforms and they need to be engaged. Regional cooperation involving the key establishments through subregional arrangements can be an option.

C. Contribution of international cooperation

International cooperation is usually thought of in terms of governments, international agencies and international associations acting as the principal actors in addressing “behind the border” issues related to trade and investment. However, other important actors must more actively be engaged in this process, such as international businesses, NGOs and the research community. They are able to provide the principal actors with information on the true transaction costs and the incentive structures at play, and can aid in the three “Cs” – capacity-building, commitment and capture.

1. Capacity-building

The importance of building capacity to design and implement domestic policy reform cannot be understated. Findlay cites studies including his own in order to demonstrate the need for this approach. However, there is a need to go further in defining the various avenues and modalities, and to go beyond what might be lumped into a TRTA model or other similar provisions of technical assistance. The case can be made for more inclusive policy reviews involving representatives from the business and research communities as well as for looking more closely at the institutions “behind the border” to see how, organizationally, they might be strengthened and restructured, in order to avoid the reproduction of incentive systems that capture rather than share the benefits of integration.

2. Commitments

Commitments made in multilateral negotiations can support domestic reforms, provided the modalities exist for ensuring that there is domestic policy coherence (and not just within commerce), coordination and understanding. Some multilateral negotiations may not be able to achieve this alone, but may be assisted through bilateral and regional efforts that can be more encompassing of domestic political considerations (although this view may be questioned by Findlay). While it is clear that comprehensive reforms at the domestic level are needed, it is not certain that multilateral commitments alone will suffice, notwithstanding the important achievements made in China. Commitments made through other modalities may be important building blocks (rather than stumbling blocks) for coordinated efforts to facilitate reform, especially if coupled with capacity-building.

3. Capturing international spillovers

The scope for capturing spillovers is broad, and the evidence of competition policy a good one. Context matters, as already pointed out; here, it is worth considering further how the application of policies in one jurisdiction might impinge on another, and how positive and negative spillovers can be appropriately managed. There is a need for more research in this area in order to understand better the political economic dimensions. Evidence can boost collective action by the right players so long as there is also effective coordination. Regional institutions may be best placed for this type of activity, especially where they are supported by research institutions and strong business associations.

Conclusion

It is true that no one institution is capable of all things, given core competencies and comparative advantage. A “portfolio approach” is indeed valuable, especially where it can attract and capture the motivations of other key players in the policy process. Brief reference has been made to business associations and leading figures as well as NGOs and the research community. In addition, secretariats such as APEC or ASEAN might be appropriate nodal institutions at the regional level, should it be possible to build up their own institutional capacity for research, outreach and coordination.

References

Duval, Y., 2006. "Cost and Benefits of Implementing Trade Facilitation Measures under Negotiations at the WTO: an Exploratory Survey", Asia-Pacific Research and Training Network on Trade (ARTNeT) Working Paper Series No. 3. Bangkok, ESCAP.

ESCAP, 2006. "South-East Asia Regional Economic Integration and Cooperation", mimeograph.

Fujimura, M. and C. Edmonds, 2006. "Impact of Cross-border Transport Infrastructure on. Trade and Investment in GMS", ADBI Discussion Paper No. 48 , Asian Development Bank Institute Discussion Series Paper No. 48. Tokyo.

Fung, V., 2005. "Business Perceptions and Expectations Regarding the WTO Doha Negotiations" in *Delivering of the WTO Round: A High-level Government Business Dialogue*, Studies in Trade and Investment No. 56, Economic and Social Commission for Asia and the Pacific, Bangkok; pp. 10-15.

Thailand Development Research Institute, 2007. "Logistics development for growth" (mimeograph). Bangkok.

Part VII

Research agenda that matters to developing country policymakers

Chapter VII

RESEARCH AGENDA THAT MATTERS TO DEVELOPING COUNTRY POLICYMAKERS: REPORT FROM THE POST-DOHA RESEARCH AGENDA FOR DEVELOPING COUNTRIES WORKSHOP

The Macao Regional Knowledge Hub (MARKHUB) in Support of Sustainable Trade and Development held its first workshop, entitled "Post-Doha Research Agenda for Developing Countries", on 30 and 31 October 2006. The objective of the workshop was to discuss current and upcoming research questions on trade policy reforms of importance to developing countries in the Asia-Pacific region. The workshop included a presentation of papers and discussions on the following topics:

- Multilateral governance of global trade;
- Regionalism as a challenge to multilateralism;
- Services liberalization as a development opportunity;
- Non-tariff barriers and the role of WTO in taming them;
- Behind the border measures and their impact on further liberalization; and
- Trade liberalization and poverty reduction.

The workshop concluded with a panel discussion involving Patrick Low, Christopher Findlay and Evan Due, and a floor discussion involving Simon Evenett, Biswajit Dhar, Ramesh Sharma, Gloria O. Pasadilla, Mustafizur Rahman, Rajesh Sharma, Andrew Stoler, Myrna Austria and Florian Alburo. The discussions dealt with the importance of selecting research topics and devising analytical frameworks that would produce research relevant to decision-making by policymakers, and which would contribute to their work on sustainable trade reforms in developing countries of Asia and the Pacific.

The underlying premise of research under the MARKHUB project is the regional relevance of trade policy and its applicability to current and emerging issues in trade policymaking in developing countries. The identification of topics was driven by the fundamental question of "what information would a contemporary policymaker need when making decisions and designing policies in the area of international trade". The ensuing discussion resulted in a number of research topics being proposed that would strengthen policy responses and measures over the short, medium and long term.

In summary, a process of more research-based and informed policymaking would require, inter alia:

- Information on trade policymaking in other countries – trading partners, including processes, key players and stakeholders and their interaction, and institutional settings;
- Empirical evidence together with analyses of economic and social impacts of various scenarios of multilateral trade negotiations under the Doha Development Agenda;
- Empirical evidence together with analyses of the economic and social impacts of bilateral and regional trade agreements;
- Systematic information on constraints and opportunities for forming regional horizontal and vertical linkages in the production and supply of manufactures, particularly in relation to the high economic growth rates of China and India;
- Estimates of the impacts of trade liberalization on the poor, and in particular the impacts of distributional changes on the various categories of poverty;
- Evidence of the impact of regulatory systems and behind-the-border measures on economic efficiency.

To provide such inputs into policymaking, research should focus on: (a) regional and multilateral trade liberalization; (b) liberalization of services trade and impact of services on economic reform; (c) non-tariff barriers and behind-the-border barriers; (d) the movement of people; (e) democratization of trade policy design; and (f) advances in methodology.

(a) Regional and multilateral trade liberalization, including:

  - More analytical work, including number crunching, to tackle the impacts of different types of preferential agreements (e.g., WTO+, WTO-) and allow for a sound comparative analysis and derivation of policy recommendations;
  - Analytically-friendly databases that would allow some econometric and quantitative analysis;
  - Consideration of the political-economy approach in studying the dynamics of the negotiating process;
  - The study of sectoral agreements at the regional/bilateral level (e.g., services, investment and labour mobility), and the possibility of pooling them into wider and more comprehensive schemes/frameworks;
  - Assessment of the extent to which WTO is a viable instrument for further trade liberalization.

(b) Liberalization of services trade and impact of services on economic reform, including:

  - Assessment of the extent to which GATS can induce further liberalization in services;

- Subsectoral studies (air transport, logistics and distribution services, and mode 4 in relation to poverty;
- Measurement issues and data collection related to services;
- Empirical studies of the links between economic development and service sector liberalization.

(c) Non-tariff barriers and behind-the-border barriers, including:

- The systematic study of these barriers, including inventories of measures/barriers;
- The impact of mutual recognition agreements on conformity and trade;
- The identification of lead factors relevant to harmonizing standards.

(d) The movement of people. This includes:

- The impact of demographic differences in the region on movements of labour and (regional) management of labour movement;
- The implications of increasing population in urban areas;
- The implications of shifting demography on trade in health and education services provision (across all GATS modes of delivery).

(e) Democratization of trade policy design. This includes:

- The role of interest groups and lobbying in policy design, particularly the role of consumers, producers, legislators (parliamentarians) and policymakers as well as their interactions;
- Political economy of trade policy formulation in major economies (including the United States, the European Union and Japan);
- Institutional settings and economic change;
- The impact of interregional linkages on process and quality of policy design;
- Assessment of resistance to trade policy reform.

(f) Advances in methodology. This includes:

- Expanding the measurement limits;
- A more extensive use of case studies that are based on systematically collected evidence;
- Primary data collection using survey instruments;
- Cost-benefit analysis;
- Estimation of data reliability.

P.S.

MARKHUB has own web-page at http://www.must.edu.mo/markhub hosted on the Macao University of Science and Technology website. The web-page provides information on:

- purpose and objectives of MARKHUB;
- list of events such as research workshops or policymakers' consultations;
- publications including the MARKePAPERS – working paper series;
- links helpful to policymakers and researchers alike;
- and contacts for further information both at the local partner – Macao University of Science and Technology and ESCAP.

United Nations
ESCAP

United Nations
Economic and Social Commission for Asia and the Pacific
Trade and Investment Division
United Nations Building, Rajadamnern Nok Avenue
Bangkok 10200, Thailand
Tel.: +66 2 2882252
Fax: +66 2 2881027
E-mail: itid.unescap@un.org
escap-publicationsoffice@un.org
Web site: http://www.unescap.org/