# MULTILATERAL AND REGIONAL TRADE ISSUES FOR DEVELOPING COUNTRIES



Edited by **R. Grynberg** and **E. Turner**

Commonwealth Secretariat

# Multilateral and Regional Trade Issues for Developing Countries

Economic Affairs Division
Commonwealth Secretariat

**Note**

All briefs in *Multilateral and Regional Trade Issues for Developing Countries* were written by the authors in their personal or official capacities. The views expressed are not necessarily shared by the Commonwealth Secretariat.

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# Contents

Introduction v

Contributors vii

Abbreviations ix

**Section I Issues in the WTO**

1. Export Processing Zones and the WTO Agreement on Subsidies and Countervailing Measures 1
2. Commonwealth Developing Countries and the WTO Telecommunications Regime 9
3. U.S. Farm Bill 21
4. Geographical Indications 29
5. Access to Medicines: After Doha 37
6. ECO-labelling and International Trade 49

**Section II WTO Disputes**

1. US Steel Duties and safeguard Actions under the WTO 63
2. United States Tax Subsidies under DISC, FSC and ETI Legislation within the Framework of the WTO 75
3. WTO Complains by Australia and Brazil Regarding the EU Sugar Regime 89
4. WTO Complaints by Brazil Against US Cotton Subsidies 101
5. India – European Union Dispute on Generalised System of Preference Conditionalities 113
6. The WTO GMO Dispute 125
7. Rules of Origin: The Way Ahead (Lessons from the USA-EC-India Textiles Dispute) 143

**Section III Regional Issues**


| | | |
|---|---|---|
| 1. | ACP – EU Negotiations of Economic Partnership Agreements | 157 |
| 2. | Challenges Facing the Caribbean During EPA Negotiations | 163 |
| 3. | ACP – EU Future Trade Relations: Challenges and Opportunities For Eastern and Southern African Countries | 173 |
| 4. | COMESA and SADC – A New Free Trade Area and Another in the making | 179 |
| 5. | The African Growth and Opportunity Act: The Impact of Its Rules of Origin | 191 |
| 6. | The United States – Singapore Free Trade Agreement | 203 |
| 7. | The United States – Chile Free Trade Agreement | 223 |
| 8. | Reform of the EU's Agricultural Policy | 247 |

# Introduction

A major challenge for most developing countries is how to use ongoing international negotiations and existing multilateral trade agreements as instruments for increasing their volume of trade and access to export markets and by so doing improve the quality of life of their citizens. A common constraint that exists among these countries is their limited capacity to both understand, and negotiate in the various international fora.

About two years ago, the Commonwealth Secretariat commenced publication of its trade briefs as part of its on going mandate to integrate its developing member states more fully into the multilateral trading system. These briefs are intended to be a source of information, analysis and guidance on trade issues and disputes for officials and policy makers in the ministries of trade, industry and finance, private sector associations, non-governmental organisations and overseas missions and embassies of Commonwealth developing countries.

The major objective of the briefs is to provide information on the implications of, and options available to, Commonwealth developing countries on various issues presently under negotiation and in dispute at the World Trade Organisation. Experts were asked to write relatively short and concise briefs on a variety of issues at the national, regional and international levels. Although there is an emphasis on issues and disputes in the WTO, some of the other subject covered are in the context of the ACP-EU Negotiations of Regional Economic Partnership Agreements (REPAs) and developed countries preference initiative to least developing countries.

**Structure of Volume one**

The first volume – "Multilateral and Regional Trade Issues for Developing Countries" - is divided into three sections: Issues in the WTO, WTO Disputes, and, Regional Issues:

**Section One** contains six briefs on present areas of interests and concerns to developing countries in the WTO. The section provides an analysis and seeks to present a case to policy makes of the effective use of WTO Agreements and Rules by developed countries to deny benefits to developing countries.

**Section TWO** contains seven briefs on WTO disputes; two of which deals with the use by developed countries of subsidies and safeguard actions, one deal with the dispute over genetic modified organisms, and another two deals the India – European dispute on GSP Conditionalities and the India-EC-USA textile dispute over rules of origin respectively. The remaining two

briefs present an analysis of two potential disputes that if successful would have serious implications for developing countries economies.

**Section Three** contains eight briefs. Six of these briefs provide an overview of the ACP-EU Negotiations, the analysis of negotiations of Economic Partnership with the EU from a Caribbean and an Eastern and Southern Africa perspective, and a review of regional economic integration from the Eastern and Southern African experience. The final two briefs deals with an analysis of the Rules of Origin of the United States Africa Growth and Opportunity Act and the European Union's reform of its Common Agricultural Policy.

The selection of Hot Topic briefs presented in this book is by no means exhaustive. The Commonwealth Secretariat continues to produce other briefs on topical issues as they develop. I would invite you to visit the Commonwealth Website, http://www.commonwealth.org for a review of other briefs in the Commonwealth Hot Topics series as well as our other newsletter, "the Doha Development News".

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# Abbreviations

| | |
|---|---|
| ACP | African, Caribbean and Pacific (States) |
| CAP | Common Agricultural Policy |
| CARIBCAN | Canadian programme that provides preferential access for Commonwealth Caribbean exports |
| CBI | Caribbean Basin Initiative |
| CEMAC | Communauté Économique et Monétaire de l'Afrique Centrale (Cameroon, the Central African Republic, Chad, Congo Brazzaville, Gabon, and Equatorial Guinea) |
| COMESA | Common Market for Eastern and Southern Africa (Angola, Burundi, Comoros, DR Congo, Djibouti, Egypt, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, Zimbabwe) |
| DISC | Domestic International Sales Corporation (US) |
| EBA | Everything But Arms (EU trade preferences for the LDCs) |
| EC | European Commission |
| ECOWAS | Economic Community of West African States (Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo) |
| EPA | Economic Partnership Agreement |
| ETI | Extraterritorial Income Exclusion Act (US) |
| EU | European Union |
| FISC | Foreign Sales Corporation |
| FTA | Free Trade Area |
| FTAA | Free Trade Area of the Americas |
| GATT | General Agreement on Tariffs and Trade |
| IOC | Indian Ocean Commission (Comoros, Madagascar, Mauritius, Reunion, Seychelles) |
| IRC | Internal Revenue Code (US) |
| LDC | Least Developed Country |
| MFN | Most Favoured Nation |
| NAFTA | North America Free Trade Agreement |
| PACER | Pacific Agreement on Closer Economic Relations (Australia, Cook Islands, Federated States of Micronesia, Fiji, Kiribati, New Zealand, Nauru, Niue, Palau, Papua New Guinea, Republic of the Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu, and Vanuatu) |

| | |
|---|---|
| RNM | (Caribbean) Regional Negotiating Machinery |
| SADC | Southern African Development Community (Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe) |
| SDT | Special and Differential Treatment |
| UN | United Nations |
| WTO | World Trade Organization |

# Section I

# Issues in the WTO

# 1. Export Processing Zones and the WTO Agreement on Subsidies and Countervailing Measures

***David Robertson***

## Introduction

Many of the Commonwealth's developing countries have established export processing zones (EPZs) as trade policy instruments designed to promote non-traditional exports. Typically, these programs provide that if a company locates a manufacturing facility within a geographically delimited zone, and exports all or most of its products, it will be provided with a number of incentives. These incentives range from exemption from various direct and indirect taxes and customs duties to provision of a number of free or low-cost services. EPZs located in developing countries typically provide the greatest number of incentives.

The WTO's Agreement on Subsidies and Countervailing Measures (SCM) contains specific definitions, restrictions and implementation deadlines in relation to the use of export subsidies. These rules may affect incentives granted to EPZ companies in Commonwealth developing countries that are currently WTO Members or are contemplating accession.

This paper aims to highlight some of the potential conflicts between the SCM Agreement and EPZ incentives. It should be borne in mind, however, that each EPZ will have particular regulatory characteristics and that each Commonwealth WTO Member may have differing bilateral or regional obligations. The comments made in this paper can, therefore, only be general in nature and should not substitute a case-by-case review of EPZ incentives.

## Agreement on Subsidies and Countervailing Measures

The SCM Agreement came into effect on 1 January 1995 and builds on Article XVI of the General Agreement on Tariffs and Trade 1947 (GATT) and the earlier Agreement on Interpretation of and Application of Articles VI, XVI and XXIII. The SCM Agreement provides a more or less complete code in relation to the use of subsidies that reference back to GATT 1947 and the earlier Agreement on Interpretation is not necessary in most instances.

## Definition of Subsidy

The rules contained in the SCM Agreement apply only to subsidies as defined within the Agreement. A subsidy is defined in Article 1 as a financial

contribution by a government or any public body, including a direct transfer of funds (e.g. grants, loans and equity infusion), government revenue that is forgone (e.g. tax credits), provision of goods or services by a government, other than infrastructure, and income or price support.

This very broad definition is qualified by two provisos. First, to become subject to the rules in the SCM Agreement, a subsidy must confer a *benefit* on the recipient, and secondly, it must be *specific*, namely, available only to an enterprise or industry or group of enterprises or industries within the jurisdiction of the authority granting the subsidy. Article 2.2 specifically provides that *"a subsidy which is limited to certain enterprises located within a designated geographical region. ..shall be specific."* Subsidies extended on the basis of administrative delineation would also be specific.

The general definition of subsidy is further refined by specifying two categories of subsidies: *prohibited export subsidies and actionable subsidies.* These two categories are also referred to as *"red light"* and *"yellow light"* subsidies. Until 2000 there was a third category of *non-actionable subsidy,* which has been discontinued.

**Prohibited Export Subsidies**

Prohibited export subsidies are those *"... contingent, in law or fact ... upon export performance ... and those contingent. ..upon the use of domestic over imported goods". Prohibited export subsidies* are described further by reference to Annex I of the SCM Agreement, which provides an illustrative list of *Prohibited Export Subsidies.* Annex 1 includes as *prohibited export subsidies* a number of the incentives that might be offered to EPZ companies including:

- transport or freight charge subsidies on export shipment provided or mandated by the government;
- the provision by governments of export credit guarantees or insurance programs at premiums that are adequate to cover the long-term operating costs and losses of the programs; and,
- the full or partial exemption remission, or deferral in relation to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises. (Direct Taxes are defined as taxes on wages, profits, interests, rents, 'royalties, and all other forms of income, and taxes on ownership of real property).

Developed WTO Members are prohibited from granting or maintaining prohibited export subsidies. However, the SCM Agreement recognises that subsidies may play an important role in the economic development of developing countries. Accordingly, least-developing countries (as designated by the United Nations), and developing countries with a GNP per capita of less than $1,000,

are exempted, from the prohibition on *prohibited export subsidies* indefinitely, or at least for so long as their GNP remains below the specified level.

Developing countries, other than least developed and those with a GNP below $1,000 per capita, are exempted from this prohibition until the end of 2002. However, they are required to phase out *prohibited export subsidies* within the eight-year implementation period, preferably in a progressive manner, and they may not increase their level of export subsidies.

If a developing country requires an extension of the period of exemption in relation to *prohibited export subsidies* Article 27.4 of the SCM Agreement provides that it may enter into consultation with the Committee on Subsidies and Countervailing Measures (the Committee) to determine whether an extension of the period is justified. These consultations must be initiated at least one year before the end of the exemption period, i.e. by the end of 200 I. If, having taken into account all relevant economic, financial and development needs, the Committee is of the view that the extension is justified then the subsidy will be subject to annual reviews from then on.

It is worth noting that developing countries may be reluctant to apply for extensions on the grounds that to do so could create unease amongst existing or prospective EPZ companies. The alternative is develop a strategy for bringing the incentive packages within the SCM Agreement rules.

A further exemption is provided in relation to the prohibition against subsidies in the form of domestic content requirements or preferential treatment for domestic over imported inputs. Developing countries were exempted from this prohibition until 2000, Least developed countries are exempt until the end of 2002.

## Some Further Examples of Measures Likely to Constitute Prohibited Export Subsidies

Each of the following measures may, subject to the particular circumstances of the EPZ concerned, constitute a *prohibited export subsidy:*

- exemption from taxes on realestate;
- exemption from taxes on profits as well as of any other tax determined on the basis of gross or net income, dividends paid to shareholders or income or sales;
- income tax exemptions based on locating plant in areas of "lesser development";
- income tax exemptions based on reinvestment in the host country;
- exemption from taxes on remittances abroad;
- provision of non-chargeable customs processing services; and,
- the provision of public administrative services to EPZ manufacturers on a non-chargeable basis, such as assistance in selection of personnel,

advice regarding government regulatory requirements and assistance with housing and educational needs of personnel.

**Actionable Subsidies**

The second category of subsidies are actionable subsidies. These subsidies are defined by reference to the effect they have on another WTO Member. Therefore, if a subsidy falls within the Article 1 definition of *subsidy,* confers a *benefit* on the recipient and is *specific*, but is not a *prohibited export subsidy*, then the following test will be applied to determine whether it is an *actionable subsidy*:

Article 5:

*"No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.*

*(a) injury to the domestic industry of another Member;*

*(b) nullification or impairment of benefits accruing directly or indirectly to other Members;*

*(c) serious prejudice to the interests of another Member."*

*Serious prejudice* is deemed in certain circumstances, namely where the total *ad valorem* subsidisation of a product exceeds 5% of its value or where subsidies are paid to cover operating losses sustained by an industry. Where *serious prejudice* is deemed to exist, the burden of proof is on the subsidising Member to show that the subsidies in question do not cause serious prejudice to the complaining Member. This presumption of *serious prejudice*, however, only applies in relation to developed countries. For developing countries *serious prejudice* must be demonstrated by positive evidence.

Further, where a developing country maintains an actionable subsidy, i.e. one which causes adverse effects to the interests of other Members as per Article 5, a remedy will only be granted where the subsidy in question also displaces or impedes imports of like products into that country, or injures a domestic market in another country. In other words, the threshold to be reached before a remedy will be granted in response to an actionable subsidy is raised for developing countries.

**Some Examples of Measures Likely to Constitute Prohibited Export Subsidies**

The measures listed below may, depending on the particular circumstances of the EPZ concerned, constitute *actionable subsidies*:

- exemption from import charges on the importation of raw materials, machinery and any other components necessary for EPZ company manufacturing (where the same exemptions are granted to imports for the manufacture of like products for domestic consumption);
- exemption from municipal taxes;

- exemption from stamp duty or transaction taxes; and
- exemption of sales and consumption taxes on purchases of goods and services.

**Non-actionable Subsidies**

The final category of subsidy recognised by the SCM Agreement was *non-actionable*. Article 8 provides that subsidies which are not specific and certain other specific subsidies, e.g.. industrial research subsidies, assistance to disadvantaged regions and subsidies to implement environmental requirements, are non-actionable. Members relying on the exemptions in Article 8 had to notify the Committee. However, Article 31 of the SCM Agreement provides that Article 8, amongst others, would apply only for a provisional period of five years. The Committee was then faced with the task of deciding whether to extend Article 8's application. The Committee failed to reach a consensus on an extension before 31 December 1999. Accordingly, this exemption no longer applies and previously non-actionable subsidies will now be treated in the same way as other subsidies.

This raises the question of whether subsidies previously notified under Article 8 continue to enjoy their exempt status, and if so for how long.

**Notifications**

The SCM Agreement builds on the obligation contained in Article XVI of GATT 1947 that Members must notify any subsidy that they maintain. Article 25 of the SCM Agreement requires Members to notify any specific subsidy within the broad definition of Article 1, i.e. prohibited export subsidies, and actionable subsidies as well as any non-actionable subsidies. Notifications are to be submitted by 30 June each year and Members may bring to the attention of the Committee any Members' failure to notify.

**Remedies**

Where a WTO Member maintains a *prohibited subsidy* the aggrieved WTO Member may initiate the SCM Agreement dispute settlement process, which includes an expedited timetable for action by the Dispute Settlement Body. If it is found that the subsidy is indeed prohibited, it must be immediately withdrawn. If this is not done within the specified time period, the complaining member may be authorised to take countermeasures.

It is worth noting that in the *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather Case*, a dispute between the United States and Australian Governments resulted in a WTO Panel ordering that the exporter concerned repay A$30 million of export assistance to the Australian Government. A sanction of this type passed through to a corporation clearly

demonstrates the risks that EPZ companies will be evaluating in relation to the incentives they receive.

An alternative course of action open to the aggrieved WTO Member, once a *prohibited export subsidy* is established, is to initiate a countervailing duty investigation with a view to imposing an additional import duty on the product or products concerned from the subsidising country. Before an aggrieved Member may impose a countervailing duty, it must comply with the detailed obligations contained in the SCM Agreement regarding the conduct of a countervailing duty investigation and the findings of a subsidy, injury, and a causal link between the two.

Affected Members can take action against a Member maintaining an actionable subsidy in the same way as for prohibited subsidies. In the event that it is determined that *adverse effects*, as defined in the SCM Agreement, exist the subsidising Member must withdraw the subsidy or remove the *adverse effects*.

Alternatively, a countervailing duty investigation may be commenced once the existence of an *actionable subsidy* has been established.

The SCM Agreement provides that a countervailing duty investigation of a product originating from a developing country is to be terminated if it is determined that the level of the subsidies does not exceed 2% (3% for some developing Members) of the value of the product, or if the subsidised imports from the developing country concerned amount to less than 4% of the total imports of the *like product* into the aggrieved country.

Finally, a countervailing duty investigation will also be terminated in circumstances where the amount of the subsidy is *de minimus* or where the volume of exports or the injury is negligible.

## What are the main issues for Commonwealth Governments with EPZS?

### *1. Illegal prohibited export subsidies*

Several of the preferential incentives typically provided to companies in EPZs fall squarely within the definition of *prohibited export subsidy* as described in Article 3 and the illustrative list in Annex I. For example:

- the exemption or partial remission of direct taxes such as wage taxes, profit taxes, rents royalties and property taxes;
- transport or freight charge subsidies on export shipment provided or mandated by the government; and,
- the provision of export credit guarantees or discounted insurance program.

It is important to note that the SCM Agreement is not targeting duty-free imports and exports. Rather, the Agreement targets the set of fiscal incentives, such as tax breaks and utility subsidies, which are offered on a preferential

basis to exporters. If these measures were applied nation-wide and to companies other than exporters, they would not be considered discriminatory and therefore would probably not be subject to WTO regulation. However, where these fiscal incentives are provided to EPZ firms on a preferential basis they become *prohibited export subsidies* (as described above) and are viewed as being an export subsidy for the EPZ companies' exported goods.

Therefore, developing Commonwealth countries with active EPZs and a per capita GNP of US$1000, technically have until the year 2003 to remove the prohibited subsidies or realign ERZ incentive schemes with national norms. Where this is not done these countries disciplinary actions and countervailing measures from trade partners.

As discussed above, the least developed Commonwealth countries and those with a GNP per capita of less than US$1000 are exempt from this restriction on prohibited subsidies.

### 2. *Illegal local content requirements*

*Prohibited export subsidies* include both subsidies contingent on export performance and those contingent on the use of domestic over imported goods (Article 3.1(b)). The phase out period for these local content subsidies is slightly different to that for export performance subsidies. Developing countries were required to remove all such subsidies by the end of 2000. Least developed countries have until the end of 2002 to remove local content subsidies. Local content requirements may also conflict with a country's obligations under the WTO Agreement on Trade Related Investment Measures.

### 3. *Introduced prohibited export subsidies*

It should be remembered that the eight year period before developing countries are prohibited from maintaining *prohibited export subsidies*, i.e. until 2003, is intended to be a phase-out period. Article 27.4 of the SCM Agreement provides that a developing country *"shall not increase the: level of its export subsidies"*. Accordingly, where Commonwealth developing countries have, or are proposing to increase the level of subsidies or introduce new subsidies, a careful assessment should be made as to whether the subsidy falls within the definition of *prohibited export subsidy*. Where such subsidies have already been introduced there is of course the possibility of retaliation from a trade partner.

### 4. *Extended time-limits for specific prohibited export subsidies*

For all developing Commonwealth countries there is room in the SCM Agreement for a one year extension of the exemption in relation to particular *prohibited export subsidies*, with annual consultation regarding further yearly extensions. These consultations must be initiated by the end of 2001.

### *5. Illegal actionable subsidies*

Where a Commonwealth country maintains an actionable subsidy, i.e. one which causes *adverse effects* to the interests of another Member and exceeds the de minimus thresholds, that country may become the focus of a direct challenge to the subsidy or a countervailing duty investigation, potentially resulting in the country being forced to withdraw the subsidy or remove the adverse effects or the country's exporters facing a higher duty on exports to certain foreign markets.

It should be noted, that while least developed countries or those with a GNP per capita below $1000 are exempt from the restrictions on *prohibited export subsidies* there is no exemption in relation to actionable subsidies. Therefore, if such a country were to export sufficient levels of subsidised product to pass the de minimus thresholds, an aggrieved country could take action against it.

### *6. Failure to notify subsidies*

Article 25 of the SCM Agreement requires Members to notify any subsidies being maintained by 30 June each year. This includes an obligation to notify that no subsidies at all are maintained.

### *7. New Round of negotiations*

The issues raised above all presume that the SCM Agreement remains unamended. However, developing countries, including Commonwealth developing countries, may decide that the export subsidy exemptions for developing and least developed countries should be extended as part of any future negotiating round.

# 2. Commonwealth Developing Countries and the WTO Telecommunications Regime

***Dan Sarooshi***

## Introduction

The importance of the telecommunications sector to developing country Members of the Commonwealth cannot be overemphasised, since it plays a crucial role in facilitating trade and economic development. However, the difficult issue that arises is to what extent should developing Commonwealth countries grant global telecommunication service providers the right to enter their markets and compete with their incumbent telecommunications service provider. This issue of domestic regulation of foreign telecommunications service providers has now, however, been largely moved onto the international plane with a comprehensive set of obligations and commitments accepted by States pursuant to the World Trade Organization (WTO) framework agreement on services. As such, the telecommunications service sector of a State, which previously seemed far removed from trade law and policy, is now fully integrated into the multilateral trading system as one part of the WTO General Agreement on Trade in Services (GATS). In the case of Commonwealth Member States, twenty-nine out of a total of fifty-four Members have made varying degrees of GATS commitments in the telecommunications sector.

This paper will explain briefly the main elements of the GATS and the 1997 WTO Telecommunications Agreement; identify the types of problems that developing countries may face when implementing the GATS in the area of telecommunications by examining how States' commitments affect their domestic incumbent telecommunications operators; and identify some of the issues of concern to developing countries in the current GATS negotiations.

The comments made in this paper are general in nature and should not be relied on as legal advice.

## The WTO General Agreement on Trade in Services (GATS)

The GATS does three main things: first, it establishes a rule-based framework for international transactions in services; second, it clarifies the obligations of WTO Member States within that framework; and third it delineates a legal structure for ensuring that these obligations are observed. As one of the WTO Agreements it applies to all WTO Member States. With 144 Members, GATS today covers over 90% of the global trade in services.

The GATS is potentially applicable whenever a service supplier and the customer are from different countries regardless of the location of the actual

transaction. The GATS stipulates that its terms are applicable to four 'modes of supply' of a service, These four 'modes of supply' are where a service is supplied: from the territory of one WTO Member into the territory of any other Member (cross-border supply); in the territory of one Member to the service customer of any other Member (consumption abroad); by a service supplier of one Member through commercial presence in the territory of any other Member (commercial presence); or by a service supplier of one Member through the presence of natural persons in the territory of any other Member (movement of natural persons to supply the service).

Once a service falls within one of these four modes of supply, then the service and the service supplier receive GATS protection; the extent of that protection being determined primarily by a particular State's commitments made pursuant to the GATS. The GATS contains relatively few general obligations that are immediately applicable to WTO Member States. The most important of these general obligations are the most-favoured nation treatment obligation; certain limitations on a State's right to impose currency and other restrictions to safeguard its balance of payments position; a requirement that all laws affecting service provision be made publicly available; and a requirement that domestic regulation be reasonable, objective, impartial, and not more burdensome than necessary.

The bulk of the GATS obligations only become operational once a WTO Member has actually negotiated concessions or, in GATS language, made 'specific commitments'. These specific commitments are negotiated on a sector-by-sector basis and are inscribed in a Member's schedule of commitments. They provide a minimum level of treatment of foreign services and service suppliers. Once a Member has made these commitments, then it must ensure that they are observed not only by its national government, but by regional and local governments within its territory as well as by non-governmental bodies that exercise powers delegated to them by governmental authorities. Typical examples of GATS specific commitments relate to (i) rights of market access for foreign services and service suppliers, and (ii) non-discriminatory treatment of foreign services and service suppliers as compared to local services and service suppliers (the 'national treatment' principle). These market access and national treatment obligations are complementary, since market access aims to secure entry of foreign service suppliers into the market of a given WTO Member State irrespective of the position of national suppliers, while the national treatment obligation ensures that once in a given market a foreign service supplier will be treated like local suppliers.

The national treatment principle operates differently in the case of services than it does for goods, since if foreign service suppliers were to be subject to exactly the same requirements as domestic companies then it may mean that

they are actually worse off. For example, if a government imposed on a foreign telecommunications service provider the same universal service or minimal coverage requirement as that of the local telecommunications service provider then the foreign entrant would in practice be put in a worse position than the local service provider, since the latter already has the required infrastructure in place and has already acquired a certain market share. As such, the definition of the national treatment principle in the GATS has been refined to prohibit government regulation that modifies the 'conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member'.[1]

Although WTO Members made a number of specific GATS commitments in various service sectors, there was still, however, at the end of the Uruguay Round a number of areas on which agreement could not be reached. States had reached agreement on 'value-added' telecommunication services, but not on 'basic' telecommunication services. Value-added telecommunication services are telecommunications for which suppliers 'add value' to the customer's information by enhancing its form or content or by providing for its storage and retrieval. Examples include email, voicemail, and on-line data processing, storage, and retrieval. Basic telecommunication services include all telecommunications, both public and private, which simply involve the relay of voice or data from sender to receiver. Examples include voice telephony, data transmission, telex, telegraph, paging, and facsimile services.

The commitments by Member States on value-added telecommunication services were incorporated into the GATS when it came into force on 1 January 1995. In the case of the provision of basic telecommunication services, further negotiations were required before Members made commitments under the auspices of the separate agreement that is known as the Fourth Protocol to the GATS or the 1997 Telecommunications Agreement, which entered into force on 5 February 1998.

The GATS also contains a Telecommunications Annex that requires each Member to ensure that all service suppliers seeking to take advantage of scheduled commitments are given access to and use of public basic telecommunication networks and services on reasonable and non-discriminatory terms and conditions.

### The GATS and WTO 1997 Telecommunications Agreement

States have made market access and national treatment commitments under the GATS, the Annex on Telecommunications, and the 1997 Telecommunications Agreement over the whole spectrum of public and private basic and value-added telecommunication services.

[1] Article XVII(3) of the GATS.

The four GATS modes of supply mean that market access commitments now cover not only the cross-border supply of telecommunications, but also services provided through the establishment of foreign firms, or a commercial presence, which includes the ability of foreign telecommunications corporations to own and operate independent telecommunications network infrastructure. The importance that developing States attach to the telecommunications sector is borne out by their commitments in relation to the four modes of supply as compared to those of developed States. A number of developing States have undertaken extensive obligations in the area of telecommunications by imposing fewer limitations on cross-border supply and consumption abroad than developed States, and they have recorded a higher incidence of commitments, overall, on commercial presence as compared to developed States, when both full and partial commitments are taken into account.[2] Developing States have as such put their confidence in the GATS by hoping that their commitments will stimulate foreign direct investment and thereby improve and extend their national telecommunication networks as well as universal access.

This approach has not meant, however, that developing States have not maintained significant limitations on market access in their telecommunication commitments, especially in relation to the establishment of commercial presence within their territories. Developing States are about five times more likely than industrialised countries to have maintained limitations on the number of service suppliers who can establish a commercial presence[3] and are almost four times more likely to require that particular types of legal entity be established to provide services.[4] They are also nearly three times more likely to have included restrictions on the bypassing of, or requirements to use, the incumbent operator's network facilities as well as restrictions on a foreign service providers ability to resell any excess capacity of circuits that have been leased from the incumbent telecommunications operator.[5] However, limits on foreign equity participation are not much more frequent for developing than for developed States.[6]

In addition to specific commitments made by States, the GATS Annex on Telecommunications stipulates more generally that each WTO Member is bound to 'ensure that any service supplier of any other Member is accorded access to and use of public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions.' The content of this obligation is further specified as requiring a Member State to ensure:

[2] Telecommunication Services, Background Note by the WTO Secretariat, WTO Doc. S/C/W/74, 8 December 1998, para.23.
[3] Ibid, para.25.
[4] Ibid.
[5] Ibid.
[6] Ibid.

- Access to and use of leased lines, with the service supplier having the right, for example, to attach equipment to the network and to connect leased lines to the public network or the leased lines of a third party;
- Public networks and services must be available for the transport of information;
- That restrictions on access and use of public telecommunications transport networks and services shall not be imposed other than as necessary to ensure public availability of the network or service, to protect the technical integrity of the public telecommunications network or service, or to ensure that service suppliers do not gain market access where they have not been given such access in a State's schedule of commitments.

**Competition Concerns in Telecommunications**

In addition to market access commitments, it was recognised in the WTO negotiations that domestic regulation promoting competition was needed in the telecommunications sector in order to ensure in particular that new entrants would be able to compete effectively with the incumbent telecommunications operator or other major domestic service suppliers. To that end, a Telecommunications Reference Paper ('Reference Paper') containing pro-competitive principles was adopted as an optional element of the 1997 WTO Telecommunications Agreement. Out of the 29 Commonwealth States who have made GATS commitments in the telecommunications sector, 20 of these have adopted the additional commitments set out in the Reference Paper in its entirety or minor modifications, a number of these being Commonwealth developing States.[7]

The Reference Paper requires Members to provide safeguards in domestic law to ensure that the market access and foreign investment commitments that States have undertaken are guaranteed in practice. The Reference Paper contains three main obligations to which States can choose to be bound pursuant to their specific commitments as part of the 1997 Telecommunications Agreement. The first is that the State should prevent its incumbent telecommunications operator or other dominant supplier from partaking in anti-competitive practices against a foreign service supplier. The second is a set of guaranties in relation to interconnection. The third is that there must be

[7] The following Commonwealth Member States have adopted the Reference Paper as part of their telecommunication commitments: Antigua & Barbuda; Australia; Barbados; Belize; Brunei Darussalam; Canada; Dominica (the schedule containing the Reference Paper commitments will be annexed to the Fourth Protocol as soon as Dominica ratifies it); Ghana; Grenada; India; Jamaica; Kenya; Malaysia; New Zealand; Papua New Guinea (the schedule containing the Reference Paper commitments will be annexed to the Fourth Protocol as soon as Papua New Guinea ratifies it); Singapore; South Africa; Sri Lanka; Trinidad & Tobago; and Uganda.

established (and maintained) an independent regulator who can ensure these competition and interconnection requirements are enforced as well as providing an impartial forum for the arbitration of disputes between operators.

1. The Reference Paper lists three examples of anti-competitive practices:
   - Cross-subsidisation: this is the use of profits derived from one area of operations in order to finance another) often loss-making, area. This is a common business practice, yet it can, become anti-competitive when the operations in the profit-making area are conducted pursuant to exclusive or special rights or when an incumbent telecommunications operator or another major supplier holds a dominant position in the profit-making area;
   - The requirement not to use information obtained from competitors: Incumbent telecommunications operators typically operate at many levels. They will, for example, both supply leased lines to data communications providers in order to enable them to complete their network and at the same time offer data telecommunications in competition with those providers. In this example, the telecommunications operator in the course of supplying leased lines to its data communications competitor would likely obtain information from the competitor that is often precise enough to identify the customers of the competitor or to guess the intentions of a competitor. If that information is relayed to the data communications division of the telecommunications operator it can be used for anti-competitive purposes.[8] It is arguable, based on the Reference Paper, that structural measures such as the legal separation of business divisions operating in different markets are needed to prevent such anti-competitive practices; and
   - The withholding of technical and commercial information to foreign telecommunication service providers: This anti-competitive practice is defined in absolute terms and not in non-discrimination terms, which means that on the face of the Reference Paper an incumbent telecommunications operator could be forced to disclose technical and commercial information to third parties which want to provide a certain service even if neither the incumbent operator itself nor any other party is already providing that service.
2. Interconnection is defined in the Reference Paper as the 'linking with suppliers providing public telecommunications transport networks or services in order to allow the users of one supplier to communicate with

[8] Note that the Reference Paper does not define anti-competitive purposes.

users of another supplier and to access services provided by another supplier.' This definition closely resembles the standard US and EC definitions. The Reference Paper grants foreign telecommunications providers a number of interconnection guaranties, which include:

- Interconnection is to be granted at any technically feasible point;
- The terms, conditions, and rates of interconnection must be non-discriminatory, transparent, and reasonable;
- The rates of interconnection must becost-oriented (though not necessarily cost-based);
- The quality of interconnection must be 'no less favourable' than that provided to subsidiaries, affiliates or third parties;
- Interconnection must be provided in a timely fashion;
- There must be 'sufficient' unbundling so there is no need to 'pay for network components or facilities' that are not required. Such a provision is difficult to ensure in practice unless the regulatory authority intervenes to provide a classification of network components in order to make the obligation more concrete;
- There must be transparency on licensing procedures for granting interconnection;[9] and, finally,
- There must be guidelines for the allocation of scarce resources in relation to interconnection.

Both developed and developing States have faced considerable difficulty in ensuring that their incumbent telecommunications operators comply with these obligations. The lack of compliance by a State with its Reference Paper obligations can, like other GATS breaches, be challenged under the WTO Dispute Settlement Process. The relatively high number of Commonwealth developing countries that have undertaken Reference Paper commitments means that these issues will be of increasing importance as telecommunication service providers from developed countries begin to use these obligations to try and gain a significant domestic market share. This has already occurred in the high profile case brought by the US against Mexico on the basis that Mexico had not complied with its obligations under the Reference Paper by failing to constrain the activities of its incumbent telecommunications operator (Telmex).

### The *Telmex* Case

Mexico was one of the early reformers of telecommunications markets in South America. It privatized its monopoly carrier Telmex in 1990, and the

[9] But the Reference Paper does not specify the situations when a license can be required nor the terms and conditions which should or should not be found a license.

government in 1994 passed legislation to permit competition in voice telephone services. The Mexican government ended Telmex's monopoly concession for domestic and international long distance telephone services on 1 January 1997, when six entrants initiated service in 60 of Mexico's largest cities. US corporations MCI and AT&T are part owners of the largest of the new providers, Alestra and Avantel (45 & 49%, respectively). Local service opened to competition on 29 December 1998. By the end of the first year, new entrants had claimed about 25% of the contestable long-distance market and 18% of the total long-distance market. Long distance prices fell by roughly 30-40%. Despite this rapid transition from privatization to competition,there were still barriers to effective market access and competitive issues that MCI and AT&T were facing. The GATS and in particular the Reference Paper have been of considerable use to these corporations in gaining US government support for their claims (especially since Mexico has adopted the Reference Paper in its Schedule of Commitments).

On 17 August 2000, the US government initiated a formal WTO complaint and is still at present engaged in a WTO consultation process with the Mexican government; claiming, on behalf of US telecommunication corporations, that Mexico's telecommunications regime has prevented US service suppliers from availing themselves of key GATS commitments undertaken by Mexico, The US claims, for example:

- Mexico's International Long Distance Rules prevented service suppliers from obtaining competitive rates and conditions for cross-border telecommunications services provided on leased lines;
- Competitive service providers have been unable to obtain local interconnection with Telmex in a timely manner -in one case for over a year;
- Competitive service providers have been unable to obtain from Telmex cost-oriented rates for interconnection at the local, long-distance,and international levels, including for calls to regions where competitors lacked their own facilities;
- Mexico's failure to provide recourse to an independent domestic body to resolve interconnection disputes within a reasonable period of time is a violation of its Reference Paper commitments;
- The Mexican government has not maintained appropriate measures to ensure Telmex does not engage in or cease from continuing anti-competitive practices, such as anti-competitive cross-subsidisation; and
- That the Mexican government has failed to ensure that its regulator's decisions and procedures are impartial with respect to all market participants.

**Policy Implications of the Telmex Case for Developing Countries**

The Telmex case, although not yet resulting in a formal case before a WTO panel, sounds a clear warning to Commonwealth developing States and others that multinational telecommunications corporations will increasingly rely on telecommunications commitments to hold governments responsible for ensuring that they can effectively enter and compete in telecommunications markets. This view is supported by the telecommunications dispute that arose between South Africa and the United States over the alleged anti-competitive treatment of AT&T by Telkom (the incumbent telecommunications operator in SouthAfrica). This case was not raised formally before the WTO, since United States government intervention was sufficient to resolve the dispute. It does, however, highlight the importance of Commonwealth developing States having detailed knowledge of the WTO telecommunications regime in order to represent their interests in a dispute. The Telmex case also highlights the need for Commonwealth developing States to ensure that they have an independent telecommunications regulator, since the lack of such a regulator may in itself be sufficient grounds for WTO complaint by another Member.

In this context, the problems that developed States have themselves faced when implementing the complex obligations of the Telecommunications Reference Paper will be important for developing States in formulating their legal and policy responses. Important issues such as what constitutes 'cost-oriented interconnection', how should a local-loop be unbundled, and what should be the structure and mandate of an independent telecommunications regulator have all been the focus of particular attention within the European Community (EC). In the case, for example, of the United Kingdom, the WTO Reference Paper obligations (as also encapsulated in EC Regulations) have been used successfully by foreign telecommunications service providers to pressure the UK telecommunications regulator, Oftel, to order British Telecom (BT, the incumbent telecommunications operator) to cut its charges for local loop unbundling, and to establish a wholesale flat-rate interconnection model for Internet Service Providers such as America Online and Freeserve. The Oftel directions to BT followed an extensive review of practices within a number of other European States. It is in the interests of Commonwealth developing States and other developing States to establish quickly their own domestic telecommunications regulators and interpretations of the Reference Paper. Otherwise, a WTO panel seeking to ascertain or establish global best practice will only have the consistent practice of developed States to consider. In fact, as part of the new WTO negotiations on services (GATS 2000), the Australian government has submitted a paper that sets out its efforts to implements its interconnection obligations as well as its understanding of a

number of the interconnection provisions contained in the Reference Paper.[10] It is important both for Commonwealth developing States to contribute to this debate from their perspective as well as to contribute their views more generally on telecommunications in the GATS 2000 negotiations

## The GATS 2000 Negotiations and Policy Issues for Developing Countries

There are a number of areas concerning telecommunication services where Commonwealth developing countries should be making proposals as part of the GATS 2000 negotiations. To date, however, Commonwealth developing States have not made formal proposals. A selection of issues, in addition to that of interconnection mentioned above, which require their contribution, include:

- Access to the Internet for Commonwealth developing States, including barriers like the high charges incurred by national Internet Service Providers for connection to international networks. A policy proposal that could be made here is that these charges should be reduced in the case of developing States to a cost-based level to ensure greater access for developing States to the Internet, at least for a certain duration;
- The scope of the universal service provision in the Reference Paper. The universal service provision allows a State to impose an obligation on telecommunication service providers to provide reasonable access to a standard telephone service and to payphones for its citizens. Such regulation may be necessary, since a telecommunication company will often decide not to operate in certain areas of a State's territory due to commercial reasons. The scope of the universal service provision obligation is important, since the Reference Paper expressly provides that universal service obligations imposed by a government on a telecommunications service provider will not in general be regarded as being an anti-competitive measure. A possible policy proposal that Commonwealth developing States may put forward here is that the scope of the universal service provision obligation should extend beyond coverage also to include satisfactory connectivity in terms of users' needs; and
- A response to the proposal of the European Community[11] that WTO Members should reduce limitations on access to telecommunication markets to the minimum necessary to ensure quality of service, including universal service and to address the issue of scarce

[10] S/C/W/110/Add.9, 24 June 1999.
[11] S/CSS/W/35, 22 December 2000.

resources. This proposal recommends removing such limitations on market access as limitations on the number of operators, limitations on the type of legal entity allowed, and time limitations for the phasing in of commitments. A possible response here by Commonwealth developing States may be that WTO scheduling of free market access in the telecommunications sector, especially through commercial presence, could be furthered if better conditions of market access were granted to other sectors of interest to Commonwealth developing countries.

# 3. U.S. Farm Bill

***Allan H. Turnbull***

On May 13, 2002 President Bush signed into law the *Farm Security and Rural Investment Act of 2002*. The new U.S. farm bill is described by the *Washington Post* as an "election-year" initiative that will "shower billions of dollars in new subsidies on bread-basket states that will help determine control of Congress in November".

Estimated by the non-partisan Congressional Budget Office to cost about US$180 billion over the next 10 years or about US$87 billion more than the cost of the current farm programs, reaction to the new farm bill by America's major trading partners has been both swift and highly critical.

## Previous Farm Bills

The United States has had a long history of farm support programs that date back to the early 1930s when according to U.S. Department of Agriculture estimates about 25% of the population lived on about 6 million farms. By comparison, the USDA estimates that today only about 2% of the population lives on about 2 million farms, and only 8% of those farms account for approximately 72% of the agricultural sales.

Traditionally, farm support programs in the United States have been based on direct commodity-specific deficiency payments designed to compensate eligible farmers for any shortfall between government determined target prices and commodity-specific market prices.

In short, traditional farm support programs were tied to current commodity-specific market prices that generally provided guaranteed price support to eligible farmers during periods of depressed world prices.

### *U.S. Farm Bill, 1996*

The U.S. Farm Bill of 2002 replaced the *Federal Agriculture Improvement and Reform Act of 1996*. The U.S. Farm Bill of 1996 signalled a major policy shift in the administration of direct farm support programs in the United States.

Instead of the old system of commodity-specific target prices and commodity-specific deficiency payments related to current market prices, farmers would be sent an annual payment based on historical payments received under the old system, whether or not the farmer plants any crops in the future and regardless of current commodity-specific prices. To receive these payments, eligible farmers had a one-time opportunity to enroll acreage in a 7-year *production flexibility contract* that obliged the farmer to abide by certain

conservation compliance requirements. There was an annual limit on the amount of commodity-specific farm support, and the level of annual payments were to decline over time, in exchange for which farmers would have few restrictions on what they could plant. As a result, the republican sponsored U.S. Farm Bill of 1996 became known as the *Freedom to Farm Bill.*

The *Freedom to Farm Bill* was intended to transition farmers away from the old system of commodity and price-specific deficiency payments through declining annual payments; provide greater flexibility to encourage farmers to make planting decisions in response to market forces; and provide for an income safety net. The safety net was to be in the form of marketing loan and loan deficiency assistance that started to move away from direct price supports in favour of income supports unrelated to current production and prices.

The decoupling provisions of the *U.S. Farm Bill of 1996* represented a significant first step towards addressing the most market distorting elements of traditional U.S. farm support programs. Ironically, since the decoupling provisions were implemented during a period of near-record high prices, U.S. domestic farm support under the 1996 farm bill would increase significantly compared to what would have been paid out on the basis of the previous commodity-specific deficiency payments relative to current market prices.

Even though the move towards decoupled income support was less disruptive of market forces, the Clinton administration was initially criticised at the time for the introduction of a new wasteful subsidy program that would confer a US$15-20 billion windfall on American farmers over the seven-year period from 1996 to 2002.

### *Emergency Domestic Support*

The policy change reflected in the *U.S. Farm Bill of 1996* with respect to domestic farm support was quickly stalled and undermined with the sharp decline in market prices that began in 1998.

The U.S. Congress responded by the provision of "temporary" emergency bailouts in each of the last four years to compensate farmers for depressed prices in the total amount of about US$30 billion over and above the farm support payments provided under the *U.S. Farm Bill of 1996.*

## Uruguay Round Agreement on Agriculture

The *U.S. Farm Bill of 1996* was enacted against the backdrop of the Uruguay Round Agreement on Agriculture ("URAA"). The URAA addressed significant agricultural trade issues such as market access; domestic support; export subsidies; and special and differential treatment for developing countries.

With respect to domestic support, the URAA distinguishes between green box and amber box support programs. Green box domestic support programs

are measures that have minimal or no trade distorting affect, while amber box domestic support programs are measures that are considered to distort trade.

The total value of trade-distorting domestic support was calculated for the base period 1986-88 for each member of the WTO. The United States and other developed countries were to reduce their total base period aggregate measure of domestic support by 20% in the period 1995 to 2000 and developing countries were to reduce their total aggregate measure of domestic support by 13 1/3% over the 10-year period from 1995 to 2004.

The maximum allowable level of trade distorting domestic support for the United States is currently capped at US$19.1 billion relative to about 2 million farmers, compared to a cap of about US$60 billion for the European Union relative to more than 7 million farmers. The maximum allowable level of trade distorting domestic support for Japan is currently capped at about US$30 billion.

The question of whether or not a domestic support program is trade distorting and subject to reduction commitments can be complex. The URAA provides two basic overriding general criteria for green box programs followed by additional policy-specific criteria depending upon the type of program being considered. The basic criteria require that the domestic support be publicly funded through a government program that does not involve transfers from consumers; and that the domestic support shall not have the "effect" of providing price support to farmers.

In the case of "decoupled" income support, aside from satisfaction of the two basic criteria outlined above, eligibility for payments must also be determined in relation to a defined and fixed base period; and the amount of such payments in any year must not be related to the type or volume of production, market prices, or to input factors used in production, in any year after the base year. As a result, whether or not an income support program is truly "decoupled" within the meaning of the URAA can readily be a matter of debate.

Despite inherent weaknesses, the URAA was an important first step towards the stated objective of a fair and market-oriented trading system in agriculture. While further progress in pursuit of that goal has been made through the mandated negotiations required under the URAA, much more needs to be done.

A new multilateral round of trade negotiations is necessary if significant progress is to be made in the liberalization of trade in agriculture.

**Doha Development Round**

In November of 2001 the WTO Ministerial Conference approved the accession of China and Taiwan to the WTO and agreed to launch a new

round of global trade talks in an effort to continue the process of multilateral trade liberalization over the next three years.

The new round of global trade talks has been labeled the Doha Development Agenda in recognition of the WTO's commitment to economic growth and reduction of poverty in developing countries. More than 75% of WTO members are developing countries and most of these countries have a major stake in agriculture trade liberalization.

With respect to agriculture, the Doha Development Agenda commits WTO members to comprehensive negotiations aimed at:

- substantial improvements in market access;
- reductions of, with a view to phasing out, all forms of export subsidies; and
- substantial reductions in trade-distorting domestic support.

The Doha mandate also reflects the agreement of WTO members that special and differential treatment for developing countries shall be an integral part of all elements of the negotiations in agriculture.

## U.S. Farm Bill, 2002

The U.S. *Farm Bill of 2002* was enacted against the backdrop of the Doha Development Agenda for the new multilateral round of global trade talks and in particular against the backdrop of the important subsidy-related issues that are to be addressed as part of the negotiations in agriculture. According to the Chair of the WTO General Council, developed countries currently expend about US$1 billion in market distorting subsidies every day. These subsidies amount to more than four times the total development assistance that is provided to developing countries.

The new U.S. Farm Bill is very detailed and complex, and covers a variety of matters including commodity programs, as well as conservation, trade, nutrition, farm credit, rural development and agri-energy related programs, that are beyond the scope of this paper.

### *Domestic Support*

At the risk of over-simplification the legislation provides for three types of domestic support payments.

First, the legislation continues direct assistance payments to eligible farmers who enter into production flexibility contracts for the period 2002-2007. The new farm bill updates and legislates the program commodity rates to increase payments to producers of grains and cotton; extends the reach of the program to include soy beans, other oilseeds and peanuts; and provides farmers with a one-time opportunity to update the acreage used to calculate program payments.

Second, the legislation continues marketing loan and loan deficiency

payments when the market price falls below the established loan rate under which a producer receives a benefit equivalent to the difference between the two. The new farm bill legislates new loan rates that have been increased for most of the eligible commodities; and extends the reach of the program to now cover peanuts, wool, mohair, honey, small chickpeas, lentils and dry beans.

Finally, the legislation includes a new counter-cyclical program payment that will be triggered when market prices are low. These counter-cyclical payments are designed to replace and effectively lock-in the temporary emergency bailouts that were used to supplement program payments under the previous *Farm Bill of 1996* for the period 1998 to 2001.

### *Conservation*

Farmers who enter into *production flexibility contracts* under the new farm bill will continue to be obliged to abide by certain conservation compliance requirements to receive the contract payments.

The legislation reauthorizes and increases the maximum acreage that can be enrolled under the conservation reserve and wetlands reserve programs.

In addition, the *Farm Bill of 2002* introduces a new conservation security program that enables farmers to receive payments in exchange for implementing certain conservation practices.

### *Country-of-Origin Labels*

The new farm bill also introduces "country-of-origin" labeling for meat, fruit and vegetables, fish and peanuts. The labels are voluntary for two years and become mandatory in September of 2004. In the case of beef, by way of example, "country-of-origin" labels would mean that only meat products from cattle born, raised, slaughtered and processed solely in the United States could be labeled to be of U.S. origin.

The manner in which this program is implemented and administered could well be an unjustified barrier to trade.

## Impact of New U.S. Farm Bill

After President Bush recently signed into law the *Farm Security and Rural Investment Act of 2002*, the *Washington Post* editorialized that the new farm bill "represents a low point in his presidency – a wasteful corporate welfare measure that penalizes taxpayers and the world's poorest people in order to bribe a few voters".

In contrast, the newspaper reported that in October of 2001 the White House had declared that the House version of the farm bill "locked in too much long-term federal spending and would increase the disparity between

large producers and small farmers". In a similar vein, the *Washington Post* further reported that U.S. Agriculture Secretary Veneman had commented in November of 2001 that the House version of the Farm Bill "creates pressure for more government payments, thereby creating a self-defeating and ultimately unsustainable cycle". For his part, President Bush acknowledges that the new farm bill is "not a perfect bill".

The combination of generally higher support rates, extended coverage to additional commodities, and the locking-in of counter-cyclical payments under the *Farm Bill of 2002* will mean more domestic support payments for U.S. farmers for the period 2002 through 2007. The Cairns Group estimates that the new farm bill represents a "massive 80 per cent increase in farm subsidies" compared to the base support levels provided under the previous *Farm Bill of 1996.*

Despite earlier pronouncements, Secretary Veneman defends the legislation on the basis that it continues "roughly" the same amount of domestic support that had been provided to U.S. farmers under the previous *Farm Bill of 1996,* as supplemented by the emergency bailouts. The Secretary of Agriculture insists that the new farm bill will be WTO compliant and that the level of trade-distorting domestic support will come within the U.S. cap commitment of US$19.1 billion. The new farm bill also gives the Secretary of Agriculture the power to make any necessary adjustments "to the maximum extent practicable" to ensure that the United States meets its WTO domestic support commitments.

Unfortunately, the new farm bill seems to treat the URAA cap commitment on trade distorting domestic support more as an invitation to spend US$19.1 billion than as a true ceiling. And, despite the power conferred upon the Secretary of Agriculture to make sure the United States meets its WTO obligations, should the US$19.1 billion cap be exceeded it is not likely to be "practicable" to claw back subsidies that may have already been paid out to American farmers.

Moreover, whether or not the United States is able to stay within the $19.1 billion cap depends in part on the extent to which the domestic support programs are determined to be amber box trade distorting measures within the meaning of the URAA, which could prove to be quite contentious.

### *Developing Countries*

What does the new U.S. Farm Bill mean to developing countries? Whether or not the *Farm Bill of 2002* is WTO compliant, the anticipated significant increase in domestic support will likely further increase U.S. agricultural production; further increase subsidized exports; further reduce market prices for agricultural goods; and thereby further increase the level of subsidy payments to be provided under the new farm bill. The result is a vicious circle that in the

words of Secretary Veneman creates a "self-defeating" and "ultimately unsustainable cycle".

The combined prospect of increased surplus production and even lower market prices undermines the agricultural competitiveness of developing countries in export markets and in their own domestic markets, and further impedes the economic growth of developing countries.

The Cairns Group expressed deep regret about the new U.S. Farm Bill in a recently issued statement that provided in part as follows:

> "At US$180 billion over the next decade, the sheer size of this package will hurt farmers around the world. The impact will be particularly damaging on developing countries, net food exporters and importers alike, many of which are heavily reliant on their agricultural sectors for their economic development and are looking to the Doha Development Agenda to reform world agricultural trade."

Most developing countries recognise that liberalised trade through progressively open markets is a positive strategy to achieve sustainable economic growth and development. But, they also recognise that "counter" trade policy that obliges them to progressively open their markets to agricultural imports at heavily subsidised low prices, that effectively precludes access for their agriculture products to attractive markets in more developed countries and at the same time destabilises their domestic markets, is a counterproductive strategy that is contrary to sustainable economic growth and development for developing countries.

### *DOHA Development Agenda*

What does the new U.S. Farm Bill mean for the potential success of the Doha Development Agenda? Agriculture is critical to the economic growth of many developing countries. Undoubtedly, a positive outcome to the agriculture negotiations under the Doha Development Agenda is essential to the successful conclusion of the Doha Round.

Leadership is required on the part of the United States and the European Union to succeed in the agriculture negotiations, and overall to successfully complete the Round. For many, the perception created by the new U.S. Farm Bill – aided by U.S. measures on softwood lumber and steel – is that the United States has given in to domestic politics and protectionism, and has damaged its credibility, at a time when American leadership is urgently required.

In that regard, the Cairns Group stated in part as follows:

> "The new [farm] legislation makes the U.S. Administration's task of continuing to take a leading role in the Doha Round more difficult. It will provide comfort for those WTO members who are determined to resist meaningful reform of the agricultural sector."

At a minimum, farm bill legislation that commits the United States to make substantial support payments to their farmers into 2007 would seem to signal that a successful conclusion to the agriculture negotiations and the Doha Round by January 1, 2005 is not likely.

Since the European Union will not move ahead of the United States on agriculture issues, the U.S. must demonstrate leadership through its actions – and not just through its words – on domestic support and farm subsidies. It is vital that the European Union and the United States not allow their transatlantic trade differences to further fuel protectionist policies and undermine the Doha Development Agenda. Such a result would hurt developing and developed countries alike and could threaten global economic recovery.

### *Some Closing Thoughts*

While this paper is not intended to address all of the significant issues related to the *Farm Bill of 2002*, the issues raised in regard to domestic support are fundamental to developing countries. Developing countries may wish to carefully review and pursue these and other related farm bill issues through the WTO or risk:

- that their agricultural products will be undermined at home and in export markets by low-priced produce supported by massive subsidies;
- the bleak prospect of competing against US$1 billion in daily subsidies from developed countries;
- a lost opportunity to secure substantial agricultural trade reform through the Doha Round; and
- collapse of the Doha Round and with it a lost opportunity to pursue sustainable economic growth, development and poverty reduction through trade liberalization.

Apart from the debate about whether the new farm bill signals green or amber measures, the legislation is viewed by many as sending the *wrong* signal, and in that sense the *Farm Bill of 2002* is a step backwards that may not bode well for the future.

# 4. Geographical Indications

***John Malcolm Spence***

## Introduction

The debate at the TRIPS Council on whether or not the kind of protection provided to Geographical Indications, commonly referred to as GIs, used on wines and spirits should be extended to Geographical Indications (GIs) used on other products has found itself bogged down in cyclical repetition of well established positions.

Submissions have been made thus far by a little over thirty countries. The United States, Canada, Australia, New Zealand, South Africa, and Argentina are among those that appear at this stage to oppose the extension of protection. They suggest that the protection granted by Article 22 provides sufficient protection and should be tried more extensively before considering the use of Article 23 level of protection. They suggest that such extension will be burdensome and costly and bring little additional benefit to users of GI's, new users in particular.

The European Union, Switzerland, Hungary, Sri Lanka, Bulgaria, India, Kenya, Jamaica, Egypt, Cuba, Dominican Republic, Honduras, Indonesia, Nicaragua, Pakistan, Turkey, Venezuela, the Czech Republic, Iceland, Liechtenstein, Slovenia and the African Group among others appear to favour the extension. They argue that it is an anomaly to have two levels of protection, that the level granted by Article 23 significantly facilitates the enforcement of rights permitting as well multilateral action against false indications of origin, and that the potential economic value to many economies outweighs the costs of forgoing the use of free-riding on the GIs of other countries.

Other countries joining the debate may help to break the deadlock. The following comments try to look at the issues from a perspective closer to the level of the producers who will use GIs in the course of international trade than those currently being expressed at the TRIPS Council. Hopefully this will encourage such broader participation or stimulate new thinking by those already participating.

## The Importance of Geographical Indications

Two almost contradictory features of expanding international trade contribute to the importance attached to GIs. The chain of production for processed goods now often extends to more than one country, and increased competition, in the production of specialty goods in particular, has heightened the value of product differentiation as a marketing strategy.

Dispersing the location of production has generally resulted in lowering

the overall cost of goods making them more competitive. This, however, disassociates the relationship between a particular place and any quality of the good that may originally have come from that place of origin.

Many producers of specialty products that have followed this cost-reduction production strategy found it valuable, however, to maintain the association between the good and the original place of origin. Often they have done this through the registration of the place name or other place identifier as a trademark or incorporating it within a trademark. This encourages consumers to associate the quality or characteristics of the good with the mark rather than the place of origin itself.

The producers of some specialty goods, however, also recognizing the competitive value of maintaining the close association between the good and its actual place of production, have developed and used various methods to prevent the dilution of this value. These methods have evolved into what are now known as the various protection systems for Geographical Indications.

GIs were considered so valuable to some producers of wines and spirits that, in the Uruguay Round of negotiations leading to the establishment of the World Trade Organisation, they were apparently willing to surrender concessions in other areas of the single-undertaking negotiations in order to obtain stronger multilateral protection for wines and spirits than was negotiated for any other goods.

With reductions being negotiated in the use of tariffs, quotas, preferences and other measures as tools to address imbalances in competitiveness, other producers, commodity producers in particular, are turning their attention to ways of differentiating their goods and creating niche markets.

Where there are qualities, characteristics or a reputation for the goods of these producers that are associated with their place of origin, there exists the possibility of emphasizing this difference between their goods and similar goods produced elsewhere. These producers have therefore more latterly come to consider the value and importance of having strong protection for Geographical Indications used on goods other than wines and spirits.

**The Haves and the Not Yet Haves**

In the light of the above comments on the growing importance of Geographical Indications, the debate on the extension of stronger protection in the TRIPS Council can be divided into two main interest groups.

There are those countries with a significant number of producers who have traditionally relied on the association that consumers of their goods make between their goods and the place that the goods are produced. Well-known examples of these types of goods are wines, spirits and cheeses. These countries have developed systems of strong legal protection for the use of this association

as a marketing tool by their producers. They are the main proponents of the extension of increased protection for GIs.

Aligned with these countries are those countries that have traditionally produced goods that consumers associate, or would be inclined to associate, with their place of production but who have not used or provided legal protection for the use of this association in the marketing of their goods. The production systems of these countries are generally facing greater threats from increased competition as they emerge from behind traditional trade barriers.

Also in this alignment are those countries that would like to retain the future option for their producers to develop goods that consumers would associate with a particular place of production.

At the other extreme there are those countries that have a significant number of producers that rely on the associations that consumers make between their goods and their production systems irrespective of where these production systems or their elements are located. These countries have generally relied on the strong legal protection for the association between the good and its producers, like trademark laws, to develop and protect their competitive marketing strategies. They are the main opponents of providing increased protection to GIs used on other goods.

Aligned with this group are those wine and spirit producing countries that have used traditional GIs of other countries on their wines and spirits for many years to describe the type of product rather than the place of origin normally associated with the GI. Both of these groups see many of the terms claimed as GIs as having become generic terms.

Also aligned with this group are those countries that would like to retain the future option for their producers to compete in the production of goods that are already well known.

Inevitably, of course, there are also those countries who consider the issue to be of little significance in the foreseeable future or who have not yet determined the advantages or disadvantages of the extension of scope of additional protection for the GIs of other products.

Within each group, therefore, there are those that have a significant current competitive advantage to protect (the haves, mostly developed countries) and those countries that might be considered as seeking to protect future competitive advantage (the not yet haves, mostly developing countries).

## The Issues Being Raised

### *What's good for the goose must be good for the gander*

The strongest argument that the proponents of the extension of protection appear to have is that the stronger protection provided for the use of GIs on wines and spirits is inequitable and puts producers who use GIs on other

products at a trade disadvantage. They point particularly to the difference in the burden of proof between the two levels of protection.

Article 22.2 of the TRIPS Agreement provides two main shields for the users of GIs on any goods. The first is generally referred to as "the misleading test". This allows the legitimate user of a GI to use the legal means available to prevent consumers from being misled into buying a good using the GI but not made in the place they would normally associate with the good through its GI.

The second shield provided to the users of GIs is the legal means to prevent any use that constitutes an act of unfair competition within the meaning of Article 10*bis* of the Paris Convention (1967). Amongst other things, this prohibits in particular acts that create confusion with the goods of a competitor.

These shields are, however, considerably weakened where the GI is used along with a clear declaration of the actual place of production of the good or with some other declaration that will break the association the consumer would normally make between the GI and the place of origin of the good it is used on. Examples of the latter are expressions such as "kind", "type", "style", and "imitation". In other words the consumer is neither misled nor confused.

They point out that the misleading test alone, therefore, leaves sufficient room for the inevitable dilution of the unique association between the GI used on a good and its place of origin.

The additional protection given to GIs used on wines and spirits by Article 23 begins by nullifying the need to show that consumers are misled or confused. It simply prohibits the use of a GI used on wines or spirits from being used on any wine or spirit not actually originating in the place normally associated with the GI. The burden of proof therefore appears to shift to the user of the GI to show that the good is actually produced in the place normally associated with the GI.

For users of GIs in many developing countries, who may ill afford the cost of surveys to produce the evidence that consumers are being misled or confused, this additional protection appears to provide a significant advantage. If the advantage continues to be restricted to use by those countries that produce wines and spirits then this represents an imbalance that will unfairly distort trade between wine-producing countries and others.

The supporters of extension, therefore suggest that if the additional protection of GIs is thought necessary for the producers of wines and spirits then it must also be necessary for producers of other products.

### *What you see isn't always what you get*

Those opposing extension, on the other hand, suggest that the existing obligation under Article 22 provides sufficient protection for legitimate GIs

and some suggest further that trademark law provides effective protection while at the same time avoiding many of the practical difficulties.

The opponents express great concern that the expectations of developing country proponents are not going to be realized. They point to their own experiences with existing systems offered by some countries that provide the scope and levels of protection being sought. They suggest that significant unexpected obstacles to the protection for their own GIs exist in these other countries. In their view, many of the GIs on which developing countries are pinning their hopes for improved competitiveness will not be accepted as qualifying for protection in the major markets into which competitive access is being sought.

One obstacle appears to be establishing a sufficient link between the geographic place and the characteristic, quality or reputation of the good. If the good can be produced elsewhere and maintain the same characteristic, quality or reputation then the link may not be considered sufficient. If the geographic place cannot be sufficiently well defined then again the link may not be sufficient. In other words, the characteristic, quality or reputation is not "essentially attributable" to that place.

Opponents have indicated the difficulty they have encountered, for example, in having a country name accepted as a GI. The argument against its acceptance is founded on either of the two difficulties mentioned, that is, if it can be produced anywhere in the country then its characteristic, quality or reputation is not likely to be essentially attributable to a geographic place.

Interestingly enough, this difficulty is one of the reasons that GIs are difficult to establish for services as opposed to goods. If people can be trained to perform the service then the characteristic, quality or reputation, it can be argued, is not likely to be attributable to a particular place. The question of linkage might also held up as an argument against the acceptance of a single GI being owned and used by, for example, more than one territory or country except as a homonymous indication allowed as an exception.

The issue arises also where immigrants from a particular region that uses a GI are producing the good in the manner of their tradition in their new locality. If they use the GI as their term for the good they produce, then it may be tacit recognition that the association between the quality, characteristic or reputation of the good is not with a place but a people.

These arguments however, would apply to GI protection generally and so should not affect the debate concerning the level of protection for GIs that is acceptable. Developing countries should nevertheless test the acceptance by other countries of the GIs that they expect to receive protection for to ensure that what they will actually get is what they expect to get.

### *To negotiate or not to negotiate*

The strongest argument that the opponents of extending protection appear to have is that there is not currently a mandate to change the existing negotiated agreement. They make it clear that they were unhappy with the level of protection given to GIs for wines and spirits. It has even been suggested that an appropriate solution might be to consider removing this extra protection from wines and spirits and so address the imbalance.

It seems generally agreed that the additional protection was a negotiated settlement as part of the single-undertaking. Opponents of extension argue that any adjustment in the existing balance would have to be negotiated in the same way. They point out that the built-in agenda avoided allowing a limited negotiation on the issue of extension and that even after the last Ministerial Conference in Doha there is no clear mandate for such negotiations.

The directions given to the TRIPS Council through the Doha Declaration are for the TRIPS Council to discuss the issue of extension and report on these discussions to the Trade Negotiations Committee (TNC) by the end of 2002. It would then presumably be for the TNC to decide whether an extension should be negotiated or not and then ask the TRIPS Council to determine under what conditions.

Opponents appear by this to be taking the position that any extension would again have to be part of the larger negotiations.

### *In for a penny, in for a pound*

Opponents of extension also point to an increased burden that the extension of stronger protection would bring. They draw attention to the large number of GIs that some countries would want protected compared to the few of others and suggest that this represents an unfair additional implementation cost for Developing Countries in particular.

The proponents of extension, however, have the argument that the incremental cost of providing for extension is not significant compared to the cost already required for protecting GIs under their existing obligation. They note that the obligation is to provide a legal means for the owners of GIs to protect their GIs can be implemented in different ways, some less costly than others and that each country would have the right to determine which is the appropriate implementation method to use according to its own circumstances.

It could also be suggested that the overall cost burden might be decreased through savings in the judicial system with the clearer determination of an infringement at the higher level of protection.

Proponents also note that other areas of Intellectual Property, like the patent system, also suffer from a significant disparity in the number of applications that come from Developed as opposed to Developing Countries.

They note that the concerns about implementation cost and disparity in applications were not given great weight when existing obligations were being negotiated.

Opponents suggest that there could be other costs. They suggest that terms that are currently used to guide consumers that may no longer be available will add costs to producers to develop other guides. The cost of these changes will of course be passed on to the consumer. They also suggest that in some cases production itself may be disrupted by the change.

***Do the exceptions prove the rule?***

Opponents of extension also down-play the effectiveness of the extra protection provided by Article 23 for wines and spirits. They point out that the exceptions provided in Article 24 would be applied to all products. Existing use of a GI would therefore be preserved, and existing trademarks that conflict with a GI would also be preserved.

Opponents note that GIs that have become generic in a particular country could also be denied protection in that country even when it is still recognized in its home country.

Proponents on the other hand argue that, where there has been free-riding by the inappropriate use of a GI, trade has effectively been distorted. Rules that remove this distortion of trade will, as has been seen in other areas of the trade agreement, have their costs, but these will be outweighed by the benefits of increased fair trade.

***In the looking glass***

And so finally what of the future? It is the nature of negotiations on trade liberalization that the next round follows on the heels of the current. If in these negotiations the level of protection provided for wines and spirits is extended to all goods, then what can be expected in the next round?

Opponents point to their current bilateral negotiations in which, for example, protection is being sought for traditional expressions associated with the production of goods protected by GIs. They suggest that these bilaterals not only indicate the interpretation of the present but also portend the future seen by the most active proponents of extension.

The future, they say, can already be seen in the looking glass.

**Conclusions**

The debate on the extension of the provisions of Article 23 of the TRIPS Agreement to other goods besides wines and spirits appears to revolve essentially around two issues; the costs of stopping the dilution of Geographical Indications as a competitive tool and the value to indigenous producers of the additional protection provided.

In connection with the first, the argument has consistently been made that the benefits to be derived from free trade outweigh the disruption costs of the transition to fair, undistorted trade. There appears to be no valid reason for this principle to not find application in the area of the protection of Geographical Indications.

In connection with the second, it is clear that the producers of wines and spirits who pushed for this protection saw its added value. In the long-run it will make it easier for consumers to identify the goods that they seek, and it will make the burden of enforcement easier on the legitimate owners of GIs. Proponents need, however, to be satisfied that extending this protection to goods of their interest will provide sufficient added value.

The major obstacles, then, to resolving this debate are to agree on a multilateral system for implementing the agreed definition of a GI in a harmonized manner, for determining which GIs are generic, for publishing the proposed GI in all Member States, for allowing opposition to the decision on a GI to be fully aired before protection is given effect, and for allowing GIs granted in error to be revoked.

If this sounds like a multilateral registration system, there may have been some wisdom in mandating the negotiation of such a system for wines and spirits, and WTO Member States should extend themselves further to apply this system to all products.

# 5. Access to Medicines: After Doha

***Peter Drahos***

## Introduction

### *1. TRIPS and the Doha Declaration*

At the WTO Ministerial Conference in Doha, Qatar of November 2001, trade ministers had to consider how international standards of intellectual property should be adapted to help deal with public health crises and problems. The global HIV/AIDS epidemic had made it clear that a statement of principle was needed.

At Doha, the ministers adopted a declaration dealing with the relationship between public health issues and the intellectual property standards contained in TRIPS in the form of the Declaration on the TRIPS Agreement and Public Health (Doha Declaration). The Doha Declaration serves as a constitutionalizing statement by WTO members as to the proper relationship between intellectual property rights and the rights of members to regulate public health.

The Doha Declaration affirmed what TRIPS already permitted, namely the right of states to issue compulsory licences. However, ministers were unable to finally settle the relationship between the compulsory licensing provision of TRIPS (Article 31) and access to medicines by developing countries that lacked manufacturing capacity. To this end, the Doha Declaration instructed the Council for TRIPS "to find an expeditious solution to this problem and to report to the General Council before the end of 2002" (see paragraph 6 of the Doha Declaration). The search for this solution relates to a structural feature of international pharmaceutical markets, a structural feature that TRIPS further entrenches.

### *2. TRIPS and the Structure of International Pharmaceutical Markets.*

Access to medicines that have been patented by pharmaceutical multinationals has, in part, been dependent upon generic manufacturers in developing countries producing those drugs at a lower price. Generic manufacturers were able to manufacture pharmaceuticals under patent because, firstly, they had the capability to reverse engineer such products and secondly, their respective national patent regimes enabled such capability to be exercised because pharmaceuticals were not patentable or patentability was confined to processes rather than products.

Only a small number of developing countries possess reverse engineering capabilities on an industrial scale. A study in 1992 by UNIDO pointed out that only five developing countries had innovative capabilities in the pharmaceutical sector (defined as the capability of producing new drugs by a process of reverse engineering). These countries were Argentina, China, India, Korea and Mexico. Since the UNIDO study a number of developing countries have, as a result of the HIV/AIDS crisis, placed resources into the pharmaceutical sector and as a result have a much stronger sector. Brazil and Thailand are leaders in the manufacture of cheap anti-retroviral drugs. *However, no developing country is self-sufficient in the pharmaceutical sector. All developing countries have interests in importing in this sector and some have interests in exporting.* The same study went on to point out that no developing country possessed a sophisticated pharmaceutical industry with a significant research base that 87 developing countries could only assemble finished products and that 59 developing countries had no pharmaceutical industry.

TRIPS essentially closes off the development of a pharmaceutical industry based on reverse engineering and export to achieve economies of scale. Under TRIPS all developing countries will have to recognize patents on pharmaceutical products. Assuming that multinational pharmaceutical companies patent pharmaceutical products in developing countries, generic manufacturers in those countries will not be able to reverse engineer and bring those products to market without the permission of the patent owner. Patents held by pharmaceutical multinationals in the relatively small number of developing countries that have the necessary or potential export capacity in their pharmaceutical sector will have a major effect on supply in the many developing countries that will be looking to import pharmaceuticals.

Under TRIPS developing countries have the benefit of transitional arrangements:

1. Developing countries that did not have product protection for pharmaceutical products have the option of delaying such protection until 1 January 2005.
2. Least-developed countries have been given until 1 January 2006 to apply the provisions of TRIPS. The Doha Declaration has, in the case of the provisions with respect to pharmaceutical products, extended this date to 1 January 2016.

The benefits of these transitional arrangements, however, are qualified by Article 70 of TRIPS. Essentially these provisions require developing countries not granting patent protection for pharmaceutical or agricultural products to provide a means for the filing of those patents and to assess them for patentability when those countries assume full TRIPS obligations on patentability (referred to as 'mailbox' provisions). In the interim period,

developing countries are obliged to offer protection in the form of exclusive marketing rights for five years or until the product has been assessed for patentability (pipeline protection). Under a waiver approved by the TRIPS Council least-developed countries are exempted from having to provide exclusive marketing rights until 1 January 2016. There is evidence that pharmaceutical multinationals are patenting in many developing countries. For example, India has reported that between 1 January 1995 and 15 October 1997, 531 applications on pharmaceutical and agricultural products were received from US companies that wanted to take advantage of India's obligation under the mailbox provisions of TRIPS.

Not all developing countries have taken the benefit of the transitional arrangements available to them under TRIPS. Argentina, Brazil and Turkey, for example, have moved down the path of recognizing product patents on pharmaceuticals. The move by some developing countries to adopt TRIPS sooner than required has occurred largely as a result of bilateral trade negotiations with the US.

One other provision of TRIPS has an important bearing on access to medicines. Article 31 of TRIPS provides that if a Member allows for the use of a patent without the authorization of the patent owner (compulsory licensing) then certain principles have to be respected. Importantly, Article 31(f) of TRIPS states that any such use has to be "predominantly for the supply of the domestic market". This provision places a significant restriction on access to medicines in the case of the HIV/AIDS treatments. Even if a potentially large exporter of cheap drugs like India issues a compulsory licence on a patented treatment for AIDS, it is very likely that it will be unable to meet the total demand of developing countries for that treatment, because the demand in its own country would have to exceed the total demand in the rest of the world. Article 31(f) poses a much greater problem for generic manufacturers in small domestic markets.

Paragraph 6 of the Doha Declaration recognizes that states with little or no pharmaceutical capability will not be able to make "effective use of compulsory licensing" under TRIPS. Developing countries with little or no manufacturing capacity would be faced with one of two situations. In some cases there would be no patent in the developing country in respect of which to issue a compulsory licence. Where there was such a patent the issue of the compulsory licence could only be satisfied by importation. In both cases of insufficient manufacturing capacity developing countries could rely on parallel importation, but their ability to source sufficient supplies at an affordable price would be dependent upon the price discriminatory practices of the relevant patent owner in other-country markets. Whether or not a developing country exporter could take the benefit of a compulsory licence issued by another developing country has been the subject of differing legal views.

### *3. The Basic Options and their Supporters - Stage 1.*

At the March 2002 meeting of the TRIPS Council, four basic solutions were put forward to deal with the problem in paragraph 6 of the Doha Declaration:

1. The issue of an authoritative interpretation of Article 30 of TRIPS. (Article 30 recognizes the sovereign right of states to regulate the rights of the patent owner in the interests of social welfare subject to the qualifications that such regulation does not "unreasonably conflict" with the "normal exploitation of the patent" and that such regulation does not "unreasonably prejudice the legitimate interests of the patent owner").
2. An amendment to Article 31 to overcome the export problem created by Article 31(f).
3. A waiver of the obligation imposed by Article 31(f).
4. A moratorium on dispute settlement in the WTO for the breach of Article 31(f).

**The US basically favoured Option 4.**

**The EU favoured Option 2.**

The Africa Group favoured a broad package of strategies combining some of the elements above, including other elements such as the ability of an export country to rely on a compulsory licence issued by another country.

Other developing countries also favoured approaches based on an Article 30. (This group of countries included Brazil, India, China, Indonesia, the Philippines and Thailand).

Basically all developing countries were more favourably disposed to an Article 30 approach than either the US or the EU.

### *4. The Discussion Broadens - Stage 2.*

As the discussions in the Council for TRIPS wore on they extended beyond the issue of exports of medicines to developing countries with insufficient manufacturing capacities. By June 2002 they included issues of market structure in such countries as well as issues of technology transfer.

*The African Group* continued to advocate a mix of options based on an amendment of Article 31, the use of Article 30 and the use of compulsory licences. On the issue of product coverage, the African Group took an inclusive reading so that technical processes and technical equipment were covered. The African Group took the view that any country needing support for public health problems should get the benefit of the new arrangements and similarly any country ought to be able to supply. The Group also suggested that right holders be given remedies to prevent the diversion of cheaper medicines into developed country markets. The principle of adequate remuneration was to

apply where licences had to be issued, but there was no obligation to go beyond this principle.

*The European Union* argued for a new paragraph to be inserted into Article 31 to overcome the difficulties of export. On the issue of product coverage, it wanted a more specific provision that mentioned public health crises in developing countries such as HIV/AIDS, tuberculosis, malaria and other epidemics. The beneficiaries would be developing countries and both importing and exporting members would have the obligation to prevent trade diversion. The principle of adequate remuneration was to apply.

*The Group of Developing Countries*, suggested that an authoritative interpretation of Article 30 was the most effective solution. These countries, especially Brazil, took an expanded view of product coverage, rejecting the suggestion that product coverage should be defined by reference to the diseases mentioned in the Doha Declaration. The category of beneficiary and exporting countries should remain open. The principle of adequate remuneration was to apply.

*The US* advocated either the use of waiver or a moratorium on dispute settlement. Product coverage was to be restricted by reference to diseases afflicting developing countries (in particular, HIV/AIDS, malaria and tuberculosis). Beneficiary countries were to be developing countries with insufficient manufacturing capacity and exporters were to come from developing countries. Ultimately all WTO members had obligations to take steps to prevent trade diversion. Compensation was to be decided by reference to the principle in Article 31 and the burden of compensation was to fall on the exporting country.

### *5. Emergence of a Draft Text - Stage 3*

On 16 December 2002, the Chairman of the TRIPS Council circulated a draft text of a decision on implementation of paragraph 6 of the Doha Declaration. The chief features of the draft text are:

1. the use of a waiver of obligations in Article 31(f) and (h), pending an amendment to TRIPS based on the draft decision
2. a definition of pharmaceutical product that refers to patented products needed to address public health problems as "recognized in paragraph 1" of the Doha Declaration.
3. a definition of "eligible importing Member" that includes by definition any least-developed country Member and any other member that has notified the TRIPS Council of its intention to use the system as an importer. A number of developed countries including Japan, Germany, the UK and the USA have indicated they will not use the system *as importing members*.

5. a definition of exporting Member that allows any member to use the system
6. a system that allows a waiver of obligation for an exporting country if an importing country has notified the TRIPS Council of the names and quantities of drugs that it needs, confirms that it has no or insufficient manufacturing capacities in relation to that drug and that it has or will issue a compulsory licence that meets other TRIPS conditions.
7. under this system notification is mandatory, but it does not have to be approved by the WTO.
8. least-developed country Members are deemed to have insufficient capacities in the pharmaceutical sector. Other potential importing Members have to show that they have no manufacturing capacity in the pharmaceutical sector or where they have some capacity that that capacity is currently insufficient for their needs.
9. eligible importing Members are obliged to prevent re-exportation of imported products and eligible exporting Members in issuing compulsory licences must stipulate conditions requiring the manufacture and export of only the needed amount, the clear labelling of the special nature of the products and the posting of shipment information to a website. Exporting members have to notify the WTO of the issue of the compulsory licence and the conditions in it.
10. adequate remuneration to be paid by an exporting Member when it has issued a compulsory licence in relation to a patented product and no such obligation to pay in the importing country in respect of that same product where remuneration is paid in the exporting Member.

### *6. Breakdown of Talks - Stage 4*

On 21 December 2002, the talks over the draft decision broke down. The cause of the problem related to the definition of pharmaceutical product. According to a press release of 20 December 2002 from the Office of the United States Trade Representative, some WTO members and advocacy organizations were seeking to expand the scope of products beyond "the 'poor country epidemic' focus of Doha to allow much wealthier countries to override a wide range of drug patents, for example, Viagra". Unable to agree to the draft decision the US announced that it would continue to work in the WTO to obtain a solution and in the meantime it would apply an interim measure.

### *7. Interim Measure by the US*

According to the US its interim measure will allow least-developed countries to import drugs from other WTO Members to help deal with "HIV/AIDS,

malaria, tuberculosis, and other infectious epidemics of comparable gravity and scale". The importation would have to comply with the WTO rules on compulsory licences.

Developed countries and developing countries that are high income countries according to the World Bank will not get the benefit of the measure. The interim measure is essentially based on the US agreeing not to bring a dispute resolution procedure against an exporting state that supplies a least-developing importing state with patented drugs in a way that breaches either the importing or exporting state's obligations under TRIPS.

### *8. Reactions to Breakdown - Stage 5*

*EU*

In a letter of 7 January 2003 addressed to trade ministers Pascal Lamy, the EU Trade Commissioner, has stated that the current draft text remains acceptable. By way of a compromise solution he suggests that the definition of pharmaceutical product contains a footnote listing those infectious epidemics that have the most damaging impact on developing countries. In addition, Members could request the World Health Organization to give advice as to other potential public health problems. Presumably this would be a way of adding other diseases to the list. The EU also announced that it would not challenge any member exporting medicines under the terms of the draft decision. At a recent EU-Commonwealth Roundtable at the London School of Economics on 20 January 2003 he stated that "we cannot rely for very long on individual unilateral waivers".

*African Group Reaction*

In a statement issued after the breakdown of the talks the African Group expressed support for the text on the basis that it represented the most likely consensus point. It opposed the inclusion of a footnote in the draft text listing only a handful of diseases under the system on the grounds that it would re-define and limit the effect of the Doha Declaration.

### *9. Next Stage?*

The current draft decision is supported by the EU and by many developing countries. Even though developing country groups like the African Group are not particularly happy with the draft text they see it as a likely consensus document. Technically the agreement of the US to a waiver is not needed. But the WTO is a consensus organization and it is unlikely that WTO members will want anything other than a consensus on this matter that includes the US. The draft decision is actually quite close to the outcome that the US has sought in any case. Any final decision on paragraph 6 is not likely to deviate

too much from the present draft. In order for that to happen developing countries would have to unite multilaterally and co-ordinate bilaterally to push for a solution based on Article 30. They would also encounter the united opposition of the US and EU since both have indicated that an Article 30 solution is not an option.

How soon an agreement will eventuate will depend on the urgency that the US assigns to the matter. In the past on intellectual property matters the US has used rounds of bilateral negotiations to obtain agreement on standards that act as a springboard for a multilateral deal. President Bush's announcement in his State of Union address of an Emergency Plan for AIDS relief, a $15 billion initiative that is aimed at African and Caribbean countries, may also affect perceptions and the sense of urgency about the need for a final agreement. Under the plan there is a proposal to provide antiretroviral drugs for 2 million HIV-infected people.

### *10. Evaluation*

*Interim Measure by the US*

The aim of the interim measure according to the US is to benefit least-developed countries by allowing them to import drugs from other WTO members under the compulsory licensing rules of TRIPS.

The interim measure changes very little. Least-developed countries get the benefit of TRIPS transitional provisions. Under those transitional provisions they do not have to apply the patent provisions of TRIPS. Even if a least-developed country has implemented TRIPS there may be no patent registered in its patent system on the drug it wants to import. Even if there is such a patent, TRIPS permits a country to issue a compulsory licence for the use of the patent. Developing country exporters also get the benefit of TRIPS transitional arrangements.

If a least-developed country has no or insufficient manufacturing capacity and a public health crisis, it will have to find an exporter of the drugs it needs at a quantity and price it can afford. The crucial question is whether the US interim measure offers generic manufacturers an incentive to manufacture medicines needed by least-developed countries. Generic manufacturers, like multinational manufacturers, need a certain legal environment before investing in the production of drugs. The US interim measure is by definition temporary. The scope of the products it covers is uncertain and some developing economy markets have been ruled out making it harder for generic manufacturers to achieve economies of scale in production.

The incentive effect of this measure is minimal. It appears to offer little beyond what the TRIPS transitional arrangements already offer to developing countries. The TRIPS arrangements at least offer the certainty of dates and

the prospect of extension. Moreover they are binding on all parties. The interim measure is a piece of discretionary unilateralism that offers neither clarity to developing countries, nor commercial certainty to generic manufacturers.

### *11. The draft decision paragraph 6*

The draft decision as it stands largely fails to achieve the primary goal of the Doha Declaration of promoting "access to medicines for all".

The emergence of competitive pharmaceutical markets of relevance to poor people depends upon sufficient numbers of generic manufacturers entering the market. Generic manufacturers in developing countries will only enter the market if the intellectual property rights regime is clearly defined, it allows them to import the ingredients and technologies they need for manufacture and it allows them to export in order to achieve economies of scale. Pharmaceutical multinationals and generic companies in the US, EU and Japan have large domestic markets that allow them to produce at an economic scale. They also deal with issues of having to source ingredients and technologies from other companies by means of complex cross-licensing arrangements. Their bargaining power based on extensive patent portfolios allows them to reach satisfactory commercial licensing arrangements.

An approach based on Article 30 would have allowed states to devise a solution that allowed generic manufacturers to have certainty over the importation of the ingredients/technologies they need on the input side. On the export side it would have allowed for the possibility of economies of scale.

The current draft decision fails to achieve these things for the reasons that follow:

- The definition of pharmaceutical product is drafted in exhaustive form ('means' rather than 'includes') and carries the possible implication that paragraph 1 of the Doha Declaration sets up a limited category of reference for products and diseases. The attempt to confine the definition of product by limiting the category of disease is unsatisfactory for a number of reasons, including the fact that a single disease can cause a cluster of health problems in an individual that then creates the need for a range of treatment products that are not directly related to the treatment products for the initial disease.
- The definition of 'eligible importing member' relies on countries that are not least-developed countries to establish that they have no manufacturing capacity in the pharmaceutical sector. The UNIDO study referred to earlier pointed out that in 1992, 87 developing countries had some manufacturing capacity. Under the draft proposal these states would have to carry out an assessment of their capacity

and establish that they had insufficient capacity to meet their needs. They could only use the system for importation while they had insufficient capacity. It is hard to see how this approach offers an importing or exporting generic manufacturer long term certainty.

- The draft is also ambiguous on the issue of importing eligibility. The Annex requires a developing country to link insufficient manufacturing capacity to "its needs". However, under its notification obligation in the main text an importing member has to confirm that it has insufficient manufacturing capacities "for the product(s) in question". Needs and the shortage of specific products are not the same. The former may exist even if the latter is temporarily met. The present draft is bound to give rise to arguments over eligibility.
- The system set up by the draft means that a generic manufacturer in an exporting country is dependent upon *both* the exporting and importing country each complying with the mandatory system of notification and conditions. The consequences of failure to comply are not spelt out, except that the waiver would not operate. Generic manufacturers would in practical terms have to monitor the bureaucracies of two countries in relation to every act of export in relation to a single product (potentially many bureaucracies). The failure of a country to comply with a condition might conceivably turn a shipment of drugs into an infringing importation allowing the intellectual property owner to seek legal remedies.
- The draft decision imposes policing obligations on both importing states and exporting states. These obligations are in addition to the rights and remedies that TRIPS requires in respect of intellectual property rights as well as the regulatory hurdles that states normally apply to the export and import of medicines. It is hard to see how making developing states bear these extra costs is consistent with the goal of promoting access to medicines for all.

### *12. Entrenching dependency*

It is interesting to note from the present draft that the main pharmaceutical exporting nations (France, Germany, Japan, Switzerland, UK and the USA) have indicated that they will not use the system *as importers*. This suggests that the pharmaceutical companies (including the generic affiliates of multinationals) in these countries may use the system *as exporters*. Generic manufacturers in developing countries may well face strong price competition in the export markets left to them under the system from these companies. This price competition is likely to be subsidized by the lucrative domestic markets of these companies, markets that would remain protected under the

proposed system. In the long run this will simply increase the dependency of least-developed countries upon individual acts of charity or politicized development aid programmes.

### *13. An unilateral approach based on Article 30*

The breakdown of the talks does present an opportunity for developing countries to re-think their options. It is open to a developing country or more preferably a group of developing countries to draft and enact an exception based on Article 30 to deal with the export and import issues. Developing countries need not wait for approval from the WTO to use Article 30 in this way. The Article recognizes the sovereign right of members to create exceptions to the exclusive rights of patent owners. Both the US and the EU have used Article 30 to create such exceptions (for example, research exemptions and testing of patented products prior to expiry of the patent).

If other WTO members took the view that an exception drafted by a group of developing countries went beyond the bounds of what was permitted by Article 30, the matter could be the subject of a WTO dispute resolution procedure. Of course, the costs, both economic and reputational, would, in the first instance, fall on the member bringing the action.

A drafting model for an Article 30 exception on the exporting side is to be found in Amendment 196 to the European Medicine Directive:

> ***Manufacturing shall be allowed if the medicinal product is intended for export to a third country that has issued a compulsory licence for that product, or where a patent is not in force and if there is a request to that effect of the competent public health authorities of that third country.***

# 6. Eco-labelling and International Trade

***Wendy Hollingsworth***

## Introduction

Eco-labelling is a process used to inform the consumer of the environmental characteristics of a good or service. The introduction of the Blue Angel eco-seal in Germany in 1977 has given impetus to many other countries to introduce stringent packaging legislation. To-date over thirty countries have passed legislation and instituted eco-labelling programmes and there are presently more than sixty eco-labels in existence globally. The number of products covered by these eco-labels is staggering. For example, in the United States there are at least twenty different eco-labelling programmes covering over three hundred (300) different products. Likewise, Canada's Environmental Choice Eco-labeling programme has awarded Environmental Choice eco-labels to over two thousand (2000) products and services provided by about two hundred (200) companies.[1]

Eco-labelling provides a degree of assurance to consumers that products conform to some minimum standard established by an entity such as public or private sector institutions or non-governmental organisations. Producers have successfully used eco-labelling and certification schemes to promote environmental stewardship and as a tool to differentiate and market their products on the basis of their environmental features. An eco-label awarded to a particular product (or process) does not guarantee that the product (or process) has no environmental impacts. What it guarantees is that, compared to similar products or processes, producers have taken measures to minimize negative environmental impact. In this regard eco-labels not only inform the public about product quality but also about its entire life cycle including for example product inputs, the production processes, its consumption and its waste management.[2]

The terms eco-label, environmental label and ecological label have been used interchangeably. The term eco-label or eco-labelling as used within the context of this article will therefore include these other terms.

Consumer demand has been a major factor in forcing manufacturers to take effective steps to make their products more environmentally friendly. Many eco-labelling schemes have been established in the major industrial countries. Some developing countries such as Brazil, India and Korea have

[1] WTO-CTE Document: Information relevant to the consideration of the market access effects of eco-labelling schemes (WT/CTE/W/150), 29 June 2000.

[2] Susanne Dröge. 2001. Ecological labeling and the World Trade Organisation. German Institute for Economic Research. Discussion paper No. 242.

**Box 1. At a Glance: Trade and Environment Review (12)**

| | |
|---|---|
| 1971 | GATT Secretariat report on the implications of environmental protection policies on international trade. |
| 1972 | UN conference on Human Environment<br>GATT establishment of the Group on Environmental Measures and International Trade (EMIT). |
| 1973-79 | Tokyo Round of trade negotiations – the Tokyo Round Agreement on Technical Barriers to Trade (TBT) also known as the Standards Code negotiated. |
| 1982 | GATT Ministerial meeting on control of exports of products that can harm human, animal and plant life and health and the environment. |
| 1986-94 | Uruguay Round of trade negotiations where environmental issues were addressed in several agreements (TBT, trade & services, agriculture, subsidies and countervailing measures, SPS and TRIPs). |
| 1989 | Working Group on exports of domestically prohibited goods and other hazardous substances |
| 1991 | European Free Trade Association requested the GATT Director General to convene the first meeting of the EMIT group. (20 years after its formation)<br>US – Mexico tuna dispute clearly focused attention on the implications of environmental protection policies and trade. |
| 1992 | UN Conference on Environment and Development (UNCED) Earth Summit in Rio adoption of Agenda 21. |
| 1994 | Uruguay Round trade negotiations concluded with the Agreement establishing the WTO and the adoption of the Ministerial Decision on Trade and Environment and the creation of the WTO's Committee on Trade and Environment (CTE). |
| 2001 | Doha Ministerial Declaration including discussions regarding trade and environment interactions and impact on trade flows. |

developed their own programmes or are in the process of enacting appropriate legislation to commence these programmes.

With the international increase in eco-labelling programmes there is concern that the initial policy intent behind the development of such schemes (i.e. environmental protection, sustainable development and consumer information) has been superceded by protectionists policies geared to protect local industry.[3] There is therefore growing concern internationally for the potential impacts of eco-labelling and certification schemes on market access of products and services in general, specifically products originating from developing countries.

It is believed that the numerous and varied approaches used to establish eco-labelling schemes have the potential to create trade tensions. Additionally, the credibility, transparency and access of eco-labelling schemes have emerged as critical issues within the context of trade and environment. These issues are currently being reviewed in the international trade arena of the World Trade Organisation (WTO); negotiations on Multilateral Environmental

[3] UNDP, Sustainable Energy and Environment Division. Trade and the Environment: capacity building for sustainable development.

Agreements (MEAs); International Standard setting bodies; and at various bilateral and unilateral trade negotiations meetings.

The eco-labelling and international trade debate and its impact on trade policies, market access and standard setting policies of relevance to developing countries can only be fully appreciated by first examining the origins of the debate and reviewing the current status of the issue of eco-labels and their effect on trade.

### Trade and Environment Interactions: The Early Days

Considerable attention is currently being focused on trade and environment interactions and their impact on established and emerging trade regulations. The trade and environment discussion has been on-going for many years. What is new, is the proliferation of eco-labelling and certification schemes and the potential for countries to use these as barriers to trade. Concern over the impact of trade and environment interactions was expressed since 1970's. A review of some of the significant trade and environment events occurring over the years is given in Box 1.[4]

### The World Trade Organisation

There are currently no agreements within the World Trade Organisation (WTO) specifically dealing with the environment. There are, however, 'Green Measures' contained in a number of WTO Agreements which make provisions addressing eco-labelling and other environmental issues. Relevant agreements are summarised in Table 1.

### The Doha Declaration

During the fourth Ministerial Conference in Doha, Qatar in November 2001 it was agreed to commence new rounds of negotiations on specific aspects of trade and environment interactions. There was reaffirmation of the commitment to the principles and objectives set out in the Marrakesh Agreement which established the WTO. Ministers also pledged a commitment to reject the use of trade protectionist policies. Recognising the fact that the majority of WTO Members are developing countries it was noted that it was essential to place their needs and interests at the center of work programmes adopted in the Declaration. It was further recognised that enhanced market access, equitable rules, technical assistance and capacity building programmes must be an integral part of the work programme if the needs of developing countries are to be served.[5]

[4] WTO Document. Early years: emerging environment debate in GATT/WTO.
[5] WTO Document WT/MIN(01)/DEC/1. 20 November 2001.

**Table 1. WTO Agreements that make provisions to address environmental issues**

| AGREEMENT | PROVISION |
|---|---|
| Technical Barrier to Trade (TBT) | Addresses product and industrial standards |
| Sanitary and Phyto-Sanitary and safety (SPS) | National measures to protect animal and plant health |
| Subsidies and Countervailing Measures | Allows for subsidies up to 20% of the cost to adapt existing facilities to new environmental legislation |
| Trade-Related Aspects of Intellectual Property Rights (TRIPs) | Provides countries with the right to refuse to issue patents on products or processes that risk damage to human, animal and plant health and the environment |
| GATT Article 20 | Under special conditions goods that protect human, animal and plant life and health are exempt from normal GATT disciplines |
| General Agreement on Trade in Services (GATS) | Article 14 - Under special conditions trade in services affecting human, animal and plant life and health are exempt from normal GATS disciplines |

With reference to trade and environment, Ministers agreed to negotiate on: (i) the relationship between WTO rules and trade obligations under the MEAs including information exchange, and (ii) the reduction or appropriate elimination of tariff and non-tariff barriers to trade in environmental goods and services. In addition, the Committee on Trade and Environment was charged to pay special attention to:

- the impact of environmental measures on market access especially on exports from developing and least-developed countries;
- provisions within the TRIPs Agreement; and
- eco-labelling.

### International Eco-labelling and Certification Schemes

Eco-labelling and certification programmes are designed to provide environmental information to the public about the environmental impacts associated with the production or utilisation of a particular product. In addition, eco-labelling programmes are used within various industries as competitive marketing tools. Eco-labels are normally voluntary although some countries

have mandatory eco-labels, for example, the US mandatory battery labelling and energy guide labels.[6]

Three categories of eco-labelling standards have been identified by the International Standards Organisation. Type 1 labels are voluntary multi-criteria labels that provide the public with information regarding the overall preference of a product over others within a similar product category. The label is in the form of a registered logo awarded by an independent entity to those within the industry that meet criteria set out by the entity.[7] Type 1 labels, also referred to as eco-seals, are based on the assessment of environmental impacts throughout the life cycle of the product, namely production, distribution, consumption and disposal. These life cycle analyses (LCA) are based on multiple criteria that can be biased since they often do not take into account conditions within the exporting country. As a consequence Type 1 labels based on LCA have been subject to much concern among developing countries and are the topic of increasing debate in the international trading arena, especially because they can be used as disguised barriers to trade.

By contrast Type II labels are self-declaration environmental claims made by importers, manufacturers and others within the industry who stand to benefit from making the claim. These labels are not verified by an independent third party neither do they state the environmental impact through the life cycle of the product. Type II label claims do not therefore provide the level of confidence, transparency or information required by discerning consumers. To deal with the potential threat of the loss of consumer confidence as a result of the proliferation of fraudulent eco-labelling claims, some countries have used legal mechanisms to ensure the credibility of Type II eco-label claims. This usually takes the form of fair trading legislation that address matters of misleading and fraudulent claims in trading practices.

Type III labels provide comprehensive environmental information on a product throughout its life cycle. The information provided on the product is verified, although no information is provided on the product relative to similar products available on the market.

## Eco-labelling and Trade Interactions

It is interesting to note that the early trade and environment debates centered around *trade* practices and their possible negative impact on the environment. The issue at the time concerned the manufacture of goods, and trade in goods and services, that were being conducted in a manner not conducive to preserving the environment for future generations. Today, however, the

[6] WTO Document WT/CTE/W/150. 29 June 2000.

[7] Tom Rotherham. 1999. Selling Sustainable Development: environmental labeling and certification programs. The Dante B. Fascell North-South Center, University of Miami.

concern expressed by stakeholders, especially developing countries, is that environmental protection measures in the form of eco-labels and certification programmes are being used as technical barriers to disrupt trade and restrict market access into developed countries.

Currently there are numerous eco-labelling schemes in existence. In addition to the Blue Angel (Germany) and Canada's Environmental Choice mentioned earlier, there exist others such as the Nordic Swan (Denmark, Iceland, and Finland), Green Seal (US) and Eco-Mark (India).[8] The current global trend appears to be to award eco-labels based on multiple criteria that include life cycle analysis of the product. Analyses of product and production methods (PPMs) are based on the environmental consequences of the product's manufacture, utilisation and disposal.

The use of LCA or PPMs as criteria for awarding eco-labels is fueling the international debate on environmental technical barriers to trade. Developing countries are concerned that eco-labelling schemes currently in place may be in conflict with WTO rules, especially under the TBT Agreement which demands that countries should not discriminate between products based on the consequences of their production methods.

For eco-labels to be effective they must not only promote environmental stewardship within various industries, but they must act to facilitate trade by ensuring market access and limit technical barriers to trade. While this is an ideal situation to achieve globally, the reality is that some eco-labelling programmes are used as protectionist trade policies hiding behind the legitimacy of environmentally friendly production.

Over eighty five percent (85%) of international trade consists of products that can *potentially* be affected by environmental trade barriers.[9] Such environmental protection occurs mostly in respect of food items, plants, bulbs and cut flowers. It is estimated that 90% of products in this category are adversely affected by environmental trade barriers. This accounts for about 13% of world trade.

Countries such as Colombia which have had access to international markets limited by stringent eco-labelling criteria are of the view that eco-protectionist trade policies are made with the sole objective of forcing environmental policy goals of the importing country on companies in exporting countries. Some foreign exporters, mostly from developing countries, are faced with the problem of high costs required both to obtain information on foreign labelling programmes and to implement required technologies with the aim of being compliant with labelling criteria. Private eco-labelling programmes often come under criticism for setting environmental policies within the economic,

[8] WTO Document. WT/CTE/W/150. 29 June 2000.

[9] International Trade Forum article: Environmental Trade Barriers: who wins, who loses, what's the score?

environmental and cultural context of the home country, while ignoring policy input and conditions within other countries. It is often the case that the criteria established by these labelling programmes have no relevance to exporters in foreign countries.

The WTO rules do not explicitly cover eco-labels. The CTE has however been mandated to examine interactions between trade and environment including eco-labels and trade effects. International debate on the trade effects of eco-labels is currently centered round product-related and non-product-related criteria used to award eco-labels. The effectiveness of using WTO trade rules, or rules under the MEAs framework, to address and clarify trade and environment disputes arising from the use of process and production methods criteria to award eco-labels is unclear.

The Committees on Trade and Environment and on Technical Barriers to Trade have been striving to bring some clarity to the debate. The CTE has identified trade-related eco-labelling problems to include the following:

- most labels are granted on the basis of production methods;
- eco-labelling criteria are based on national conditions and often conditions within the exporting country are not taken into account;
- there is a loss of transparency and consumer confidence due to the proliferation in the number of available eco-labels.

Examination of relevant WTO rules as set out in the TBT Agreement and the GATT; shows that non-product–related criteria used in establishing eco-labelling programmes are not explicitly regulated. Only those parts of eco-labelling schemes determining product and product-related criteria appear to be covered under WTO rules and as a consequence these rules may be applicable in instances of relevant trade disputes.

It can be argued that the trade effects of non-product-related production and processing methods may be addressed by mutual recognition of national labels at the international level. With the loss of transparency and consumer confidence, there is a need for the harmonization of labelling criteria at the international level. Harmonisation of criteria can be achieved by internationally recognised bodies such as the ISO. There are however inherent problems associated with mutual recognition at the regional level. Such recognition is more easily achieved when the countries involved are at similar levels with regards to their environmental conditions and priorities, for example, mutual recognition of eco-labelling programmes between Canada's Environmental Choice and the US Green Seal programmes.[10] The effectiveness of this approach is however limited when dealing with countries with different environmental conditions and priorities as exists between developed and

[10] UNCTAD Document. Integrating trade, environment and development: recent progress and outstanding issues. TD/B/COM.1/3. 12 December 1996.

developing countries. Some countries have suggested the use of the strategy of equivalency between eco-labelling criteria to promote compatibility of trade and environmental interests.

### Eco-labels and Market Access: The Case of Colombia's Cut Flowers

Colombia's case is one in which cut flower exporters have complained in international fora that environmental measures adopted by Germany have negatively impacted on the market access of their cut flowers into the German market.[11] Colombian exporters view the emergence and operation of several private eco-labels in Germany as being inconsistent with WTO rules on transparency and non-discrimination.

The main trade considerations in this case is the objection by Colombia's cut flower exporters to a system of certification proposed by the German Importers Association. The grounds of the objection are that the proposed programme is costly, the approach taken was coercive and the programme was discriminatory. The proposed programme was intended to apply only to the exporting cut flowers into Germany from Colombia and Ecuador. The government of Colombia objected to the proposed scheme because verification of the eco-labelling programme would have been conducted by foreign experts.

Colombia is concerned that private eco-labels can affect trade flows by creating a situation of demand for flowers displaying national eco-labels. Such labels have the tendency to be non-transparent and could easily mislead consumers.

The main recommendations of the Colombia case study within the context of eco-labelling are as follows:

- WTO members should observe the principles of the Code of Good Practices;
- Article 4 of the Agreement on TBT should be applied;
- The WTO should analyse and make recommendations on areas of mutual recognition and equivalence with respect to eco-labelling.

### WTO Members Express their Views

Countries making submissions to the CTE are in agreement that eco-labelling programmes must be developed and implemented in a manner consistent with WTO trade rules especially those rules of non-discrimination and national treatment. The view of most developed countries is that the Code of Good Practices of the TBT Agreement should be applied to eco-labelling programmes. Members are still divided on the issue of non-product-

[11] WTO Document. Environmental labels and market access: case study on the Colombian flower-growing industry. WT/CTE/W/76 (G/TBT/W/60). 9 march 1998.

related PPMs. Some members, for example, Canada and the US, support the view that WTO rules as applied under the TBT Agreement are adequate to cover non-product-related PPMs. By contrast, other countries, mostly developing countries (such the ASEAN Group), consider that the GATT-WTO Agreements do not make provision to cover non-product PPMs. The CTE has, however, decided that the TBT Agreement provides adequate flexibility to cover non-product PPMs.

Certain countries are of the view that if eco-labelling criteria are mutually recognised and agreed upon by several countries, and if the WTO acknowledges these mutually recognised standards, there would be no need to take trade related disputes before the WTO. Such mutually beneficial arrangements were advocated by Colombia and are promoted as a win-win situation that would also benefit developing countries.

Several Members are supportive of the development of guidelines for eco-labelling schemes on the basis of mutual recognition of national standards and equivalency. Developing countries have also expressed concern about suggestions for a WTO Eco-labelling Agreement which they believe would establish a precedent for considering non-product PPMs as legitimate means of discriminating between products.

**Other Labelling Issues: Labelling Genetically Modified Foods**

Calls for mandatory labelling for genetically modified (GM) foods are also proving to be a contentious trade issue. As with other eco-labelling schemes there are divergent views as to the criteria to be used to develop GM labelling standards. The international debate is polarized. On the one side are countries like the US, Canada and Argentina which have adopted voluntary labelling standards for GM or GM-free products. On the other side are the EU and some other countries that have adopted or plan to adopt mandatory GM-labelling schemes.

The international trade debate on the labelling of GM foods is as yet still focused among developed countries, especially the EU and the US. Developing countries have not yet extensively expressed their views within the multilateral trading fora. In brief, the contentious issues are: (i) segregation of products of biotechnology may prove to be a costly exercise that will eventually be reflected in the price offered to the consumer; (ii) there are no globally accepted standards for accessing safety of products; (iii) imports of GM products are not efficiently or effectively regulated; (iv) a variety of different GM-labelling standards and approval procedures exists, all of which can lead to trade conflict.

There are currently several international organizations that are involved at some level in trying to regulate trade in GM products and to ascertain the impact of GM labelling on trade flows especially with reference to developing

countries. These organizations are: the Codex Alimentarius, the Food and Agricultural Organisation, the International Plant Protection Convention, the International Epizootics Organisation, World Health Organisation, the World Trade Organisation, the Organisation of Economic Cooperation and Development.[12] The Biosafety Protocol and regional initiatives also seek to address these issues. Collectively these organizations provide information on such matters as health and safety standards, labelling criteria, trade rules and dispute settlement. Despite what may appear to be a concerted international effort to address GM issues, there still remains a lack of consensus on how to achieve international regulation of trade in GM products and harmonization of labelling criteria.

Similar to discussions occurring in the overall eco-labelling debate, there have been calls for the use of mutual recognition initiatives to help resolve some of the trade conflict ensuing from GM labelling and trade conflicts. Mutual recognition initiatives such as the Trans-Atlantic Economic Partnership between the EU and the US already exist. It is envisaged that the use of similar initiatives in the form of regional agreements, memoranda of understanding and formal dialogues can avoid GM labelling and regulation being used as technical barriers to trade.

In July 2002 the European parliament voted in favour of the European Commission's proposal on new regulations for the traceability and labelling of GM foods and feed products. The proposal calls for tracing of all GM food and feed products throughout all stages of the production and marketing cycle. This provision would allow for the use of non-product PPMs criteria to be used in developing GM-labelling schemes.

The proposed EU labelling and traceability regulation has not yet been enacted. It is finding great opposition within Europe and North America and appears to have sparked the beginning of another trans-Atlantic trade dispute. The proposed EU regulation reflects responsiveness to consumer concerns regarding food safety, environmental impact and GM foods. In a response to the US threats to take the EU before the WTO trade dispute body over its GM policy, the Trade Commissioner of the EU reiterated that their GM policy is a mechanism to rebuild consumer confidence in food products.

Discussions on the proposed EU labelling and traceability regulations have already taken place within the WTO Committees on TBT and the Committee on SPS Measures. Both Canada and the US have complained to the WTO regarding the EU's proposed labeling and traceability regulation on the grounds that labelling GM products may violate WTO rules.

[12] Peter W. B. Phillips. 2003. Policy, National regulation and international standards for GM foods. IFPRI Brief 1, January 2003.

**Concluding Remarks**

The proliferation of labeling schemes onto the global market place has significant implications for developing countries. Eco-labelling schemes and policy directives have the potential to be used as technical barriers to trade therefore developing countries must be concerned with the market access of their exports into developed countries. To overcome such technicalities producers in developing countries will need to be innovative in the strategic positioning of their products in international markets. It will be imperative to form suitable alliances with importers in developed countries. Such alliances may be based on equitable contractual arrangements and mutual recognition of production and processing methods. It is also critical that developing country producers be aware of the nature of international debates occurring within the context of trade and environment and lobby at the governmental level to have their concerns addressed at these international fora. Greater emphasis must be placed on taking part in international dialogue, meetings and negotiations regarding the establishment of international eco-labelling standards.

# Section II

# WTO Disputes

# 1. US Steel Duties and Safeguard Actions under the WTO

*Cliff Stevenson*

## Introduction

Safeguards are one of three trade protection instruments (or trade remedies) that are permitted under WTO rules. Each allows the adoption of import measures in specific circumstances.

Article VI of the GATT 1994 and the WTO Anti-Dumping Agreement – Authorises anti-dumping duties or price undertakings in situations of discriminatory pricing (i.e. where export price is below domestic price).

Article VI of the GATT 1994 and the WTO Subsidies & Countervailing Measures Agreement – Authorises countervailing duties or price undertakings where countervail able subsidies are found.

Article XIX of the GATT 1994 and the Agreement on Safeguards - Authorises adoption of safeguard measures where there is a surge of imports. Measures can take the form of additional duties or quotas.

Whereas anti-dumping and countervailing duties deal with problems perceived to be "unfair", safeguard measures are taken against imports that are fairly traded but which cause serious problems through sheer volume.

## Recent trends in use of safeguards

Prior to the creation of the WTO, safeguards were rarely used. In the last few years, however, the incidence of safeguards has dramatically increased. Trade protection measures are usually measured by the number of cases initiated. Whilst measures are not adopted in all cases, the initiation of investigations often itself has an effect on trade. Thus, the number of investigations initiated provides the best single indicator of the overall level of safeguard activity.

**Safeguard Investigations Initiated 1995-2001**[1]

| Year | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| No of cases | 2 | 5 | 3 | 10 | 15 | 26 | 53 |

[1] All data in this paper is calculated from WTO documents and members notifications to the WTO.

We must note the significant impact that the US steel safeguard investigations have had on the figures for 2001. In this context, it is interesting to observe that the us steel safeguards are often referred to in the singular (i.e. as if they should be counted in the statistics as only one investigation), However, the different products investigated are not all like or directly competitive and therefore they cannot be counted as a single safeguard investigation. The US International Trade Commission made injury determinations on 33 products and this is how the US steel safeguards have been calculated in the above figures.

Only three countries have initiated a significant number of safeguard investigations during this period. The US with 42 initiations now leads the way. Chile andIndia, with 16 and 11 respectively, are the next two most significant users. Whilst these three countries have been by far the most active in terms of safeguard investigations during this period, 18 other countries have initiated safeguard investigations[2], indicating that the use of such instruments is increasingly widespread.

Until 2002 (see section 5.2 below), the EU had not initiated any safeguard investigations against WTO members. Likewise, Canada has not initiated any cases and Australia has only initiated one such investigation. Thus, apart from the US, the new users of safeguards have not been the traditional anti-dumping users.

It can be noted that the number of safeguard cases still remains low in relation to the use of anti-dumping, use of which reached record levels in 2001.

**Anti-Dumping Investigations Initiated 1995-2001**

| Year | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|---|---|
| No of Cases | 156 | 221 | 242 | 232 | 339 | 251 | 348 |

Note, however, that a safeguard is more restrictive than anti-dumping duties. The latter are taken against individual countries, whereas the former must be taken against imports of the product in question from all sources. The anti-dumping statistics traditionally measure the number of countries targeted in anti-dumping investigations rather than the number of products. This means that an investigation into the same product from 5 different countries counts as 5 cases in anti-dumping statistics. In fact, of the 251 cases initiated in 2000, 120 products were involved. Thus, it is clear that the number of safeguard investigations is significantly increasing even in relation to anti-dumping.

[2] Argentina, Australia, Brazil, Chile, Colombia, Czech Republic, Ecuador, Egypt, El Salvador, India, Japan, Jordan, Korea, Latvia, Morocco, Phillippines, Poland, Slovak Republic, Slovenia, US, and Venezuela.

One might ask why there has been such a significant increase in the use of such trade protection instruments? One of the principal reasons for the increase, which is a phenomenon seen in both developed and developing countries, is liberalisation. The fact that use of the trade protection instruments has increased is in fact a sign of how successful the Uruguay Round was in leading to genuine trade liberalisation. The fact that domestic industries are turning to such instruments is a clear indication that they are facing increased competition from imports, thus proving that liberatisation has been successful. Some would go further and argue that such provisions are a crucial safety valve that "channels" protectionism into narrowly defined instruments that at least have the merit of being relatively transparent (as opposed to less transparent non-tariff barriers). Those supporting this line of argument would say that this is a price" worth paying in order to obtain the significant liberalisation gains that all countries are experiencing.

A second reason for growth in the number of countries using such measures is, perhaps, a domino effect. The use of trade protection instruments by developing countries may have been prompted, and has certainly been legitimised, by the significant use of such instruments by large developed economies such as the US, EU, Canada and Australia.

## WTO Rules on Safeguards

A safeguard provision has existed since the GATT was created. Article XIX of the GATT 1947 allowed for "emergency action on imports of particular products".

This allowed safeguard measures to be adopted where a product is imported in such increased quantities and under such conditions as to cause or threaten serious injury to like or directly competing products. Two further conditions were that the increase in imports must have been a) the result of unforeseen developments and b) the effect of obligations incurred under the agreement (e.g. reduced tariffs).

WTO members concluded to an agreement on safeguards for the first time as part of the Uruguay Round Agreements, In addition, Article XIX of the GATT 1994 was maintained. The safeguards agreement, whilst adopting similar substantive conditions to Article XIX, provides more detailed guidance and interpretation both on the substance and procedure of safeguard investigations.

The main provisions of the safeguards agreement are as follows:

### *Substance*

- As in Article XIX, safeguard measures can only be applied where imports are in "such increased quantities" as to "cause or threaten to cause serious injury" to "like or directly competitive" products. (Article 2.1).

- Unlike Article XIX, however, the Safeguards Agreement explicitly states that safeguard measures cannot be aimed at specific countries. They must be applied to all imports irrespective of source. (Article 2.2). This is different to anti-dumping duties and countervailing duties, both of which can be adopted against individual countries.
- In order to assess whether serious injury has occurred, all relevant factors should be evaluated (Article 4.2a).
- In establishing the existence of a causal link, injury caused by other factors should not be attributed to the increased imports (Article 4.2b).

***Procedure***

- An investigation must be conducted and the opportunity to make views known must be offered to interested parties, including views on whether any proposed safeguard measures would be in the public interest. (Article 3).
- Although not explicitly stated, it is implicit in Article 5 that safeguard measures can take the form of either a tariff or quota. In addition, measures should only be applied to the extent necessary to prevent or remedy serious injury and to facilitate adjustment.
- Provisional measures can be adopted in critical circumstances where delay would cause damage difficult to repair (Article 6).
- Measures should have a maximum 4 year duration, with the possibility to extend them by a further 4 years (Article 7).
- When adopting safeguard measures, members should attempt to maintain an equivalent overall level of concessions. In this regard, members may agree on compensation to its trading partners affected by adoption of a safeguard (expected to be in the form of reduced tariffs). If no compensation can be agreed, equivalent concessions can be adopted by other WTO members, but not usually for 3 years. In other words, if no compensation is agreed, other members can "retaliate" by increasing tariffs on products from the country in question. (Article 8).
- Developing countries should be excluded from safeguard measures if they account for less than 3% of total imports. There is no equivalent *de minimis* provision for developed countries. When adopting their own safeguard measures, developing countries can adopt measures for an additional two years than normally envisaged by the agreement. (Article 9).

**WTO Jurisprudence**

In addition to the agreement on safeguards, a considerable body of WTO jurisprudence has now been created on safeguards. The cases, listed below, are extremely helpful in clarifying and putting some flesh on certain provisions of the safeguards agreement.

| | |
|---|---|
| Korea | Dairy Products (WT/DS98) |
| Argentina | Footwear (WT/DSI21) |
| United States | Wheat Gluten (WT/DSI66) |
| United States | Lamb Meat (WT/DSI77 & DS178) |
| United States | Circular welded carbon quality line pipe (WT/DS202)[3] |

All of the panel decisions in these cases were appealed. The fact that the Appellate Body has made rulings in all of these cases has been of great assistance in interpreting the provisions of the safeguards agreement. In some respects, the thinking and substance has developed in each Panel and Appellate Body report. The most recent Appellate Body decision regarding the US safeguard on line pipe is, therefore, perhaps the most useful that it clearly brings together a number of strands developed in earlier decisions and provides clear and unambiguous guidance to governments intending to use safeguards. It can be noted that all of these safeguard measures, including that on line pipe, were found to be WTO inconsistent, thus proving that the agreement on safeguards establishes high standards for the use of these provisions.

A detailed review of all of the detailed points arising out of these cases is beyond the scope of this short paper. However, the key points at have emerged are as follows:

- The increase in imports must be "recent", "sudden" and "sharp".
- Despite the fact that "unforeseen circumstances" are not mentioned in the Agreement on Safeguards, the requirement of Article XIX is relevant. The fact that imports increase as a result of a reduction in tariffs (arising from WTO obligations) cannot per se be used to apply safeguard measures as this can foreseen.
- Injury caused by other factors must be "distinguished" and separated from that caused by imports. The Appellate Body has recognised that this may be a difficult task but nevertheless has confirmed that the safeguards agreement sets this high standard of economic analysis.
- The fact that measures can only be applied to the extent necessary to prevent or remedy serious injury means that safeguard measures must only prevent or remedy injury attributed to the imports. That is, injury caused by other factors (which must have been distinguished and separated) should not be remedied by the measures.

It is also interesting to note certain general comments made by the Appellate Body in its report on line pipe:

> ... *safeguard measures are extraordinary remedies to be taken only in emergency situations.*

[3] All of these Panel and Appellate Body reports can be downloaded from the WTO website.

> *... safeguard measures are ... remedies imposed in the form of imports restrictions in the absence of any allegation of unfair trade practice.*
> *... safeguard measures may ... be imposed on the fair trade of other WTO members and, by restricting their imports, will prevent those WTO members from enjoying the full benfit of trade concessions under the WTO agreement.*

These comments indicate the context within which the Appellate Body is making its decision and are helpful in establishing the underlying principles of safeguard measures. The stress on the emergency and extraordinary nature of such measures is in line with the traditional perception of safeguard measures and appears to be inconsistent with the dramatic growth that we have seen in the use of safeguards.

All of these issues have critical importance in the use of safeguards and all safeguard actions must meet such standards (in addition to other provisions not highlighted here).

## Recent Developments

### *The US Steel Safeguard Action*

The US action was initiated on 28 June 2001. In October 2001, the US International Trade Commission (ITC) determined that steel imports have been a substantial cause of serious injury, or threat thereof, to the US steel industry[4]. The level of measures was recommended by the ITC in December 2001 and President Bush decided to adopt the measures in the form of increased tariffs ranging from 8% to 30% (levels generally higher than those recommended by the ITC but below that requested by the US industry) in March 2002[5].

As required by the safeguards agreement, developing countries accounting for less than 3% of US imports of each of the products have been excluded from the measures. Thus, except for a small number of exceptions on a few particular products, developing countries are generally excluded from the safeguard measure. Nevertheless, the US is likely to monitor the situation closely and may impose measures where products from excluded developing countries surge following the introduction of the measures.

### *EU Reaction to the US Safeguard Measures*

Whilst various trading partners of the US have reacted to the US steel safeguard measures, the most comprehensive response has come from the EU which has in itself raised several interesting issues worthy of comment.

[4] The USITC injury findings are principally summarised in 3 reports (Volume I – Commissioners' Determinations/Volumes II & III - Staff Reports) totalling more than 1100 pages. These can be downloaded from the USITC website at www .usitc.gov/steel.

[5] Details of the products covered by the measures can be found in the document notifying the US measures to the WTO (G/SG/N/10/USA6) which can be downloaded from the WTO website.

**Firstly,** the EU has requested consultations with the US as the first step towards a full WTO challenge on the measures. This has unanimous support, both from the EU member states and other trading partners of the US. The consultations are not likely to result in the measures being removed and therefore the EU is highly likely to request a panel on the measures.

There is a high expectation that the US measures will be found to be WTO inconsistent. One reason for this is that in some respects they appear to have similar problems that were found in the three earlier safeguard challenges against the US. In addition, there are also potential problems with the US determinations that the increase in imports has been sudden, sharp and recent. For some products, it is clear that the most recent trend in imports has been downward.

**Secondly,** the EU has adopted its own provisional safeguard measures in response to the US safeguards. In principal, these are different in nature to the US measures. The US measures are aimed at reducing imports below their current levels. The EU measures are supposed to be aimed at preventing a future surge in imports in the EU as a result of the US market being closed.

The measures will apply for six months while the Commission conducts a full investigation. The EU measures are in the form of a tariff quota (i.e. up to a certain quantity threshold, no measure is applied and above the threshold an additional duty comes into effect). The measures have been presented by the Commission as allowing imports to continue at current levels, + a 100 % leeway to allow for growth, free of any measure. However, the thresholds have been calculated on the basis of an average of the level of imports in 1999-2001. Imports of a number of the products covered by the safeguards increased significantly throughout these three years. In such cases, the average level of imports for the 3 years is actually significantly below that of 2001. Thus, the measures are potentially restrictive (i.e. reducing imports) at least in some products.

The impact of the EU measures, to the extent that they are restrictive, will worsen the negative impact of the US measures the rest of the world.

The provisional measures have all been adopted on the grounds of threat of material injury. Whilst logically this may make sense if there is a threat of a surge in steel imports as a result of trade diversion, it may be credibly argued that that there is a threat of serious injury to the EU industry. However, this is not what the EU has argued. The reason for this is that Article 2.1 of the safeguards agreement states that a member may apply a safeguard measure when it is:

"being imported ... in such increased quantities ... as to cause or threaten to cause serious injury".

The use of the present tense (i.e. "is being imported") clearly suggests that the increase has already happened. Thus) while the imports may not yet have caused serious injury (and thus might be classified as threatening to cause serious injury), measures cannot be adopted on the basis of the threat of an increase in imports

Thus, the EU measures have been adopted on the basis of a threat of serious injury as a result of import increases that have already occurred, despite the fact that it is really the fear of future surges in imports that has motivated the measures.

In some cases it is clear that there has been a sudden, sharp and recent increase in imports. It is also clear, looking at the injury indicators, that an argument could be made that; serious injury has already been caused. Thus, measures could perhaps have been adopted on that basis for such products. However, this has not been the case. For no product is a current injury finding made. The emphasis is all on future injury that is likely to be caused.

There are a number of possible problems with the EU measures. Firstly, for some products it is not that there has been a sudden, sharp and recent increase. In such cases, only when the increase has actually happened could safeguard measures be justified. Secondly, for products currently suffering from injury, case for threat of injury must involve establishing that the existing injury is likely to worsen (which may be difficult to do if the increase in imports has already caused serious injury).

Thirdly, the EU has requested compensation from the US under Article 8.2 of the safeguard agreement, However, one of the most controversial issues is under what circumstances the EU can unilaterally suspend concessions against the US if compensation cannot be agreed. Article 8.2 provides that members affected by a safeguard can suspend substantially equivalent concessions against the country imposing the safeguard measures. Article 8.3 postpones this possibility for three years, subject to the condition that the measure has been taken as a result of an absolute increase in imports and that such a measure conforms to the provisions of this Agreement".

As noted above, in would appear that not all of the products covered by the US safeguards have seen a recent absolute increase in imports (although it all depends on what constitutes "recent"). Further, there are a number of serious question marks over the extent to which the US action conforms to the safeguard agreement's provisions. Thus, read literally, this provision would appear to authorize such "retaliation" in the form of increased duties on other products. However, there are a number of uncertainties about this provision. Perhaps most significant is how the level of retaliation is authorised? One would expect that the WTO has to sanction the level of retaliation. Perhaps an

arbitrator has to be appointed but no procedure is provided for this. A further issue is the timing of the retaliation. Read literally, it appears that Article 8.2 requires the retaliation to be imposed within 90 days of the measure being applied. However, it is not logical that there is an incentive to adopt retaliation quickly. The EU is interpreting this provision as meaning that the deadline must be respected for notifying the retaliation to the WTO but then suspending the application of the retaliatory measures until a future date. However, this remains an open question.

There are other ambiguities in Article 8.2. For example, the suspension can only be imposed if the Council for Trade in Goods does not disapprove. However, no explanation of what would constitute a disapproval is provided. All in all this is a controversial provision that has never been used. It can be noted that this provision existed in the original Article XIX and it appears to have been "cut and pasted" into the safeguards agreement without adequate consideration.

At the time of writing, the European Commission has notified to the WTO a list of US products against which retaliatory measures might be applied by EU member states. However, whether the EU will proceed and actually impose such retaliatory measures remains to be seen.

## Implications of the Increased Use of Safeguards for Developing Countries

### *The US steel safeguard and steel exporters*

From a general perspective, those companies exporting to the US from countries that are not excluded from the measures will find it harder (if not impossible) to sell in the US market at the higher prices implied by the tariff increases.

Given that most developing countries are excluded from most of the US steel measures, developing countries that produce steel may find the US market very attractive due to reduced import competition and likely higher prices. Such opportunities should not be neglected but care should be taken if the US puts an anti-surge mechanism in place.

On the other hand, steel that would have gone to the US may now have to find other markets in which it can be sold. It is the fear of such trade diversion that is resulting in other countries taking certain defensive actions (see 6.2 below).

If significant quantities of steel previously exported to the US are shut out of that market, certain products will be subject to over-supply in the global market. Where such volumes are substantial this will have a downward effect on steel prices and will have an impact on developing country markets.

### *Steel importing countries*

Domestic industries in steel importing countries are greatly concerned about diversion of exports to the US into their markets. Thus, the EU has already adopted provisional measures on 15 steel products to prevent a sudden surge of imports into the EU market. likewise, Chile has initiated a safeguard investigation in December 2001 (presumably in anticipation of the likely US measures) and Canada likewise in March 2002. This "domino effect" may spread even further, as each new safeguard investigation initiated increases the concern of domestic industries in markets that remain open.

Most developing countries are steel importers and therefore should benefit to the extent that global steel prices fall as a result of excess stocks as mentioned above.

### *Implications for the Doha Development Round*

The controversy surrounding the US safeguards obviously raises the question of whether the safeguard regulation should be changed. Whilst the AD and SCM agreements were both mentioned as negotiating issues in the Doha Ministerial Declaration, safeguards was not mentioned. However, this does not mean that it could not be part of the negotiations if members agreed that it was necessary.

Does the safeguards agreement need to be amended? At one level the answer to this is no. The panel and Appellate Body reports mentioned above have clarified the substantive and procedural elements of the existing agreement and the high standards set are satisfactory and desirable.

The safeguards agreement has proven to be ambiguous in the area of suspending concessions against the country imposing the safeguard measures where agreement cannot be reached on compensation (under Article 8.3). As pointed out in section 5.2, clarification of this provision would be desirable.

A more radical suggestion for consideration relates to the possibility of retroactive remedies and dispute settlement. In the case of temporary safeguards, there are cases where the safeguard measure is likely to be removed by the time that any WTO dispute would have been completed. This allows cynical use of safeguard measures in a WTO inconsistent way in the knowledge that, as long as the offending measure is brought into conformity with WTO obligations by the time that the dispute process has ended, there are no sanctions that can be taken against the offending country. Perhaps this is one area where members should consider the possibility of retroactive compensation if a safeguard measure is found to be inconsistent.

Certain WTO member states, not least the US, would be likely to resist any discussion on safeguards in the round. Nonetheless, the issues raised above are important and further consideration would be justified.

Apart from specific considerations regarding the safeguards agreement itself, the US action may have broader implications for the round. The US action has been perceived so negatively by a large number of its trading partners that the atmosphere within the negotiations may change. This may in fact weaken the US position in the negotiations which, in turn, may actually create more general problems for progress towards a conclusion of the round.

***Increased use of safeguards***

As recorded in section 2, we are already seeing a dramatic increase in the use of safeguard measures. The widespread use of safeguard measures to protect steel industries across such a broad range of products may encourage other countries to do the same. Safeguard measures have the apparent advantage - in the view of many - of being an easier tool to use than anti-dumping or countervailing measures. The latter both require detailed analysis of whether dumping is occurring or if subsidies exist. A safeguard investigation, on the face it, is much simpler, requiring only an analysis of the imports and the injurious situation of me domestic industry.

This may be a significant issue for developing countries with few resources to setup anti-dumping administrations.

On the other hand, the growing number of WTO inconsistent safeguards does highlight the high standards required by countries planning on imposing safeguards. If the US measures are found to WTO inconsistent (on top of the previous measures already found to be inconsistent), this may serve as a deterrent to other countries' using such measures.

In this regard, it should be noted that a developing country choosing to have an active safeguard policy will be restricted to act in fewer situations than would have been the case with anti-dumping.

Overall, there is a fear that the increasing numbers of countries that have already started to use safeguards will result in even more countries tempted to do so. The more that countries such as the US continue to adopt WTO inconsistent measures (as they have in the 3 previous cases and may have in the steel cases), the weaker the deterrent of the high WTO standards becomes.

# 2. United States Tax Subsidies under DISC, FSC and ETI Legislation within the Framework of the WTO

***Asif H. Qureshi assisted by Amine M. Sassi***

## Introduction and Executive Summary

Since the 1970's a particular trade conflict between the United States and the European Union has been festering. This conflict concerns certain built-in fiscal subsidies in the US systems of corporation tax [under the DISC, FSC and the ETI legislation respectively] intended to promote US export trade. The trade conflict has been set against the different US and EU approaches to international taxation; and has been drawn out over the years in the form of a number of trade disputes, between the EU and the US, within the WTO dispute settlement system, and its predecessor the GATT 1947. However, although the disputes have arisen as between the EU and the US, the implications of the US fiscal subsidies, along with the WTO Panel and Appellate Body deliberations arising from the various disputes, are of concern to the wider membership of the WTO — including developing countries, and the Commonwealth membership as a whole. Thus, in the WTO cases involving the US FSC and ETI legislation Australia, Canada, India, Barbados, and Japan participated as third parties. Finally, this is a dispute involving two key players in international trade relations. How the dispute is ultimately resolved may have implications for the WTO system itself and its development.

Under the WTO, member States are prohibited from granting export subsidies. The DISC, FSC and ETI legislation, have been characterised as comprising tax subsidies for exports, generally on all goods and services. The subsidies operate not just for exports to Europe, but to all US exports worldwide. The subsidized exports may unfairly compete and reduce developing countries' market share in their domestic and/or foreign markets. Further, the subsidies are of significant value. In the case of the FSC legislation, the subsidy has been calculated to amount to about 4 billion US dollars annually[1].
Generally, the fiscal subsidies, under the various US legislation, have boosted US exports, by lowering the income tax between around 15% to 30% on export-related profits[2].

[1] United States –Tax Treatment for "Foreign Sales Corporations", Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement [WT/DS108/ARB] para 3.1.

[2] See FSC Panel report, p. 39, para. 4.211, 4.212. Note that the savings are comparable under the three regimes, see FSC Panel report where it is noted that "the FSC Legislation was designed to be functionally equivalent to the DISC while being easier to defend under the GATT, p. 34, para. 4.176 and 4.267.

| Export Sales | 1,000,000 | 750,000 | 500,000 | 250,000 | 100,000 |
|---|---|---|---|---|---|
| Tax Liability without FSC | 340,000 | 255,000 | 170,000 | 85,000 | 34,000 |
| Tax Liability with FSC | 289,000 | 216,750 | 144,500 | 72,250 | 28,900 |
| Tax Savings | 51,000 | 38,250 | 25,000 | 12,750 | 5,100 |
| % | 15% | 15% | 14.7% | 15% | 15% |

[Simplified table using pricing formula 925 (a) (1) IRC rule and applying a corporate tax rate of 34%][3].

The fiscal subsidies established under the DISC, FSC and ETI regimes were in response to what the US perceived as built-in fiscal advantages in the territorial system of taxation used by certain European States, which when combined with certain general tax measures[4], conveyed to exports from European States an even greater fiscal subsidy[5].

States normally orientate their tax systems around two distinct approaches, or a combination of both, with respect to the taxation of foreign income. The two approaches involve, either taxing the worldwide income of the tax payer [and then giving relief for foreign tax paid on that income] known as the *worldwide* system; or taxing only income generated territorially, known as the *territorial* system. The United States adopts the former worldwide approach. The territorial system of taxation may lend itself to affording fiscal advantages for exports, in particular by availing the opportunity to place the "income receiving part" of the export process, for example a sales subsidiary of a manufacturing enterprise, outside the territory, and thus outside the system of taxation. This advantage can be reinforced through national transfer pricing policies, which facilitate the movement of the profits between related parties located in different jurisdictions, for example to the foreign subsidiary. Transfer pricing is the practice of pricing goods and services exchanged, as between related parties. If the market price is not the operative price as between the related parties located in different jurisdictions engaged in the export process, the tax burden of the related party engaged in the export process within the territory can be reduced, and shifted to the subsidiary engaged in the export process abroad. These fiscal advantages may be further buttressed by a system

[3] The tax savings would depend which administrative rule the taxpayer chooses to apply. The determination of the exempt foreign trading income can be arrived at via the application of two distinct administrative rules: (i) [23% x Export Sales] x 15/23 or (ii) [1.83% x Export Sales] x 15/23. The choice of the formulas would generally depend on the taxpayers' profit margin. Alternatively, taxpayers are allowed to use normal transfer pricing rules as laid down in section 482 IRC.

[4] E.g., transfer pricing policies and export expense deductions.

[5] GATT Panel Reports [1976]: Income Tax Practices Maintained by France, Belgium, Netherlands, BISD 23rd Supplement.

of taxation that is more reliant on indirect taxes rather than direct taxes. In accordance with WTO norms, indirect taxes need to conform to the destination principle. Under this principle, exports are exempted from indirect taxes[6]. Finally, by adding a generous expenses regime related to export expenditures[7]; the fiscal advantages can be further expanded.

However, it is the case also that when a worldwide system of taxation is also combined with some of these features, or adapted to incorporate these features; it can produce a similar result as has been the case with the US DISC, FSC and ETI legislation. These fiscal advantages, either on their own, or through their combined operation, can effectively amount to tax subsidies contingent upon export, where a subsidy is defined in terms of revenue foregone by the government that is conditional upon export performance, as is the case in the WTO.

In 1971, the United States passed the DISC legislation under the Deficit Reduction Act 1971. The DISC legislation was the subject of a GATT Panel ruling, wherein the Panel determined the DISC legislation to be inconsistent with GATT prohibitions against export subsidies. In 1984, the United States passed the FSC legislation to replace the DISC system, in order to meet requirements of the GATT Panel decision. In 1997, the EU challenged the FSC legislation under the WTO, contending that it also constituted an export subsidy prohibited under the WTO. In 1999, a WTO Panel, and subsequently in 2000, the Appellate Body, ruled against the US. Consequently, the US passed legislation to repeal the FSC legislation and introduce a new system [the ETI regime] to replace it, under the Extraterritorial Income Act 2000. This attempt too was challenged by the EU in the WTO. A Panel ruled against the US, deliberating that the ETI constituted an export subsidy. The US appealed and the Appellate Body upheld the Panel decision. In the circumstances the EU sought to impose tariffs to the value of some $4 billion against the US for the US non-compliance with the WTO rulings in connection with the FSC legislation. The United States challenged the appropriateness of the proposed EU countermeasures. However, under a WTO Arbitration ruling issued on the 30th August 2002 the EU has been given the authority to take countermeasures and suspend concessions under the WTO, up to a maximum amount of $4,043 million per year of tariffs, as of the year 2000, the year when the United States was supposed to implement the WTO rulings on its FSC legislation[8].

[6] The destination principle does not apply to direct taxes.

[7] For example in the DISC Case the GATT Panel held that the provision in the DISC regime allowing 10% of export promotion expenses assigned as a deductible expense to a DISC amounted to an additional pecuniary benefit. See GATT Panel Report on the ISC case BISD, 23rd Supplement.

[8] Op cit footnote 2.

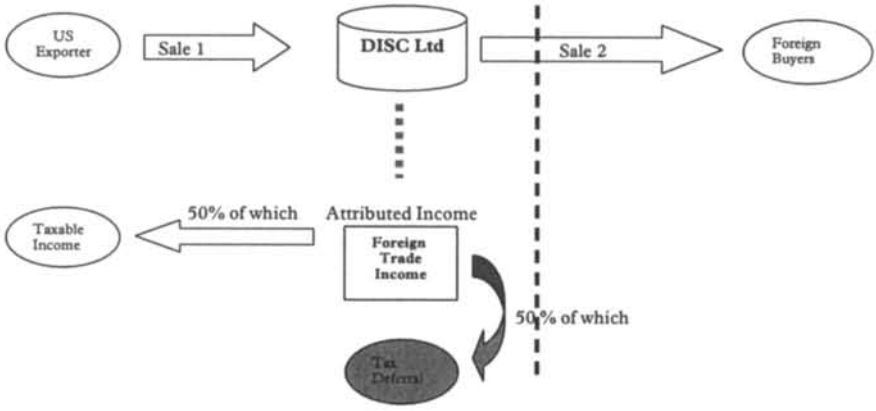
The relevant WTO jurisprudence generated by the various disputes contains important lessons, for the membership of the WTO, in the formulation of national tax policy — particularly the reach of WTO obligations with respect to direct taxation, in addition to touching on certain systemic WTO issues, particularly related to subsidies. Most developing members of the WTO will have to bear the full weight of the WTO Subsidies Code after the end of the transitional period for exemption from the prohibition of export subsidies to non-agricultural products.

## The DISC, FSC and ETI Legislation

In a nutshell, the DISC, FSC and ETI are three regimes under which qualified US exporters are offered substantial tax benefits on income derived from the export of "export property". Export property has generally been defined as property manufactured, produced, grown or extracted in the United States, and sold, leased or rented *for use outside the United States*, with no more than 50% of its fair market value attributable to imports. The value of the tax subsidy is comparatively similar under the different regimes, although the respective legal frameworks have been amended to reflect the different WTO rulings. Thus, the tax benefits essentially take the form in the case of the DISC of a *deferral* of tax liability, in the case of the FSC of an *exemption* from taxation, and in the case of the ETI of an *exclusion* from taxation.

### *The DISC Regime*

Under the DISC legislation[9], US companies were given the opportunity to benefit, *inter-alia,* from a tax deferral on a portion of the profits generated from export activities, for an indeterminate period of time. For this purpose,

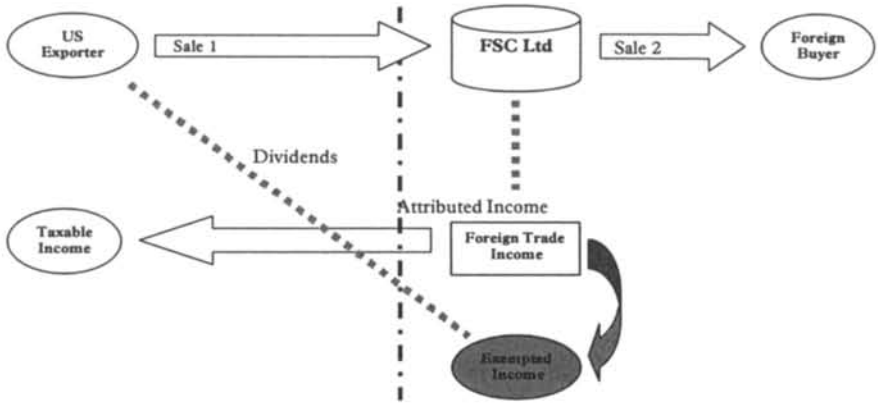



[9] Incorporated in Section 991-997 IRC.

they were invited to set up a DISC, through which their exports would be channelled. The US exporter would first sell the goods or services to the US DISC, which would then resell them to the foreign buyer. A share of the exporter's profits would then be attributed to the DISC *via* the application of three administrative formulas, which at the discretion of the US exporters would yield the maximum subsidy[10]. Half of the DISC's profits were deemed redistributed to the US exporter and therefore subject to taxation. Taxation on the other half would be deferred for an indefinite period — effectively tax exempt. The primary function of a DISC was to reduce the fiscal liabilities of US exporters on the profits they realised from their exports.

### *The FSC Regime*[11]

The FSC regime was more sophisticated, as it attempted to implement the DISC Panel decision and respond to the criticisms that the DISC regime was nothing other than a domestic tax haven. Under the FSC regime, while the transaction would involve two successive sales, the FSC had to be incorporated in an "accepted jurisdiction" i.e., outside the US. The FSC would then be attributed a share of the income derived from export activities. A portion of it would be deemed not connected with the conduct of business in the US, and therefore exempt from US taxation. The remaining portion would fall under the net of US taxation. In contrast to a DISC, the revenue of a FSC was based on the economic role it fulfilled — such as contract negotiation, solicitation, arranging deliveries, shipments, *etc.* Moreover, a FSC would have to bear some direct costs involved in the export transaction. Dividends distributed by the FSC to the US parent company would be eligible to a 100% deduction.



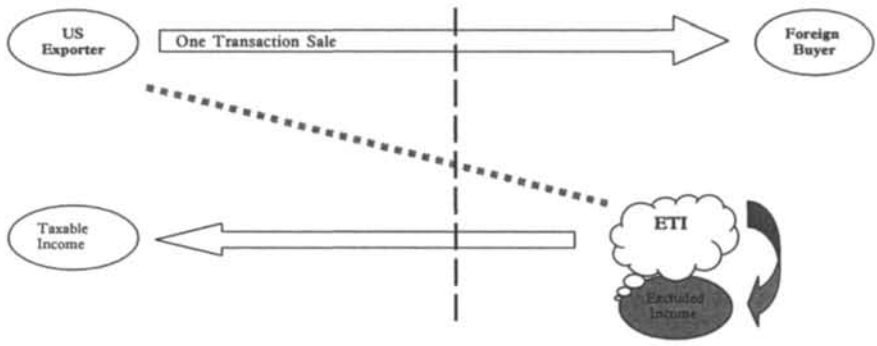

[10] Similar to those mentioned in footnote 4.
[11] Incorporated in Sections 921-827 IRC.

### *The ETI Regime*[12]

Under the ETI regime, a portion (Excluded Income) of the income that can be attributed to foreign economic processes (Extraterritorial Income or ETI) is *excluded* from gross taxable income. The ETI and the Excluded Income are calculated in very similar ways to the Foreign Trade Income and the Exempted Income under the FSC regime.

The ETI is an "income" concept rather than corporate entity-related. The main difference with the previous regimes is that the benefit is made directly available to US exporters, in the sense that the export property need not be channelled through a specifically created separate entity (e.g., a FSC or a DISC). Moreover, US exporters wishing to benefit from ETI benefits are not required to notify the IRS or elect to be treated under the ETI regime. However, ETI rules may not be used in conjunction with foreign tax credits.

The ETI benefits have been extended to foreign companies, provided that they elect to US fiscal residence. The ETI benefits are also made available in relation to property produced outside the US, whereas previous regimes had restricted the subsidy to property produced within the US. However, the ETI benefits remain contingent upon the consumption of the export property outside the US.




### The WTO Panel and Appellate Body Deliberations

In 1976, a GATT Panel[13] ruled that the DISC legislation:

- Conferred a tax benefit by way of a subsidy [through a *deferral* of tax payment, the manner of allocation of profits between parent companies and DISCs, and the allowance of export promotion expenses], that was related to US exports, and thus not consistent with US obligations under Article XVI: 4 of GATT 1947.

[12] Section 114 IRC.

[13] United States Tax Legislation [DISC] Panel Report 12th November 1976 [L/4422] BISD, 23rd Supplement.

This GATT Panel Report was adopted, *inter-alia,* on the basis of the 1981 GATT Council Understanding that:

- *"...in general, economic processes located outside the territorial limits of the exporting country need not be subject to taxation by the exporting country and should not be regarded as export activities in terms of Article XVI: 4 of the General Agreement."*[14]

In other words, if the DISC fulfilled an economic function, and its income was generated outside the US, then the US could exempt the whole or a part of that income.

To comply with the GATT ruling on DISC, as conditioned by the 1981 Understanding, the US adopted in 1984 the FSC legislation.[15] Some fourteen years later, the FSC was challenged by the EU (1998).[16] The WTO Panel and Appellate Body found:

- the FSC regime to constitute an export subsidy contingent upon export performance, contrary to both the WTO Subsidies Code, and the Agreement on Agriculture[17].
- The FSC tax exemptions were considered *"financial contributions"*, as the US government had foregone revenue otherwise due. This conclusion was arrived at by applying the *"but for test"* — i.e. through a comparison between the revenues due under the FSC and the revenues due without the FSC measure. This comparison was made on the basis that what is "otherwise" due is informed by the rules of taxation that each member of its own choice establishes. In this instance, it was clear that US exporters derived between 15% and 30% tax saving as a result of the measure[18].
- US claims that the issue at hand concerned transfer pricing — which in accordance with footnote 59 of the WTO Subsidies Code *"should normally"* be resolved *"using the facilities of existing bilateral treaties or other international mechanisms"* were rejected[19].
- Similarly, the US claim that the FSC legislation should be read in the light of the 1981 Council Understanding was rejected, as it did not form part of the law of the GATT 1994, nor did it constitute

[14] BISD 28S/114. The 1981 GATT Council action represents the adoption by the GATT CONTRACTING PARTIES of four controversial Panel reports regarding tax measures of France, Belgium, the Netherlands and the United States.

[15] Income Tax Reform Act 1984, incorporated in sections 921-927 IRC

[16] EU sought consultation under Art. 4 DSU, Art. XXIII. 1 GATT 1994 and Art. 4 SCM Agreement, 18 November 1997, WT DS108/1, 28 Nov. 1997.

[17] WTO Panel Report [1999]: United States -Tax treatment for "Foreign Sales Corporations" [WT/DS108/R]. WTO Appellate Body Report [2000]: United States –Tax treatment for "Foreign Sales Corporations" [WT/DS108/AB/R].

[18] ibid Panel Report paragraphs 7.41-7.85 and 7.86-7.119.

[19] ibid paragraphs 7.12-7.22.

subsequent practice in the application of GATT 1947 of the contracting parties to the GATT[20].

The US was therefore requested to bring its legislation in line with its WTO obligations by October 1, 2000.[21] In November 2000, the US Congress passed the ETI Act, and repealed the FSC legislation. However, the EU alleged that this legislation was not in conformity with the WTO ruling on the US FSC legislation, and violated *inter-alia* the WTO Subsidies Code. In a similar reasoning to that applied in the FSC dispute, a WTO Panel and the Appellate Body:

- Found that the ETI regime constituted a prohibited export subsidy, because the export contingency remained for property produced within the US[22].
- Moreover, the transition rules laid down by the ETI were found in violation of Article 4.7 of the WTO Subsidies Code, and the previous WTO ruling on the FSC, in that it remained perfectly possible for operating and established FSC's to be used until 31 December 2001.[23]
- The US argument that the ETI legislation was a measure to eliminate double taxation was rejected, because the ETI excluded income that could not possibly be legitimately taxed in any other jurisdiction[24].
- The ETI was also found to violate the Agreement on Agriculture and the national treatment standard under GATT 1994[25].

Finally, the US challenged the appropriateness of the level of the proposed EU countermeasures for its non-implementation of the WTO rulings on the FSC legislation. The Arbitration Panel dealing with the US challenge authorised the EU to suspend concessions under GATT 1994 "in the form of the imposition of a 100 per cent *ad valorem* charge on imports of certain goods from the United States in a maximum amount of $4,043 million per year"[26], until the US complies with the WTO rulings on its FSC legislation[27]. The award was calculated using the year 2000 as the year of assessment, it being the year when the US should have implemented the WTO ruling on the FSC legislation. The award was justified on the following grounds:

- Under the WTO Subsidies Agreement the countermeasures had to be "appropriate" i.e., the countermeasures "must be suitable or fitting"

[20] ibid paragraph 7.85.
[21] US-Tax Treatment for Foreign Sales Corporations, WT/DS108/AB/R 2000. The deadline was later extended to November 1 then November 17 with the consent of the EU.
[22] US-Tax Treatment for Foreign Sales Corporations, WT/DS108/AB/R 2000. The deadline was later extended to November 1 then November 17 with the consent of the EU.
[23] Ibid. The transition rules preclude the establishment of FSCs after 30 September 2000.
[24] Ibid.
[25] Ibid.
[26] Op cit footnote 2 para 8.1.
[27] ibid para 5.5.

in the particular circumstances in question[28]. Further, the countermeasures should not be "disproportionate[29]" i.e., disproportionate in the light of the fact that the subsides under the provision are prohibited. In other words, the appropriateness of the countermeasure is to be informed by the "nature and legal status of the particular underlying measure in respect of which the countermeasures are applied"[30]. In the particular case the subsidy is a prohibited subsidy and therefore it informs by aggravating rather than mitigating the appropriateness of the countermeasure[31].

- "Appropriate countermeasures" under the Subsidies Agreement, in the circumstances in question involving prohibited subsidies, are not limited to measures equivalent to the "trade effect" on the complaining WTO member, rather they are informed by the nature of the illegality in question, so as to induce compliance[32]. However, where the trade effect is greater than the subsidy, the trade effect has a role in the determination of the "appropriateness" of the countermeasure[33].
- The countermeasures proposed by the EU mirror the total amount of the US fiscal subsidy. The financial contribution by the US in the subsidy reflects accurately its involvement in the subsidy; and therefore that fact has an important and fundamental role with respect to the evaluation of the countermeasure[34]. The proposed EU countermeasures are proportionate in relation to the amount of the US export subsidy[35].
- The US obligation not to engage in prohibited subsidies is not mitigated by the fact that some of the subsidy impacts on its other trading partners. The US obligation is *erga omnes* owed in its entirety to any WTO member[36].
- In the circumstances in question the EU was the only complainant. However, had there been multiple complainants, that fact would be relevant in evaluating what constitutes "appropriate countermeasures"[37]. Similarly, in the event of future complaints under these circumstances, those complaints would give rise to a different situation for assessment of "appropriateness", and conceivably give

[28] ibid para 5.12.
[29] ibid para 5.15.
[30] ibid para 5.22.
[31] ibid 5.23.
[32] ibid paras 5.30 and 5.60.
[33] ibid para 6.33 and footnote 84.
[34] ibid para 6.20.
[35] ibid para 6.15.
[36] ibid para 6.10.
[37] ibid para 6.27.

rise to the allocation of the amount of countermeasures amongst the complainants[38]. In this respect the Arbitration Panel noted the EU willingness to share the task of applying the countermeasures against the US with other members[39].

**National and International Implications**

The US fiscal subsidies and the consequent WTO rulings touch upon a number of trade, as well as taxation issues; and which have an impact for national systems, as well as the international trading order.

*Taxation:*

- Direct Taxes: Taxation being the hand-maiden for national policy makers to secure a universe of national economic and social objectives, including trade policy — its interface with international trade regulation is consequently somewhat inevitable. In the context of the WTO the focus on this interface has hitherto been more pronounced in terms of indirect taxation. However, the WTO rulings on the US fiscal subsidy cases provide ample demonstration that direct taxes can equally be the subject of WTO disciplines.
- National sovereignty in taxation: Apart from border taxes, the WTO Agreements do not limit the fiscal sovereignty of a member in raising revenue. Members in fact enjoy a broad range of discretion in relation to their internal tax policy. This involves the freedom to decide the objectives, level, principles and methods of the system of internal taxation as it affects goods and services.
- Limits on national fiscal sovereignty: National fiscal sovereignty is constrained by the WTO agenda of trade liberalization i.e., the trade-related aspects of international taxation. In particular, the national remit has been limited by the WTO prohibitions on discriminatory and protective taxation, subsidies through taxation, and allied fiscal obstacles related to the flow of goods and services.
- Measures to avoid double taxation: Members have a wide degree of discretion in adopting measures to avoid double taxation, but the national measures to avoid double taxation must be in relation to *foreign-source income* and not just any income. Thus, only income that can be taxed in a foreign State as well as the State taking measures to avoid double taxation, qualifies[40].

[38] ibid para 6.29.
[39] ibid.
[40] See United States – Tax Treatment for "Foreign Sales Corporations" Recourse to Article 21.5 of the DSU by the EU [WT/DS108/AB/RW] paragraphs 138-186.

- Harmful tax competition: At a time when the OECD has been at the forefront of fighting harmful tax competition, the exploitation by the US of tax havens and low tax jurisdictions, as part of its apparatus for the maintenance of its fiscal subsidies for exports, raises questions in terms of the further development of an international code on harmful tax competition. It is the case though that in so far as the WTO rulings are concerned, they do not touch upon the international efforts to deal with harmful tax competition as such.

***Trade:***

- Generally, the US DISC/FSC and ETI fiscal subsidies have involved substantial subsidies — to the tune of about 4 billion US dollars a year.
- The subsidies have allowed US exporters to lower the prices of their exports in the domestic markets of other countries, as well as their respective foreign markets [i.e., third country markets].
- The subsidies have been very wide ranging, involving both goods and the services sector.
- The subsidies benefit export sectors which raise moral, social and political concerns, for example, armament and tobacco exports. In US Congress debates relating to the FSC/ETI legislation, it has been pointed out, based on US IRS statistics that US tobacco companies have enjoyed FSC tax breaks to the tune of more than $100 million a year.
- The subsidies benefit some of the largest and most profitable corporations in the world, for example Boeing, General Motors, R.J.Reynolds, Motorola, Cisco Systems, Monsato and Microsoft. Indeed, according to reports in the US congress, 78% of FSC tax benefits have gone to companies with assets exceeding $1 billion.
- Some of the subsidies are in sectors where the need for such assistance has been questioned[41]. Thus, US armament exports, it has been observed, are already very competitive in the international market. Similarly, it has been claimed, the US pharmaceutical sector benefits already from substantial research and development tax credits. Some drug companies have been noted to have been amongst the most profitable enterprises.

[41] See statements made in US Congress in the context of repeal of the US FSC legislation in particular statements by Mr Stark [106th Congress, 2nd Session, 146 Cong Rec H 7416, vol.146, No.106.

[42] According to one set of statistics for 1992 found on the US IRS website some 74 percent of FSCs were incorporated in US possessions. See Sarah E.Nutter "Statistics of Income Studies of International Income and Taxes", WWW.IRS.USTREAS.GOV

- The FSC system necessitated the establishment of offshore companies. The repeal of FSC has had some impact on the economies where these were set up, normally low or no tax jurisdictions. These economies benefit from licence fees, remuneration for attorneys and other professionals, including bank deposits and funds generated by the use of hotels and restaurants etc. Most of the FSCs were however incorporated in the US Virgin Islands and Guam[42]. The revenue implications therefore for the Caribbean financial centres are relatively smaller than that for the US possessions[43].
- The continued maintenance of these US fiscal subsidies will challenge the international trading system. In particular, the ability of the WTO to manage trade wars rather than concentrating its attention to the liberalization of international trade. The circumstances have entitled the EU to impose the largest retaliatory sanctions in the history of international trade. Although such retaliatory punitive sanctions, if actually enforced by the EU, will only exacerbate international trade relations.

*Developing countries:*

- The subsidies have been wide ranging and have included, in particular, sectors that are of especial interest to developing countries, for example agriculture, pharmaceuticals, and the software industry. On the other hand the subsidies exclude sectors in which subsidies might be beneficial to developing countries, for example fiscal subsidies in the intellectual property rights sphere, petroleum and unprocessed timber.
- The subsidies benefit export sectors [for example tobacco and armaments] which challenge in particular the moral, social and political vulnerabilities of developing countries.
- The Arbitration Award of 4 billion countermeasures in favour of the EU[44], although in theory does not preclude other complainants from pursuing litigation in the WTO against the US in respect of the same fiscal subsidies, leaves some uncertainty as to the precise mechanisms involved in relation to the allocation of the countermeasures for future WTO member litigants. Indeed, by making such an award to the EU the Arbitration Panel raises the question whether *de facto* it has handed the lead policing role of WTO norms to the EU in respect of the US

[43]In the case of Barbados at the end of 2000, the total number of FSCs was 2,975 [WTO Trade Policy Review Barbados 2002: Report of Barbados]. Following the WTO Panel and Appellate Body rulings on the FSC the number of new FSCs declined to 118 in 2000, down from 384 licensed during 1997. As a consequence the Barbados authorities estimated a decline in income from licensing fees. For about 2,500 FSCs in 1999, the contribution to government revenue in terms of licence fees was about BDS$3.6 million [See WTO Trade Policy Review Barbados 2002: Report of the Secretariat].

[44] Op cit footnote 2.

fiscal subsidies in question. In particular, the award raises the question whether the litigation choices for WTO members generally, and more particularly developing members, have been complicated in relation to these specific US fiscal subsidies. Developing members may well be more prone to allowing the EU to take the leadership role here.

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# 3. WTO complaints by Australia and Brazil regarding the EU Sugar Regime

***Stephen J. Orava and Carol C. George***

## 1. Introduction

On 27 September 2002, the Governments of Australia and Brazil (the "Complainants") filed requests for consultations with the European Communities ("EC") alleging that the structure of its sugar market violates its obligations under certain agreements of the World Trade Organisation ("WTO"). If the Complainants are successful in their challenge, the EC may find itself obligated to change the nature of its sugar market in order to bring it into compliance with WTO obligations. Such changes could result in a significant reduction in price supports from which domestic and certain African, Caribbean and Pacific ("ACP") suppliers benefit.

## 2. The EU Common Market Organisation (CMO) for Sugar

### *2.1 General Structure*

The EU's Common Market Organisation ("CMO") for sugar has the following five principal features:

- *production quota scheme*
- *guaranteed price and intervention mechanism*
- *export refund programme*
- *production levies*
- *preferential import programme*

### *2.2 Quota Scheme*

Under the CMO, processors are required to pay growers a guaranteed minimum beet price, and the EC will pay producers a fixed "intervention price" for a certain quantity (quota) of refined white sugar per EC Member state. National quotas are allocated to individual sugar-producing factories. There are two types of quota: A and B, the main difference being the level of the production levies applied to them. Only "quota sugar" can be sold in the EC; sugar produced in excess of quota ("C-sugar") must be exported without any export refund. Thus, the quota system acts as a limitation on the supply of sugar on the EC sugar market.

### *2.3 Prices*

Quota sugar in excess of EC consumption is eligible for price support through the intervention mechanism and export refunds. The "intervention price" is the price at which the EC is prepared (and obligated) to buy white quota sugar. The intervention price therefore acts as a guaranteed minimum price. It is fixed annually by the EC Council of Ministers of Agriculture based on a proposal by the Commission. Producers may either sell their surplus quota sugar to an Intervention Agency at the fixed price, or they may export it and obtain a refund of the difference between the EC intervention price and the world market price. Producers pay a levy on the production of quota sugar to cover the cost of refunding these losses.

Raw sugar and "basic beet" and cane prices are derived from the intervention price. The basic beet price guaranteed to the farmers is about 58% of the intervention price, while processors receive 42%, plus the difference between the higher EC market prices and the intervention price.

### *2.4 Export and Production Refunds*

Under the export refund programme, surplus quota sugar and preferential sugar are exported with the support of export refunds. Losses incurred on the world market are recouped by receipt of export refunds paid out of production levy proceeds. The Commission manages this programme by deciding weekly on the refund rates based on offers made by sugar traders and taking into account the world price of sugar and the total quantity of sugar that might qualify for refunds during the marketing season. Approved export refunds will never exceed the maximum export refund, which is equal to the intervention price (plus storage and shipping costs), minus the export price obtained on the world market.

In addition, the EC makes available to domestic chemical and pharmaceutical producers "production refunds" in connection with their use of highly priced sugar products as raw materials. The production refund level is derived from the average of the awarded export refunds and fixed on a quarterly basis.

### *2.5 Production Levies*

The EC charges producers "production levies" that are intended to recover from the sugar industry the cost of the export refunds and production refunds. Thus, the export refund support system is "self-financing" and therefore, arguably, not a direct subsidy from the EC. The levies are paid by the sugar producers who reclaim 58% of the levy from the farmers by a discount on the beet price.

Each Member State has a national Paying Agency and Intervention Agency that collects the production levies, pays the export refunds and buys the sugar at the intervention price, should it be offered to them. In practice, there has only been one intervention purchase (by a German Intervention Agency in the mid-eighties). Apparently, the option of exporting surplus quota sugar with the support of export refunds is more attractive than selling the sugar to an Intervention Agency.

### *2.6 Preferential Import Programme*

The UK has historically imported large quantities of raw cane sugar from ACP countries for refining in the UK. When the UK joined the EC, provision for importation of sugar from the ACP countries was incorporated into the 1975 EC/ACP (IVth Lomé) Convention and embodied in the CMO. This protected the interests of the UK refiners and supplying countries, and ensured that supply channels were not disrupted. Under the 8th Protocol (Sugar Protocol) to the Convention, the EC guarantees that it will buy annually a fixed quantity of white sugar equivalents from the ACP countries for an indefinite period. These imports are exempt from import duties. India was also added to the list of countries for preferential treatment. This imported sugar is referred to as "preferential sugar".

Prices to be paid for preferential sugar are negotiated annually between the EC and the ACP countries. Under the Sugar Protocol, the price is to be "within the price range obtaining in the Community, taking into account all relevant economic factors". In practice, the price for ACP raw cane sugar has always been equivalent to the intervention price for EU-produced raw sugar, and the guaranteed price of white sugar has been equivalent to the derived intervention price in the UK. The EC guarantees that price and is prepared to buy through the Intervention Agencies in case no other buyer is prepared to buy at the guaranteed price (which has never happened). In practice, therefore, the ACP countries receive the same guaranteed price as Community sugar producers.

## 3. Basis for WTO Complaints

The Complainants present two main claims: firstly, that the EC has provided export subsidies in excess of its WTO commitments, and secondly, that the provision of a guaranteed intervention price is a violation of the national treatment obligation in that it is available only to EC producers. Little elaboration is provided in the request for consultations, and we can only surmise that the following is the approach that Brazil and Australia will pursue in potential dispute settlement proceedings.

### *3.1 Export Subsidies in Excess of Commitments*

The Complainants assert that under the CMO for sugar the EC is, in two regards, providing export subsidies for sugar that exceed the reduction commitment levels set out in its Schedule. First, they claim that the *CMO for sugar, its intervention price system and regulatory mechanism*, taken as a whole, enable producers to export C-sugar at prices below the total cost of production. They argue that by guaranteeing a high domestic price for A-quota and B-quota sugar, the EC is subsidising exports of non-quota C-sugar on the world market, in excess of its reduction commitments.

Secondly, they claim that the "*export refunds*" provided to producers in relation to surplus A-quota and B-quota sugar are export subsidies in excess of the export subsidy reduction commitments of the EC. In support of these assertions, they cite certain provisions of the WTO Agreement on Agriculture, the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") and the GATT 1994.

#### *3.1.1 SCM Agreement*

Without demonstrating that the measures at issue are export subsidies, or subsidies at all, the Claimants cite Articles 3.1 and 3.2 of the SCM Agreement, which prohibit subsidies that are contingent upon export performance. A footnote to Article 3.1(a) makes clear that factual, as opposed to legal, contingency may suffice[1]. Importantly, however, Article 3.1 is expressly subject to the provisions of the Agriculture Agreement, which apply to agricultural products, including sugar, by reason of Article 2 and Annex I on Product Coverage. The Agriculture Agreement therefore supersedes the prohibition on export subsidies under the SCM Agreement.

The Complainants also contend that the alleged export subsidies are not exempt from challenge under Article 3 of the SCM Agreement, by reason of the "Peace Clause" in Article 13(c) of the Agriculture Agreement. This clause imposes restraints on countervailing duty actions against export subsidies and exempts them from actions under Article 3, 5 or 6 of the SCM Agreement during the implementation period, which expires at the end of 2003. Brazil claims that the Peace Clause does not apply because the alleged export subsidies do not "conform fully to the provisions of Part V of the Agriculture Agreement", based on the level of subsidies exceeding scheduled commitments.

[1] FN 4: *"This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision."*

### *3.1.2 Agriculture Agreement*

In the WTO Agreement on Agriculture, Members have undertaken to *reduce* export subsidies and, further, that they will not provide export subsidies except in accordance with the Agreement and the commitments as specified in each Members' Schedule[2]. Article 8 is the basic foundation for the Claimants main claim.

#### 3.1.2.1 Definition

The Agriculture Agreement does not define "subsidy". Article 1 of the SCM Agreement, which defines "subsidy" for the purposes of *that* agreement, deems a subsidy to exist if there is any form of income or price support (Article 1(a)2)...and (b) a benefit is thereby conferred. If Article 1 of the SCM Agreement applies to these claims, the first question is whether the CMO on sugar, or the export refund, even if they amount to price support, confer a benefit. If so, and they are therefore "subsidies", are they "export" subsidies?

"Export subsidies" are defined in Article 1(e) of the Agriculture Agreement as "subsidies contingent on export performance, including the export subsidies listed in Article 9 of this Agreement". This corresponds generally to the description of the prohibited subsidies in SCM Article 3.1, except that it includes no sub-text in relation to legal or factual contingency. Although that provision may be subordinated to the Agriculture Agreement, it is possible that a WTO panel might seek to harmonise the agreements in regard to the definition, thus adopting the standard of actual or anticipated contingency as a means of determining whether export subsidies exist.

With respect to the system as a whole, neither Brazil nor Australia identify precisely which element of the "intervention price system" is the benefit conferred, or how the alleged subsidisation of C-sugar is contingent upon export performance. From one perspective, the EC has never, with the exception of one incident, provided any intervention payment to producers, and EC market prices sustain themselves. This is not a government payment scheme: consumers pay the high prices. Neither is it clear that the industry-financed export refund, which *is* contingent upon export, is a benefit conferred by the government. Taken in isolation, the export refund regime may be interpreted as not price support at all, but a voluntary insurance fund to cover losses incurred by the industry.

#### 3.1.2.2 Export subsidies subject to reduction

Certain types of export subsidies are positively identified, in Article 9.1 of

[2] Agreement on Agriculture - Article 8: *"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule."*

the Agriculture Agreement, as being subject to reduction commitments. These are largely *direct* export subsidies, which are considered to cause the most distortion. The Claimants point to those export subsidies defined in sub-paragraphs (a) and (c) of Article 9.1[3].

Article 3.3 of the Agriculture Agreement states that a Member cannot provide these types of export subsidies in regard to any agricultural products or groups of products that are not specified in Section II of Part IV of the Member's Schedule. It may only provide Article 9.1 export subsidies in relation to those particular agricultural products/groups of products set out in its Schedule, and only to the extent of the budgetary outlay and quantity commitment levels specified therein.

3.1.2.3 Non-circumvention of export subsidy commitments

Article 10 of the Agriculture Agreement requires that "other" export subsidies, those not listed in Article 9.1, shall not be applied in such a way as to circumvent the export subsidy commitments. The fact that the Complainants rely on this provision implies that they may wish to demonstrate that the CMO in sugar amounts to another type of export subsidy, perhaps not as well-defined as those listed in Article 9.1, that allegedly circumvents the commitments of the EC. This view is supported by the fact that they have also cited provisions of Article XVI of GATT 1994, which contains references, in paragraphs 3 and 4, to the concept of indirect subsidisation. Those provisions also denounce the notion that any subsidy should result in a WTO Member having more than an equitable share in the world export trade in the subsidised product.

Most of the relevant obligations in Article XVI of GATT 1994 have been elaborated upon in the SCM Agreement, but WTO dispute settlement panels are still obliged to apply them along with the Uruguay Round agreements, including the SCM Agreement, whenever such application is possible and does not raise a conflict.

### *3.1.3 Conclusion*

The success of the claim, that export subsidies have been applied in excess of commitments of the EC, will depend on a persuasive argument that the overall effect of domestic price support, exports of surplus quota sugar with

[3] Agriculture Agreement - Article 9.1(a) and (c)

"*1. The following export subsidies are subject to reduction commitments under this Agreement:*

*(a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance;*

*(c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;"*

refunds, and exports of C sugar should be considered together and that the cumulative effect is a form of indirect subsidisation that is not in keeping with the spirit of the Agreement. To support this claim, the concept of export subsidies subject to reduction in the Agriculture Agreement will have to be construed much more broadly than the express provisions appear to dictate. Notably, the other factors in play in the system, the special safeguard measures keeping out non-preferential sugar imports and preferential arrangements with the ACP countries have not been directly challenged by Brazil and Australia in these requests.

### *3.2 Intervention Price Constitutes a National Treatment Violation*

The second main argument put forward by the Complainants is that the guarantee of a fixed Intervention Price for in-quota sugar sold in the EC is a violation of Article III of the GATT, because it is only available to EC producers, thus affording imported products less favourable treatment. Article III of the GATT has been considered at length in the history of the GATT and the WTO and extensive analysis would be necessary to thoroughly assess whether there is legal foundation to this claim. Whatever its technical merits, however, the claim is of little practical importance, given that almost all non-preferential sugar imports are excluded from the EC market by 140% tariffs. The only significant imports are those imported on a preferential basis, which enter free of tariffs and receive what is in effect the guaranteed intervention price. In the absence of a challenge against tariffs, non-tariff barriers and MFN, Brazil and Australia will benefit little from a national treatment claim.

## 4. Policy Arguments in Suppport of Complaints

The policy arguments in favour of the complaints by Australia and Brazil are persuasive from both a trade and a development perspective. From a trade policy perspective, principles embodied in the WTO and other trade agreements disfavour the use of subsidies as an instrument of trade policy, particularly where they are directly related to exports. The basis for this relates to the distortions that such subsidies cause in otherwise competitive markets. In this case, EU export-contingent subsidies for sugar are alleged to be the cause of substantial declines in the world market price for sugar to levels below the cost of production for the most efficient producers. Such distortions and the inefficiencies that they cause are the basis for the prohibitions on export subsidies in trade agreements.

In addition to basic trade policy objections to the EU's sugar regime, substantial development-based objections have been raised, both by WTO Members and by non-governmental organisations ("NGOs"). For example, Oxfam prepared a briefing paper on "The Great EU Sugar Scam", in which

it set forth its unequivocal views on the cover:

> "European consumers and taxpayers are paying to destroy livelihoods in developing countries. Under the Common Agricultural Policy (CAP), the EU has emerged as the world's largest exporter of white sugar. Subsidies and tariffs generate vast profits for big sugar processors and large farmers - and vast surpluses that are dumped on world markets. Smallholder farmers and agricultural labourers in poor countries suffer the consequences. Oxfam is calling for an immediate end to EU sugar exports and improved market access for the poorest countries."

As discussed below, however, certain ACP countries rely heavily on the EU regime to support their economy. Oxfam considers that those benefits accruing to certain ACP countries are unjustified, however, because "almost 80 per cent of the benefits accrue to just five of them - Mauritius, Fiji Islands, Guyana, Swaziland and Jamaica - none of which are least developed countries." It also argues that the preferential access accorded to these ACP countries has:

- "limited the opportunity for these ACP countries to add value to their commodity exports and create their own white sugar brands" and
- "led several countries to have a high degree of dependence on exports of raw sugar cane."

Essentially, other WTO Members and certain NGOs consider that sacrificing the interests of certain developing ACP countries, at least in the short term, is acceptable in order to improve the situation for a larger group of developing and least developed countries that are not benefiting under the current EU regime. It is obvious that Australia and Brazil support their WTO complaints because it is in the interests of their sugar producers and exporters, but they have not paired this self-interest with any proposals about how to address the adverse consequences, whether intended or unintended, on a number of ACP countries. Certain NGOs similarly ignore or otherwise marginalize the interests of these ACP countries by failing to understand the magnitude of the irreversible damage that would be caused.

It would appear warranted for the Complainants and interested NGOs to evaluate how to address the specific consequences of succeeding in a WTO challenge prior to moving forward and to present proposals now for addressing the potentially catastrophic effects of a successful WTO case on a number of ACP countries.

## 5. Impact on ACP Countries

For certain ACP countries, the consequences of a successful case that results in the removal or substantial lowering of the guaranteed price for the purchase of ACP raw cane sugar could be catastrophic in the short term.

For example, as reported by the EC's Court of Auditors, Mauritius benefits the most out of all ACP countries in the preferential structure of the EC regime. Approximately 95 percent of all 1998 sales were conducted under the EC's Sugar Protocol. A substantial decline in the prices guaranteed to raw sugar cane originating in Mauritius, in favour of cheaper exports from Australia and Brazil, would have disastrous effects on the local economy and societal welfare generally.

More generally, the benefits of the EU's preferential sugar regime are estimated at Euro 500 million per year compared to the earnings available on the world market. Most of the benefits of the sugar regime accrue to only a few developing countries, including Fiji, Guyana, Jamaica, Mauritius, and Swaziland. Thus, the impact on these countries of a successful challenge by Australia and Brazil would be to destroy their primary source of income.

Although it may be the case that these five economies, as well as several other developing and least developed ACP countries, focus too narrowly on a single crop, the type of systemic changes necessary to transform their economies will take decades. The effects of the reforms in the EU market, however, are likely to be immediate and catastrophic.

## 6. Third Party Participation in WTO Proceedings

Based on the significant adverse effects described above, those ACP countries that are also WTO Members may determine that it is in their interests to participate directly in the WTO case. Because the countries would essentially be supporting the EC's defence of the case, their role would be limited to joining in consultations, if permitted, and participating as a third party in any dispute panel and/or Appellate Body proceedings.

### *6.1 Joining Consultations*

Article 4.11 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") provides for the participation of third party countries in consultations. In general, for a WTO Member to participate in consultations in the dispute involving the EU sugar regime, it must:

(1) consider that it has a substantial trade interest in the consultations between the EU and the Complainants;
(2) notify the EU, the Complainants, and the WTO's Dispute Settlement Body ("DSB") by Friday, 11 October 2002; and
(3) ensure that the EU agrees that the third country's claim of substantial interest is "well-founded" and informs the DSB accordingly.

The previous section on the impact of a successful case appears to provide ample support for certain ACP countries to satisfy the above conditions for consultations. As a legal matter, the only condition effectively outside the

control of these countries is the final condition of obtaining the EU's consent for the countries to join consultations.

In the past, WTO Members have refused to grant this consent, although only in unusual and highly controversial cases and/or where the countries denied consent were supporting the complainants. For example, as part of the lengthy dispute settlement proceedings challenging the EU's banana regime, the EU requested WTO consultations regarding the U.S. approach to retaliation following an adverse panel and Appellate Body decision, the so-called "carousel".[4] The United States refused to allow Australia, the Dominican Republic, Jamaica, Japan, and Saint Lucia to join consultations, relying on the discretion accorded to the defending Member under DSU Article 4.11 and on its view that such countries did not have a substantial trade interest in the dispute. The EU was especially critical of the U.S. action and thus is unlikely to refuse requests from the ACP countries, especially as they are supportive of its defence.

Therefore, the first step for ACP countries that would be adversely affected by a successful challenge to the EU sugar regime or that would otherwise be affected by any reform to such regime is to request immediately to join consultations under DSU Article 4.11.

### *6.2 Third-Party Participation Before a Panel and/or the Appellate Body*

Assuming consultations fail to resolve the dispute and the Complainants decide to request the establishment of a WTO dispute settlement panel, ACP countries may decide to participate in the panel proceeding as a third party. DSU Article 10.2 enables third-party WTO Members to notify the DSB and participate in the proceedings where they have a substantial interest in the matter before the panel. Unlike in consultations, DSU Article 10.2 does not accord any discretion to the defending Member(s) or the Complainants to prevent other WTO Members from participating in the proceedings as third parties. Thus, ACP countries that may be adversely affected by a successful challenge to the EU sugar regime have the right, as WTO Members, to participate in the panel proceedings. A similar right exists if a panel's findings are appealed to the Appellate Body.

## 7. Conclusion

Australia and Brazil have initiated the first formal step in WTO dispute settlement proceedings by requesting consultations with the EC regarding its sugar regime. The precise nature of the Complainants' claims remains unclear,

[4] See, e.g., United States - Section 306 of the Trade Act of 1974 and Amendments Thereto, WT/DS200.

although they clearly target the EC's mechanisms for ensuring relatively higher prices for EU-origin sugar beets and for preferential imports of raw cane sugar. If the Complainants are successful, the EC may decide to reform its sugar regime in a manner that reduces or eliminates the price supports for the purchase of preferential imports of raw cane sugar. Such a result would be catastrophic for certain ACP countries that rely almost exclusively on the EC market for sales of their raw cane sugar.

Although the Complainants and certain NGOs have voiced strong opposition to the EU sugar regime on trade and development grounds, they have not shown sufficient concern about the effects of reforms on those developing and least developed ACP countries that rely on the regime almost exclusively to support their countries. Certainly, the benefits to reforming the EU sugar regime for the Complainants and other producing countries should be balanced against the significant and irreversible harm that may be caused to certain ACP countries. The focus moving forward should be on achieving such a balance through comprehensive negotiations in the context of the Doha Development Agenda among all interested parties rather than on a resource-intensive WTO dispute on the technical details of the EU regime.

# 4. WTO Complaints by Brazil Against US Cotton Subsidies

*Carol C. George*

## 1. Introduction

On the 27th of September 2002, Brazil requested consultations with the Government of the United States in connection with US subsidisation of its domestic cotton industry. Zimbabwe, India and Argentina have submitted requests to join the consultations. Brazil itemises 12 types of measure which it considers to be inconsistent with the WTO obligations of the US, alleging that these are prohibited and actionable subsidies provided to US producers, users and exporters of upland cotton, which seriously prejudice the interests of Brazil. Brazil says that these subsidies result in significant price depression and price suppression in Brazilian and other markets, displacement or impediment of Brazilian cotton exports to third countries, and an increase in the US world share of the upland cotton market. Further, it says that these measures create mandatory conditions that will continue to suppress prices and foster US over-production that will continue to displace and impede Brazilian exports.

The immediate motivation for the Brazilian claim against US subsidies is the enactment this year of the 2002 Farm Act, which increases government payments to American agricultural producers. The 2002 Act modifies and expands existing programs under the 1996 Farm Act to ensure that the US government provides substantial income support to farmers, including cotton producers, into 2007. The increase in US subsidisation comes at an inopportune time, as negotiations under the Doha Development Agenda face difficult issues in regard to the liberalisation of trade in agricultural products. The increase in US support flies in the face of US commitments to progressively reduce subsidies, and undermines the confidence of developing countries which are reliant on such reduction commitments for improved access to the markets of developed nations.

The policy basis of the claim is clear. The legal situation is somewhat more complex, given the simultaneous application of the SCM and Agriculture Agreements of the WTO, and the 'peace clause', which requires Members to restrain from action against each other's agricultural subsidies until after the end of 2003.

By focusing on inequalities at the centre of global agricultural trade, the Brazilian challenge against US subsidies may have wider implications for the

Doha Agenda agriculture negotiations. The dispute will address the role of production subsidies and associated export dumping in driving down world prices, and their potential to undermine the trade prospects of developing countries where they would otherwise enjoy a comparative advantage. The questions are central to the economic well-being of many of the world's developing nations.

## 2. The challenged measures

Brazil requests consultations in regard to all US subsidisation of the US upland cotton industry. First, it refers generally to domestic support subsidies and export subsidies provided during 1999-2002, subsidies contingent on the use of US upland cotton, and all trade-distorting domestic support measures that are not 'green-box subsidies' under the WTO Agreement on Agriculture (see below), and are thus subject to reduction commitments.

Secondly, Brazil targets specific domestic support and export subsidies provided under a number of pieces of itemised US legislation, the primary one being the new *US Farm Security and Rural Investment Act of 2002* ('FSRIA' or '2002 Farm Act'), followed closely by its predecessor, the *1996 Federal Agriculture Improvement and Reform Act* ('FAIR Act' or the '1996 Farm Act'). The 2002 Farm Act supports farmers through three main commodity programs:

- direct income payments;
- 'counter-cyclical' payments that provide benefits whenever the effective price of the commodity is less than its 'target price'; and
- marketing assistance loans and loan deficiency payments.

Measures which provide for subsidies relating to crop disaster and insurance are identified under the Agricultural Risk Protection Act of 2000 and Brazil also challenges 'subsidies' provided under the Extraterritorial Income Exclusion Act of 2000, the Agricultural, Rural Development, Food and Drug Administration and Related Agencies Appropriations Acts of 1999, 2000, 2001 and 2002 and the Crop Year 2001 Agricultural Economic Assistance Act.

Targeted export measures include those under the Agricultural Trade Act of 1978 and the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ('ETI Act') and other programs which facilitate the export of US upland cotton. Export measures include export subsidies, exporter assistance, export credit guarantees, export and market access enhancement, and the 'Step 1 and Step 2' certificate programs under the 1996 Farm Act.

Lastly, Brazil includes a catch-all claim against any export or domestic subsidies provided under secondary legislation or administrative procedures and any measures, existing or future, that implement any of the measures previously listed.

## 3. The claim: serious prejudice

The claim of Brazil is a comprehensive one: that virtually all US cotton subsidies, in the form of domestic assistance, support for exports, and payments contingent on use of domestic goods, violate the WTO agreements on Agriculture and the SCM Agreement. The overarching assertion is that the challenged domestic and export subsidies are 'actionable' under the SCM Agreement because they have caused serious prejudice to the interests of Brazil, while export subsidies are *prima facie* prohibited by the SCM Agreement. Remedies for these complaints entitle Brazil to both countervailing duty action and dispute settlement proceedings under the SCM Agreement.

The catch is that each of these claims is subject to provisions of the Agreement on Agriculture which exempts agricultural subsidies from action by other Members until the end of 2003. Brazil claims that while both types of subsidies are maintained on agricultural products, neither conforms sufficiently to the requirements of the Agriculture Agreement to benefit from this 'peace clause'.

Lastly, Brazil claims that government payments contingent on the use of domestic over imported cotton offend the WTO requirement on national treatment, which requires that imports be treated no less favourably than domestic products.

*Actionable subsidies: 'serious prejudice'*

Brazil claims that the US has, through the use of subsidies, caused serious prejudice to its interests, in violation of Article 5(c) of the SCM Agreement. Both domestic support measures and export subsidies can be actionable under this head. Brazil argues firstly that all the relevant criteria have been met to demonstrate that the measures are in fact 'subsidies' under the Agreement, and then points to Article 6.3 of the SCM Agreement, which says that serious prejudice may arise where the effect of a subsidy is to displace or impede the imports or exports of the like product of another Member.

Brazil says that the US subsidies have caused serious prejudice by depressing or suppressing upland cotton prices in Brazil and displacing or impeding exports of Brazilian cotton in third country markets. It claims that the effect of the subsidies has been to increase the US world market share in upland cotton in 2001 as compared to the average market share during the 3 prior years, and this follows a consistent trend which has resulted in an overall increase of 23.3% (from 16.7 to 20.6 %) during the period from 1985 to 2001.

The actions or remedies available on grounds of 'serious prejudice'[1] include a dispute settlement procedure which is new to the SCM Agreement[2], and the

[1] While 'actionable subsidies' also include those that cause 'injury to the domestic industry' or 'nullification and impairment of benefits accruing under GATT 1994', Brazil focuses here on 'serious prejudice to the interests of another Member'.

[2] SCM Agreement, Article 7.

parallel Part V countervailing duty procedure, an elaboration of that set out in GATT Article VI. Imposition of countervailing duties requires a national investigation to demonstrate that the subsidies have caused injury to the domestic industry, a ground not pursued by Brazil in this proceeding.

## 4. The 'peace clause': exemption for agricultural subsidies

Even if Brazil is able to provide sufficient evidence to show that 'serious prejudice' has been caused, the whole SCM action could be thwarted if the US successfully invokes the requirement of 'due restraint' on challenges against agricultural subsidies set out in Article 13 of the Agreement on Agriculture. The SCM Agreement repeatedly subjects its provisions to those of the Agreement on Agriculture. Express references to Article 13 of the Agreement on Agriculture, which exempts agricultural subsidies from action under the SCM Agreement, can be found in Articles 5, 6.9 and 7.1; a more general caveat in relation to application of the Agriculture Agreement is set out in relation to the prohibition of export subsidies[3], and, in the provision for countervailing duty actions[4].

Under the Article 13 'peace clause', Member states have agreed that until the end of 2003 they will not challenge each others' agricultural subsidies, as long as the measures conform to the terms of the Agriculture Agreement. Separate provisions regarding conformity apply to domestic support measures[5] and export subsidies[6].

### *4.1 Domestic support measures*

According to the peace clause, there are two bases on which domestic support measures for agricultural products will be exempt from actions under the SCM Agreement and the GATT. If the measures are 'green box' measures that conform to Annex 2 requirements, they are:

- non-actionable for the purposes of countervailing duties,
- exempt from challenge as 'actionable' subsidies causing injury, nullification and impairment or serious prejudice under GATT and the SCM Agreement, and
- exempt from 'non-violation' actions based on nullification and impairment of tariff concessions[7].

[3] Agreement on Agriculture, Article 3.
[4] Ibid, Article 10.
[5] Agreement on Agriculture, Article 13(a) and (b).
[6] Ibid, Article 13(c).
[7] Ibid, Article 13(a).

If the measures are 'amber box' trade-distorting measures and they are being reduced in accordance with Article 6 of the Agreement on Agriculture and the Member's scheduled commitments[8], then they are:

- exempt from countervailing duties unless there is a finding of injury,
- exempt from challenge as 'actionable' subsidies, *provided that* they don't grant a specific commodity support in excess of 'that decided during the 1992 marketing year, and
- exempt from 'non-violation' actions based on nullification and impairment of tariff concessions[9].

These provisions raise two issues. The first is whether the subsidy in question is a green box measure which is not subject to reduction, or an 'amber box' measure which is considered trade-distorting and subject to reduction. The second is whether the amber box support for upland cotton exceeds that decided during the 1992 marketing year.

### *4.1.1 'Green' or 'amber'?*

The two basic criteria for green box measures are that they must be funded through a government program that does not involve transfers from consumers, and may not have the 'effect' of providing price support to farmers. Green box also requires that eligibility for payments be determined in relation to a defined and fixed base period; and the amount of such payments in any year must not be related to the type or volume of production, market prices, or to input factors used in production, in any year after the base year. As a result, whether or not an income support program is truly 'decoupled' within the meaning of the Agreement on Agriculture can be a matter of debate and each of the challenged provisions will have to be addressed separately by a panel in order to make the appropriate determination.

- *Direct income payments* to farmers are the least coupled of the programs under the Farm Act 2002, but may influence production through wealth and investment effects. Provisions for updating base acreage and program yields may also have some influence on current production choices if farmers expect future legislation will again allow them to update these items for their farms[10]. Direct payments are calculated annually by way of a fixed payment rate for each crop for

[8] Under the Agriculture Agreement, WTO Members are required to reduce their annual levels of amber box domestic support ('aggregate measurement of support' or 'AMS') by reference to a 'Base Total AMS' calculated for each Member over a specified period. Developed countries, including the United States, were required to reduce their total AMS by 20% during the period 1995 to 2000, while developing countries are committed to a reduction of 13.33% over the 10-year period from 1995 to 2004. US amber box domestic support is currently capped at a maximum US$19.1 billion for about 2 million farmers ($9,950 per farmer), as compared to US$60 billion for the EU's more than 7 million farmers ($8,571 per farmer).

[9] Ibid, Article 13(b).

[10] *The 2002 Farm Act: Provisions and Implications for Commodity Markets*, Economic Research USDA, 2002, 17.

the entire life of the Act, and are in theory not affected by current production or by current market prices. Direct payments are based on 'historical' acreage and yields, although the new Act increases commodity rates and gives farmers an opportunity to upgrade the registration of their 'historical' acreage to reflect their current operations.

The 'decoupling' process was started under the 1996 Farm Act, to encourage farmers to respond to market forces and backed by a safety net in the form of a marketing loan and loan deficiency program. The 1996 Farm Act fixed total expenditure levels for each fiscal year and payment levels were allocated among contract commodities according to percentages specified in the Act. Eligible farmers obtained the annual payment by enrolling acreage in a 7-year 'production flexibility contract' that obliged the farmer to meet certain conservation compliance requirements. In exchange, farmers were largely freed from restrictions on what they could plant, giving rise to the name '*Freedom to Farm Bill*'[11].

Arguably, the 2002 Act 'recouples' subsidies to production by linking payments to recent output levels based on a 1998-2001 reference period and an updated registration of the acreage on which farmers' annual income payment is based. Direct payments are tied to acreage, so these benefits will be capitalised into farmland values, thereby increasing aggregate producer wealth. These payments may change production somewhat if the changes in wealth influence farmers' perception of the risks associated with production alternatives[12]. The requirement that the acreage be subject to agricultural use, and the fact that direct payments are not available for fruits, vegetables and other crops may also influence production decisions for crops such as cotton.

- *Marketing assistance loans and loan deficiency payments* are linked to the volume of farm production and fall into the amber box category. Commodity loan programs allow cotton producers to receive a government loan at a commodity-specific rate per unit of production by pledging production as loan collateral. After harvest, a farmer may obtain a loan for all or part of the new commodity production.

[11] Ironically, the decoupling provisions of the 1996 Act were implemented during a period of near-record high prices, resulting in a significant increase in US domestic farm support over what would have been paid on the basis of the previous commodity-specific deficiency payments relative to current market prices. The policy change reflected in the Act ended abruptly with a sharp decline in market prices starting in 1998. US Congress responded by providing 'temporary' emergency bailouts over a four year period to compensate farmers in a total amount of about US$ 30 billion over and above the domestic support payments provided for in the Act.

[12] *The 2002 Farm Act: Provisions and Implications for Commodity Markets*, Economic Research USDA, 2002, 17.

Alternatively, loan program benefits can be taken directly as loan deficiency payments. Farmers may choose to receive marketing loan benefits through direct loan deficiency payments when market prices are lower than commodity loan rates. This option allows the producer to receive the benefits of the marketing loan program without having to take out and subsequently repay a commodity loan. Commodity certificates can be purchased at the loan repayment rate for loan commodities. The certificates are available for producers to immediately exchange for crop collateral pledged to the Commodity Credit Corporation for a commodity loan. Under the 2002 Farm Act loan rates were increased for most eligible commodities and the program expanded to include others.

- The *counter-cyclical payments* were designed to replace and effectively lock-in 'temporary' emergency bailouts that were used to supplement payments under the *Farm Act of 1996* for the period 1998 to 2001. This new program provides price-dependent benefits for covered commodities, triggering payments whenever the effective world price for cotton is less than its target price, as established by the Act. Payments are based on historical area and yields and are not tied to current production of the covered commodity. Nevertheless, because they are linked to world prices, they may fall into the amber box.

#### *4.1.2 Support that 'exceeds that decided during 1992'*

Even if all of the challenged measures are 'amber box', they will be exempt under the peace clause as long as they are being reduced in accordance with the US commitments under the Agriculture Agreement, and do not exceed support for cotton as 'decided during the 1992 year'. The second question is therefore whether the support granted in facts exceeds that decided during the 1992 marketing year. Notably Brazil does not argue that the US has failed to comply with its aggregate reduction commitments under Article 6, nor that it has exceeded its Annual Bound Commitment level for any year. Instead it focuses on the level of specific commodity support and argues that because the subsidisation is 'excessive' the peace clause does not protect it. The argument is that the US cannot use Article 13 as a defence to the claim of serious prejudice, because the subsidies grant support to a particular commodity (upland cotton) in marketing years 1999-2002 'in excess of the support decided by the United States in the 1992 marketing year'.

The issues here relate to what figures are to be used to make this calculation. The legal merits of Brazil's assertion are difficult to assess, mainly because the legal criteria for exemption in Article 13(b)(ii) are themselves unclear. What does it mean that measures shall be exempt from SCM actions, provided

that they do not subsidise a specific commodity 'in excess of *that decided during the 1992 marketing year*'[13]? Is the intention of the provision to establish a high watermark for support, where individual commodities are concerned? If so, who is to have 'decided' the upper limit? Is it a total annual measurement of support that we are claiming is excessive, or an average measurement over some undefined period? Brazil has claimed that US subsidies over a 3 year period exceed 'support decided by the US during 1992'. The language of Article 13 is 'decided during', not 'provided during' the 1992 marketing year. If the cap is to reflect national commitments made during the 1992 year, why is there no reference to the Members' Schedules?

The identification of the correct measurement of support, 'decided during the 1992 marketing year' is crucial to Brazil's case. This is a matter for clarification of the panel and is itself a justifiable reason to pursue this case on behalf of developing states. Further, Brazil must have in hand sufficient evidence to show that US 'amber box' domestic support exceeds the established figure.

Brazil's claim on this point, whether or not it achieves the desired result, will have the immense benefit for all WTO Members, but especially for developing countries, of testing the language of the Agreement on Agriculture, and interpreting and clarifying it for the benefit of future negotiations and trade relations.

### *4.2 Export subsidies*

Subsidies contingent on export performance, or on the use of domestic over imported goods, are prohibited generally by Article 3 of the SCM Agreement. Export subsidies are also 'actionable', along with measures of domestic support, under Articles 5 and 6. Brazil claims that payments provided to exporters of US upland cotton under the 'Step 2' program of the 1996 and 2002 Farm Acts are prohibited export subsidies and actionable under the SCM Agreement. It also asserts that US export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978 and other programs are, as applied and as such, prohibited export subsidies, and actionable.

The questions raised by these claims are whether the challenged measures are export subsidies at all, and, if so, whether they conform sufficiently to the Agriculture Agreement reduction commitments to exempt them from action under the SCM Agreement and the GATT 1994.

#### *4.2.1 'Export subsidies'?*

Whether the challenged programs are export subsidies depends on whether

[13] Agreement on Agriculture, Article 1(b) (ii).

they are 'subsidies contingent on export performance', including those set out in Article 9 of the Agriculture Agreement[14].

- *Step 2* payments are provided to both exporters of US cotton and to domestic mills using US cotton, with the alleged aim of bringing US internal prices into line with the international price[15]. Whether these payments are export subsidies does not turn on an indiscriminate application of benefits to both exporters and domestic users of cotton. If payments are contingent on export[16], or contingent on the incorporation of cotton into exported products[17], they are export subsidies subject to reduction commitments.
- The *Export Credit Guarantee Program* enables importers to borrow in dollars at US interest rates, and the lending bank can have the loans guaranteed by the US government. It is said to give American exporters a large advantage over rival exporters in countries with shortages of hard currency and high interest rates[18]. Exporters in developing countries will have difficulty in obtaining comparable levels of support. Brazil claims that this program as well as others amount to prohibited export subsidies.

### *4.2.2 Conformity with export reduction commitments*

Even if the US export assistance programs amount to prohibited export subsidies, they may nevertheless be exempt from action by application of the 'peace clause'. Article 13(c) says that so long as the export subsidies maintained on agricultural products conform to the reduction requirements in Part V of the Agriculture Agreement, they may be:

- subject to countervailing duties only upon a determination of injury or threat thereof[19]; and
- exempt from challenge as 'actionable' subsidies causing injury, nullification and impairment or serious prejudice[20].

Article 8 of Part V requires that each Member provide export subsidies only in accordance with the Agreement on Agriculture and the commitments specified in its Schedule.

[14] Agreement on Agriculture, Article 1.
[15] Oxfam, *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*, 2002, 15.
[16] Agreement on Agriculture, Article 9.1(a).
[17] Ibid, article 9.1(f).
[18] Oxfam, *Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*, 2002, 16.
[19] In accordance with GATT 1994 Article VI, and Part V of the SCM Agreement
[20] Under GATT 1994 and the SCM Agreement.

## 5. Impact on Developing Countries

*Third party participation*

Countries from India, Africa and South America have expressed support for Brazil's WTO claim against the United States. According to the Oxfam Report, '*Cultivating Poverty: The Impact of US Cotton Subsidies on Africa*', Benin, Burkina Faso, Mali and Senegal are among those African countries most affected by the artificially low world cotton prices and who reportedly appealed to their governments and the West African Economic and Monetary Union (UEMOA)[21] to file briefs in the WTO in support of the challenge. Previously, on 24 June 2002, the Ministers of Agriculture of UEMOA met in Abidjan (Cote d'Ivoire) to search for a common strategy for addressing the market crisis on cotton products.

Whatever informal complaints may have been registered, Zimbabwe is the only African state that has filed formal notice of its interest as a producer, supplier and exporter of cotton under the procedure provided by the WTO's dispute settlement rules. WTO Members had 10 days from the date of the circulation of Brazil's request for consultations with the US to notify the parties and the Dispute Settlement Body of their desire to be included in the consultations[22]. On 15 October 2002 Zimbabwe filed its request[23], followed by India[24] and Argentina[25] on the 18th and 22nd of October, respectively.

It is unlikely that the consultations will result in mutually agreeable solutions. If no agreement is reached, the dispute will likely go to the panel stage within 60 days. If so, Zimbabwe, Argentina and India will be able to participate as third parties to the dispute at both the panel and any subsequent Appellate Body proceedings. DSU Article 10.2 governs participation of third parties and states.

*Effect of a successful challenge*

A successful WTO challenge of the US subsidies could, in general terms, counter the current cotton market crisis and enable cotton producers outside the US to expand their market access opportunities. Over the last twenty years, under the influence of farm programs, yields in the US have risen more slowly than in those countries with dynamic cotton industries including Australia, Brazil, China and Turkey. US costs of production have also risen faster and the US is now an uncompetitive cotton producer dependent on continued government distortion of the cotton market to maintain its current share of world production. With world production costs falling, US competitiveness is

[21] Comprising Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo.
[22] Article 4.11 of the Dispute Settlement Understanding
[23] WT/DS267/2
[24] WT/DS267/3
[25] WT/DS267/4

set to fall further, and further perpetuating the reliance on government intervention for market survival. To the extent that Brazil's WTO claim results in effective reduction in US farm support programs, the competitiveness of developing country and other cotton industries will be enhanced.

Such enhancement is not likely, however, to be as dramatic or immediate as the affected countries might hope. The result of a positive finding that US subsidies exceed the maximum permitted level of support will simply require that the US bring its support programs back in line with its reduction commitments under the WTO Agreement on Agriculture. Perhaps as important is the fact that the case will provide the WTO Dispute Settlement Body with an opportunity to interpret and define certain aspects of the Agreement on Agriculture which will result in more future legal and practical certainty for all WTO Members and their agricultural producers. From that point, the parties will have to continue the ongoing negotiation of commitments under the Agreement on Agriculture to further reduce export and domestic subsidies. Countries must make the talks on agriculture and the problems of the cotton industry a priority in their negotiations within the WTO.

## 6. Conclusion

The US 2002 Farm Act has increased both domestic and export support for upland cotton, in apparent contradiction to the stated intentions of the US to liberalise trade in agricultural products during the Doha Agenda. Whether these particular measures on agricultural products technically violate the WTO depends firstly on whether they are amber box subsidies or prohibited export subsidies. If so, they will be subject to dispute settlement and countervailing duties remedies unless they are exempt from action by application of the due restraint or 'peace' clause in Article 13 of the Agreement on Agriculture. Until the end of 2003, they will be exempt if they are being reduced in accordance with the domestic and export subsidy reduction requirements of the Agriculture Agreement and the scheduled commitments of the US. Brazil argues that the US has no such defence, that domestic support for cotton is in excess of that decided by the US in 1992, and that the export subsidies do not comply with its reduction commitments.

In this case, the questions addressed by the WTO panel will, for the first time, focus on inequalities at the centre of global agricultural trade, with wider implications for the Doha Agenda agriculture negotiations and the expansion of the agricultural trade prospects for the developing world. Policy arguments in support of reduction and elimination of agricultural subsidies are persuasive from both a trade and development perspective. The road to that elimination is, however, by way of the negotiating table, at which Members' most vital interests remain at stake.

# 5. India-European Union Dispute on Generalised System of Preference Conditionalities

*B. Bhattacharyya*

## Introduction

At its meeting on 27 January 2003, the Dispute Settlement Body (DSB) of the World Trade Organization (WTO) established a Panel, at the request of India. The Director General, WTO, composed the Panel on 6 March 2003. The Panel has to examine whether:

- the provisions of the EU GSP Scheme granting Tariff Preferences under the Special Arrangements for Combating Drug Production and Trafficking and the Special Incentive Arrangements for the Protection of Labour Rights and the Environment;
- any implementing rules and regulations;
- any amendments to any of the foregoing; and,
- their applications are consistent with Article I:1 of the GATT 1994 and the requirements set out in paragraphs 2(a), 3(a) and 3(c) of the Enabling Clause.

## Background

The origin of the dispute was the EU's granting of additional market access in textiles in 2001 under the Special Arrangements to Combat Drug Production and Trafficking in its Scheme of Tariff Preferences. The trade package for Pakistan had two elements. First, a fifteen per cent quota hike in the textiles sector, and a zero duty market access for products as allowed under the Drug Window.

India was seeking increased market access in the EU at par with Pakistan on the strength of its own record in drug control. Bilateral discussions between the EU and India began in March 2002 where India sought compensation for an estimated loss of around $225 - $250 million worth of textiles exports on account of preferential treatment to exports from preferential origin countries.[1] The broad thrust of India's negotiating stance was to seek either enhanced access to the EU through the Generalised System of Preferences (GSP) Scheme or negate the adverse impact of the EU's GSP Regime through other means. During the consultations, the EU was not agreeable to accept India's request. As a consequence, India asked the WTO for the setting up of a Panel.

[1] Rediff. Com. April 2002.

India stands to lose in terms of price competitiveness to Pakistan because of its special status under the Drug Window, as the two countries compete in several products in the world market, the competition being most severe in the clothing sector where Pakistan is a major player. Pakistan exported Euro 2.66 billion in 2000 to the EU of which trade worth Euro 1.4 billion (including Euro 642 million for textiles and clothing) have graduated out of the Generalised System of Preferences.

The value of trade covered by the GSP was estimated at Euro 1.45 billion of which clothing accounted for Euro 1.06 billion. Therefore, it is expected that Pakistan may dramatically improve its utilisation of GSP coverage following the concessions given by the EU under the Drug Control Window of GSP. "It is apprehended that India would stand to lose trade substantially in the clothing sector where the applicable duty for our items is 10 per cent", according to the Additional Secretary from the Department of Commerce, Government of India.[2]

India's challenge has evoked wide interests in the WTO with Brazil, Colombia, Costa Rica, Colombia, Cuba, Ecuador, EL Salvador, Guatemala, Honduras, Paraguay, Peru, Sri Lanka, USA and Venezuela requesting third party rights.

India has challenged the conditionalities of the EU's GSP Scheme on several grounds.[3] First, the Special Incentive Arrangements for the Protection of Labour Rights, for the Protection of Environment and Special Arrangements to Combat Drug Production and Trafficking under the GSP Scheme are discriminatory. Thus, it violates Art. 1:1 of GATT which provides for Most-Favoured Nation (MFN) treatment. Since the GSP Scheme was introduced under a waiver from the GATT with respect to Article 1 and was to be generalised, non-reciprocal and non-discriminatory; it allows discrimination in favour of developing countries but not inter-se. Second, the GSP was introduced with the objective to facilitate and promote the trade of developing countries and respond positively to the economic needs of the developing countries. India has argued that the conditions under which the EC accords Tariff Preferences under the Special Arrangement cannot be reconciled with those two requirements. India has also cited para 2(a) of what is commonly known as the Enabling Clause which has a reference to the GSP.

In response, the EU said that its GSP Scheme was an autonomous programme granted on a non-reciprocal, generalized and non-discriminatory basis. The incentives it provides for combating drug trafficking and for labour and environmental protections are fully in line with internationally recognised objectives aimed at promoting sustainable development. The EU also warned

[2] The hindubusinessline.com. 2002/06/07
[3] WTO, WT/DS 246/1 12 March 2002

that India's Challenge would hamper all developed countries efforts to help developing countries. But the Indian official noted that its challenge was strictly limited to the conditions the EU imposed and not to its GSP Programme as a whole.[4]

## Analysis of the Legal Regime

To analyse the issues under dispute, it is necessary to consider how the GSP was negotiated, the GATT waiver, the history of the so-called Enabling Clause, the way trade policy objectives have evolved since then in the developed countries and the EU Scheme of GSP.

### *Generalised Tariff Preferences*

The GATT is based on the principle of reciprocity and non-discrimination. Part IV of the GATT, introduced in 1966, legitimized the 'principle' of non-reciprocity without changing the legal framework. The concept of preferential and differential treatment was formalized in the second UNCTAD Conference (1968) held in New Delhi when it adopted the Generalized System of Preferences.

GSP was the first multilateral agreement which provided for non-reciprocal tariff preferences on an MFN basis. Resolution No. 21 (II) of UNCTAD II, entitled Preferential or Free Entry of Exports of Manufactures and Semi-manufactures of Developing Countries to the Developed Countries, reads as follows:

"The United Nations Conference on Trade and Development,

Having examined the problems relating to the application of a generalized non-reciprocal, non-discriminatory system of preferences in favour of developing countries,

.....

Recognising the unanimous agreement in favour of the early establishment of a mutually acceptable system of generalized non-reciprocal and non-discriminatory preferences which would be beneficial to the developing countries,

.....

1. Agrees that the objectives of the generalized, non-reciprocal, non-discriminatory system of preferences in favour of the developing countries, including special measures in favour of the least developed among the developing countries, should be:

(a) to increase their export earnings;

(b) to promote their industrialization;

[4] Inside US Trade, 31 January 2003.

(c) to accelerate their rates of economic growth;[5]
....."

***The GATT Waiver***

The UNCTAD resolution on GSP was to be legalized in the GATT Framework to make it operational. It was done by a waiver (Decision of 25 June 1971). The relevant paras, one from preamble and one from decisions, are reproduced below:

"Recalling that at the Second UNCTAD, unanimous agreement was reached in favour of the early establishment of a mutually acceptable system of generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries in order to increase the export earnings, to promote the industrialisation, and to accelerate the rates of economic growth of these countries;"

***Decide:***

(a) "That without prejudice to any other Article of the General Agreement, the provisions of Article 1 shall be waived for a period of ten years to the extent necessary to permit developed contracting parties, subject to the procedures set out hereunder, to accord preferential tariff treatment to products originating in developing countries and territories with a view to extending to such countries and territories generally the preferential tariff treatment referred to in the Preamble to this Decision, without according such treatment to like products of other contracting parties;"[7]

The 1971 waiver was a non-permanent waiver from the MFN obligation of GATT Article 1. To make the derogation permanent, it was necessary to incorporate into the GATT legal structure of the concept of non-reciprocity as a component of the broader concept of Special and Differential Treatment. The Framework Group during the Tokyo Round was seized of this issue. Out of the deliberations of the Framework Group emerged the so-called Enabling Clause whose proper nomenclature is 'Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries (Decision of 28 November 1979).[7]

The Enabling Clause provides the legal basis for derogation from the MFN obligation to extend differential and more favourable treatment to developing countries. It is necessary to go into the details of the Enabling Clause as India's challenge specifically seeks to review the consistency of

[5] Indian Institute of Foreign Trade (1968), UNCTAD : A Step Forward, New Delhi.
[6] GATT, BISD. 18/S, P.25
[7] WTO, www.wto.org

some of the special features of the EU's GSP Scheme with the provisions of the Enabling Clause. The relevant provisions of the Enabling Clause are:

1. Notwithstanding the provision of Article 1 of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according to other contracting parties.
2. The provisions of paragraph 1 apply to the following:
   (a) Preferential tariff treatment accorded by developed contracting parties to products originating in developing countries in accordance with the Generalised System of Preferences.

   . . . . . .
   . . . . . .

3. Any differential and more favourable treatment provided under this clause:
   a) shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other contracting parties;

   . . . . . .
   . . . . . .

   c) shall in the case of such treatment accorded by developed contracting parties to developing countries be designed and if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.

Foot note 3. As described in the Decision of the Contracting Parties of 25 June 1971 relating to the establishment of generalised non-reciprocal and non-discriminatory preferences to the developing countries (BISD 18S/24)

### *The GSP Scheme of the European Communities*

The GSP Scheme of the EC was first introduced in 1971 and has evolved over the years. The one under challenge is the Generalized Tariff Preferences for the period from 1 January 2002 to 31 December 2004.[8]

The Scheme provides for preferential market access to the designated beneficiary countries. The Scheme has four Special Incentives Arrangements, relating to least developed countries:

- for combating drug production;
- for combating drug trafficking;
- for the protection of labour rights; and,
- for the protection of the environment.

[8] Council Regulation (EC) No. 2501/2001 of 10 December 2001. Official Journal of the European Commission 31.12.2001

The list of beneficiary countries differs according to each of these special arrangements.

The Preamble of the Scheme for 2002-04 provides inter alia:

"(2) The community's Common Commercial Policy must be consistent with and consolidate the objectives of development policy, in particular the eradication of poverty and the promotion of sustainable development in the developing countries."

"(6) The Special Arrangements to Combat Drug Production and Trafficking should be closely monitored."

. . . . . .

. . . . . .

"(18) The special incentive arrangements for the protection of labour rights should require effective application of all standards referred to in the International Labour Organisation (ILO) Declaration on Fundamental Principles and Rights at Work."

. . . . . .

. . . . . .

"(21) The Special Incentive Arrangements for the Promotion of the Environment should take into account new developments concerning internationally agreed standards and certification schemes."

The Special Incentives Arrangements provide greater market access to the designated beneficiary countries compared to those which are eligible under the General Scheme. There is, however, one basic difference as to the eligibility criterion for these incentives arrangements. For the Special Arrangements for the least developed countries, the benefit of this arrangement should be granted to all countries recognised and classified by the United Nations as least developed countries. Likewise, for the special arrangements (a) for the protection of labour rights and (b) for the protection of the environment, the eligibility is on the basis of application by a prospective beneficiary and its acceptance by the EC on the basis of criteria indicated in the GSP document. However, for the Special Arrangement to Combat Drug Production and Trafficking, the document is silent as to on what basis a country is considered and designated as a beneficiary.

The extent of preferences under each Special Incentive Scheme is also substantially higher compared to what is available under the General Scheme. Countries which are eligible only under the General Scheme will have duty-free access for the non-sensitive products while all other products, with the exception of textiles and clothing, will face a uniform reduction of 3.5 percentage points.

The countries which apply and receive the Special Incentives for labour and environment protection will receive an additional reduction in duties to the

extent of 5 percentage points. (3.5 + 5 = 8 percentage points in total). However, this additional 5 percentage points reduction, under the environment window, is available only for products of tropical forest. Under the labour window, this incentive will not be applicable to products not included in the general arrangement for the country concerned. The incentive system for drug provides for zero duty market access for almost all products, with a few exceptions.

The Special Incentive Schemes have so far not found much favour with the developing countries except the one for drug. The current list of countries which have been made eligible for this incentive scheme are principally the Central and South American countries. The only other country which has been accorded this facility from other regions is Pakistan.

**Analysis of the Dispute**

India has noted that the EC's Special Arrangements for Drug Production and Trafficking as well as the Special Incentive Schemes for the Protection of Labour and Environment are not available to all countries otherwise eligible to the Tariff Preferences under the General Scheme. The Panel has to determine whether these provisions and their application are consistent with Article 1:1 of the GATT 1994 and the requirements as set out in the paragraphs 2(a), 3(a) and 3(c) of the Enabling Clause.

India's position has so far been on two tracks: Economic and Legal. On the economic side, India has observed that its record in combating drug production and trafficking is no less credible than that of Pakistan and, therefore, it should also receive also receive similar treatment. Just as for Pakistan, textiles and clothing sector is crucial, this sector is also very important for India, in terms of its contribution to exports and employment.

On the legal side, India has noted that:

- Selective application of the special arrangement and incentive scheme is discriminatory and thus violates the Most-Favoured-Nation obligation of Article 1:1; and,
- The Enabling Clause Paragraph 2(a) specifically refers to the GSP. Since the GSP, at the time of negotiations, had specific trade objectives, introduction of new non-trade objectives such as labour, environment and drug trafficking is not permissible.

To summarise, India's position is that the GSP under the Enabling Clause allows a derogation from the MFN obligation only to the extent it allows discrimination in favour of developing countries in a generalized way. Imposition of any additional conditionalities outside the developmental objectives of GSP, as referred to in Para 2(a) of the Enabling Clause violates the MFN obligation under Article 1:1 of the GATT. Further, the developmental objectives of GSP are reinforced by Paragraphs 3(a) and 3(c) which allowed differential

and more favourable treatment only "to facilitate and promote the trade of the developing countries ..." and ... "to respond positively to the development, financial and trade needs of developing countries."

The initial response of the EC has been to assert that:

- Its GSP Programme was an autonomous regime granted on a non-reciprocal, generalized and non-discriminatory basis; and,
- The Special Incentives provided for in the GSP programme are fully in line with internationally recognised objectives aimed at sustainable development.
- Neither party has made any written submissions so far to the Panel.

**The Legal Basis of India's Position**

The basic principle of GATT/WTO is the MFN obligation, as enshrined in Article 1.1 of GATT 1994. Any derogation from this obligation will have to be under a specific waiver. The initial derogation required for the introduction of the GSP scheme was allowed under the GATT Decision of 25 June 1971 for a period of ten years. The Decision was made on the basis of a Communication (C/W/178) from the prospective preference-giving contracting parties applying for a waiver in accordance with Article XXV:5. The 1971 waiver was not renewed in the light of the Decision of 28 November 1979 on "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries" (Enabling Clause) which authorises Preferential Tariff Treatment accorded by developed contracting parties to products originating in developing countries in accordance with Generalised System of Preferences'.[9] Thus, GSP Programme has to be consistent with the Enabling Clause.

GSP has been conceptualized as a system of generalised, non-reciprocal and non-discriminatory preferences. The 'non-discriminatory' and 'generalised' refer to the system being uniformly applicable to all beneficiary countries under the GSP. Therefore, the EU's Special Arrangements which provide differential scales of incentives introduce a discriminatory treatment. It thus violates a basic premise of GSP, and by inference, the Enabling Clause.

The issue of non-discriminatory treatment has another dimension in the context of the EU GSP Programme. The Programme allows prospective beneficiary countries to apply to be eligible to the Special Incentives under the Labour and Environment Windows. But this facility is not available for the Drug Window. While in the case of the former two, the EC programme provides guidelines on eligibility, it is silent on the drug window. There is, therefore, lack of transparency.

[9] WTO (1995) Guide to GATT Law and Practice: Analytical Index, Vol. 1, P.49.

The waiver, whether under the GATT Decision of 25 June 1971 or the Enabling Clause, is conditional upon the fact that the derogation is only to achieve specified objectives. The objectives in the UNCTAD 1968 resolution were only three. These are: (a) to increase their (developing countries) export earnings; (b) to promote their industrialization; and, (c) to accelerate their rates of economic growth.

The Enabling Clause addresses the issue in a more generalized way in para 3 (a) and 3(c) which reads as: 3(a) "to facilitate and promote the trade of developing countries" and (3c) "to respond positively to the development, financial and trade needs of the developing countries". The Special Incentives Programmes for Drug Production and Trafficking under the Labour and Environment windows cannot thus be covered either under the GSP (1968) or Enabling Clause provisions.

**Possible Response of the EC**

EC position may indicate that the GSP is a non-reciprocal, preferential arrangement. The non-reciprocity means that no violation of GATT contractual right is involved. Enabling Clause only enables a derogation of MFN obligation but as such does not confer any contractual right on the beneficiary countries.

It can argue that discrimination in the sense of non-uniformity of treatment to all the beneficiaries is allowed under the so-called 'Graduation Principle' which is used by many GSP-granting (donor) countries. This can be interpreted as allowing derogation of the MFN obligation.

EC can also draw attention to the Council discussions on the Decision 25 of 25 June 1971:

> "The waiver did not specify the determination of the beneficiary countries and covered general guidelines for a decision on beneficiary countries presented by the preference-giving countries in the UNCTAD, 'according to which donor countries would in general base themselves on the principle of self-election."[10]
>
> On the issue of objectives (Enabling Clause Para 3(a) and 3(b), UNCTAD Resolution 21 (II)), EC can point out the preamble of the WTO which aims at 'sustainable development'."
>
> The relevant part of the Preamble is:
>
> "Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's

[10] WTO (1995), op.cit., P. 49

resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development."[11]

To the extent, the objectives as modified under the GSP Scheme are consistent with the objective as in the WTO Preamble, it can seek to justify its conformity with those in the Enabling Clause.

EC may also observe that the Special Incentives Programmes for Labour and Environment are designed with transparent rules, both with respect to eligibility as well as temporary suspension.

**Task Before the Panel**

The issues raised in this dispute, especially the use of trade policy instruments to achieve primarily non-trade objectives, such as protection of human rights, improvement in labour standards and environment protection, are currently at the forefront of global debate on rule-making in international trade. The debate on the so-called 'social clauses' in the WTO is well-known and is no where near where any convergence of views either exists or is even expected.

However, the linkage between trade policy instruments and other non-trade objectives is already established in some bilateral or regional trade agreements. This linkage was in fact introduced by the United States in its GSP Scheme in mid 1980s. Under the GSP Amendment of 1984, USA can suspend concessions granted under the GSP to countries where labour standards are not considered to be in conformity with 'internationally recognised' standards. Several countries were already suspended.[12] The EU linked its GSP concessions to core ILO labour standards effective 1997.[13] The Panel may also look at the earlier GATT discussions on this and related issues. On the issue of MFN treatment, the 1972 Working Party Report on the Danish Temporary Import Surcharge noted that:

"Without prejudice to the legal issues involved, the Working Party noted that as from the introduction of the Danish General Preference scheme on 1 January 1972, products included in that scheme would be exempted from the surcharge when imported from Members of the group of seventy seven. Several members of the Working Party welcomed this decision of the Danish Government noting that this had been one of the recommendations of the Group of Three. Other members expressed concern that the exemption did not extend to all developing countries. Some other members said that

[11] WTO (1994), The Results of the Uruguay Round of Multilateral Trade Negotiations : The Legal Texts, P.6.
[12] De Castor (1995)
[13] Gavin (2001)

discrimination caused by these discriminations gave their delegations cause for concern."[14]

On the GSP Scheme, the Committee on Trade and Development in its 1980 report referred to a statement from a representative of a developing country that the preferential treatment of certain textiles imports under the EC's GSP scheme for 1980 had not been extended to all beneficiaries of the Community's GSP scheme and amounted to discrimination inconsistent with the spirit of the GSP. The representative of the European Communities replied that in view of the increasingly serious difficulties in the textiles sector, the communities had to limit their zero duty treatment for textiles imports under the GSP to countries which were either a signatory of the MFA or had entered into a commitment to abide by obligations similar to those under that Arrangement.[15]

On the question of the compatibility of 'graduation' with the Enabling Clause, at 58th session of the Committee on Trade and Development, one representative stated:

> "The Enabling Clause provided the legal basis for GSP programmes and the GSP had offered an opportunity for developing countries to expand and diversity their exports to the developed countries ... She said that the guidelines provided in paragraph 3 of the Enabling Clause were important, and particularly paragraph 3 (c) which indicated that special and differential treatment should be provided on a dynamic basis, taking into account changes in the development levels and the development, financial and trade needs of developing countries ... She noted that paragraph 7 required differentiations between developing countries beyond that envisaged for the least developed countries."[16]
>
> "During the review of the implementation of Part IV and of the operation of the Enabling Clause at the 63rd Meeting of the Committee on Trade and Development, the representative of Brazil stated: although preferential concessions constituted an unilateral act of the donor country the exclusion of countries from GSP was *per se* a discrimination which was not based on the agreed principles ... some countries were clearly moving away from the observance of the basic principles set out in the Decision of the Contracting Parties of 25 June 1971 and of 28 November 1979 concerning the granting of preferential treatment to products originating in developing countries ... Developed contracting parties acting individually had been authorized to grant such a preferential treatment provided that the corresponding schemes were of a generalized, non-discriminatory and

[14] GATT, L/3648 adopted on 12 January 1972.
[15] GATT, L/5074, adopted 26 November 1980. 27S/48.
[16] WTO (1995), op. cit., P. 58.

non-reciprocal nature. The fact that such schemes were of a voluntary character and did not constitute a binding obligation for the preference-giving countries did not in his view give them the right to ignore the legal framework under which they have been authorised to implement such schemes."[17]

**Implications**

Considering the arguments and evidences cited above and many more which would come out during the submissions before the Panel, it is quite clear that this is a complicated dispute. However, the Panel decision will have more of a policy impact than a trade impact. This is so because of the following reasons:

- The only country which has so far opted for the special incentives under the labour window is Moldova;
- Not a single country has opted for the special incentives under the environment window; and,
- The drugs programme has been extended to 12 countries all of which except Pakistan are in Central and South America. These are: Bolivia, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Nicaragua, Panama, Peru, Pakistan, El Salvador and Venezuela. Of these, the only Commonwealth country is Pakistan.

Therefore, the major trade impact in case the Panel finds the drug window to be incompatible with either the MFN obligation or Enabling Clause or both, India becomes the obvious beneficiary, though not the sole beneficiary, because all the other GSP receiving countries, at least in theory, can benefit from the non-extension of the special market access to Pakistan.

The more important impact would be felt on the trade policy formulation whichever way the Panel decision might go. In the recent years, there has been an increasing trend in many developed countries where trade policy instruments are being linked to attaining non-trade objectives. The discussions on the desirability and legality of such a linkage in the multilateral framework is currently a matter of acrimonious debate in the WTO. GSP is a special case because it is a non-reciprocal arrangement. But despite this, a Panel decision either way may provide some light on the legality of such linkages. To what extent transparency in trade policy formulation and in implementing preferential market access programmes are legally required may also get addressed in the Panel decision. That will also be of great value for future.

[17] WTO (1995), op.cit., P.58-59.

# 6. The WTO GMO Dispute

***Maxine Kennett***

## 1. Introduction

The United States (US) announced on 13 May 2003 its request for WTO consultations with the European Communities (EC) on certain measures taken by the EC that affect the trade in genetically modified organisms (GMOs). The US claims that since October 1998, the EC has applied a moratorium on the approval of GMOs which has restricted the import of agricultural and food products from the United States.

The European Commission (which speaks for the European Communities on trade matters) dismissed the US's claim as "legally unwarranted, economically unfounded and politically unhelpful"[1]. Pascal Lamy, the EC's Trade Commissioner, added that "The EU's regulatory system for GMO's authorisation is in line with WTO rules: it is clear, transparent and non-discriminatory. There is therefore no issue that the WTO needs to examine"[2]. The European Commission has also tried to undermine the US claims by asserting that work on new EC labelling and traceability regulations is being finalised and that the EC regulatory system is being brought into line with the latest scientific and international developments.

This paper provides background to the WTO GMO dispute and outlines some of the implications of this dispute for developing countries. In addition, this paper considers a few issues on the periphery of the dispute, namely, the EC's proposed new labelling and traceability regulations; recent decisions of the Codex Alimentarius; and the coming into force of the Cartegena Protocol on Biosafety.

## 2. Background: The Development and Adoption of GMOs

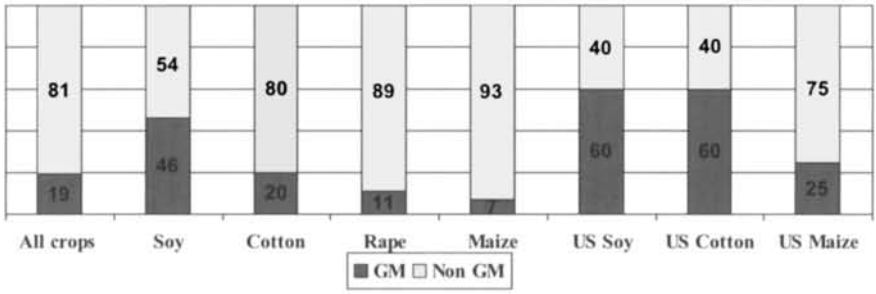
Although genetic manipulation of plants has been an ongoing science since prehistoric times, when early farmers began carefully selecting and maintaining seed from their best crops to plant for the next season, genetic modification involves passing on genes and traits that would be unavailable through traditional breeding methods. Genetic modification is a laboratory technique in which specific genes are cut from one source of DNA[3] and then incorporated into other DNA or used to make customised DNA.

[1] Statement by the European Commission. 13 May 2003.
[2] Statement reported by World Trade Online. 13 May 2003.
[3] Deoxyribonucleic acid (DNA) is a self-replicating material present in all living organisms and the carrier of genetic information.

For example, tomatoes are sensitive to frost. This shortens their growing season. Fish, on the other hand, can survive in very cold water. Genetic engineers have been able to identify the particular gene, which enables a flounder to resist cold, and to insert this "anti-freeze" gene into tomatoes, thereby extending their growing season. Likewise genes from other sexually incompatible plants, animals, bacteria or insects can be introduced into living organisms to enhance or reduce their existing traits.

The first genetically modified plant (proof of concept) was produced in 1981, and the first field test was concluded in 1985. Within ten years, the first approval for the commercial production of a GM crop was granted in the US, and by 1996/7 there was large scale production of GM maize, soy bean, rapeseed and cotton[4]. By 2001, more than 50 million hectares of GM crops were grown in more than 13 countries worldwide and GM crops accounted for 19% of the world's crops (46% of the world's soy bean crop, 20% of the world's cotton crop, 11% of the world's rapeseed crop and 7% of the world's maize crop)[5].

**Table 1. Percentage of GM and non-GM crops by acreage in 2001 (Source ISAAA and ENN)**




So far, scientists have mostly used genetic modification to help growers in providing crops with herbicide tolerance (Bt) or with insect resistance (Ht). As a result, 75% of commercially available crops are herbicide tolerant and 17% are insect resistant[6]. However, future GMOs (such as food products with enhanced vitamins, minerals, carbohydrates or proteins) may well not be targeted at growers but at food companies and consumers[7]. GM crops that are of interest to developing countries such as drought tolerant, acid soil tolerant and vaccine enhanced crops are still in development[8].

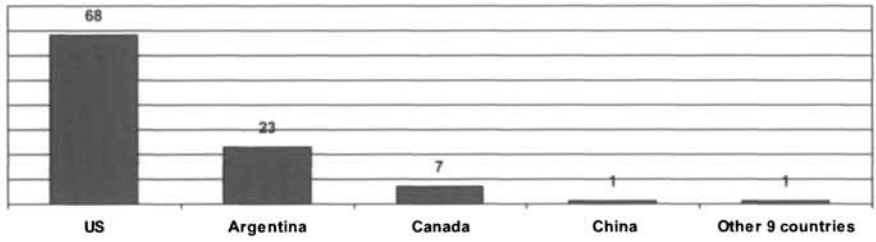
[4] The words maize and corn as well as rapeseed and canola are synonyms.
[5] Source ISAAA and ENN.
[6] Statement by the European Commission. 13 May 2003.
[7] Statement made by Andrew Bennett of Monsanto at a workshop on GMOs in South Africa. 22 May 2003.
[8] Statement by the European Commission. 13 May 2003.

In 2000, 13 countries grew GM crops. No least developed country grew GM crops and only a few developing countries were represented. Interestingly, almost half of the countries that grew GM crops in 2000 claimed to only grow Bt Cotton – which is for the most part a non-edible crop[9].

**Table 2. Countries that grew GM crops in 2000 in order of acreage (Source ISAAA)**

| | | |
|---|---|---|
| 1. United States | 6. Australia* | 11. Germany* |
| 2. Argentina | 7. Mexico* | 12. France* |
| 3. Canada | 8. Romania | 13. Uruguay |
| 4. China* | 9. Bulgaria | |
| 5. South Africa | 10. Spain* | (A * denotes Bt Cotton only.) |

**Table 3. Percentage distribution of GM crops by acreage in 2000 by country (Source ISAAA)**




## 3. Background: Growing Tensions Between the US and the EC

Adoption of GM crops has been far greater in the US than in any other country where nearly 60% of the soy bean and cotton crop and about 25% of the maize crop is genetically modified. In total, the US grows more than 30 million hectares of GMOs: 68% of the world's GMOs[10].

A considerable amount of these GMOs are consumed on the domestic market where US regulators treat GMOs as a natural extension of existing products. GMOs must simply pass the same safety tests as their natural counterparts. Once these tests have been passed, no discrimination may take place against this product[11]. As a result, almost none of the US's GM crops are segregated from their natural counterparts[12].

[9] It is often forgotten that cotton seed oil is edible.

[10] James, C., *Global status of commercialized transgenic crops*, ISAAA Briefs No. 21: Preview, ISAAA Ithaca, NY. (2001).

[11] Food and Drug Administration Policy for Foods Developed by Biotechnology (1995).

[12] Only 1-2% of GM-crops are segregated from their natural counterparts in the US.

Access to export markets for these GM food and agricultural products is vital to the US economy. In a Statement made before the Committee on Agriculture of the US House of Representatives on 21 May 2003, Robert B. Zoellick, the US Trade Representative stated that "U.S. agriculture must look overseas to generate sales and the expansion of farm income. U.S. population and consumption growth are relatively flat, which means growth prospects for farmers and ranchers in our home market are limited. At the same time, U.S. agricultural productivity continues to climb, driving increased domestic output that can only be sold profitably if we expand overseas markets. Foreign customers are already critical for U.S. producers and processors. Twenty-five percent of all cash receipts for agriculture are generated by exports. Nearly half of American wheat and rice, about one-third of our soybean and meat production, and 20 percent of U.S. corn is sold for export."[13]

The EC has traditionally been a big importer (and exporter) of food and agricultural products. However, the European consumers have had a negative attitude towards GMOs. (It has been argued that the difference between American and European perspectives is historical and cultural.[14]) The first field trials of GM crops in the EU were destroyed by anti-GM activists in 1988. By 1997, attacks on facilities conducting research on GMOs were occurring throughout Europe with alarming frequency, imports of GM food products into the EC were being denounced as dangerous "Frankenfoods" and many large European supermarket chains were refusing to stock GMOs.

American agricultural exports to the EC plunged. The US traders refusal to segregate GM crops from their natural counterparts meant that many buyers preferred to import non-GM food and agricultural products from elsewhere.

The soy bean market was particularly hard hit as European buyers were looking to non-GM suppliers and to alternative ingredients. American soy bean imports into the EC fell from 398m bushels in 1997-98 to an estimated 221m bushels in 1999-2000. Bob Wisner, an Iowa State University economist, believes this is equivalent to losing the market for one out of every three bushels of soy beans grown in Iowa[15].

A glance at export figures for US soy beans into some of the EC Member States provides a more general indication of the extent of difference in opinion. In the period 1997 – 2001, exports of US soy beans fell significantly year after year both in value and in quantity[16].

[13] Statement of Robert B. Zoellick, US Trade Representative, before the Committee on Agriculture of the US House of Representatives. 21 May 2003.

[14] Runge, C., Bagnara, G. and Jackson, L., *Differing US and European Perspectives on GMOs: Political, Economic* and Cultural Issues, *in Estey Centre Journal of International Law and Trade Policy (2001).*

[15] The Economist, *To plant or not to plant,* 13 January 2000.

[16] Except in Italy and Portugal which reported an increase in the quantity imported from the US.

Maize exporters did not fare any better. Since 1997, US maize imports to the EC have largely been replaced by Argentinean and Chinese maize and when the US tried to supply maize grain as food aid, there was fierce resistance from some African countries which wanted to remain GM-free.

## 4. Background: EC Regulation and the Moritorium

After the first field trials of GM crops and the first attacks on GM research facilities, the EC introduced a "first generation" of regulations on GMOs. Since then, the regulations have been reformed and refined. Currently, the EC has a number of different regulations which govern the authorisation, labelling and traceability of GMOs.

Under these EC regulations, the prospective effects of GMOs on human and animal health and the environment have to be scientifically assessed before the product can be marketed.

Biotech companies must supply the competent national authority of a Member State with a full risk assessment. This is then sent to the European Commission who circulates it to all the other Member States.

If the competent national authority gives a favourable opinion, the Member State will inform the other Member States of this opinion through the Commission. If there are no objections, the same competent authority will grant the consent for the placing of that GMO on the commercial market.

If any Member State raises an objection, the European Commission must seek an opinion from the Scientific Committee. If the scientific opinion is favourable, the Commission can then take a decision.

To date, 18 GMOs have been authorised by the EC. However, since 1998 no new GMOs have been authorised for release. There is technically no legislative ban by the EC on GMOs. The problem is that approvals have been blocked by some Member States and the European Commission has taken no action to push the approvals process through.

*Current EC Regulation*

Authorisation – Directive 2001/18/EC Articles 13 - 24 on the deliberate release of GMOs and the Novel Foods Regulation No. 258/97: Articles 4-5.

Labelling – Directive 2001/18/EC Article 13.2(f); Novel Foods Regulation No. 258/97 Article 8; Regulation 1139/98/EC (as amended) on labelling of foodstuffs and Regulation 50/2000/EC on labelling of GM additives and flavourants.

Traceability – Directive 2001/18/EC Article 4(6).

The European Commission openly stated that "the EU's regulatory regime was incomplete to address the challenges posed by modern technology of genetic modification"[17]. However, the Commission added that as a result of a

[17] Statement reported by the European Commission reported by World Trade Online. 13 May 2003.

**JS exports of soy beans 1997 - 2001 (Source ITC TRADE MAP /COMTRADE statistics)**

**List of importing markets for a product exported by United States of America in 2001**
**Product : 120100 Soya beans**
**ed States of America's exports represent 53% of world exports for this product, its ranking in world exports is**

| orters | Exported value 2001 in US$ thousand | Share in United States of America's exports, % | Exported quantity 2001 | Quantity unit | Export trend in value between 1997-2001, %, p.a. | Export trend in quantity between 1997-2001, %, p.a. | Ranking of partner countries in world imports | Share of partner countries in world imports, % |
|---|---|---|---|---|---|---|---|---|
| | 5,447,232 | 100 | 28,836,688 | Tons | -5 | 5 | | |
| | 434,536 | 8 | 2,398,015 | Tons | -13 | -3 | 2 | 10 |
| | 247,839 | 5 | 1,401,930 | Tons | -15 | -5 | 6 | 5 |
| | 98,119 | 2 | 549,724 | Tons | -3 | 11 | 14 | 2 |
| embourg | 81,048 | 1 | 446,780 | Tons | -18 | -8 | 9 | 2 |
| | 74,621 | 1 | 400,900 | Tons | -31 | -23 | 4 | 8 |
| | 62,662 | 1 | 349,629 | Tons | -6 | 3 | 13 | 2 |
| | 59,630 | 1 | 324,182 | Tons | -16 | -8 | 11 | 2 |
| dom | 58,188 | 1 | 320,338 | Tons | -18 | -9 | 15 | 2 |

new regulatory framework which was adopted in March 2001, and which entered into force in October 2002, biotech companies have been able to submit revised applications – and two GM cotton seed oils for food use have recently been placed on the market.

But, the problem is not only with the approvals process. GM products, which have already been approved, have been banned in some Member States and the European Commission has taken no action.

US trade representatives have repeatedly contended that Europe's "go-slow" approach is WTO inconsistent. Some EU officials are rumoured to agree with them and have themselves called the moratorium "illegal and unjustified".[18]

## 5. The US Request for Consultations

The US announced on 13 May 2003 its request for WTO consultations with the EC on certain measures taken by the EC that affect biotech products. The US Ambassador to the WTO wrote[19]:

> "Since October 1998, the EC has applied a moratorium on the approval of biotech products. The EC has suspended consideration of applications for, or granting of, approval of biotech products on the market have been blocked in the approval process under EC legislation and have never been considered for final approval. The approvals moratorium has restricted imports of agricultural and food products from the United States."
>
> "Moreover, the Member States maintain a number of national marketing and import bans on biotech products even though those products have already been approved by the EC for import and marketing in the EC. The national marketing and import bans have restricted imports of agricultural and food products from the United States."
>
> "The measures affecting biotech products in the EC include:
>
> 1. the suspension by the EC of consideration of applications for, or granting of, approval of biotech products;
> 2. the failure by the EC to consider for approval applications for biotech products...; and
> 3. national marketing and import bans as maintained by Member States...."

Questions have arisen about the timing of the US request for consultations as new legislation on authorisation, traceability and labelling is soon to come into force in the EU. Once it is in force, European officials claim, the moratorium will be lifted.

[18] The Economist, The GM gamble. 15 May 2003.

[19] Letter to the Ambassador of the Permanent Delegation of the European Commission to the WTO from the Ambassador of the Permanent Delegation of the United States to the WTO. 13 May 2003.

The Americans, having heard such promises before, are sceptical. US Trade Representative Robert B. Zoellick stated that "We've waited patiently for five years for the EU to follow the WTO rules and the recommendations of the European Commission....With this case, we are fighting for the interests of American agriculture." In fact, the US threatened to bring the case to the WTO earlier in the year, but waited for the war to finish in Iraq.

There are other reasons why the US does not seem to have chosen the perfect timing for such a dispute. Next month, they hope that there will be a reform of the EU's common agricultural Policy (CAP). The European Commission is pushing for far-reaching changes, but is facing resistance from some EU countries, notably France, a staunch opponent of GM food. Challenging the French over GM food, after they have already been wounded by war in Iraq, will not encourage them to accept CAP reform.

Indeed, in a report this week, some 15,000 French farmers, reinforced by coach loads of supporters from Germany, Belgium and Luxembourg, were due to take to the streets in four key French farming regions to make their voices heard[20].

However, being able to infuriate the French may perhaps have encouraged some US trade representatives to bring this dispute now. In addition, there may be a desire to hit back at Europe's behaviour in other trade disputes. "Last week, the Europeans upped the ante in a row over America's foreign-sales corporation tax, in which the WTO has already ruled in Europe's favour. The EU announced a list of products on which it might slap tariffs if the Americans do not fix their WTO-illegal practices. The Europeans set a deadline of 1 January 2004, by when they want America's tax code to be put right"[21]. When questioned, Zoellick stated that the US administration was not trying to counter the WTO's previous decisions favouring Europe. "I'm absolutely denying that," he said[22].

More generally there are good reasons for holding back on a GMO dispute in the WTO. The Categena Protocol on Biosafety, which addresses the potential risks posed by cross-border trade and accidental releases of GMOs, is about to come into force. In addition, the Codex Alimentarius is in the process of defining an international standard for the testing and labelling of GM foods. As international law the provisions of the Protocol and the standards set by the Codex Alimentarius may support or condemn the EC's stance (see below).

[20] World Trade Forum Weekly News Brief. 30 May 2003.
[21] The Economist. *The GM Gamble.* 15 May 2003.
[22] New York Times. *US Challenges Europe on Genetically Modified Food.* 13 May 2003

## 6. Other Parties to the Dispute

On 13 May, Zoellick also announced that the United States said that it would be joined in its challenge by Argentina, Canada and Egypt and that other countries expressing support for this case by joining it as third parties include: Australia, Chile, Colombia, El Salvador, Honduras, Mexico, New Zealand, Peru and Uruguay. (Interestingly, many of these countries are keen to negotiate bilateral trade agreements with the US.)

The Egyptian Government now says that it has decided "not to become a party" to the WTO complaint because it recognises "the need to preserve adequate and effective consumer and environmental protection". In a letter dated 27 May 2003 the Egyptian Ambassador to the European Union wrote that "The Government of Egypt took this decision in conscious emulation of the need to preserve adequate and effective consumer and environmental protection, and with the desire to reduce further distortions and impediments to international trade that may result due to the further pursuit of this matter within the WTO".

The other parties to the dispute have been remarkably quiet and Anti-GM voices claim that the US-led trade war coalition has started to crumble. "We're delighted that Egypt has withdrawn from this US attempt to force GM food and crops into Europe. Countries should be allowed to choose what they eat and what they grow in their fields. The United States should withdraw its WTO challenge, and stop trying to bully Europe over GMOs."[23]

New Zealand's decision to support the US has angered local GMO opponents. The chairman of the Sustainability Council, Sir Peter Elworthy said the move was "a blow to our marketing and to consumer perceptions of New Zealand". "Why is New Zealand joining a fight that pits us against our biggest trading partner over products we do not even grow?" he asked.[24]

## 7. The WTO Agreements

WTO members have committed to ensure that trade flows as smoothly, predictably and freely as possible. These commitments are embodied in the WTO Agreements. There are general agreements which cover the trade in goods and services and the trade related aspects of intellectual property and there are additional agreements and annexes dealing with the special requirements of specific sectors or issues.

[23] Statement made by Friends of the Earth Europe's GM campaigner Geert Ritsema. Press Release by Friends of the Earth International. 29 May 2003.

[24] Reported in the WTO Forum's Weekly Trade Brief. 16 May 2003.

*General WTO Agreements*

General Agreement on Tariffs and Trade (GATT 1994) sets out the basic principles that apply to the liberalisation of trade in goods.
General Agreement on Trade in Services (GATS) establishes rules and obligations for the liberalisation of international trade in services.
Trade Related Aspects of Intellectual Property Rights (TRIPS) sets minimum standards for the protection and enforcement of intellectual property rights.

The US claims that the EC's measures appear to be inconsistent with the following provisions:

1. SPS Agreement, Articles 2, 5, 7 and 8 and Annexes B and C;
2. GATT 1994, Articles I, III, X and XI;
3. Agriculture Agreement, Article 4; and
4. TBT Agreement, Articles 2 and 5.

## 8. The SPS Agreement

The SPS Agreement is a specific agreement which applies to measures aimed at the protection of human and animal (sanitary) and plant (phytosanitary) life and health. The aim of the SPS Agreement is to balance the rights of Members to impose SPS measures which meet their chosen level of protection and the general need to liberalise trade in food and agricultural products.

Members are encouraged to use international standards, guidelines and recommendations where they exist and Members may use measures that result in higher standards if there is scientific justification. Where there is insufficient scientific evidence, they may take provisional measures. In each case, the approach must be consistent, least trade restrictive, not arbitrary or unjustifiable.

*US claims – The SPS Agreement*

The US request for consultations claims that the EC measures appear to be inconsistent with the following provisions of the SPS Agreement:

1. Article 2 – Basic Rights and Obligations
2. Article 5 – Assessment of Risk and Determination of the Appropriate Level of Sanitary or Phytosanitary Protection
3. Article 8 – Control, Inspection and Approval Procedures
4. Annex B – Transparency of Sanitary and Phytosanitary Regulations
5. Annex C – Control, Inspection and Approval Procedures

## 9. The GATT 1994

The GATT 1994 is a general agreement which relates to international trade of goods. The most notable provisions are set out in Article I which requires WTO Members to offer most favoured nation treatment (MFN)[25] to other Members; Article III which requires WTO Members to provide national treatment (NT)[26] to other Members; Article X which governs the publication and administration of trade regulations and Article XI which prohibits WTO Members from using quantitative restrictions to regulate the trade in goods.

Much debate has focused on the meaning of "like products" within these provisions. Under WTO law, it is acceptable to treat different products differently, but like products must be treated the equally. The question therefore will be if GM and non-GM products are "like".

*US claims – The GATT 1994*

The US request for consultations claims that the EC measures appear to be inconsistent with the following provisions of the GATT 1994:

1. Article I – General Most Favoured Nation Treatment
2. Article III – National Treatment
3. Article X – Publication and Administration of Trade Regulations – General Elimination of Quantitative Restrictions

If GM and non-GM products are "like" products, Article XX of GATT 1994 provides a list of exceptions to the obligations of the GATT 1994 (including the provisions of Article I, III, X and XI above), which may be used by the EC. Article XX (a) of the GATT 1994 allows members to adopt measures "necessary to protect public morals". Article XX (b) of the GATT 1994 allows members to adopt measures "necessary to protect human, animal or plant life or health". Article XX (g) allows members to adopt measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption".

However, even if a measure fits within the scope of one of the exceptions of Article XX of GATT 1994, it must still conform to the chapeau of Article XX which requires that such measures do not result in arbitrary or unjustifiable discrimination and do not constitute disguised protectionism. If the measure

[25] Most Favoured Nation (MFN) treatment means treating one's trading partners equally. Discrimination between "like" products imported from different trading partners is prohibited.

[26] National Treatment (NT) means equal treatment for foreign and domestic goods (and services in GATS). Discrimination between "like" products that are made domestically and those that are imported is prohibited.

does result in arbitrary or unjustifiable discrimination and does constitute disguised protectionism it may be found to be WTO inconsistent.

## 10. The Agriculture Agreement

Agricultural trade has its own specialised agreement within the WTO, which includes specific commitments by WTO member governments to improve market access and reduce trade-distorting subsidies in agriculture.

*US claims – The Agriculture Agreement*

The US request for consultations claims that the EC measures appear to be inconsistent with Article 4 of the Agriculture Agreement of not imposing any measures other than tariffs to regulate market access:

1. "Market access concessions contained in Schedules relate to bindings and reductions of tariffs, and to other market access commitments as specified therein."
2. "Members shall not maintain, resort to, or revert to any measures of the kind which have been required to be converted into ordinary customs duties, except as otherwise provided for in Article 5 (Special Safeguard Provisions) and Annex 5 (Special Treatment)."

## 11. The TBT Agreement

The Technical Barriers to Trade Agreement applies to mandatory technical regulations, voluntary standards and conformity assessment procedures. The aim of the TBT Agreement is to balance Members' regulatory autonomy to pursue domestic policy objectives and the need to prevent protectionism. In order to achieve this, the TBT Agreement not to discriminate between "like products", not to impose measures more trade restrictive than necessary and to use international standards except where these standards would be ineffective or inappropriate to achieve the objective.

*US claims – The TBT Agreement*

The US request for consultations claims that the EC measures appear to be inconsistent with

1. Article 2 – Preparation, Adoption and Application of Technical Regulations by Central Government Bodies; and
2. Article 5 – Procedures for Assessment of Conformity by Central Government Bodies.

## 12. WTO Dispute Settlement

The US has requested consultations with the EC, pursuant to:

1. Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU);
2. Article 11 of the SPS Agreement;
3. Article 19 of the Agreement on Agriculture;
4. Article 14 of the TBT Agreement; and
5. Article XXII of the GATT 1994

Under these provisions, any member that considers that a benefit accruing to it under the WTO Agreements is being "impaired or nullified" by measures taken by another WTO Member may request consultations with that other Member.

Unless otherwise agreed, the defendant (the EC) has 10 days to reply to the request and should enter into consultations within 30 days. WTO Members have broad discretion as regards the manner in which consultations are conducted. The outcome of the consultations could be a mutually agreed solution or an agreement to establish of a dispute settlement panel (Panel). If at the end of the 60 days, no resolution has been achieved, then the claimant (the US) may seek the formation of a Panel to hear arguments.

After panellists are nominated, the complaining party normally has 3 – 6 weeks to file its first written submission and the complaints are given another 2 – 3 weeks to respond. Oral hearings and further written submissions follow. Panel proceedings usually take about 12 months. If either party disagrees with the Panel's decision, it can appeal to the Appellate Body on specific points of law, to make a final decision. The appeals process should not last for more than 90 days. Therefore, at the very latest, the outcome of this GMO dispute should be known before the end of 2004.

In this case, the US has made a broad range of claims under different WTO Agreements. Some of these claims may be dropped during the consultation process. However, once in the panel proceedings, it is likely that the US will require a Panel only to consider its strongest claims. In addition, for judicial economy, the Panel will try limit it's the number of claims it considers.

The scope of each agreement will therefore become very important because perhaps solving one issue under one agreement resolves another issue under a different agreement. For example, it is agreed that the TBT and SPS Agreements are mutually exclusive, which means that a measure taken by a WTO Member will either be a SPS measure or a TBT measure (or neither), it can not be both. If a measure is found to be consistent with the SPS Agreement, there is a presumption that that same measure is consistent with the more general GATT 1994. However, the TBT Agreement and the GATT 1994 have concurrent application.

## 13. Additional Issues: Code of Conduct

An additional issue concerning a potential conflict of interest in the WTO Secretariat was brought to light by Robert Howse of the University of Michigan.

On May 18 2003, Rob Howse noted that[27]:

> "Rufus Yerxa, the most senior legal official at the WTO, to whom the legal affairs division reports, worked as European then International Counsel for Monsanto immediately before being appointed to his WTO post, or so indicates his curriculum vitae on the WTO web site."
>
> "A significant number of Monsanto [GM] products are listed in the annex to the US letter requesting consultations with the EC. Mr. Yerxa is the ultimate boss of the legal affairs division at the WTO, which in a number of ways may influence the proceedings if a panel goes ahead on GMOs - including involvement in the selection of panellists, legal advice to the panellists, advice in the identification and selection of outside scientific "experts" in the case."
>
> "According to Rules of conduct for the understanding on rules and procedures governing the settlement of disputes, including Secretariat officials assisting in respect of [Dispute Settlement] proceedings are covered by the following Governing Principle:
>
> "1. Each person covered by these Rules (as defined in paragraph 1 of Section IV below and hereinafter called "covered person") shall be independent and impartial, shall avoid direct or indirect conflicts of interest and shall respect the confidentiality of proceedings of bodies pursuant to the dispute settlement mechanism, so that through the observance of such standards of conduct the integrity and impartiality of that mechanism are preserved. These Rules shall in no way modify the rights and obligations of Members under the DSU nor the rules and procedures therein."
>
> "A threshold issue is whether Mr. Yerxa is a covered person - the exact wording of the Rules of conduct could lead to a negative inference - he isn't a secretariat member singled out to assist in the particular dispute. On the other hand, as the "top boss" he has unparalleled potential scope to control and direct the work of such secretariat members."
>
> "If the Governing Principle does cover him, does the requirement to "avoid direct or indirect conflicts of interest" require that a kind of Chinese wall be created whereby Mr. Yerxa doesn't engage in communications with members of the legal affairs division staff in relation to the case, or is a more stringent approach needed?"

[27] Email from Rob Howse to the WTO Forum Groups. 18 May 2003.

Three days later, Robert Howse noted that[28]:

"Responding to my post, a WTO employee contacted me by email to let me know that "very shortly after assuming his post in October, DDG Yerxa officially recused himself from all GMO matters through a letter to the Director-General's office and to the Legal Affairs division."

Robert Howse concluded that "Intuitively, that seems to me to have been the right thing to do on Rufus' part - a voluntary recusal to pre-empt conflict of interest concerns. On the other hand, while a precedent for subsequent practice, it doesn't substitute for thinking about appropriate rules and structures in the WTO concerning conflict of interest, which I encourage list members to do."

## 14. Additional Issues: New EC Regulation

In July 2002 the European parliament voted in favour of the European Commission's proposal on new regulations for the traceability and labelling of GM foods and feed products. The proposal calls for tracing of all GM food and feed products throughout all stages of the production and marketing cycle.

The proposed regulation on GM food and feed applies to products consisting of, containing, produced from (but not produced with) GMOs. Therefore, for example, genetically modified cows, pies containing beef from genetically modified cows and pastry containing suet from genetically modified cows would be covered, but beef feed on GM feed would fall outside of the regulations (as the cows were only produced with GMOs and the GM material is no longer present).

The regulations set thresholds for the adventitious presence of genetically modified material. The suggestion in the European Council has been that anything containing less than 0.9% of the GM product will not have to be labelled, unless the product is unauthorised in the EU, in which case it will have to be below a threshold of 0.5%. The new regulations also provide for a centralised authorisation procedure, which would limit the Member States' ability to block approvals of new GMOs.

The proposed EC labelling and traceability regulation has not yet been enacted, but it is already finding opposition within the WTO Committees on TBT and the Committee on SPS Measures where it has been discussed. Both Canada and the US have complained to the WTO regarding the EC's proposed labelling and traceability regulation on grounds that these new measures violate WTO rules.

[28] Email from Rob Howse to the WTO Forum Groups. 21 May 2003.

## 15. Additional Issues: The Codex Alimentarius

On 28 April 1999 representatives from America, the EC and 36 other countries gathered at a meeting of the Codex Alimentarius in Ottawa, Canada, to discuss the testing and labelling of GM foods. The Codex Alimentarius was established by the Food and Agriculture Organisation (FAO) and the World Health Organisation (WHO) in 1962 to recommend minimum standards on food safety that all countries should follow.

Draft guidelines were published in May 2002, which covered "food and food ingredients composed of or containing GMOs obtained through modern biotechnology, or food and food ingredients produced from, but not containing GMOs obtained through modern biotechnology"[29]. The draft guidelines are applicable to the labelling of food and food ingredients composed of GMOs or containing proteins or DNA from gene technology, or that are produced from gene technology, but do not contain GM material.

The scope of the draft guidelines requires clarification. No examples of what should and should not be labelled were provided. For example, meat fed on GM grain and food processed with enzymes produced by GMOs could be covered by these guidelines, or could be excluded form the guidelines. Moreover, the draft guidelines did not set out what a label should contain.

Labelling can either highlight GMO content or spotlight those products that do not contain GMOs. The first type of labelling, which Runge, Bagnara and Jackson[30] call positive labelling might require a statement such as: "This product may contain GMOs". However, given the extent to which GMOs have already entered the food chain, such a label would convey relatively little information. Nonetheless, some advocates of positive labels argue that such statements would steer consumers away from GMO products. On the other hand, positive labels that indicate an attractive nutritional or pharmaceutical property, such as "vitamin enhanced rice", could very well lead to a greater demand for GMOs.

A negative label would read: "This product contains no GMOs". No would imply a minimum threshold-approaching zero. The cost of reaching zero is neither easy nor cheap. Hardly any processed food is 100% GMO-free. Even if non-GM soya can be found, for example, trying to keep it separate from GM soya – a process known as "identity preservation" would require segregation, monitoring and testing at every step. If these costs are not too prohibitive, such practices would create a possibility for niche markets specialising in non-GM foods.

[29] ALINORM 03/22 Appendix IV

[30] Runge, C., Bagnara, G. and Jackson, L., *Differing US and European Perspectives on GMOs: Political, Economic* and Cultural Issues, *in Estey centre Journal of International Law and Trade Policy (2001).*

When the Codex Alimentarius guidelines are finalised, there will be an international standard for the labelling of GMOs – and any WTO Member that "bases" its measures on this international standard is likely to be in conformity with the WTO Agreements.

### 16. Additional Issues: The Cartegena Protocol

The 1992 Convention on Biological Diversity (CBD) included a commitment to establish an international protocol on biosafety in biotechnology. After four years of negotiations, the Cartagena Protocol on Biosafety (BSP) was approved by representatives of 130 countries at a meeting in Montreal, Canada, in January 2000.

Whilst the CBD addresses the potential risks posed by cross-border trade and accidental releases of GMOs, the BSP specifically allows governments use the "precautionary principle" to ban the importation of a GMO even in the absence of conclusive evidence that the product is not safe.

To assist countries in making import decisions, the BSP provides for a database to be established to facilitate the exchange of information relating to GMOs. Once a decision concerning acceptance or non-acceptance has been made, the Biosafety Clearing House communicates that decision to the world at large.

The BSP also provides for stricter Advanced Informed Agreement procedures to apply to seeds, live fish, and other GMOs that are to be introduced into the environment in the future. In these cases, the exporter must provide detailed information to each importing country in advance of the first shipment, and the importer must then authorise the shipment.

In addition, the BSP provides that international shipments that "may contain" GM food products must be so labelled. The exact nature of the genetic modification need not be specified, but the agreement calls for negotiations on more specific labelling requirements in the future. However, this labelling provision applies only to large-scale shipments, and does not affect labelling requirements on consumer products, which are determined by each country.

The overall aim of the BSP is to ensure that recipient countries have both the opportunity and the capacity to assess risks involving the products of modern biotechnology. Then once they are able to assess the risks and to make a policy decision, this decision can be communicated clearly and unambiguously to the world at large.

Particular issues to be aware of include the precautionary principle which has not been clarified sufficiently to prevent ambiguous interpretation, and the Advanced Informed Agreement regulation which could result in considerable administrative costs. In addition, the provisions relating to Acknowledgement

of Receipt of Notification (Article 9), Decision Procedure (Article 10), Review of Decisions (Article 12), Handling, Transport, Packaging and Identification (Article 18), Socio-Economic Considerations (Article 26) and Compliance (Article 34) may be applied in such a way as to constitute impediments or technical barriers to trade (which could be WTO inconsistent).

Although the BSP has been signed by 103 countries, it will not enter into force until after it has been ratified by 50 governments. On 20 May 2003, Colombia ratified the BSP, bringing the current number of ratifications to 49[31]. Once the BSP does come into force, questions will arise about how the rights and obligations under the BSP should relate to the rights and obligations of the WTO Agreements.

[31] http://www.biodiv.org/biosafety/signinglist.asp?sts=sign

# 7. Rules of Origin: The Way Ahead

## Lessons from the USA-EC-India Textiles Dispute

***B. Bhattacharyya***

*'Rules of Origin are very, very complex. You don't want to know about them. They are terrible things to deal with'.*

Canadian Trade Minister before the Canadian Parliament.

### Introduction

The successive trade rounds under the GATT/WTO have resulted in substantial reduction in the level of tariffs, especially in the developed countries. In the post-Uruguay Round period, the applied and bound tariff levels are shown in Table 1.

**Table1. Average Applied and Bound Rates (Percent)**

| | Developed | | Developing | |
|---|---|---|---|---|
| | Applied | Bound | Applied | Bound |
| All Merchandise | 2.6 | 3.7 | 13.3 | 13.0 |
| Manufactures | 2.5 | 3.5 | 13.3 | 13.3 |
| Textiles & Clothing | 8.4 | 11.0 | 21.2 | 25.5 |

*Source: WTO*

It is evident from the data in the Table 1 that tariffs which used to be the principal instrument for trade control has significantly lost its importance in the developed countries. There are, however, sectors, both agricultural and industrial, where the average level of tariff protection conceals significantly higher protection level. Textiles and clothing is one such sector.

The Rules of Origin (ROO) whose basic function is to determine where a particular product has originated geographically have been found by many experts as a trade policy instrument which they should not be. One possible explanation behind such usage is what Bhagwati has termed as the 'Law of Constant Protectionism'.[1] According to this law, if one form of protectionism is brought down, e.g., tariff, another form will substitute it. The net effect is displacement, though not any overall rise in the protection level. The growing

[1] Bhagwati, Jagdish (1988) Protectionism, MIT Press, P. 53

realization that ROO may act as a trade barrier rather than facilitate trade transactions, has also come about because of the increasing number of regional trading arrangements (RTAs). All preferential trading regimes require extensive and precise rules of origin to ensure that only goods originating in the partner countries are allowed to enter the importing country at preferential rates of duties. Due to the multiplicity of RTAs, the twin dangers of trade diversion and complexity of origin rules are currently being highlighted. There is a third reason as well. Increasing use of anti-dumping measures requires clear rules for the determination of origin of goods.

**ROO and GATT/WTO**

Though ROO is fundamental to trade, especially the customs administration, the GATT legal regime on this has been lax. Though there are specific references to ROO, such as Articles I and XXIV, there is no precise definition. The issue has been mostly dealt with in the World Customs Organisation. The laxity in the GATT legal regime allowed the member-states to draft their own rules and apply differently, sometimes with specific trade objectives in mind. The first GATT effort towards bringing some uniformity in this complex web of ROOs was made in the Uruguay Round when the Agreement on Rules of Origin was negotiated.[2]

The Preamble of the Agreement on Rules of Origin provides, inter alia,

*Recognising* that clear and predictable rules of origin and their application facilitate the flow of trade;

*Desiring* to ensure that rules of origin do not nullify or impair the rights of members under GATT 1994;

*Recognising* that it is desirable to provide transparency of laws, regulations, and practices regarding rules of origin;

*Designing* to ensure that rules of origin are prepared and applied in an impartial, transparent, predictable, consistent and neutral manner;

*Recognizing* the availability of a consultation mechanism and procedures for the speedy, effective and equitable resolution of disputes arising under this Agreement.

It is important to carefully note the objectives of the Agreement, as indicated in the preamble. It seeks to ensure that the rules themselves should not obstruct trade, should be clear and predictable, applied in a neutral manner, i.e., non-discriminatory way. As such, ROO should not act as a trade barrier but serve only as determinant of origin.

The Agreement on ROO has three distinct features. First, it makes a clear distinction between non-referential and preferential ROOs. Non-

[2] WTO (1994), The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts.

preferential ROOs apply to MFN trade, i.e., for the determination of origin in the framework of GATT trade policy instruments such as anti-dumping duties, quantitative restrictions, safeguards, application of rules of origin to marks of origin, trade statistics and government procurement. Preferential ROOs apply to preferential tariff regimes, such as GSP, RTAs, etc. The Agreement brings only the non-preferential ROOs under the WTO discipline. Second, the Agreement has the objective of harmonizing the national ROOs through detailed technical work carried out in the World Customs Organisation. Third, 'the harmonized set of rules of origin has to be used for all MFN purposes ...'.[3]

On the restriction of the Agreement to non-preferential arrangement, Hockman and Kostecki observed:

> 'Rules of Origin have been problemetical mostly in the context of preferential trade agreements; exactly the arena where WTO rules do not apply. This was no oversight, and reflects the fact that many countries did not want to see constraints imposed on their policy freedom with regard to regional integration or the mechanics of trade preferences for developing countries.'[4]

The disputes that EU and India had with USA on textiles show that even non-preferential rules of origin are quite problematic.

It is also necessary at this stage to consider the related issue of the marks of origin. Marks of origin show where the product/produce has originated as information to prospective buyers. Marketing literature indicates that buyers associate several attributes such as quality, ethnicity etc. with the place where the product has come from.[5] This information has, therefore, strong commercial importance. Legally, GATT permits WTO members to maintain laws relating to marks of origin on imported products to protect buyers from false and misleading information under GATT Article IX. However, marks of origin should not be discriminatory or unreasonably burdensome. Further, these are not to work to the detriment of products with distinctive regional or geographic names (GATT Article IX: 6).

It is also observed 'that country-of-origin marking requirements that single out foreign goods may be found to violate GATT's national treatment provisions'.[6]

[3] UNCTAD (1998), Globalization And The International Trading System: Issues Relating to Rules of Origin (UNCTAD/ITCD/TSB/2), PP 10-11.

[4] Hockman and Kostecki (1995), Then Political Economy of the World Trading System, Oxford University Press, P. 104.

[5] There is a large international marketing literature on this. See for example, Bhattacharyya (1992), Export Marketing: Strategies for Success, Global Business Press, New Delhi, Ch. 3.

[6] Matsushita, Schoenbaum and Mavroidis, (2003), 'The World Trade Organization: Law, Practice and Policy', P. 119. See also footnote note 51 and the references therein.

## The EU-US Dispute

Trade in textiles was regulated under various agreements through a rigorous quota regime. In the Uruguay Round, the Agreement on Textiles and Clothing was negotiated which would result in a 10 year phase-out by 2005 of the quota regime and integration of the textiles and clothing with the WTO regime.

The rules of origin followed by USA up to 1 July 1996, for the determination of origin for textiles were:[7]

1. Dyeing of fabric and printing, when accompanied by two or more of the following operations: bleaching, shrinking, fulling, napping, decating, permanent stiffening, weighting, permanent embossing or moireing.[8]
2. Spinning fibres into yarn.
3. Weaving, knitting or otherwise forming fabric.
4. Cutting of fabric into parts and the assembly of those parts into the completed article.
5. Substantial assembly by sewing and/or tailoring of all cut pieces of apparel articles which have been cut from fabric in another country into a completed garment.

The alternative to the four operations rule was substantial transformation, resulting in a change in tariff heading.

Consequent upon the ATC becoming effective, USA introduced changes in its rules of origin regarding textiles and clothing. The new rules de-recognized the four operations rule. The origin now vests on the country where the fabric was woven or sewn. For a final product, the assembly became the determining factor.

Section 334 of the Uruguay Round Agreement Act (URAA) provides that a product is to be considered as originating in a country if:

A. the product is wholly obtained or produced in that country.
B. the product is a yarn, thread, twine, cordage, rope, cable or braiding and
   i) the constituent staple fibres are spun in that country; or
   ii) the continuous filament is extruded in that country.
C. the product is a fabric, including a fabric classified under the Chapter 59 of the HTs and the constituent fibres, filaments or yarns are woven, knitted, needled, tufted, felted, entangled or transformed by any other fabric-making process in that country ...; or
D. the product is any other textile or apparel product that is wholly assembled in that country ... from its component pieces'.

[7] US Customs notification 19 CFR 12.130.
[8] This is commonly known as four operations rule

(3) Multicountry rule – If the origin of a good cannot be determined under paragraph (1) or (2), then that good shall be considered to originate in, and be the growth, product or manufacture of:

(a) the country in which the most important assembly or manufacturing process occurs, or

(b) if the origin of the product cannot be determined under subparagraph a, the last country in which important assembly or manufacturing occurs.

These new rules created problems for the EU exporters of clothing. Under the previous four operations rule, the EU exporters could claim origin by undertaking four recognized operations, even if the fabric was from a non-EU country. Under the new rules, origin of the fabric determined the origin of clothing. The immediate impact was that the EU clothing exports indirectly got included under the ATC quota regime in those cases where the fabrics were sourced from a country whose exports were subject to quota restraints. A second problem was that as origin changed, the right to label the products, as made in Italy or any other EU member states also disappeared. This reduced the marketability of the final product.

The EU brought the issue to the conciliation process under WTO's Dispute Settlement system. The WTO Agreement on Textiles and Clothing provides in Article 4.2:

> 'Members agree that the introduction of changes, such as changes in practices, rules, procedures and categorization of textiles and clothing products ... should not upset the balance of rights and obligations between the Members concerned - - - adversely affect the access available to a Member, impede the full utilization of such access, or disrupt trade under this Agreement.
>
> - - - -
>
> Members agree that the Member initiating such changes shall inform and, whenever possible, initiate consultations with the affected Member or Members prior to the implementation of such changes, with a view to reaching a mutually acceptable solution ...[9]

There were two *process-verbal* agreements between the EU and the USA. USA agreed to amend the relevant legislation to undo the damage caused by the 1996 rules to the EU exports to USA. The final outcome was that Section 405 of the Trade and Development Act of 2000, entitled 'clarification of Section 334 of the Uruguay Round Agreement Act', was adopted.

Section 405 was, therefore, adopted essentially to take care of the EU objections. "To settle the dispute, the United States agreed to amend Section 334, creating two exceptions to Section 334's fabric formation rules.[10]

[9] WTO (1994), The Legal Texts.

[10] United States – Rules of Origin for Textiles and Apparel Products, WTO, WT/DS 243, P.8.

Section 405 provides, inter alia,

...

B. Notwithstanding paragraph (1) ( c ), fabrics classified under HTS as of silk, cotton, man-made fibre, or vegetable fibre shall be considered to originate in, and be the growth, product, or manufacture of, the country, territory or possession in which the fabric is both dyed and printed when accompanied by two or more of the finishing operations:
.....

C. Notwithstanding paragraph (1) (D), goods classified under HTS headings (.....), except for goods classified under such headings as of cotton or of wool or consisting of fibre blends containing 16 percent or more by weight of cotton, shall be considered to originate in, and be the growth, product, or manufacture of, the country territory, or possession in which the fabric is both dyed and printed when accompanied by two or more of the following finishing operations: ...'.

What the amendments meant are the following:

i) The four operations rule was reintroduced, except for fabrics made of wool.

ii) for silk, cotton, man-made and vegetable fibre fabric, origin would be conferred by dying and printing and two or more finishing operations.

iii) For certain textiles products, excepted from the assembly rule, origin would be conferred on the identical bases, with exceptions.[11]

The amendments through Section 405 satisfied the EU as a result of which no dispute settlement panel was set up.

**India-USA Dispute**

India sought consultations with USA pursuant to Article 4 of the understanding on rules and procedures governing settlement of disputes, Art XXII:I of GATT and Article 7 of the Agreement on Rules of Origin concerning the USA rules of origin on textiles and clothing, Consultations were held during February-March 2002 which failed to come to an agreement.[12]

As a result, India requested establishment of a panel which was set up in June 2002 with the following terms of reference:

> 'To examine in the light of the relevant provisions of the covered agreements cited by India in document WT/DS 243/5/Rev. 1, the matter referred to the DSB by India in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.' [13]

[11] WT/DS 243/R
[12] WTO, WT/DS 243/5 Rev. 1
[13] WTO, US – Rules of Origin Textiles and Apparel Product, WT/DS 243/6.

Bangladesh, China, the European Communities, Pakistan and the Philippines reserved their third party rights to participate.

The major points made by India were that rules of origin, set out in Section 334 and as modified by Section 405 and the relevant customs notifications

a) are being used by the United States as instruments to pursue trade objectives, thereby violating Article 2(b) of the RO Agreement. Section 334 is being used as an instrument to protect the United States' textile and apparel industry. Section 405 is being used as an instrument to favour imports of the products of concern to the European Communities;
b) create restrictive, distorting and disruptive effects on international trade and are, therefore, inconsistent with the United States' obligations under Article 2(c), first sentence, of the RO Agreement;
c) require the fulfillment of a certain condition not related to manufacturing or processing and pose unduly strict requirements and are, therefore, inconsistent with Article 2(c), second sentence, of the RO Agreement; and
d) with respect to section 405, discriminate between Members, and in particular, discriminate in favour of the European Communities and are, therefore, inconsistent with the United States' obligations under Article 2(d)of the RO Agreement.[14]

Due to these reasons, India considered the US rules of origin for textiles and apparel products to be inconsistent with paragraphs (b), (c), (d) and (e) of Article 2 of the Agreement on Rules of Origin.

Leaving aside complex legal points and textual interpretations, the major economic issue raised was the possible use of rules of origin as a trade policy instrument, specifically to provide protection to domestic industry. The desire to use this instrument to subdue the competitive effect of MFA dismantling is prima facie clear. The restrictiveness in trade flows in this case is coming out of the quota regime of ATC due to which India had argued that it had suffered disadvantage. Specifically, India cited its export of greige fabric to Sri Lanka for manufacture into bed linen. India had argued that Section 334 caused a major setback to this trade, because the products were considered as Indian and not of Sri Lanka, as a result of which Indian quota got exhausted.

In addition to the issue of providing protection, India also raised the issue of trade distortion. The main argument was that complex origin rules by themselves can disrupt trade. One interesting point raised by India in connection with the quota regime is the issue of circumvention. The statement of

[14] WTO, WT/DS/243 R., P. 69

Administrative Action (SAA) lists four objectives for Section 334. These are: i) to reflect the important role assembly plays in the manufacture of apparel products; ii) to combat transshipment; iii) to harmonize US rules with those of major trading partners and iv) to advance the ARO goal of harmonization. According to India, what is allowed is prevention of fraudulent circumvention and not legal circumvention. For prevention of circumvention, India observed that Article 5.2 of ATC is the relevant provision and Section 334 does not assist the USA in combating transshipment.

India also argued that since section 405 was a product of bilateral settlement between EU and USA, this is discriminatory to India, as it unduly favours the EU and, therefore, violates Article 2(b) and 2(d). Basically, the point was that settlement took into account products of export interest only to the EU.

**US Response**

USA responded to all these points, in addition to its own as to why India's contention was not valid. Legally, it raised the point that as a complainant, it was India's responsibility to provide the burden of proof which India had not done.

USA maintained that ARO allows changes in the rules of origin during the transition period and the changes made are, in the ordinary meaning of Article 2, consistent with the ARO. It argued that 'a finding that the US regime is inconsistent with Article 2 leads to an impossible result under the ARO: that the United States should have no rules of origin and instead simply make case by case determination of origin or that the WTO dispute settlement system can assign origin determination for specific products'.[15]

USA argued that Section 334 does not have the objective of protecting domestic industry, as the statement of Administrative Action (SAA) reveals.

> 'USA has a regime in place for the purpose of protecting its domestic industry during the transition ATC period, i.e., a quota regime ... (which) provides effective protection for the domestic industry. Indeed this is why this dispute exists ...'[16]

USA also argued that even if Section 405 was the result of bilateral consultations, the Section was not discriminatory as it is applied to all WTO members on an MFN basis. The concept of de facto advantage was not applicable in this case.

Coming to the economic issues, USA argued that effects on trade which can be expected of any change in rules of origin, could not be equated with trade distortion. Further, restrictive, distorting or disruptive effects on trade cannot be determined by examining effect on one single Member's trade.[17]

[15] WTO, WT/DS 243, P. 5, Executive Summary of 1st submission of US.
[16] WTO, WT/DS 243, P. 5, Executive Summary of 2nd submission of US.
[18] WTO, WT/DS 243, P. 5, Executive Summary of 2nd submission of US.

On the issue of providing protection to domestic textiles trade, USA argued that 'Section 334 has facilitated an enormous increase in trade and textiles product, to the US market. Accordingly, a conclusion that Section 334 was enacted to protect the US textile industry and is, therefore, a trade objective in the context of Article 2(b) would not be based on any legal or factual foundation'.[18]

**Findings**

The Panel issued the interim report in April 2003 which became the final report since neither party gave comments or sought meeting with the Panel. The Report was released by the WTO on 20 June, 2003.

The Panel concluded:

a) India has failed to establish that Section 334 of the Uruguay Round Agreements Act is inconsistent with Articles 2(b) or 2(c) of the RO Agreement;
b) India has failed to establish that Section 405 of the Trade and Development Act is inconsistent with Articles 2(b), 2(c) or 2(d) of the RO Agreement; and
c) India has failed to establish that the customs regulations contained in 19 C.F.R. ¡± 102.21 are inconsistent with Articles 2(b), 2(c) or 2(d) of the RO Agreement.[19]

The arguments which led the Panel to come to these conclusions are too complex and would take space not available here and, therefore, will not be summarized. However, few observations of the Panel merit reference here.

1. Article 2 of the ARO provides a fair amount of discretion to members, as to the determination criteria which confer origin, changing those criteria overtime, or applying different criteria to different goods. (PP. 71-72)
2. The objectives identified by India, i.e., the objective of protecting domestic industry against import competition and favouring imports from one member over imports from another may, in principle, be considered to constitute trade objectives in pursuit of which ROO may not be used. (PP 73-74)
3. India seeks to cost doubt on the validity of the fabric formation rule as set forth in Section 334 as it is used to pursue a trade objective. The Panel observed that there is no requirement in Article 2 of ROA to use a particular type of rule (P. 81). As to India's point on the

[18] Op. cit., P. 6.
[19] T/DS/243/R, Part 1, P. 124. All subsequent page numbers refer to the same Report.

rationality of the rule, the Panel said; 'the silence of Article 2 on the issue suggests that Members are, subject to the discipline contained in Article 2(b) and 2(c), free to make determination as they deem fit' (P 82). As to India's point that the fabric formation rule does not take into account subsequent value-added operations, the Panel observed that there is 'no requirement in Article 2 that Members need to confer origin on the country where a significant, or even the most significant economic contribution to a final good has been made' (P. 82).

4. On India's contention on the effect of the fabric formation rule on the quota regime, the Panel observed that no factual evidence was provided and a priori conclusions could not be drawn on this alleged effect. '..The evidence and argument adduced by India do not support the conclusion that the fabric formation rule necessarily or in fact, brings more imports of made-up articles under quota in the United States' (P.84)..... Moreover... the mere fact of making the quota system more restrictive could not, *ipso facto,* condemn the fabric formation rule. A restrictive fabric formation rule may have been adopted in pursuit of legitimate objectives.'(P. 84)
5. 'Even if we were to accept India's contention that the concept of circumvention does not include legal quota avoidance strategies, this would not detract from the fact that the United States has offered a plausible explanation of how the fabric formation rule promotes the objective of preventing illegal quota circumvention. ... we do not consider that there is an inherent link between the possible objective of preventing circumvention – defined here as the prevention of quota avoidance through legal means – and the objective of protecting the United States' textiles industry, such that the two objectives could invariably be viewed as one and the same. (P. 85)
6. As to India's claim that section 405 is inconsistent with Article 2(b) as it favours imports from the European Communities, the Panel observed that since the 'section 305 applies equally to qualifying goods from all Members, we do not see how section 405 is being used as an instrument to pursue the objective of favouring EC imports ...' ... setting a bilateral trade dispute does not imply an intention on the part of the disputing parties to disfavour members who are not parties to a settlement agreement'. (P. 91)
7. On the trade restrictive effect of the fabric formation rule in Section 334, the Panel was not convinced of the factual evidence – provided by India. 'The mere assertion by an Indian exporters' association, that, as a result of the fabric formation rule provided for in section 334, "exports of grey fabrics from India to Sri Lanka suffered a

major set back", is insufficient to establish that the level of exports of Indian greige fabrics to Sri Lanka has decreased or there exists a causal link between the fabric formation rule in Section 334 and the alleged decrease in India's exports of greige fabric'. The Panel also observed that data on more than only one country are required to study the restrictive effects on international trade. (PP. 100-101).

**Conclusions**

India's decision to take USA to the Dispute Settlement Board possibly arose out of the concern that the unilateral determination of rules of origin during the transition period might bring unexpected and undesirable consequences to its export interests. The long delay in the work programme of the Committee on ROO strengthened this threat perception. Had India won the case, that would have set restraints on such future actions by other member-states. India has already felt the adverse impact of the NAFTA rules of origin, especially the triple transformation rule, on India's exports of T&C to USA.

But arguably, still more critical was the perception that the fabric formation rule, as followed by USA, would be detrimental to India's interests from a long term point of view and, therefore, its legal status needed to be questioned. This was more so, because in the Committee on ROO, a large number of countries have indicated their preference for such a rule.

India is a large exporter of textiles and clothing, with almost one-third of its total exports originate in this sector and its concern to ensure that hidden non-tariff barriers in the form of restrictive ROO conditionalities do not proliferate is understandable. As the NAFTA experience as well as almost total collapse of India's grey fabric exports to Sri Lanka reveal, ROO can effectively deny market access to textiles and clothing exports from India, especially till the time the ATC quotas are in place.

However, the dispute, despite all its legal complexities, does not have much substantive long term implications for two reasons. First, the dispute arose out of the quota regime of the ATC which will become inoperative by 2005, with the complete integration of the T&C trade. Second, non-preferential rules of origin will have to be harmonized under the work programme of the Doha Development Agenda. That cannot be indefinitely postponed, even if there are delays as of now.

The short-term importance of the dispute arises out of this second reason. There are strong non-convergent views in the Committee on Rules of Origin. It is possible that this dispute by bringing on the surface some of the implications of national rules of origin may influence the views of the negotiators in the Committee on Rules of Origin.

From the legal stand point, two points are important. First, this as well as some other current disputes tend to substantiate the view that since under the WTO's dispute settlement system, the WTO rules can be consequentially enforced only if there are formal challenges, the body of case law may get developed in a skewed form, depending upon the interests of important members who are willing to use the DSM to push the envelop in their own interest. Second, the Panel Report brought into sharp focus the importance of trade data, in addition to the legal interpretation of the Agreements in arriving at findings. The Panel has observed with reference to at least two claims made by India on the inadequacy of empirical evidence submitted. This shows that trade economists along trade lawyers should be involved in preparing a country's substantive and legal position.

Finally, from a systemic standpoint, the rapid rise in the number of disputes being brought to WTO, despite this being a sign of the robustness of the mechanism, calls for a review of the current system, to ensure that it does not collapse because of its own success.

# Section III

# Regional Issues

# 1. ACP-EU Negotiations of Economic Partnership Agreements

*Michael Davenport*

## 1. Introduction

The Procedural Guidelines drawn up by the ACP Secretariat clearly propose two stages of negotiations, the first to cover 'cross-cutting' issues and the second to cover trade negotiations per se at the national or regional level.[1] However, the West African members of ECOWAS and Mauritania are currently negotiating a mandate for regional negotiations with the EU. Meanwhile the Eastern and Southern African countries are struggling with a number of complex, overlapping integration issues which need to be resolved before they are in a position to start regional negotiations with the EU.

Other regions have special interests in the postponement of regional negotiations for several years. For example, the Caribbean is engaged in a complicated trade-negotiation juggling act and would benefit from a delay in negotiations with the EU. The Caribbean, as is the Pacific, is faced with the complications of a web of implicit and explicit MFN obligations.

This note stresses the importance of maintaining ACP solidarity in respect of the two stage approach. Solidarity is critical to avoid pre-empting the determination of the geometry of the regional partnership agreements. It also emphasises the timing and sequencing of negotiations and the importance of avoiding precedents which will undermine subsequent negotiations. It first

[1] para 12. The negotiations should therefore be conducted in two phases:

(a) During the first phase, negotiations will take place at an all-ACP level with the EU with a view to concluding an all ACP-EU Agreement, focusing on objectives and principles of EPAs and issues of common interest to all ACP States, whilst allowing ACP States to undertake necessary back-up research and capacity building actions. This first phase could extend from September 2002 through 2003 when a review could take place. The negotiations in the second phase could start in September 2003.
The following list of issues could be discussed under Phase I: principles, objectives, scope and content, special and differential treatment, financing the cost of adjustment, rules of origin, standards, sanitary and phytosanitary measures, customs and administrative co-operation, framework agreement on trade in services, development of the service sectors, fisheries, treatment of trade-related issues such as competition policy, investment promotion and protection, trade and environment, institutional matters (including the Council and the future of Joint Assembly, CDE, CTA), modalities for the phasing of negotiations and the resultant implementation issues, dispute settlement mechanisms, safeguard measures, legal status of the Agreement, support measures to overcome supply constraints, capacity building, treatment of commodity protocols, trade facilitation, evaluation of the impact of CAP reform on agricultural exports, WTO-compatibility, product coverage and transitional periods and arrangements with respect to the establishment of the FTA, investment promotion schemes, including measures to promote the transfer of technology, know-how and skills.

(b) In phase 2, the issues will cover, *inter alia,* tariff negotiations and any other specific sectoral commitments at national or regional level as the case may be and issues of specific interest to ACP countries or regions (***Draft ACP Guidelines for the Negotiations of Economic Partnership Agreements*, Brussels, 21 June 2002**).

briefly considers the particular problems faced by the four regions which appear envisaged at least by the Commission as prime candidates for EPAs.

## 2. The ECOWAS-Mauritania proposal

ECOWAS is a grouping of 15 West African states, of which all but three are LDCs – Cote d'Ivoire, Ghana and Nigeria – while among the CEMAC members Chad and Equatorial Africa are LDCs. This means that there is an atypically large number of LDCs in this regional group. This is important in that these negotiations could set precedents as regards the future status of the LDCs. Secondly the LDCs already have tariff- and quota-free access to the EU for most commodities – and will have it for all goods but arms – by mid 2009. Thus the ECOWAS countries will likely find it relatively easy to agree the terms of an EPA – at least on the trade side – since access to the EU market is already established for the LDCs and for the non-LDCs by far the most important export good is tariff-free oil. Though the EBA preferences for LDCs are 'concessionary' on the part of the EU, there is every likelihood that they will be maintained over the indefinite horizon.

Reciprocal access for EU exporters to the non-LDC West African markets will be less of a problem than elsewhere owing to the low manufacturing base of the West African countries. For the LDCs the manufacturing base is generally even more restricted and, in any event, they may be granted much longer lead-in times if not exemption from the reciprocity restriction as long as they remain within the UN's list of LDCs. The LDCs could be persuaded to participate in the EPA on the grounds that their exporters will receive assistance as regards technical and regulatory barriers on the EU market and on the basis of the non-trade components of the agreement. In general the ECOWAS countries (plus Mauritania) will be able to negotiate an EPA with fewer painful concessions that other ACP groups. The longest negotiations are likely to revolve around the package of EU development assistance.

The negotiations with the ECOWAS-Mauritania members are also less likely to become mired in the future regimes for 'protocol' commodities – bananas, beef, sugar and rice – since these products are of lesser importance as export goods here than among other ACP regions. True, Congo Brazzaville has a small sugar quota of 10,000 tonnes and there is a banana interest in Cote d'Ivoire, but generally the significance of these commodities is much more limited than for East and Southern Africa or the Caribbean. The latter regions will have to focus much of their bargaining effort on the terms of access for these products on the EU market.

The general risk is that premature negotiations may create a number of powerful precedents. The ECOWAS members plus Mauritania is, in a sense, a special case because trade interests are relatively limited and the development

assistance *volet* that much more important. There may be a danger that unfortunate precedents are set over the treatment of LDCs, over the protocol commodities or over other trade issues of critical importance to other regions. Early negotiations could also mean a poorer outcome for the West African states themselves for the reasons set out in section 6 below.

### 3. Eastern and Southern Africa

Another major concern arising from the possibility of early negotiations with the West Africa countries there could be damaging implications for other regional groups arises from the a premature fixing of the EPA geometry. In particular it would preempt an EPA [at the African Economic Community level – or even] at the ECOWAS-CEMAC-COMESA-SADC level.

The Eastern and Southern African countries are in no position to engage in regional negotiations with the EU in the near future. These countries have embarked on ambitious integration processes – which are now beginning to yield benefits. However the membership of the main regional groupings, COMESA, SADC and the IOC overlap while trading relations are complicated by the fact that four members of SADC, Botswana, Lesotho, Namibia and Swaziland are in a customs union with South Africa – not itself an ACP State – which has already signed a free trade agreement with the EU. Similarly COMESA is pressing ahead with plans for a customs union – initially restricted to a limited number of members – but among these will be Egypt which has also signed a free trade agreement with the EU and is also not an ACP State. These complex regional trading arrangements need a chance to settle, some of the complications need to be resolved and the situation as regards non-ACP States needs to be clarified before negotiations for an Eastern-Southern African EPA – or wider Sub-Saharan [or pan-African EPA] – with the EU are initiated.

### 4. The Caribbean ACP States

The Caribbean states are at present giving priority to the FTAA negotiations. This is inevitable given that

- the FTAA negotiations are already in progress. Other negotiations within the hemisphere are ongoing and the increasing number of trade agreements being negotiated could leave the Caribbean countries at a disadvantage in their principal markets.
- the FTAA negotiations are extremely demanding in terms of meetings and preparatory work. The resources of the RNM and national negotiators are being stretched to their limits both in terms of personnel and funds;
- the greater part of Caribbean trade is with the Western hemisphere and that share appears to be rising, while the principal competitors to

Caribbean exports of goods and services are Latin American countries. In a number of sectors the Caribbean is currently losing markets to Mexico and to other FTAA countries.

However the FTAA negotiations are all-or-nothing negotiations, and small countries – and the Caribbean states are particularly small – start from a weak bargaining position. Their markets are often too small to be of great significance to other players. To a large extent they have to depend on the good will and desire for inclusiveness of the United States and Canada. Their only serious, but implicit, counter-threat is that they will become even more worrying as a key element in the illegal drugs trade.

In the Market Access Group the Caribbean will seek to preserve as many of the special preferences of the CBI, including the rules of origin which are less demanding than those of NAFTA which could be the model for the FTAA rules. This could also be a strategy for obtaining special provisions for small economies in terms of market access. All Caribbean and Central American countries are beneficiaries of the CBI except Cuba, so that the current beneficiaries as a group could argue that on the grounds of 'differences in size and level of development of economies' they should have easier rules of origin, longer transition periods, technical assistance and so on. Canada already offers a preferential system to the Caribbean countries under CARIBCAN and might well support such an initiative.

In the end, however, to what extent the Caribbean, and other the Latin American countries, can obtain SDT other than longer adjustment periods is doubtful. But the Caribbean states have another problem. They face the requirement that any trade liberalisation negotiated within the FTAA framework must be extended to the EU under the Cotonou Agreement. Even if they succeed in delaying implementation of market opening under the FTAA to allow a longer period for adjustment – which is clearly in their interest – market opening to EU exports is no longer part of an EPA bargain as far as the Caribbean is concerned. It is already conceded. The only alternative for the Caribbean is to accept the limited US GSP scheme – the CBI is scheduled to end in 2005 – and target an EPA with the EU. But with the great preponderance of their trade being with the US this is not an attractive option.

## 5. The Pacific ACP States

The Pacific states are faced with a similar predicament to that of the Caribbean. Under the PACER Agreement between Pacific ACP countries and Australia and New Zealand, the ACP states have an MFN obligation to extend to Australia and New Zealand any access preferences which are granted to the EU under the post-Cotonou negotiations. Even if that obligation has not been triggered, negotiations on the opening of Pacific Island markets to Australia

and New Zealand are scheduled to start within several years. Under Cotonou, that would of course trigger MFN obligations in opposite direction. To complicate matters further, the Marshall Islands, the Federated States of Micronesia and Palau have MFN commitments to the United States under the Compact of Free Association.

This 'web of MFN obligations' facing the Pacific ACP States does not necessarily imply any particular type of EPA with the EU, except perhaps that that EPA must have a major services trade component. It does imply, however, that all the options as regards the EPA should be kept open as long as possible. It must be borne in mind that a small share of the Pacific Islands trade is with the EU, the bulk being with Australia, New Zealand and Japan.

## 6. A two stage approach to negotiations

A period of pan ACP-EU negotiations in advance of individual EPA negotiationswould have a number of benefits. These may require more than the year proposed in the ACP Guidelines. That period would provide

- the opportunity is establish common positions and conduct common negotiations on cross-cutting issues. This means subsequent efforts to establish FTAs between ACP regions – for example the construction of the African Economic Community – will be easier;
- individual regions or countries will be negotiating from weaker positions if they seek to negotiate these issues independently. Judging by past EU bilateral trade agreements, the EU will push for *a la carte* agreements including the maximum amount of reciprocity, competition law and open government procurement it deems feasible, using promises of development assistance as the principle carrot. This could both inhibit economic opportunities in the region in question and undermine the bargaining power of other regions;
- time is needed for the ACP States to build capacity both for the negotiations themselves but also to undertake studies of the implications of the various options, both at the regional and national levels;
- a number of ongoing negotiations and changes to trading regimes will help define the possibilities and opportunities that can emerge form regional ACP-EU negotiations. These include negotiations in the WTO to be concluded by 1 January 2005; review of the EU GSP in 2004; ongoing regional integration processes in various ACP regions/ sub-regions which are expected in some cases to result in the establishment of customs unions; and trade negotiations between some ACP countries and third parties (notably the FTAA), and between the EU and third parties. EU enlargement which is expected to take

place in 2004 and reform of the EU's Common Agricultural Policy (CAP) may also change the parameters of the negotiations;

- negotiations within the WTO on the "clarification and improvement" on Article XXIV of GATT 1994 could radically improve the conditions of WTO compatibility for FTAs;
- many ACPs, while accepting the principle of reciprocity, emphasise flexibility in the process of adjustment to new trading arrangements for small economies, through longer transition periods in the liberalisation process, and also through special safeguard clause(s), freedom from antidumping and other contingent protection, easier rules of origin and technical assistance programmes. If principles of SDT for small economies can be established through the WTO or through the FTAA negotiations, the ACP position in negotiations with the EU will be strengthened.

## 7. Conclusions

The ACP States do not come to the post-Cotonou negotiations unencumbered by regional integration commitments and by a web of MFN obligations – the former strongly encouraged by the European Union and the latter partly imposed by the European Union. In the light of these and other considerations, not least progress in contemporary negotiations in other fora, in particular the WTO and the FTAA, it is critical that regional negotiations not be rushed. There is much to be said for a period of pan ACP-EU negotiations on issues of current interest for at least a year before regionally-based negotiations are launched.

A period of pan ACP-EU negotiations is particularly important as regards the African ACPs. The African ACP Sates are much more dependent on EU trade than are either the Caribbean or Pacific States. Many of them are currently involved in intricate integration processes. The problems of overlapping membership of different regional organisations, the presence of non-ACP states within these organisations and the unanswered question of what is the optimal geometry for a regional EPA with the EU imply that a period of analysis, research and preparation is essential.

It is also important to recognise that precedents can easily be established which can limit the scope of subsequent negotiations. The longer the first stage the more time will be available for the ACP States jointly to establish detailed guidelines for regional negotiators to prevent such precedents. But it is also important to narrow the scope for creating such precedents by negotiating the cross-cutting issues – see footnote 1 for the ACP Secretariat's list of these – at the plenary level. In general to maximise the gains from the negotiations unity and solidarity among all ACP States cannot be stressed too much.

# 2. Challenges Facing the Caribbean During EPA Negotiations

***Junior Lodge***

## Introduction

ACP-EU negotiations on Economic Partnership Agreements (EPAs) represent a step into uncharted territory for ACP countries. The preceding five trade cooperation pacts between the two groupings of countries (Lome I-IV and Cotonou) were based on the EU granting non-reciprocal trade preferences. From the perspective of EC, reciprocity is one of the pillars on which EPAs stand.

As stated in its mandate, the EU will seek "*the elimination of customs duties on imports from the EC for substantially all trade over the course of a transitional period*" (Para. 3.2) Both parties already implicitly accept that taking into account the different levels of development between the ACP and EU, the concessions to improved market access will be asymmetric. For example, ACP countries should be granted a longer transitional time period to remove barriers to EU imports.

The ACP conducts these negotiations with two primary goals. Firstly, to halt the decline in the value of their preferential access to EU markets (exacerbated as a result of MFN liberalization, the EU granting other developing countries trade preferences and Agenda reform of the CAP). Secondly, and associated with the first objective, is to strengthen their productive capacity in order to seize marketing opportunities stemming from preferential access to EU markets.

The major fault line in the upcoming negotiations can be generalized as follows: – the EU wants to integrate the ACP into the world economy on the twin basis of strict adherence to tight WTO rules and liberalized markets. The ACP countries seek to carve out a greater policy space in order to pursue their own developmental agenda and appropriate policy measures.

## The Costs of Reciprocity

Caribbean economies are extremely open, that is, the ratio of foreign trade to GDP is rather high. The region's trade regimes are also open with trade-weighted average tariffs pitched at just above 8%. Furthermore, imports on most capital and intermediate goods tend to enter duty free. Any further liberalization of the trade regime might generate welfare gains for consumers, but also welfare losses for both producers and government.

One major component of the cost of granting reciprocity is the loss of fiscal revenues. According to Eastern Caribbean Central Bank Annual Report of 2000, border taxes as a share of recurrent fiscal revenues in six OECS countries area as follows: Antigua (66.1%), Dominica (54.8%), Grenada (61.2%), St. Kitts and Nevis (50.7%), St. Lucia (55.4%) and St. Vincent (50.2%). The options facing the loss of a source accounting for greater than one-half of all fiscal receipts are very limited. Obviously, VAT is an option – either introducing it or hiking its rate. This potential course of action comes with a hefty political, economic and administrative price tag.

Admittedly, the granting of reciprocity is mitigated by the fact that the EU is not the major source of imports. However, the Caribbean is part of two processes – one multilateral and the other hemispheric - that threaten sources of fiscal revenues. The Doha Round is scheduled to conclude in 2005 with all WTO members committing themselves to lowering the bound rates. Similarly, as FTAA negotiations drift towards a conclusion in 2004, parties are presently preparing to table offers. The hemispheric process poses an even greater threat to government revenue given the fact that the United States is the major source of the region's imports.

The cost of reciprocity goes far beyond the loss of fiscal revenue. Granting EU products increased access to Caribbean markets promotes the displacement of national producers with the attendant loss of jobs, productive capacity and growth potential. Under such circumstances, the retraining of workers and instituting appropriate anti-dumping and safeguard measures are required but are also taxing on a small and resource-constrained economy. The net welfare effect of granting reciprocity can be exacerbated in an environment where there is a fiscal deficit depriving governments of the means to cushion economic shocks.

**Caribbean Configuration of EPA**

The second fundamental difference posed by EPAs vis a vis previous ACP–EU trade pacts is the configuration of the ACP side. Both Lome and Cotonou were hinged on the same trade preferences granted to all ACP. The EU has argued that this one-size fits all approach is responsible for the halving of the ACP share of EU imports over the last decade. This argument ignores other important considerations. Falling ACP market share is the result of a combination of factors, for example, increased role of Eastern Europe in the world trading system, the declining value of preferences caused by multilateral reduction of MFN rates and the EU granting trade preferences to a raft of non-ACP developing countries. Loss of market share might also be testimony to the failure in Lome Conventions to seriously tackle ACP countries systemic supply side constraints.

According to Article 37(5) of CA, the configuration of the ACP side to negotiate EPAs falls within the remit of the ACP group itself. Paragraph 12(b) of the ACP Negotiation Guidelines also addresses this issue by offering regions the chance to discuss region-specific issues during Phase II of EPA negotiations. The EC has made no secret of its preference for negotiations on regional EPAs (REPAs), preferably with the six constituent regions of the ACP. In the animated exchange leading to the adoption of its negotiation guidelines, a host of alternatives to REPAs were floated. For example, EPAs based on specific product lines, e.g. sugar and services. Another proposal, championed by Mauritius and favoured by the Caribbean, called for an all-ACP EPA. A third alternative would be the avoidance of warding the EC reciprocity by settling for GSP. An inability to forge consensus on either one of these proposals left REPAs as effectively the only proposal on the table.

The EC sees EPAs building on regional trade integration efforts. 13 of 16 members of the Caribbean Forum of ACP states (CARIFORUM) are members of a regional integration movement – the Caribbean Community (CARICOM). Cuba and the Dominican Republic - two non-CARICOM members have signed FTAs with CARICOM. Recall however, that Cuba is not a signatory to the Cotonou Agreement and resultantly not a direct participant in EPA negotiations. Bahamas enjoys membership of CARICOM's political institutions but is not a signatory either its Single Market and Economy or Common External Tariff (CET).

EPA negotiations pose a number of challenges to the Caribbean, including regional configuration. Would the Dominican Republic and Bahamas, not members of CARICOM, be compelled to join ranks with all CARIFORUM (except Cuba) to form an FTA with the EU? If the Dominican Republic and the Bahamas negotiate with CARICOM, what would be the economic logic of two constituent parties to an FTA (DR and CARICOM) granting the EU (a block of industrialized countries) enhanced market access conditions that they themselves do not grant each other? Another element of the difficulty of regional configuration revolves around the status of Haiti. This country ranks among the LDCs and accordingly benefits automatically from duty- and quota-free provisions of the EBA. Haiti therefore has the choice of (a) opting out from negotiating a Caribbean-based REPA and therefore relying solely on unilateral market access provisions, or (b) joining CARIFORUM in REPA negotiations with the obvious price of granting the EU reciprocal and preferential access to its market. The choice facing Haiti assumes a regional dimension with that country recent conferral of full CARICOM membership.

EPA negotiations present a second substantive challenge to the Caribbean, namely, how to devise a negotiation strategy for an economically diverse set of countries. The Bahamas' per capita income stood at US$ 15,000 in 2000,

compared with Haiti's commensurate figure of US$510. Even if the figures were distorted by Haiti opting out of EPA negotiations, a non-LDC, Guyana, records the region's second lowest per capita income of US$ 760. Caribbean countries are all small economies by WTO and UN standards. But even here the variance is wide with the Dominican Republic posting the region's highest GDP in 2000 of US$19.7 billion while at the other pole of the gamut, St. Kitts and Nevis' GDP was US$310 million.

**Changing Profile of Caribbean Economies**

The region's recent export performance to the EC compounds the dilemma of shaping a Caribbean agenda for EPA negotiation. For example, the structure of the region's exports to the EC has changed radically in the last decade. According to EUROSTAT data, total Caribbean exports to the EU grew in value form •1.42 billion in 1990 to •3.12 billion in 2001 – a growth rate of 120%. Specifically, Caribbean agricultural exports grew in value from •0.69 billion in 1990 to •1.42 billion in 2001 – an increase of 51%. Faster growth of non-agricultural exports to the EU has pushed the share of agricultural exports from 50% of total exports in 1990 to 33% in 2001.

The data support the anecdotal evidence of the Caribbean no longer an exporter of labour intensive agricultural products facing mature international markets and prices that are both low and volatile. A further signal of this altered trade profile is provided by a cursory glance of the top ten Caribbean exports (measured in terms of value) to the EC in 2001. Only three agricultural products – contributing to 25% of total exports – rum, sugar and bananas, featured among the top ten Caribbean exports to the EC. (The data highlight the high degree of export product concentration within the region. The aforementioned ten product lines generated a staggering 75% of total Caribbean exports in 2001).

Caribbean economies are not only defined by the falling value of agricultural exports. The region's economies are increasingly dominated by services – tourism, finance, IT and distribution. In 2000, Services contributed 73% of GDP in Barbados, 52% in Belize, 55% in the Dominican Republic, 62% in Jamaica, 83% in St. Lucia and 55% in Trinidad and Tobago. Guyana with its dominant agricultural sector was the sole Caribbean country where services was outstripped.

While a Caribbean-EU EPA must reflect the altered economic profile of its constituent members, and in particular the export opportunities, it would be foolhardy not to give due consideration to some of the mature (traditional) industries. Obviously, the rise of the services sector mirrors the decline in agriculture. But statistics can mask more than it reveals. For example, St. Kitts remains dependent on exports of sugar, St. Lucia, St. Vincent and

Dominica on bananas and Guyana's on sugar, rice and rum. While Jamaican exports have diversified in the last decade, sugar and bananas still feature heavily. The imperative of granting due consideration to agriculture (apart from the obvious reference to multi-functionality) – this sector generates one in every three jobs within the region.

The lack of two instruments – financial clout and subscription to appropriate WTO safeguard measures dictates that the region has no recourse to subsidizing agricultural exports a la the US Farms Bill or EU CAP. While the region recognizes the declining value of trade preferences along with bilateral, hemispheric and multilateral processes that reduce MFN rates, creative approaches to improving current conditions of market access for the region's major agricultural exports are urgently required.

ACP preferences on agricultural exports to the EU are linked to the CAP, the mechanism responsible for above world market prices in agricultural products and, in consequence, the source of attraction for Caribbean exports. The two major agricultural commodity exports from the Caribbean to the EU are sugar and bananas. However, in an era of reciprocal trading arrangements, the region might be forced to review its traditional embrace of the CAP. Under an EPA, for example, while the CAP encourages the region's sugar exports, this mechanism simultaneously subjects Caribbean domestic producers to unfair competition from subsidized EU agricultural exports into their own economies.

**Improving Market Access Provisions**

As stated earlier, Caribbean exports to the EU have more than doubled within the last decade. In spite of this laudable performance, the challenge remains on the matter of retaining market share to the EC. The task is made more onerous by the marked decline in the margins of tariff preference. In order to increase the supply of exportables, improved market access terms form a prerequisite. The altered profile of Caribbean exports offers proof of the pivotal role played by preferences. Methanol from Trinidad and knitted sweaters from Jamaica are two further success stories. The region also benefited from the Multi-Fibre Agreement that effectively capped the volume of low cost exports from Far Eastern countries.

One important area where access to the EU can improve is reviewing existing rules of origin. Like in any other trade agreement, copious pages are reserved for explaining rules of origin under the CA. Both the EC and the ACP recognize the need to simplify such rules. Yet previous commitments to simplify rules of origins have not been fulfilled.

Here, the Caribbean must focus on two core pursuits. The first concerns constructing a rule of origin that is itself a vehicle for the delivery of preferences. The difficulty of succeeding on this front is highlighted by the EC's recent

posture on "harmonizing" rules of origins, irrespective of the level of development of its trade partner. The second pursuit refers to simplifying the law on cumulation. Under existing rules, inputs imported from a list of neighbouring countries can qualify for preferential treatment. This provision could spur increased CARICOM imports from Cuba. Sadly, the experience of potential importers points to this arrangement's administrative complexity and opaqueness.

**Special and Differential Treatment**

One of the elements that will determine the success of EPA negotiations will be the kind of special and differential treatment granted to ACP members. There is a universal clamour within the ACP membership for new and flexible WTO rules on S&DT. Specific proposals have been tabled demanding longer phase out periods to dismantle trade barriers; reduced obligations to liberalize trade regimes and the carving out of exemptions on product and sector coverage. From the perspective of the most ACP countries, the award of more generous S&DT provisions would dampen the costs of reciprocity.

The present discussion in Geneva focuses on seeking clarification on the rules governing the notification of Regional Trade Agreements (RTAs) under GATT Article XXIV. One critical concern of the Caribbean relates to the computation of substantive trade. In practice this has been interpreted to stand at 90% of all trade with no sector exemption. In order to offer the region the opportunity of protecting sensitive sectors, Caribbean has argued for these rules to be made more flexible. While this discussion is the preserve of the Council on RTAs, the substance of the discussions revolves around the provision of S&TD.

**Coherence Among Various Trade Negotiations**

The start of talks on EPAs means that the Caribbean will be negotiating simultaneously in three theatres – WTO, FTAA and EPAs. From a regional perspective, one common thread in all three negotiation theatres will be staunch pursuit of strong S&DT provisions. Para. 44 of the Doha Ministerial Declaration after reaffirming the centrality of S&DT provisions in WTO Agreements, calls for a review of such provisions *with a view to strengthening them and making them more precise, effective and operational.*

In spite of the well-documented lack of progress on this issue in Geneva, the Caribbean has no other option but to seek the issue on the front burner with the WTO. Our European partners have not been particularly helpful in supporting the position of the ACP on this issue of vital importance. In the absence of any movement by Brussels on the treatment of S&DT, ACP negotiators should perhaps consider coupling the pace of negotiations with

the EU position on this issue. If this strategy were pursued, the results of the Cancun WTO Ministerial could serve as a benchmark for the ACP-EU negotiations.

Another point of confluence among all three negotiations will be the imperative of injecting greater flexibility into Article XXIV rules governing the FTAs. Article XXIV was initially crafted to regulate FTAs solely among industrialized countries. While the UR reformulated Article XXIV, it remains a legal quagmire. Resultantly, North-South FTAs are exposed to challenges by other WTO members. In addition, the Caribbean has some fundamental concerns on issues such as product coverage, length of transitional phase-in periods.

Coherence also extends to the inter-relationship between the EPA and FTAA processes. Trade lawyers warn that the MFN provisions within Cotonou make it mandatory for the EU to be automatically granted equivalent treatment as those granted by the Caribbean to any industrialized country. The EC mandate is also unambiguous when it states that:

"*... ACP countries shall grant to the Community at any time treatment no less favourable than MFN treatment. This does not apply with respect to concessions made between ACP countries or by ACP countries to other developing countries in the framework of regional agreements or other trade provisions compatible with WTO requirements.*"

If the weight of legal opinion is correct, Caribbean negotiations on EPAs have a distinct element of automatism. FTAA negotiations are scheduled to be concluded by latest December 2004 with EPAs following three years later. In this regard, the FTAA negotiations assume even greater importance.

**Addressing Supply Side Constraints**

Given the level of development of Caribbean countries, trade preferences form a necessary but not sufficient condition for them to trade themselves onto the path of sustainable development. Preferences are redundant in the absence of a steady supply of exportable goods and services. Most ACP-EU trade pacts have recognized this link. Yet, the history of efforts aimed at addressing ACP supply side constraints is a litany of failure. A recent survey of the sectoral distribution of EDF programming showed the following results Structural Adjustment (30.7%); Transport (21.4%); Governance (7.9%); Rural Development (7.0%) and Water (6.7%). Interestingly, in spite of the new mantra emanating from DG Trade to mainstream trade into NIPs, this programme line received a meagre 0.1% of all EDF resources.

The EC designed and implemented programmes have tended to target poverty reduction as the major aim. In pursuit of this laudable objective, EDF financed programmes have ignored the imperatives of improving the stock of

human capital, addressing inadequate physical infrastructure, low level of technology and poor regulatory framework. Worse, the EC appears wary of committing extra resources beyond EDF to tackle supply side constraints. The problems with EDF programmes extend beyond programme design. One of the major concerns expressed by all ACP partners is the slow disbursement of funds. The Commission itself has given a commitment to reduce the average lag between project approval and disbursal of funds to 3.2 years in four years' times.

Programmes aimed at tackling supply-side capacity constrains form part of the strategic objectives during EPA negotiations. An associated element of this objective is seeking EU contribution to underwrite the costs of adjustment incurred in adopting a more liberalized trade regime. These goals are key to giving weight to the Caribbean hope that EPAs are FTAs combined with a strong developmental component.

**Concerns on Phase I**

The ACP has now, finally, adopted its Negotiation Guidelines. As most observers are aware, the document calls for a two-phased process of negotiation with Phase II possibly starting in September 2003. The Caribbean favoured a lengthy Phase I covering areas of common interests to all ACP countries. In contrast to the region, the EU is keen on using this period to focus merely on issues of principles and objectives and negotiation structures and timetables.

The Caribbean argued that the following non-exhaustive but indicative list of issues should fall under the ambit of Phase I negotiations - rules of origin, S&DT, competition policies, anti-dumping and countervailing measures, standards, investment, services, commodity protocols, trade facilitation, SPS, financing the costs of adjustment, programmes aimed at addressing supply side constraints, dispute settlement measures, WTO-compatibility, intellectual property measures and trade and environment.

The Caribbean stance on having a substantive Phase I process has been accompanied by a wave of misunderstandings. For example, some argue that the significance of Phase II is devalued by having the same issues discussed under the two phases. Yet, it is difficult to imagine that the EC will not table a uniform set of rules of origin for all of the ACP parties wishing to negotiate an EPA. Whereas Phase I focuses on crosscutting issues of interests to all ACP members, such as those enumerated in Para. 12(a) of the ACP negotiation Mandate, Phase II is specific to the regions or countries negotiating an EPA. Similarly, building on the success attained by developing countries at the Doha Ministerial, why should not ACP countries pursue their common interest in realizing flexible interpretations of both S&DT and Article XXIV provisions within the WTO?

The imperative of a substantive Phase I is grounded not merely on the need to buttress bargaining leverage or overcome capacity constraints. EPA negotiations are scheduled to be conducted within an environment of potentially seismic trade policy developments. For example, the introduction of a new EU GSP in 2004, CAP reform in 2006, the first wave of countries acceding to the EU in 2004, Cancun WTO Ministerial in 2003, the outcome of the Doha Round in 2005 and the conclusion of the FTAA in 2004. This cluster of developments injects an understandable element of uncertainty for Caribbean countries. Prudence dictates that these elements are fully taken into account before tabling commitments under an EPA.

Finally, the region will shortly be embroiled in three simultaneous sets of trade negotiations – EPAs, WTO and FTAA. Perhaps the region has succumbed to a bout of negotiation fatigue, exacerbated by limited negotiation capacity. It should be noted that resource constrained countries have been negotiating trade rounds almost continuously since the Uruguay Round. The conclusion of that landmark trade round spawned the current volley of FTAs. CARICOM has since 1994 concluded FTAs with Colombia, Venezuela, Cuba and the Dominican Republic in addition to negotiating Lome IV, Cotonou and the FTAA.

## Conclusion

In summary, EPA negotiations pose a cluster of challenges that the Caribbean cannot sway from. These challenges include the cost of reciprocity, the configuration of a regional EPA, the quest for improving market access conditions from both traditional and new exportables, the need to instil a strong developmental component in EPAs by tackling supply side constraints and obtaining EU funding to underwrite the costs of adjustment and the search for coherence among all FTAA, EPA and WTO negotiations.

EPA will no doubt prove to be a stern test of the region's capacity to defend its fundamental economic interests. At the same time, the Caribbean has every incentive to continue its proactive stance. Here this means tabling specific proposals on rules or origin, law on cumulation S&DT provisions, for example. The need for coherence among the various negotiation spheres compels the region to adopt a joined-up stance with respect to both the substantive issues under discussions and tactical approaches in pursuit of attaining stated objectives.

# 3. ACP-EU Future Trade Relations: Challenges and Opportunities for Eastern and Southern African Countries

***Kaire M. Mbuende***

## Introduction

The decision of the European Union (EU) to conclude Economic Partnership Agreements (EPAs) with African, Caribbean and Pacific (ACP) group of countries represents a fundamental transformation of the trade relations between the two groups of countries.

The successive Lomé Conventions and the Cotonou Agreement that governed the relationship between ACP and EU since 1975 provided inter-alia for tariff-free and non-reciprocal market access to EU markets for products from ACP countries. This is going to change under the EPAs. The EPAs are going to be based on the principle of reciprocity and compliant with the provisions of the World Trade Organisation (WTO).

The preferential trade regime was critical for the development of the manufacturing sector in a number of ACP countries. ACP countries are concern that EPAs may not be an effective instrument for the promotion of sustainable social and economic development, reduction of poverty, regional integration and the smooth and gradual integration of ACP countries into the global economy.

## A Case for EPAs?

The European Commission believes that there is a need for a new system, as in its view, the past system of non-reciprocal trade preferences extended to ACP countries has on the whole failed to deliver expected results in terms of broader economic and social development. The trade performance of ACP countries have not been impressive. The share of ACP imports into the EU fell from 7% in 1976 to 4% in 2000. Foreign Direct Investments (FDI) from EU to ACP has stagnated. ACP received currently less than 2% of EU foreign direct investment.

Furthermore, the exports of other developing countries to the EU grew faster than that of ACP. The exports of ACP countries to the EU grew on average at 2% per annum between 1976 and 2000. The exports from Mediterranean and Latin American countries grew at an average of 6% per annum, while exports from Asian developing countries grew at an average of

12% per annum. Asian countries had replaced ACP as the main developing country exporters to the EU by 1992.

In as much as there are justification for a new system, it is important to point out that trade preferences played a positive role in preventing the further maginalisation of ACP states in the world economy. Individual ACP economies performed better in areas where significant preferences were enjoyed compared to those areas where no preferences are enjoyed. While ACP exports to the EU as a whole increased in volume terms between 1988 and 1997 by 3.6%, in those products where the trade preferences provided margins of preference greater than 3%, the expansion in exports in volume terms was 61.9%. This is an export performance that is 17 times better than their general export performance.

In short, the relationship between non-reciprocal trade preferences and export performance by ACP economies is complex. If one desegregates ACP countries, you will find that 26 ACP economies have enjoyed higher export growth to the EU than the average for Mediterranean and Latin American developing countries. Eight ACP countries have enjoyed higher export growth to the EU than the average for Asian developing countries. Furthermore, certain ACP countries have developed entirely new manufactured and non-traditional agricultural and horticultural exports. They have also expanded the export of existing manufactured goods in a significant way. The trade preferences enjoyed by ACP countries were important for their development and the erosion thereof will have far reaching implications.

The objectives of the Economic Partnership Agreements is, inter alia:

- to promote and expedite the economic, cultural and social development of the ACP states with a view to contributing to peace and security and to promoting stable and democratic environment;
- to reduce and eventually eradicate poverty;
- to foster the smooth and gradual integration of ACP states into the world economy;
- to support the regional integration process within the ACP group of states and to foster regional integration as key instrument for the integration of ACP countries into the world economy; and,
- to enhance co-operation in all areas relevant to trade and to achieve progressive and reciprocal liberalisation of trade in goods and services in accordance with WTO rules.

The success of the EPAs will ultimately depend on the extent to which they are able to promote regional integration in the regions of the ACP. Regional integration is cardinal for the competitiveness of individual ACP countries as well as their integration into the world economy on a competitive basis. The

question of the regional configuration of EPAs is therefore of fundamental importance.

ACP solidarity is important in the redesigning of relationship with the EU. It is important that ACP regions are not played against each other. This is why the ACP guidelines for negotiation makes provision for a two phase approach to negotiations. The first phase will be an ACP wide negotiations where general principles will be agreed upon. This phase may take up to one year. The second phase will be region specific and will among others deal with details relating tariff phase down. This approach is important to maintain ACP solidarity. At the same time, regions need time to agree on regional configurations and to adopt negotiation mandates by the different regional organisation.

It is important to note that there are a number of parallel negotiations in which ACP countries are involved and that would have a bearing on the EPAs. These include the WTO Round negotations (scheduled to be concluded by January 2005), the negotiations on the General Agreement on Trade in Services (GATS) in Geneva, EU enlargement (2004), the Free-Trade Area of the Americas (FTAA) in the case of certain ACP countries, the reform of the common agricultural policy (CAP) and the revision of the Generalised System of Preferences (GSP) in 2004.

EPAs should be ideally concluded with regional organisations that ACP countries themselves have formed for the purpose of integrating their economies and not through groups that are solely constituted for the purpose of concluding an EPA. A configuration of a group of countries for the sole purpose of dealing with the EU will not have internal cohesion and may work at cross-purpose with regional integration initiatives in the particular regions.

Three members of COMESA, Kenya, Tanzania and Uganda have formed the East African Community (EAC). The EAC has set out to harmonise policies in a number of areas and has also created common institutions. It simply represents an advance form of integration with COMESA even though Uganda and Kenya are trading on the basis of the COMESA treaty. Tanzania on its side suspended its membership in COMESA opting for integration through SADC.

SACU is an ideal configuration for an EPA because of its cohesion and level of integration. However, it is already in a trade agreement with the EU by association through the EU-South Africa Trade, Development and Co-operation Agreement. Botswana has already given concurrence for that agreement to come into effect. Lesotho, Namibia and Swaziland are yet to do so, as they have to understand the full implications of the agreement. They also need to design measures to mitigate against possible adverse impact and get commitment from all stakeholders (include the EU and South Africa) for

their implementation. Rules of Origin not withstanding, EU products that enter South Africa under the agreement do find their way into the markets of the BLNS[1] countries.

BLNS countries will therefore be exposed to low tariff EU products much earlier than other ACP countries. This will lead to substantial revenue loss. The estimated fiscal losses for BLNS countries emanating from the implementation of the EU-South Africa Agreement as a percentage of total Government revenue amounts to 5.3% for Botswana, 8,6% for Namibia, 12,9% for Lesotho and 13,9% for Swaziland.

The EU needs to introduce extra-ordinary measures in order to mitigate against the impact of EU-South African agreement on BLNS countries. This should include programs to improve efficiency of revenue collection as well as to develop alternative sources of revenue through greater market access particularly in the horticultural sector. There is also a need for targeted support to investment promotion in order to over come supply side constraints. Trade is after all a function of investment and production.

**The Need for Development centered EPAs**

It is not evident, however, that EPAs in themselves can provide the necessary stimulus to attract investment in ACP countries. Particularly in the light of poor physical infrastructures, lack of access to inexpensive water and electricity and human resource constraints. This situation is further compounded by the multiplicity of free trade area arrangements, which the EU is concluding with non-ACP states. Why should EU enterprises invest in ACP States to serve EU and ACP markets when they could locate in low wage cost and high skill zone within an expanding EU? The investment promotion effects of EPAs are not automatic, conscious and deliberate efforts have to be made if that objective is to be attained.

BLNS countries need immediate market access beyond that provided by the Cotonou Agreement because of their exposure to competition from EU low tariff products that will enter their markets as a result of the EU-South Africa Agreement. An appropriate market access to them should be equivalent to that afforded to Least Development Countries (LDC), Every Thing But Arms (EBA).

SACU member states are also involved in a process of integration through SADC and to a lesser extend COMESA. That relationship especially the one with SADC is important and cannot be simply sacrificed. SACU represents a variable geometry in the broader SADC integration. There are greater benefits to be derived through a SADC wide EPA rather than a SACU based one.

[1] BLNS countries are Botswana, Lesotho, Namibia and Swaziland.

A SADC based EPA will however be complex. Of the 14 SADC member states four belong to other regions than Southern in the context of the ACP-EU co-operation under the Cotonou Agreement. That is, Tanzania, Mauritius, Seychelles belong to the East African region and the DRC to the Central African region.

This is not a major problem however as countries will make their choice. It may result in a disconnection between the regional indicative programmes on the one hand and EPA on the other. This will be unfortunate as the regional indicative programmes could be used to address the supply side constraints. This does not present a problem to the Island states, which are not part of the regional infrastructure development programs. It could be a problem for Tanzania and DRC.

South Africa is already in a category of its own because of the existence of the EU-South Africa agreement. The relationship between South Africa and a SADC based EPA has to be crafted carefully. South Africa's access to the EU is already defined in terms of the agreement. Support to the development of infrastructure is not a problem as it has been possible to co-finance a project with the SADC regional indicative programme with funds and resources earmarked for South Africa under its Agreement with the EU. What is at issue is the regional integration function of the EPA vis-à-vis South Africa as access provided to the EU should also be provided to the other members of the EPA. It will ultimately depend on which of the trade regime is more preferential.

Application of the principle of special and differential treatment will be important to a SADC based EPA. Eight out of fourteen SADC member states are least developed countries. South Africa and to a certain extent, Botswana, Lesotho, Namibia and Swaziland are in a special category. Zimbabwe and Mauritius are thus the only SADC countries that are neither least developed nor dissociated directly or indirectly with a trade agreement with the EU other than the Cotonou Agreement and that will affect negotiations for EPA.

In terms of the need for market access Botswana, Namibia and Swaziland are in the same position with Mauritius and Zimbabwe. This represents a broader base for negotiations.

Some members of SADC are also members of COMESA and they have to make a choice between the two organisations in terms of EPAs. Countries of Southern Africa in particular have in the past not made clear indications in terms of their preferred organisation for regional integration. They have made commitments in the context of different organisations that are not always compatible. The time may have come for countries to pronounce themselves unequivocally in terms of their preferred organisation. The choice of an organisation for the purpose of concluding the EPA will constitute substantial

statement on the side of countries in Southern Africa in terms of their preferred organisation for integration. For EPAs will among other things serve to promote regional integration. According to the European Commission, any trade preferences extended to the EU by any ACP country will be automatically extended to the other members of the EPA. In this way, the EPA will significantly influence the pace of regional integration in ACP countries by reducing trade barriers among neighbouring countries.

Five member states of SADC are not members of COMESA, i.e. Botswana, Lesotho, Mozambique, South Africa and Tanzania. Namibia and Swaziland have had derogations from implementing the COMESA trade program because of their membership of SACU. These countries need a home for the purpose of an EPA. Their logical home is SADC.

The Eastern African States under the ACP arrangement with the notable exception of Tanzania have express themselves in favour of negotiating an EPA through COMESA. The question is whether the SADC member states that are also members of COMESA will go the SADC or the COMESA route.

In the East African group only two countries, Kenya and Mauritius can negotiate an EPA in all honesty. The other members of the group are least developed countries and will enjoy EBA benefits. This state of affairs may help the middle income countries make the case for EBA status.

The situation will not change substantially if the SADC member states went the COMESA route. Zambia and Malawi are least developed countries and Zimbabwe will be the only addition to Kenya and Mauritius.

Given the predominance of least developed countries in the East and Southern African regions any configuration of countries must be accorded EBA status to be meaningful. At the same time the interest of least developed countries must be safeguarded especially when it comes to the introduction of reciprocity.

Countries of Eastern and Southern Africa can only derive maximum benefits from the conclusion of EPAs if the supply side constraints are addressed comprehensively. These constraints include poor infrastructures, lack of access to inexpensive power and water and shortage of skilled manpower which was further exacerbated by the HIV/Aids pandemic. Needles to say, on the contrary, the EU based companies will not face such constraints in their bid to take advantage of the opportunities offered by the creation of larger integrated markets. As such, the playing field is not leveled between ACP and EU enterprises.

# 4. COMESA and SADC— A New Free Trade Area and Another in the Making

*Gavin Maasdorp*

Economic integration in Eastern and Southern Africa made notable progress in 2000, the year ending with the establishment of a new free trade area (FTA) and the first steps towards the ultimate establishment of another. The FTA of the Common Market of Eastern and Southern Africa (COMESA) saw the abolition of tariffs in the broader region for the first time since the dissolution both of the Federation of the Rhodesias and Nyasaland and of the East African Community in the 1960s and 1970s respectively. The FTA came into operation just two months after the Southern African Development Community (SADC) had begun implementing tariff reductions which will lead to its FTA in 2008. This paper discusses the current situation in these two regional groupings, and their approach to forthcoming World Trade Organisation (WTO) negotiations and the proposed Economic Partnership Agreements with the EU.

## The Present Position

### *Common Market of Eastern and Southern Africa*

The Treaty establishing COMESA came into force on 8 December 1994, and represented a transformation of the old Preferential Trade Area for Eastern and Southern African States (PT A) which had operated since 1 January 1983. Despite its name, COMESA is not a common market although that is its long-term aim. The PTA, as its name implied, was concerned with establishing preferential trade among member countries. It sought to do so by adopting a systematic programme of tariff reductions of 10 percentage points per annum until zero tariffs had been reached, when the PTA would become a free trade area. In fact, this schedule was adhered to more in the breach than in the observance, and by the early-1990s it was clear that the time frame had been too optimistic and that the obstacles had been underestimated. The PTA members thus decided to work with a revised schedule through COMESA.

In 1983 there were 18 members and this grew, at one stage, to 22. The present membership is 20: some have recently withdrawn (Lesotho, Mozambique, Tanzania), some joined in the 1990s (Egypt, Eritrea, Madagascar, Seychelles, Namibia and DR Congo), and Somalia ceased to exist as a state.

An important change in the new Treaty was the acceptance of the principle of variable geometry: some countries had moved more rapidly than others in reducing their tariffs, and it was felt that they should not be held up by the laggards but rather should be allowed to proceed towards zero tariffs with the laggards eventually catching up at their own pace. One manifestation of variable geometry was the Cross-Border Initiative (CBI), funded by the EU, World Bank, African Development Bank and International Monetary Fund as a fast-track group of 14 countries. The CBI operated from 1992-2000 when it was replaced by the Regional Integration Facilitation Forum with support from COMESA to continue to fast-track integration. The CBI pursued various trade liberalisation objectives, and lent new imptus to the PTA programme of tariff reductions. By the time the CBI was discontinued, four COMESA countries had reduced their tariffs on intra-trade by 90 per cent, six by 80 per cent, one by 70 per cent and three by 60 per cent. The initiative, therefore, helped to pave the way for the commencement of the FTA on I November 2000, consisting of only nine of the 20 member countries. The present (July 2001) position is shown in the box.

**COMESA FTA – Country Status, July 2001**

**Members:** Djibouti, Egypt, Kenya, Malawi, Madagascar, Mauritius, Sudan, Zambia, Zimbabwe
**Indicated intention to accede 2001:** Burundi, DR Congo, Seychelles
**Reaffirmed commitment:** Comoros, Rwanda
**Investigating implications:** Eritrea, Ethiopia, Uganda
**Non-reciprocal members:** Namibia, Swaziland
**Conflict ridden:** Angola

COMESA has a total area of 11.94 million km2 and a population of about 350 million of whom 180, million reside in the present FTA. The GDP of COMESA as a whole in 1998 was estimated at $160 billion and for the FTA at $124 billion. Egypt is by far the largest economy with a GDP of $85 billion, accounting for just over one-half of total COMESA GDP. The next largest economies are Kenya ($10 billion) and Zimbabwe and Angola ($8 billion each).

Zimbabwe was the dominant economy in the old Federation of the Rhodesias and Nyasaland, and Kenya in the old East African Community. There is still a residual feeling in Uganda and Tanzania that they could be dominated by Kenya in the resuscitated East African Cooperation, and indeed that is the reason why Tanzania has held back the entry into force of an EAC FTA or customs union. South Africa has usurped Zimbabwe as the major

trading partner of both Malawi and Zambia. Egypt has very little export trade with the COMESA countries of Eastern and Southern Africa, and is probably too geographically distant to become dominant especially since, in Southern Africa where COMESA countries also belong to SADC, it will face competition from South African firms which are already entrenched in SADC markets. Within COMESA, therefore, there is no single, long-term, dominant economy. As is the case in many regional groupings which consist of developing countries only, intra-trade in COMESA as a whole constituted only a small proportion – 6.6 per cent – of the total foreign trade of COMESA countries in 1998. The major exporters within COMESA were Kenya, Zimbabwe, Zambia and Mauritius, while the major importing countries were Uganda, Malawi, Zambia and Egypt. The only countries with intra-COMESA trade above 10 per cent of their total foreign trade were Rwanda (25 per cent), Uganda (20 per cent), Malawi, Zambia, Kenya, Djibouti, Burundi and Comoros.

A common problem in regional integration schemes in Africa is that countries join without having studied the implications. Then, when the time for ratification and implementation approaches, the realisation dawns that there could be important transitional problems to do with the loss of customs revenue and the loss of local markets to regional competition. This is what has happened in COMESA, and was one reason why Tanzania withdrew just before the FTA came into operation. There was some opposition in the private sector to Tanzania's decision, but the country still retains contacts with COMESA and might well rejoin it when the EAC forms a customs union, Ethiopia, Eritrea and Uganda are studying the effects of free trade before agreeing to join the FTA.

Namibia and Swaziland are unable, because of their Southern African Customs Union (SACU) membership, to grant reciprocal tariff reductions, and hence have enjoyed the privilege of being non-reciprocal members. A study has now been completed of the implications for them of FTA membership. In the meantime, their legal status remains unchanged. However, since it is technically not possible for only some members in a customs union to join another free trade area, membership of the two organisations is in conflict for Namibia and Swaziland, and it is difficult to see how they could choose the COMESA FTA given the importance to them of intra-SACU trade.

Those countries which, despite having reduced their tariffs, did not become founder members of the FTA, continue to offer preferential tariffs. Thus, Comoros, Eritrea and Uganda are offering tariff reductions of 80 per cent, and Burundi and Rwanda of 60 per cent. COMESA, then, contains both a free trade area and a preferential trade area. Trade between FTA members is at zero tariffs, while trade between a FTA country and a PTA country takes place at the latter's preferential rate, the principle being that trade should be on a reciprocal basis.

At this stage it seems that the most likely FT A expansion scenario will be that Burundi, Eritrea and Rwanda will join next, with DR Congo, Ethiopia and Uganda to follow. However, the number of war-torn countries poses a problem for the widening of trade integration, and it is possible that neither Burundi nor the DR Congo will be in a position to join the FTA in 2001. Instability has been holding back Angola, Rwanda, Eritrea, Ethiopia and Comoros. Angola has apparently indicated its interest in rejoining trade deliberations within COMESA.

In practice, the FT A seems to be working reasonably well. There have been examples of companies taking advantage of reduced tariffs and moving into new markets but, of course, the Secretariat hears more about the problems than anything else as countries want it to solve their problems. Some of the problems which have been experienced so far are:

- Malawi has been accused of dumping into Zambia.
- Zambia has accused Zimbabwe of using sanitary and phyto-sanitary measures as well as technical barriers to trade to prevent the entry of milk products, strawberries and eggs.

The Secretariat is spending considerable time on these issues, but the mechanism to deal with them is working. Countries which are members both of SADC and COMESA are trading according to the COMESA regime. Apart from overlapping membership between these two organisations, some COMESA members also belong to other regional arrangements. The seven-member Inter-governmental Agency on Development (IGAD) consists of Djibouti, Ethiopia, Eritrea, Sudan, Kenya and Uganda as well as Somalia. IGAD concentrates mainly on conflict resolution and desertification. The EAC is aiming to establish a customs union by 2004 -the same time schedule as COMESA—but progress on trade liberalisation has been slow. However, there has been more progress on a common currency and the movement of people. Mauritius, Madagascar, Comoros and Seychelles are part of the Indian Ocean Commission together with Reunion, and are committed to trade liberalisation within the COMESA framework.

### *Southern African Development Community*

SADC started life as the Southern African Development Coordination Conference (SADCC), formed in 1980 on the initiative of the so-called frontline states concerned with the dependence of Southern Africa on apartheid South Africa, especially in the field of transport. The emphasis, therefore, was on investment in transport and communications infrastructure to reduce this dependence. SADC adopted an inefficient system of allocating to each member state the responsibility for a particular portfolio; often the allocation did not match the competency of the country in the particular field, and this has

continued to plague the organisation. However, it has recently decided to implement a more centralized structure which should improve efficiency.

When it became clear after 1990 that South Africa would move towards universal suffrage, SADCC transformed itself into SADC in 1992 and took on the objective of establishing a FT A. In doing so it moved from the regional cooperation to the regional trade integration model. This confused the regional picture since all its member states belonged either to SACU or the PTA, i.e., they were already in trade integration arrangements.

SADC gained impetus from South Africa's accession in 1994. Starting with nine members in 1980, the organisation today has 14 members. South Africa and the BLNS countries (Botswana, Lesotho, Namibia and Swaziland) are all members of SACU while Angola, DR Congo, Mauritius, Malawi, Namibia, Seychelles, Swaziland, Zambia and Zimbabwe are members of COMESA. Lesotho, Mozambique and Tanzania have left COMESA in the last few years. Like COMESA, SADC suffers from the problem of instability in Angola and the DRC, neither country being able to implement the Trade Protocol for the same reasons that they have not joined the COMESA FTA. Seychelles has thus far also not acceded to the Trade Protocol, and the embryonic FTA therefore consists of 11 of the 14 countries.

SADC covers an area of 9.1 million $km^2$ and contains a population of about 195 million of whom about 132 million reside in the Trade Protocol area. Total GDP is about $184 billion, of which South Africa contributes $131 billion (or 71 per cent). This is a high degree of domination, unmatched in COMESA. There is a strong feeling of wariness and suspicion in SADC about South Africa; this is most apparent in the field of trade because of the imbalance in the direction of intra-SADC trade which runs at about 5:1 in favour of SACU (mainly South Africa).

Trade integration schemes work best when major macroeconomic indicators in member countries are in convergence. In general there is more convergence today in SADC than at the time of its establishment when countries were following widely diverging economic systems ranging from market-based economies in BLNS and Malawi, through various notions of state socialism in Tanzania and Zambia, to central planning in Angola and Mozambique. All countries now have liberalised their economies, albeit at a different pace, and accepted the market. But there remains a lack of convergence among the non-SACU countries, and this has been exacerbated by continued instability in Angola and the DRC as well as the recent rapid degeneration in Zimbabwe where the inflation and interest rates are now far out of line with those in the rest of SADC.

Intra-SADC trade hovered around 4-5% of the total foreign trade of member countries until the accession of South Africa when the figure was

boosted overnight to about 21%; however, if SACU is excluded, this falls to a miniscule 5% (roughly the same level as in COMESA). By contrast, there is a high degree of intra-trade within SACU, especially for BLNS. The majority of the intra-SADC trade of the SACU countries is in fact intra-SACU trade. Of the non-SACU countries, only Malawi and Zambia obtain more than 50 per cent of their imports from SADC, and that is mainly from South Africa. Mozambique depends most on export markets in SADC, but again this is mostly trade with South Africa.

The Protocol on Trade in SADC was signed in August 1996 but, because of protracted negotiations, only entered into force on 25 January 2000 when it had been ratified by two-thirds of the member states. The amended Trade Protocol, together with the schedules of rules of origin, will be the document which governs the tariff reduction process. The participation of South Africa and the existence of SACU both created complications during the negotiations. South Africa is the dominant economic power of the grouping, while SACU (by definition) already has free trade, and BLNS have always enjoyed duty-free access to the South African market – a competitive edge they were not likely to surrender easily to non-SACU neighbours. In the event, it was decided to phase in free trade on an asymmetric basis as shown in the box.

**SADC Tariff Reduction Schedule**

**SACU** – immediate reductions, zero tariffs after 5 years except on sensitive products.
**Non-SACU** – tariff reductions to start mainly after 4 years, zero tariffs after 8 years except on sensitive products.
**Category "A" goods** – comprise about 47% of traded goods in SADC. Duty will be reduced to zero upon gazetting in each country.
**Category "B" goods** – tariffs to be reduced over 8 years on an asymmetric basis. When complete, 85% of goods traded within SADC will be duty free.
**Category "C" goods** – sensitive goods for which tariffs will not be reduced until 2012.
**Sugar** – a sensitive product subject to a special agreement; initial access for non-SACU producers to the SACU market based on their share of the total world market; their SACU market share to be gradually increased until 2012 when the SADC market will be fully liberalised.

The implementation of the SADC tariff reductions started in September 2000. At the time of writing Mozambique was the only country which had not yet lodged its Instruments of Implementation with the SADC Secretariat, but should do so in time to begin implementing the agreement on 1 August 2001. The aim is that by the end of eight years 85% of all trade will be at zero tariffs,

and that at the end of 12 years the figure will have reached about 98% so that there will be virtually no exclusions.

This schedule was designed to allow the non-SACU countries quicker access to the South African market than vice versa. However, there was a common offer from SACU in order to preserve the integrity of the customs union. The basic approach was that South Africa would reduce its tariffs more quickly, but SACU has to comply with this. BLNS were in a difficult position as developing countries (Lesotho in fact being a least-developed country) in the same customs union as South Africa. The SACU tariff has in fact been significantly lowered since the offer to the WTO came into operation in 1995. SACU tariffs are generally the lowest in the region, contrary to a widespread perception that they are highly protectionist. On a trade-weighted basis, they are about 5% (excluding clothing, textiles and motor vehicles) against goods from SADC. However, non-SACU countries fear that South Africa will use non-tariff barriers such as technical and health standards to keep out their products.

The non-SACU countries were to make two offers – one to South Africa and one to the rest of SADC including BLNS. This was known as the differentiated offer. When the offers were made, however, the extent of differentiation was lower than expected. Of the BLNS countries, Swaziland and Namibia receive COMESA preferences, and felt that the non-SACU offer to them was not liberal enough: should they lose these COMESA preferences, they did want to revert to most-favoured-nation (MFN) trade in the first few years with those SADC countries which also belong to COMESA. The MMTZ (Malawi, Mozambique, Tanzania and Zambia) group of least-developed countries were granted duty-free quotas and single-transformation of their exports into SACU, and therefore Namibia and Swaziland wanted them in particular to improve their offers. The understanding was that there would be a general improvement in offers to all countries except South Africa. However, some LDCs apparently were under the impression that it would be on the basis of a bilateral offer to BLNS. If it is in fact a general offer, the MMTZ countries will improve their differentiated offers, but only if Zimbabwe and Mauritius follow suit. This should not be problem for Zimbabwe and Mauritius since the only non-SACU countries which are not part of the COMESA FTA are Mozambique and Tanzania. Where countries are also members of the COMESA FTA, they are now trading under that FTA, not under SADC.

So far only the SACU countries and Mauritius have submitted their gazetted schedules to the Secretariat, although apparently Zambia has also gazetted its schedule while Zimbabwe has gazetted its offer to South Africa. All countries need to gazette their schedules.

The products on which there is as yet no agreement are: motor vehicles; wheat, and flour and wheat products; electrical machinery; optical goods; and plastics. An agreement on textiles and clothing has more or less been finalised, although the special quota on textiles and clothing is not in operation yet. This applies to the MMTZ countries (Mozambique, Malawi, Tanzania and Zambia). They have been allocated a quota for textiles and clothing into the SACU market using differentiated rules of origin which allows them a single stage of transformation. The other Member States have to comply with a two-stage transformation process. However, there is an outstanding request for single transformation for man-made fabrics from Mauritius and Zimbabwe.

In the case of the other outstanding products, rules of origin are the issue. On electrical machinery, the problem concerns white goods, the SACU countries wanting to prevent single assembly, while on plastics SACU wants to exclude the use of imported plastic waste. This-is seen by the non-SACU countries as a protectionist strategy for the South African polymer industry. All these issues should be resolved by the end of 2001.

SADC and COMESA have adopted different rules of origin. COMESA's is based on value criteria (35 per cent value added or 65 per cent wholly produced). By contrast, SADC has different rules of origin for each chapter head, sometimes allowing single transfornlation. Being on a product-by-product basis, the rules appear to be overly complicated for easy progress towards free trade, and involve complex customs procedures.

### Dealing with the WTO and Cotonou

#### *WTO*

Neither COMESA nor SADC have representatives in Geneva, but both believe it is important for them to playa significant role in WTO matters. Both are involved with the Geneva-based Africa Group. South Africa is a member of this group, and is keen to have a new WTO round whereas the rest of Africa is not, arguing that the points agreed in Singapore on agriculture, textiles and technical assistance to LDCs have not yet been implemented. South Africa also wants the abolition of agricultural subsidies whereas food-importing countries in Africa are against this. The OECD countries want environmental and labour issues on the agenda, but Africa does not, arguing that other specialist institutions such as the ILO should deal with those concerns. A problem, though, is that the WTO is the only rules-based institution with an enforcement mechanism. The Africa Group also argues that the WTO is a negotiating forum anyway so that a new round is not required, but it will probably not oppose a new round provided the agenda can be agreed in advance.

Africa as a whole cannot afford the large permanent delegations which the developed countries have in Geneva. In order to optimise the use of trade

officers, COMESA is attempting to coordinate the work of its 15 members who are also members of the WTO. The idea is that each country will select one negotiating committee and report back monthly to COMESA. SADC's view is that it would strengthen the voice of Southern Africa if positions were coordinated since no one SADC country is able to attend all WTO meetings (there could be as many as 12 parallel groups). An exchange of information would be particularly important.

There will not be a coherent COMESA or SADC negotiating position since free trade areas, unlike customs unions such as the EU, do not negotiate on behalf of members. The Secretariats therefore, do not have the mandate to pursue a common negotiating position. While there might be a common position on broad issues, the negotiations on special subjects will be government-led.

The ongoing negotiations in the WTO relate to agriculture, GA TS and public procurement. The developed countries want to include competition policy under the WTO, but COMESA is trying to establish a regional competition policy and would need to know what the developed countries have in mind.

***Cotonou***

As with the WTO, so too in the case of the negotiations on Economic Partnership Agreements (EPAs) between the ACP countries and the EU, the position of COMESA and SADC is that they need to play an important role. Both organisations have prepared discussion papers and held workshops on the subject.

The Cotonou Agreement runs until 2020. The continuation of Lome preferences on a non-reciprocal basis is for seven years till the end of 2007, but the remaining benefits under Cotonou will continue thereafter. The exception is for LDCs whose preferences are guaranteed beyond 2007. Developing countries, however, could lose their preferences and their commodity protocols. Sugar was not part of Cotonou, but there is an article in the Agreement to the effect that all protocols will be part of a review. Thus, sugar-producing countries in COMESA and SADC have an interest in being part of the negotiations.

It is important that WTO-compatible trade arrangements be instituted between the EU and ACP countries, but at the regional level. At the national level, individual countries lack negotiating capacity, and the proposal, therefore, is to develop EPAs on a regional trade basis. The EPA negotiations are due to start in September 2002, and in the meantime countries and the regional organisations need to consider what approach to adopt.

The everything but arms (EBA) deal has complicated matters for COMESA and SADC. The EBA offers a special deal for the LDCs in that the EU

extends duty-free and quota-free access to all imports from LDCs except arms from March 200 I. The only other exceptions are that the EU market for bananas will be opened only in 2006 and for sugar and rice in 2009. Strict rules of origin will be enforced to ensure that only LDCs benefit from the EBA regulations.

Both COMESA and SADC contain LDCs and non-LDCs. The LDCs have to decide whether, with full market access to the EU already being enjoyed under the EBA, they further need to enter into FTAs with the EU through COMESA and SADC. For example, Malawi as an LDC has full access into the EU and feels that it does not need to negotiate further; by contrast, non-LDCs such as Kenya and Zimbabwe will have to be part of an EPA in order to receive full duty preferences.

**Supporting COMESA and SADC in Multilateral Negotiations**

As mentioned above, no African regional grouping or individual country can afford large permanent delegations in Geneva, and hence they are at a disadvantage in preparing for negotiations. Another problem is that there is a lack of communication between national ministries and their Geneva-based representatives. The result is that there often is insufficient guidance on national trade policy given to these representatives. Throughout COMESA and SADC the trade ministries lack capacity in trade negotiations, and struggle to keep skilled trade economists. Typically, there are insufficient budgetary allocations for skilled personnel in the trade ministry, and the professional staff are over-extended, often having to deal with several different trade negotiations concurrently. Almost all countries need additional human resources, whether they be local or expatriate.

Both COMESA and SADC already receive considerable assistance in the way of information from UNCTAD, the WTO itself, OECD and DFID. For example, SADC has a Trade Negotiating Forum which has received considerable UNCTAD and Commonwealth Secretariat assistance in preparing countries for future GATS negotiations. However, it is clear that unless the member countries of COMESA and SADC are provided with more resources, they will be at a disadvantage in preparing themselves for, and participating in, future WTO rounds as well as in negotiations concerning the EPAs. The Secretariats could do more in the vital role of coordination, but they, too, would require more technical assistance and funding.

**COMESA-SADC Relations**

Relations between the organisations are better than ever before, and there is clear, if belated, support at the political level to ensure close cooperation and coordination. At the COMESA meetings in Cairo recently, there was a side

meeting between the SADC and COMESA chairmen. It was agreed to set up a joint task force to do a technical audit of all programmes in the two organisations so as to ascertain how to implement them jointly where possible and to increase cooperation and complementarity generally. It was agreed to bring all of Eastern and Southern Africa (including the IOC, EAC and IGAD) into a common regional support strategy and regional indicative programme for EU funding, to be prepared jointly by the two Secretariats. The EU is the biggest donor to the region.

Both organisations, of course, are more than simply trade blocs. They have a wide range of other programmes intended to enhance trade integration and, in the case of SADC, general sectoral cooperation. This paper cannot consider these programmes, but mention must be made of such trade-enhancing initiatives as common customs documentation, common statistical rules, removal of non-tariff barriers, the framing of competition policy, various measures on transport liberalisation and harmonisation, monetary harmonisation, the PT A Bank, regiot: lal payments and clearing mechanisms, regional political risk guarantee facilities, and protocols on the free movement of persons. In all these fields there is scope for the two organisations to work together more than they have done in the past, and cooperation certainly is improving.

**Future Developments**

No article on economic integration in Southern and Eastern Africa can ignore the overlapping memberships of various regional organisations. The most important of these is the Southern African Customs Union (SACU), established in 1910 out of earlier customs unions in the area, and the oldest one in the world. This article cannot describe the main features of SACU in detail. It is the base economic integration scheme in the region, and four of its members also belong to the Common Monetary Area (CMA). This means that there is a free flow not only of goods and services but also of capital; in addition, there is a high degree of de facto labour mobility, so that the four SACU/CMA countries are very close to being a common market akin to the EU. The currency of the fifth SACU country - Botswana - is valued against a basket of currencies in which the rand predominates. The SACU and CMA together impose a strong fiscal, monetary and macroeconomic policy discipline on member countries which has led to consistent, prudent and generally conservative policies as well as the maintenance of reasonable economic growth rates and inflows of foreign direct investment.

SACU is the yardstick against which all other economic integrations schemes in the region have to be measured. The present position is that there is an old customs union and a newly functioning free trade area (COMESA)

in the region. COMESA could develop into a customs union in 2004. If Africa-wide regional integration is to be advanced, the logical way would be to try to harmonise the common external tariffs of these two customs unions and then, provided the COMESA countries are prepared for free trade with South Africa, to merge the two customs unions. This might have to wait until 2008 when the non-SACU members of SADC are due to have eliminated tariffs on South African goods. Included in these countries would be Mozambique and Tanzania; however, they are not part of COMESA, and the remaining function of the SADC free trade area would then be to provide the mechanism for bringing them into a broader customs union.

Theoretically, this is the logical way to proceed in building African economic integration. In practice, however, it is unlikely to be as simple as this. Trade negotiations are the most difficult of all, and vested interests and political factors are likely to assert themselves. An alternative, of course, is for SACU to expand incrementally, absorbing those countries with macroeconomic indicators in convergence with those of SACU, on a variable geometry basis. This would affect the proposed COMESA customs union since a country cannot belong to more than one customs union.

# 5. The African Growth and Opportunity Act: The Impact of Its Rules of Origin

***Aaditya Mattoo, Devesh Roy and Arvind Subramanian***

## 1. Introduction

On 18 May 2000, "The African Growth and Opportunity Act (AGOA) was signed into American law. Subsequently, President Clinton issued a proclamation on 2 October 2000 designating 34 countries in Sub-Saharan Africa as eligible for the trade benefits of AGOA. On 18 January 2001, Swaziland was designated as the 35th AGOA eligible country and on 16 May 2002 Côte d'Ivoire was designated as the 36th AGOA eligible country. The U.S. Government has moreover announced that it will work with eligible countries to sustain their efforts to institute policy reforms, and with the remaining 12 Sub-Saharan African countries to help them achieve eligibility. AGOA has become a major plank of United States' initiatives toward the African continent.

## 2. Requirements for eligibility

The Act authorizes the US President to designate countries as eligible to receive the benefits of AGOA if they are determined to have established, or are making continual progress toward establishing among others market-based economies; the rule of law and political pluralism; elimination of barriers to U.S. trade and investment; protection of intellectual property; efforts to combat corruption; policies to reduce poverty, increasing availability of health care and educational opportunities; protection of human rights and worker rights; and elimination of certain child labor practices.

The US, like other developed countries, has been providing preferential access to African countries under the Generalized System of preferences (GSP). There are two provisions in AGOA viz. GSP provisions and apparel provisions (discussed below). The eligibility criteria for GSP and AGOA substantially overlap, and countries must be GSP eligible in order to receive AGOA's trade benefits, including both expanded GSP and the apparel provisions. Although GSP eligibility does not imply AGOA eligibility, 45 of the 48 Sub-Saharan African countries are currently GSP eligible.

## 3. Objectives of AGOA

The Act aims broadly at improving economic policy-making in Africa, enabling countries to embrace globalization, and securing durable political and economic stability. As an incentive for Africa to adopt the necessary policy reform, AGOA offers increased preferential access for African exports to the United States. In simple terms this means that African exports to the US from eligible countries would be free of tariffs and quotas provided the exports meet some criteria (to be explained in detail in the section on rules of origin). The Act moreover envisages the possible conversion of AGOA—which is essentially a one-way preferential arrangement (meaning only eligible African country exports into US get preference and not the reverse)—into reciprocal free trade areas (FTAs) where feasible with interested African countries (indeed negotiations have begun with the countries in the Southern African Customs Union).

## 4. AGOA'S Main Provisions

Broadly, the provisions under AGOA can be classified into two categories:

(i) Generalized System of preferences (GSP) provisions

(ii) Apparel provisions

### *GSP provisions*

One part of AGOA relates to extension of the earlier preference which African countries (along with other developing countries) have been receiving under the Generalized System of Preferences. Prior to AGOA, 45 sub-Saharan African countries were granted preferential access to the U.S. market—essentially paying a zero tariff subject to certain conditions—for a range of exports under the GSP. In 2000, the GSP covered about US$4 billion out of Africa's total exports of US$23 billion. The margin of preference—the advantage faced by African exporters compared with other most-favored nation (MFN) suppliers—was about 5 percent (the average MFN tariff rate)[1]. AGOA represents two advances over the GSP scheme.

- First, the existing preferential access enjoyed by sub-Saharan African (SSA) countries under the GSP scheme has been extended in time (till 2008); The GSP scheme would probably have been extended even without the AGOA initiative. Nevertheless, the early assurance of its continuation under AGOA provides real benefits because it helps create a more predictable environment for traders and investors.
- Second, it increases the range of products for which preferential access is granted to include:
  - petroleum products;
  - a range of other agricultural and industrial products.

[1] The percentage is as a percentage of the price or unit value of the product.

### *Apparel provisions*

The Act provides for duty-free and quota-free (apparel imports have been subject to quota limits under the MFA arrangement[2]) access to the U.S. market without limits for apparel made in eligible Sub-Saharan African countries from U.S. fabric, yarn, and thread. It also provides for substantial growth of duty-free and quota-free apparel imports made from fabric produced in beneficiary countries in Sub-Saharan Africa. Under AGOA I, apparel imports made with regional (African) fabric and yarn are subject to a cap of 1.5% of overall U.S. apparel imports, growing to 3.5% of overall imports over an 8 year period. AGOA II, which was ratified recently, doubles the applicable percentages of the cap.

Under a special rule for Lesser Developed Beneficiary Countries (LDBC), those with a per capita GNP under $1,500 in 1998 will enjoy duty-free access for apparel made from fabric originating anywhere in the world until 30 September 2004. The Presidential proclamation of 2 October 2000 designated 28 countries as eligible for the Special Rule, once they have met the additional requirements for the AGOA apparel provisions (these additional requirements are laid out in the section on rules of origin). Forty-two countries in sub-Saharan Africa fall below the specified GNP level and hence qualify as an LDBC under AGOA; another two countries—Botswana and Namibia—have recently been designated as LDBCs despite their high GNP levels under AGOA II. Thus, only the following four do not qualify for the special rule: Gabon, Mauritius, Seychelles, and South Africa.

## 5. Product Coverage under AGOA

Table 1 describes the coverage of the existing and future regimes for Africa and allows a disaggregated assessment of benefits. In terms of import coverage, whereas GSP covered about 17 percent of SSA's exports in 2000 (first unshaded panel in Table), AGOA would increase this fourfold to 72 percent. The really important *incremental* benefits (i.e. the products which did not receive preference under GSP but do receive preference under AGOA) provided by AGOA relate to the two non-petroleum categories in the lightly shaded panel in Table 1. The first comprises exports of apparel products and the second a whole range of non-apparel products, including footwear, agricultural products, watches etc.

[2] The Multi Fiber arrangement is a system under which countries including the US put a country specific quota on the amounts of apparel that can be imported. This quota could vary in time. It is important to note that in 2000, only 2 countries in SSA were formally subject to quotas: Mauritius and Kenya. And only Mauritius faced quotas (on about 25 percent of its exports) that could be considered binding.

## Table 1

| Category/ Import program | Number of tariff lines (8 digit HTS) | Average MFN ad-valorem rate[3] | SSA Exports in 2000 (million US $) | Main products |
|---|---|---|---|---|
| **Current GSP: Extended Under AGOA** | | | | |
| Energy | 10 | 1.5 % | 3149 | Energy and related products |
| Non-energy | 2458 =A<br>1071 = A*<br>1630 = A+<br>Total = 5159[4] | 5.0% | 776 | Agricultural products, machine tools, minerals, metals, yarns and fabric, and chemicals. |
| *Sub-Total GSP* | *6159 (48%)* | | *3925 (17%)* | |
| **AGOA: Incremental Coverage** | | | | |
| Energy | 36 | 1.5% | 15569 | Energy and related products |
| Apparel | 622 | 12.8%[5] | 816 | Apparel products |
| Non-energy non-apparel | 1780 | 9.4% | 424 | Agricultural products, minerals, plastics and metal products, articles of wood, watches and accessories, paper products, footwear |
| *Sub-Total AGOA* | *1783 (14%)* | | *16809 (73%)* | |
| **Exclusions from AGOA** | | | | |
| Duty between 0 and 5% | 174 | 2.5% | 14.5 | Yarns, fabrics, agricultural products (tomatoes, mandarins, olives, grapefruit), watches, footwear, glass products |
| Duty greater than 5% | 893 | 10.9% | 25.4 | Fibers, yarns, and other textile products |
| *Sub-total exclusions* | *893 (8%)* | | *40 (0.2%)* | |
| **Total** | **12750** | | **23160** | |

[3] Includes ad valorem tariffs or the ad valorem equivalent of specific tariffs wherever applicable.
[4] A refers to GSP for all developing countries, A* to GSP for some countries and A+ to least developed countries.
[5] This understates the true measure of protection because of the quotas on textile exporters under the MFA.

A number of items in the non-apparel category, are, however, subject to tariff rate quotas[6], with out-of-quota tariffs (average and peak) being exceptionally high in many cases. Some of these items are of special export interest for Africa and include tobacco (350 percent), peanuts (164 percent), Brazilian nuts (132 percent), beef (26 percent) etc. It is difficult to estimate how binding the quotas are in reality i.e. whether they restrict exports to levels lower than the one that would be without the quota. The reason is that quotas might not be binding (i.e. exports are below the quota limit) for the simple reason that exporters would deliberately restrict their exports in order to not pay such high tariffs, which are imposed on the exports exceeding the quota[7].

In both these apparel and non-petroleum non-apparel products, although current exports are low, *potential* benefits are large because average protection in the US is high: while the table shows that average tariffs on apparel are 13 percent, actual protection is considerably higher because of the quotas on exporters under the MFA[8]. If this protection were eliminated, exports could increase substantially. However, a key determinant of these benefits will be the rule of origin that African exporters will have to meet to qualify for the duty free treatment. The following sections examine in greater detail, how the rules of origin will affect the benefits flowing to African countries in the key apparel sector and how they qualify the generosity of AGOA.

Without doubt, apparel is the most talked about sector with respect to AGOA among policy makers and businesses alike. There are several reasons for this. Apparel traditionally is an industry where labour is the predominant input and labour in Africa as in most developing countries is the relatively cheap and abundant factor. (Mauritius and South Africa, with reasonably high wages, are notable exceptions in this regard). Second, some African countries like Mauritius and Madagascar already have a foothold in the US market and can begin to reap very quickly the fruits of preference.

## 6. The rules of origin under AGOA

The benefits of the incremental coverage under AGOA—the extension of access to apparel and other products—will hinge crucially on the rules of origin that African exporters will have to meet. These rules vary across these two categories of exports.

[6] Products subject to tariff rate quotas are allowed duty free access to the US market as long as the total exports is less than a pre-specified quota limit. Exports beyond that limit face tariffs, which are usually exceptionally high.

[7] In the estimates that we develop of the potential gains under AGOA, it has been assumed that they are not binding. Consequently our estimates are an overestimate of the benefits accruing to African nations owing to AGOA.

[8] As in the literature we use the term protection for tariffs and/or quotas. The term protection is used to refer to the fact that tariffs, quotas and in general any trade barriers *protect* the domestic producers from competition from foreign producers.

### *Rules of origin for non-apparel exports*

Under the GSP scheme, duty-free treatment is to be applied to any designated article that meets the requirements of the basic GSP origin and related rules. The key is a requirement of 35 percent value addition[9] within the customs territory claiming preference. However, for non-apparel products eligible for duty- free access under AGOA, the 35 percent value added content can be met also by counting production or materials from other beneficiary countries or the United States. The rules of origin clauses are supplemented with implementation requirements. For example, an importer claiming duty-free treatment must make and maintain (for a period of five years from the date of entry) the records validating facts like proof of production, value addition, shipping papers etc.

### *Rules of origin for apparel exports*

Before elaborating on the rules of origin, it is important to understand the stages in production of apparel. Broadly the production of apparel can be classified into three stages of transformation. In stage 1 yarn is converted into fibers (spinning), in stage 2, fiber is converted into a textile or a fabric (weaving) and then fabric is made into an apparel (assembly). Rules of origin relate to restrictions at different stages of production and the inputs used.

AGOA's provisions on rules of origin relating to apparel essentially require that apparel be assembled in eligible sub-Saharan African countries and that that the yarn and fabric be made either in the United States or in African countries. It is important to note here that prior to the enactment of AGOA, African exporters predominantly imported yarn and fabric from outside Africa mainly from China and India. This reveals that the cheapest source of input were these countries. Hence, adhering to the AGOA rule of origin would make production costlier. Such stringent rules of origin do not apply to the least developed countries in Africa until 2004. The least developed countries in their grace period can obtain yarn and/or fabric from anywhere in the world but would need to do the assembly within the customs territory in order to receive preference. In addition a number of customs requirements need to be satisfied by both groups of countries. To receive the apparel and textile benefits of AGOA, a United States Trade Representative (USTR) chaired inter-agency committee must determine, inter alia, that countries have an effective visa system and enforcement procedures to prevent unlawful transshipment[10] and the use of counterfeit documents.

[9] Value addition roughly refers to the difference between the value of the final product and the raw materials used.

[10] Transshipment refers to goods that are imported into a country and exported without any change to the final market, with the objective of this transaction being to benefit from advantageous tariff treatment.

## 7. Methodology for evaluating impact of AGOA on African exports

Mattoo, Roy, and Subramanian (2002) conducted a study to evaluate the potential impact of AGOA on the African exports, taking into account three things (i) the product coverage of AGOA illustrated in Table 1; (ii) margins of preference under AGOA; and (iii) rules of origin. The methodology in the study is based on obtaining the net margin of preference, which is obtained by subtracting the increase in cost of production owing to rules of origin from the tariff (or tariff equivalent of a quota[11]), which constitutes the gross margin of preference.

The impact of preferences is essentially to increase the price received by exporters that are accorded preferential access. The extent of the increase in price is equal to the tariff that other, non-preferential exporters have to pay.

If there are strings attached to getting the preference such as restrictions on the inputs to be used, certain processes to be performed in the source country etc, then they too need to be accounted for as well. These restrictions i.e. the *rules of origin*, if effective, erode the margin of preference because in order to get duty-free entry exporters have to produce goods in a more expensive way. Hence the new price is not as high as it would be without the strings attached since a part of the higher price now goes toward meeting the higher costs. Combining the net margin of preference along with some estimate of how exporters would respond to the price increase that they enjoy (referred to as elasticity of export supply) yields estimates of the change in exports.

The study by Mattoo et al. (2002) places a lot of emphasis on the apparel sector as trade barriers are highest, and hence potential benefits the largest, in this sector. In quantifying the impact of the apparel provisions additional complications arise due to changes taking place in the external environment. Beginning 1 January 2005, WTO member countries, including the US, are required to eliminate all existing quotas on textile and apparel imports. There are only two African countries viz. Kenya and Mauritius where the quota actually bites in the sense that these countries have been restrained by quotas. In contrast, there are several efficient Asian suppliers to the US market most importantly China and India, which are severely quota constrained. This has helped the African suppliers who are relatively less efficient. First it has kept the price high in the US market and second it has let countries in Africa cater to the demand for apparel not satisfied by the Chinese and Indian (and others) suppliers owing to the quota.

Unless there is a major change in the efficiency of the African suppliers, the opening of the floodgates in 2005 will adversely affect the competitiveness

[11] Restriction of imports through either quota or a tariff raises the price in the US market. Hence one can find a tariff that would raise the price by the same amount as a given quota.

of the African apparel sector; in quantifying the economic impact of AGOA's apparel provisions this is an important consideration that has to be kept in mind.

One important breakpoint in the timing of benefits comes at the beginning of 2005 when under the WTO commitments, the United States is expected to fully withdraw the quotas imposed on the rest of the world producers of apparel. To the extent that countries like China and India which before 2005 would be quota constrained, this would be a big structural break in the flow of benefits. In the calculations listed below in section VI we indeed find that the impact of this change is likely to be substantial. In particular we estimate that with the rules of origin intact, removal of MFA quotas would wash even the marginal benefits which would otherwise accrue. In fact removal of MFA quotas on competitors of Africa would withdraw much more than AGOA possibly adds.

Given that the impact of removal of MFA quotas is likely to be substantial, African producers would be required to undertake some major changes in order to survive in the changed environment. Important changes that can be prescribed would be to reassess their comparative advantage within the apparel sector. This might require moving up the value added chain[12], producing high value luxury clothing, adoption of new technology (that compares unfavorably with countries like China) and in the long term if AGOA is extended to develop indigenous sources of yarn and fabric to cut costs[13]. Of course the underlying assumption in such a prescription is that overtime Africa can possibly develop some dynamic comparative advantages on the input side i.e. net of cost of transportation can produce inputs at costs comparable to the rest of the world.

## 8. Results from study

The important results from the Mattoo, Roy and Subramanian study are:

- AGOA will provide real opportunities to Africa. Even on conservative estimates about Africa's supply response, Africa's non-oil exports could be increased by about 8–11 percent. Most of this increase will be accounted for by the apparel sector, which is expected to grow by approximately 8.3%.
- AGOA's generosity has not been all encompassing for Africa: for about 1,067 tariff lines[14] (1 percent of non-oil exports), preferential

[12] Mauritius is a good example in Africa which in order to overcome labor shortages (and hence rising labor costs) branched out into high value added apparel production in the EU market.

[13] This is true since our calculations show that rules of origin are a substantial erosion of margin of preference which becomes even more critical post 2004.

[14] Every item that gets imported is accorded a digit classification (known as a tariff line). The higher the number of digits, the more disaggregated the product is. A product like shirt for example would be accorded two digits while a shirt made with cotton three digits, and a shirt made with cotton with fibers less than 10 microns in diameter four digits and so on. The analysis by Mattoo et. al. is done at the eight-digit level.

access was not extended. For 893 of these lines preferential access could have been meaningful because of the high level of MFN tariffs.

- While AGOA has increased the scope for preferential access for African exports, this increase is important only for categories of products which have significant protection. These currently account for 5 percent of total exports and 23 percent of non-oil exports.
- Even for these categories, the real medium-term benefits depends upon the impact of the rules of origin requirements as described above; particularly in the apparel sector.
- The medium-term gains could have been much greater if AGOA had not imposed certain conditions and not excluded certain items from its coverage. The most important condition is the stringent rule-of-origin, i.e., the requirement that exporters source certain inputs from within Africa or the United States[15]. The estimates suggest that the absence of these conditions would have magnified the impact nearly five-fold, resulting in an overall increase in non-oil exports of US$0.54 billion compared with the US$100-US$140 million increase that is expected in the presence of these restrictions.
- These restrictions, particularly on apparel, will come at a particularly inopportune time (for the least developed beneficiaries in particular), as Africa will be exposed to competition from other developing countries when the quotas maintained on the latters' exports under the Multi-Fiber Arrangement (MFA) are eliminated in 2005. Africa's apparel exports will be lower by over 30 percent with the dismantling of the MFA; if, on the other hand, AGOA had provided unrestricted access, the negative impact of the dismantling could be nearly fully offset. In case of a representative general beneficiary (like Mauritius) and a least developed beneficiary like Madagascar, our estimates suggest that in the most optimistic scenario, the growth in their exports would remain positive (18 percent and 6 percent respectively) only without the rules of origin. With rules of origin the impact on the exports in case of both set of countries would be to unambiguously reduce them. The most pessimistic scenario based on our calculations is that exports of the representative country like Mauritius would fall by as much as 65% while in case of a LDC beneficiary such as Madagascar by around 40%.

[15] In the analysis calculations have been made under two different assumptions about the cheapest source for importing inputs in order to meet the rule of origin. In the first, the cheapest source was assumed to be South Africa because the data since 2000 indicated that this was the overwhelming choice by Mauritian and South African exporters facing rules of origin. Second, calculations were also made on the assumption that the United States was the cheapest source. However, the results were broadly similar under the two scenarios because the relative efficiency of the United States in producing inputs was offset by the larger transport costs of sourcing from the United States relative to South Africa.

## 9. Conclusions

As stated in the results above, AGOA will raise the level of non-oil exports by between 8 and 11 percent, depending on the restrictiveness of rules of origin in the non-apparel sector. This expected change can be compared to a notional benchmark-fully unrestricted access— which is the level that Africa's trade would have attained had the U.S. (i) not excluded any product from the scope of AGOA and (ii) not imposed stringent rules of origin requirements to qualify for the benefits under it. The estimates are that non-oil exports would have been higher by about 43 percent if unrestricted access had been provided. This means that AGOA as it is now will yield only 19-26 percent of the benefits that could have been provided if access had been unconditional. Nearly eighty percent of this shortfall is accounted for by the rules of origin requirements in the apparel sector, which will significantly reduce exports below SSA's full potential.

Looking at the projected estimates of the gains, there is the broader question of whether the magnitude of gains is significant. The increase in exports indeed represents a small fraction of these countries' GDP, but this is a direct consequence of the fact that SSA is marginalized from global trade in the first place. However, even though in aggregate the gains are small, the experience of individual countries such as Mauritius and Madagascar show that the trading opportunities provided by preferential access can be harnessed in a way that promotes long-run growth.

AGOA has not been in place for a long time but it is worth examining post-AGOA trade to see if any inferences can be drawn about its impact (See Table 2 below). Based on the notification of eligibility, AGOA provisions are now up to twelve months old for some sub-Saharan African countries. Knowledge about the implementation of AGOA has been publicly available since the beginning of 2000. The early trends could provide some indication of the changes in sub-Saharan Africa-U.S. trade owing to AGOA. There are a few striking features especially in the data on the apparel sector.

Apparel exports have recorded a substantial increase following AGOA: both in terms of values and quantities, exports in 2001 were about 27 percent higher than in 2000. What is striking however is that the most impressive gains have been recorded by the least developed beneficiary countries: as the table shows, Madagascar, Kenya, Swaziland, and Lesotho have recorded gains varying from 47 percent to 83 percent. In contrast, South Africa and especially Mauritius, have posted more modest growth. These results are consistent with the hypothesis that rules of origin are a restrictive clause in AGOA.

This differential performance could be due to a variety of factors. It is plausible that South Africa and especially Mauritius are running run up against capacity constraints especially with rising wage levels, whereas the least

developed countries are exploiting their cheap labor costs and attracting large amounts of new investment. A second reason could be that AGOA, for the period 2001–2004, changed the relative attractiveness of sourcing supply in the least developed countries compared with Mauritius and South Africa by imposing rules of origin requirements on the latter. A striking feature of the data is that a very small portion of total exports (9-14 percent) from South Africa and Mauritius have benefited from the tariff preference, whereas for the least developed countries not subject to the rule of origin requirement (till 2004) the corresponding share is close to 50 percent, highlighting the restrictive impact of the rules of-origin. Given the fact that the LBDCs will be subject to the same rules of origin in 2004, the above serves as a cautionary reminder about the likely effects for the poorer countries after 2004; in other words, export growth may be considerably muted for the LBDCs after 2004 as the rules of origin kick in.

It is interesting to compare the performance of SSA countries with those in the Caribbean, which have received preferential access similar to AGOA. Data for 2001 indicates that about 55 percent of the apparel exports of Caribbean countries benefited from preferential access compared with 9–14 percent for Mauritius and South Africa. One reason that Caribbean countries found it profitable to import yarn from the United States and avail themselves of the preferential access, a course that Mauritius and South Africa evidently found not to be profitable, appears to be the lower transport costs.

Although rules of origin have restrictive effects, mention should be made of their less unfavorable consequences. If there were literally no rule of origin, Africa could become a staging post for transshipping goods made abroad. In this case, there would be no value addition in, or economic engagement on the part of, the African beneficiaries. On the other hand, an onerous rule of origin that requires "too much" value addition in Africa could nullify completely the benefit of AGOA by making any such value addition unprofitable. It is quite possible that given time and a guaranteed market, weaving and spinning industries can be profitably established in Africa, but the question remains whether rules-of-origin are the right way of creating the incentives to do so.

The design of AGOA, with less onerous conditions for the least developed countries for a transitional period, also highlights an equity objective that the rule of origin aims to achieve. The design—tilting the incentives in favor of the poorer countries—seeks to ensure that within Africa the benefits of preferential access are not appropriated entirely by Mauritius and South Africa.

## Table 2. Apparel Trade Under AGOA, 2000 and 2001

| | *Lesser Developed Beneficiary* | | | | *Other* | | *All* |
|---|---|---|---|---|---|---|---|
| | *Swaziland* | *Lesotho* | *Madagascar* | *Kenya* | *Mauritius* | *South Africa* | *Countries* |
| Exports (in US$ million) | | | | | | | |
| 2000 | 31.9 | 140.2 | 109.6 | 44 | 245 | 163.3 | 776 |
| 2001 | 48.0 | 214.8 | 178 | 64.5 | 238.3 | 194.9 | 975 |
| Growth (in %) | 50 | 53 | 62 | 47 | −3 | 19 | 26 |
| Of 2001 exports: | | | | | | | |
| Granted preference | 8.2 | 129.2 | 92 | 51.6 | 38.8 | 30.4 | 350.4 |
| (in % of total 2001 exports) | 17 | 60 | 52 | 80 | 16 | 16 | 36 |
| of which (in % of total granted preference): | | | | | | | |
| sourced from regional fabric | 0 | 0 | 0 | 0 | 85 | 97 | 18 |
| sourced from U.S. fabric | 0 | 0 | 0 | 0 | 5 | 1 | 1 |
| sourced from other foreign fabric | 100 | 84 | 79 | 100 | 0 | 0 | 82 |

Source: OTEXA and authors' calculations

# 6. United States-Singapore Free Trade Agreement

***Stuart P. Seidel***

## 1. Introduction

The United States – Singapore Free Trade Agreement ("the Agreement") is the fifth Free Trade Agreement ("FTA") negotiated by the United States[1] and its first in Asia. Singapore has negotiated five other FTAs or "Economic Partnership" agreements.[2] Singapore is the 11th largest trading partner of the United States with nearly US$33 Billion in bilateral goods trade. Although negotiations have been on-going for several years, the U.S.-Singapore FTA and the U.S.-Chile FTA (the negotiations of which were completed at approximately the same time) are the first FTAs to be completed after approval of Trade Promotion Authority (also called "fast-track") by the U.S. Congress as part of the Trade Act of 2002. Among other provisions, the Trade Promotion Authority legislation requires trade agreements to meet certain negotiating objectives.

At the end of January 2003, the U.S. Congress was officially notified of the intention of the Bush Administration to sign the Agreement. The official signing may occur 90 days thereafter. After signing, the Agreement and any necessary implementing or conforming legislation and statements of administrative action will be submitted to the Congress for approval. Under the terms of Trade Promotion Authority, Congress may hold hearings and review the FTAs, but may only vote in favor of, or against, the FTA, it may not amend the texts of the agreements. It is hoped that Congressional action is completed in a time frame to permit the Agreement to come into force on 1 January 2004.

The full 800+ page text of the agreement[3] was released to the public on 7/8 March 2003 via internet posting on the websites of the U.S. Trade Representative ("USTR") and the Singapore Ministry of Trade and Industry.[4]

[1] The others are the US-Canada FTA, NAFTA, US-Israel FTA, US-Jordan FTA. The US-Canada FTA has been suspended while NAFTA is in effect. The U.S. also has a "Bilateral Trade Agreement" with Vietnam that covers many of the typical FTA subjects.

[2] Singapore has negotiated "Economic Partnership" agreements with New Zealand and Japan and FTA's with Australia, EFTA and the other ASEAN countries. The Australian FTA is expected to come into effect during the second half of 2003.

[3] The final legal text, annexes and side letters is in excess of 1,400 pages.

[4] http://www.ustr.gov/new/fta/singapore.htm and http://www.mti.gov.sg/public/FTA/frm_FTA_Default.asp?sid=36

According to a 7 March 2003 Press Release issued by the USTR, "publication of the proposed U.S.-Singapore FTA represents the [Bush] Administration's commitment to an open and public process of reviewing trade agreements by all interested parties. Public summaries and fact sheets were made immediately available upon conclusion of the agreements. The full texts of both agreements have been available to members of Congress and the approximately 700 private sector advisers since early January. In addition, as negotiations on the agreements progressed over the past two years, the Administration has provided Congress and the official private sector with advisors U.S. negotiating proposals in advance of formally tabling them with Singapore and Chile.

U.S. negotiators also held more than 100 meetings with some 700 cleared advisors from business, farm groups, labour unions, environmental groups, consumer organisations, and state governments to discuss and seek their advice, on U.S. negotiating positions."[5]

As indicated above, in January 2003, the confidential draft texts of the two FTAs were submitted to 31 industry advisory committees for a 30 day review, as required by legislation, after which the committees were to file reports with USTR. During this review period, the industry representatives were permitted to review, but not download, print or copy the text, from a secure website maintained by the USTR. This process reportedly made it difficult to review or discuss provisions with those who were experts in specific areas covered by the FTAs.

The 31 advisory committees, which are chartered by the U.S. Congress, include:

- a broad-based Advisory Committee for Trade Policy and Negotiations (ACTPN);
- three policy advisory committees: trade and environment, labour and agriculture;
- five technical advisory groups on specific agricultural groups (ATACs);[6]
- 17 industry sector advisory committees (ISACs);[7]
- four industry functional advisory committees (IFACs);[8] and,
- an intergovernmental policy advisory committee (IGPAC).

[5] http://www.ustr.gov/releases/2003/03/03-13.htm

[6] The ATACs are: animal and animal products; fruits and vegetables, grains; feed and oilseeds; sweeteners; and tobacco, cotton and peanuts.

[7] The ISACs are: Aerospace, Capital Goods, Chemicals and Allied Products; Consumer Goods; Electronics and Instrumentation; Energy; Ferrous Ores and Metals; Footwear, Leather and Leather Products; Building Products; Lumber and Wood Products; Nonferrous Ores and Metals; Paper and Paper Products; Services; Small and Minority Business; Textiles and Apparel; Transportation, Construction and Agricultural Equipment; and Wholesaling and Retailing.

[8] The IFACs are: Customs Matters; Standards; Intellectual Property Rights; and Electronic Commerce.

The members were asked to examine each FTA from the various interests represented within each chartered committee and the objectives set by the U.S. Congress. The advisory reports[9] were submitted at the end of February. With only one exception, all of the advisory committees that submitted reports supported the results of the negotiations, although there are several reports that include dissenting views. The one report that was universally negative regarding both the Singapore and Chile FTAs came from the Labour Advisory Committee. Another committee was unable to submit a detailed report because a lawsuit by environmental groups prevented a member from joining the committee, and the committee could not meet until a replacement member was named, not allowing sufficient time for a proper review. One committee[10] elected not to file a report because virtually all fruit and vegetable products already are duty free and relatively minor interests are involved. The Textiles and Apparel ISAC report reflected the divergent views between the fibre, yarn and textile members who favoured the "yarn forward" rules but were concerned about high Tariff Preference Levels, and the apparel members who were unhappy with the complicated origin rules.

After the negotiations with Singapore were completed, U.S. and Singaporean lawyers began reviewing the Agreement for legal clarity and consistency, so it is possible that certain provisions will be revised prior to the official signing. The Singapore text is in English only (although some words have American spellings and others have Singaporean spelling, at least in the draft).[11]

Previous U.S. FTAs have been made public at various stages. According to USTR, the U.S.-Canada FTA, was released first in outline form and the complete text of the proposed agreement was made public two months later. The draft NAFTA text was released to the public several weeks after the proposed agreement was announced and was finalised over a period of weeks thereafter as part of a three-way legal review. The U.S. - Jordan FTA was made public only after it was signed.

The Agreement consists of 21 separate chapters. A major theme throughout the Agreement is transparency which is reflected in provisions that urge:

- the advance publication of proposed regulations;
- an opportunity for comment by interested parties or the public at large;
- publication of adopted rules, which to the extent practicable, address the comments received; and,
- delayed effective dates for final regulations.

[9] The full advisory committee reports are available at http://www.ustr.gov/new/fta/Singapore/advisor_reports.htm

[10] The Fruits and Vegetables ATAC.

[11] When the Agreement was signed, the final text was posted on the Internet at http://www.ustr.gov/new/fta/Singpore/final.htm

Some chapters have additional transparency requirements which are discussed in more detail below. In addition, the Agreement recognises the digital age in many ways that are also discussed in the chapter summaries below.

## 2. Comparison with the Other U.S. Trade Agreements

It is natural to compare the U.S. Singapore Free Trade Agreement to other trade agreements that the United States has negotiated. However, in comparing such agreements several points should be noted:

- The North American Free Trade Agreement ("NAFTA") was completed during the Uruguay Round negotiations which resulted in the creation of the WTO and its multi-lateral agreements, and was deeply influenced by those negotiations;
- NAFTA was a tri-lateral agreement negotiated by three countries, each of which had a federal structure consisting of states or provinces with substantial rights under the respective constitutional structure. This was reflected in some of the reservations, exceptions and non-conforming provisions.
- Canada and the United States followed the common law while Mexican jurisprudence was founded on civil law principles. This required adjustments to various transparency and related provisions.
- Canada and the United States were already developed economies, while Mexico was a developing country.
- The U.S.-Jordan FTA was intended to put Jordan on a par with Israel and so is closely patterned after the earlier U.S.-Israel FTA, rather than NAFTA.
- The U.S.-Vietnam Bilateral Trade Agreement ("BTA") was intended to fully normalize trading relationships between two former foes and to assist Vietnam in meeting WTO membership requirements.

For the reasons mentioned above and others (e.g., adoption of WTO multilateral and plurilateral agreements, stage of economic development, trade agreement experiences), the U.S.-Singapore FTA differs from earlier U.S. trade agreements in several respects. The Agreement is generally patterned after NAFTA, although there are some major differences. For example, agricultural interests were not a major concern during the Singapore negotiations (except for the precedent that might be set), but were clearly a concern during the negotiations with Chile and will be a serious issue for future negotiations.

The U.S.-Jordan FTA is based on the U.S.-Israel FTA and, except for textiles and apparel, uses the rather subjective "substantial transformation test" rules to establish origin for purposes of obtaining preference. The Singapore Agreement follows the NAFTA precedent of using objective rules

based on a shift in tariff classification, although the NAFTA rules for certain industries and commodities are far more complex. The Singapore rules also recognise the unique "integrated sourcing initiative" ("ISI") for high tech products. Under ISI, products that are partially assembled in nearby foreign countries are accorded Singapore origin. The Singapore Agreement also departs from the NAFTA and Jordan FTA origin certification model. In both those agreements, the foreign producer or exporter is responsible for providing a required Certificate of Origin in a prescribed format. The Singapore Agreement puts the certification requirement on the importer, without mandating a prescribed format, and prefers electronic certifications. Regional value content rules have also been simplified over those set forth in NAFTA. The textile and apparel provisions in the Singapore Agreement reflect U.S. concerns over transshipment and require new registration and recordkeeping regimes for Singapore companies seeking the Agreement's benefits. In addition, the Parties have agreed to review the textile and apparel rules of origin to see if the rules should be revised or eventually harmonised with any WTO Rules of Origin that may be adopted in the future.

The U.S.-Jordan FTA does not have a chapter on investment because the U.S. and Jordan had negotiated a separate bilateral treaty covering that topic in 1997, and a framework agreement on trade and investment two years later. The Vietnam BTA addresses investments in Chapter IV and in an exchange of letters between the parties. In the area of services, both the Jordan FTA and Vietnam BTA identify specific sectors or requirements that are included under the agreements. Trading rights in the Vietnam BTA are phased in over a seven year period. The Singapore Agreement takes a negative list approach. That is, the agreement covers all investments, financial services and cross-border services unless they are covered by a reservation, exception, or listed in a non-conformity schedule.

The telecommunications provisions are significant in that they require access to public communications networks in an "unbundled" manner. This means that an enterprise is only required to pay for the services it requires. The Agreement's e-commerce provisions ensure that electronic commerce between the parties will remain free of duties, fees or charges on the importation or exportation of electronically transmitted digital products.

The Singapore Agreement includes more substantial commitments in the area of intellectual property rights protection than in any previous U.S. trade agreement. In addition to requiring the accession or ratification of a number of international agreements or recommendations, the Agreement requires the adoption of specific civil and criminal remedies and *ex officio* border enforcement of intellectual property rights. In addition, Singapore has agreed to establish a registration regime for optical disc manufacturing to deter copyright piracy.

The Agreement also includes provisions on digital encryption devices and protection, encrypted satellite signals and internet domains.

The transparency provisions throughout the agreement are also the most extensive of the existing U.S. trade agreements. Posting via the internet is recognised as an acceptable means of publication of government guidelines and information.

Emergency actions under the Agreement are limited to an initial two year period with the possibility of a two year extension.

U.S. Trade Promotion Authority ("fast track") legislation sets forth negotiating goals and objectives for future trade agreements. The Singapore and Chile Agreements were the first two such agreements to be subject to review for consistency with the legislation. Although all the private sector advisory groups (except for the Labor Advisory Committee) have recommended approval of the agreements, their reports contain comments from individual members that dissent from the committee reports or suggested that future agreements address what they believed might be shortcomings in certain areas when applied to other countries. These comments frequently reflect the view that the Agreement's text is acceptable for a Singapore FTA because it is generally a free trade area with open markets and adequate protection for investors and traders, but that the provisions should not necessarily set a precedent or become a template for future agreements. Some of the areas in which concerns were expressed are:

- The scheduling of duty elimination for sensitive products, such as agricultural goods, certain chemicals or those goods being eased out of subsidies or support programs;
- The definition of "expropriation" is too narrow;
- Restrictions on energy investments;
- Transfer of capital restrictions;
- Restrictive rules of origin for textiles;
- Unavailability of dispute settlement procedures in certain areas (e.g., portions of the labor, environment, investments chapters);
- Size or availability of dispute settlement pools for panels;
- Protection of workers' rights—the Agreement only requires compliance with local laws;
- Greater rights in the U.S. for foreign investors than U.S. investors have;
- Non-inclusion of simplified visa procedures for temporary business visitors;
- Failure to mandate recognition of conformity standards;
- Reservations for certain services, such as health care;
- Failure to have one set or origin rules for all FTAs;

- Failure to provide funding or resources for capacity building; and
- Failure to address patent delays due to ministries of health procedures.

It should be noted that the above concerns are not shared by all members of the particular advisory committee involved. Some members, often the majority, take the view that the Singapore FTA should set the standard for all future FTAs entered into by the U.S.

Other countries negotiating FTAs with the U.S. should review the private sector advisory committee reports that have been posted on the USTR website.[12]

A chapter-by-chapter summary of the Agreement follows:[13]

### 3. Chapter 1 —Establishment of a Free Trade Area and Definitions

This chapter establishes a Free Trade Area between Singapore and the U.S. consistent with Article XXIV of GATT, 1994 and Article V of GATS and defines certain terms used throughout the Agreement. Many chapters contain further definitions of terms used within those chapters. In addition, the chapter reaffirms existing rights and obligations under existing agreements, including the WTO Agreement.

### 4. Chapter 2—National Treatment and Market Access for Goods

With certain exceptions, the Agreement requires that goods of one Party imported into the other Party's territory be given the same treatment as goods of that Party ("national treatment"). Customs duties will be immediately removed by Singapore on the few categories of U.S. goods that are currently subject to duties, while U.S. duties on Singapore goods will be removed progressively according to schedules. The parties will consult on accelerating the schedules.

The Agreement requires the WTO Valuation Agreement to be applied to all transactions necessitating a customs valuation. Originating goods from Singapore will be exempt from the U.S. merchandise processing fee and export taxes are prohibited. The chapter requires each Party to permit the temporary duty free entry for a variety of broadly defined professional equipment, goods intended to be displayed or demonstrated at exhibitions or fairs, and commercial samples. It also provides that goods reentered in a Party's territory after repairs or alterations in the other Party, which do not change the article into a different commercial item, are not subject to duty, regardless of origin.

[12] Id. The advisory reports on the U.S.-Chile FTA may be found at: http://www.ustr.gov/new/fta/Chile/advisor_reports.htm .

[13] All references are to be text released on 7/8 March 2003, as the final legal text was not available when this article was written.

Singapore agrees to harmonise its excise taxes on domestic and imported distilled spirits by 2005. The Agreement prohibits a Party from imposing an import ban on broadcasting apparatus, including satellite dishes. Singapore will lift its ban on chewing gum, but only for therapeutic reasons.

### 5. Chapter 3—Rules of Origin

There are several methods under the Agreement for goods to qualify as "originating" goods that receive preferential treatment. These are:

1. Goods which are wholly obtained or entirely produced in one or both Parties;
2. Goods which meet the product specific rules (which generally involve a tariff heading or sub-heading shift and, in some cases, a regional value content test);
3. Goods otherwise provided as originating in Chapter 3; or
4. Designated goods involved in the Integrated Sourcing Initiative (a Singapore program allowing partial manufacturing operations, primarily of information technology goods and technical equipment, in other countries).

A provision not found in other FTA's to which the U.S. is a party, permits certain used goods that are disassembled into individual parts and then processed and reassembled ("remanufactured"), to qualify for preferential treatment.

When a regional value content is required, it may be calculated using a "build-up" or "build-down" method. Most textiles and apparel are subject to special yarn and fibre rules.

Unlike the previously negotiated FTAs to which the United States is a Party, a certificate of origin is not required by the Agreement, but the importer may be required to submit a statement setting forth the reasons that a good qualifies as an originating good, preferably electronically. The importer must keep records for up to five years and the claims are subject to verifications.

### 6. Chapter 4—Customs Administration

The Agreement has specific, concrete obligations on how customs procedures are to be conducted. These are intended to provide openness and transparency to the customs processing of goods. All Customs laws, regulations, guidelines, procedures and administrative rulings governing Customs matters must be promptly published in writing or on the internet. Laws and regulations must be applied in a uniform, impartial and reasonable manner. The Agreement further requires each Party to designate one or more contacts for public inquiries and to publicise the contact information on internet.

Proposed regulations are to be published in advance with an opportunity for public comment, although exceptions are made for law enforcement guidelines, including risk analysis and targeting technologies. When the final regulations are published, Parties are to address the comments submitted on the proposed regulations and delay the effective date so that traders may plan for the new regulations.

The Agreement requires the customs authorities, upon the request of an importer or exporter, to provide written advance rulings on tariff classification, customs valuation, country of origin, and the qualification of a good as originating for purposes of the Agreement. The requirements for making such ruling requests are to be published. Once a request is received, the customs authorities are to act expeditiously and decide the matter within 120 days. Upon request, a full explanation of the reasoning supporting the ruling is to be made available.

Any treatment provided in a ruling is to be applied without regard to the identity of importer, exporter or producer provided facts and circumstances are identical to those in the ruling. If it is later decided that a modification or revocation of a ruling is necessary because of an error of fact or law, or due to a change of material facts or circumstances, or a change of law consistent with the Agreement, the effective date of the modification or revocation is to be postponed for not less than 60 days, if relied upon to requestor's detriment. Decisions of customs authorities will be subject to at least one level of independent administrative review plus judicial review.

In order to encourage cooperation between the Parties, the Agreement states that a Party will endeavor to provide the other Party with advance notice of any significant modification of its administrative policy or any other development related to its import laws or regulations that is "likely to substantially affect the operation of the agreement." The Agreement further provides for mutual assistance in enforcement activities and technical cooperation on improving risk assessment techniques, and in simplifying and expediting customs procedures. Cooperation in specific cases is to be provided only if there are written assurances of confidential treatment for the requested information, except where a Party allows disclosure for law enforcement or judicial proceedings.

The Agreement requires each Party to maintain civil and administrative penalties and where appropriate, criminal penalties, for violations of its customs laws and regulations governing classification, valuation origin and preference eligibility.

In the area of trade facilitation, each Party is to adopt procedures that provide for release of imported goods within a time not greater than required to ensure compliance, but to the extent possible, within 48 hours of arrival of

the goods at the port of arrival. Customs authorities may require reasonable security guarantees prior to release. To expedite release, the Parties agree to try to process information and data prior to arrival and to have their authorities use risk analysis and targeting to focus customs enforcement activities on goods considered to be high risk while facilitating clearance of low risk goods.

The Agreement provides for expedited and simplified clearance for express shipments based upon pre-arrival information and electronic data processing. Release of express shipments is normally to occur within six hours of submission of the required documents, provided the shipment has arrived.

### 7. Chapter 5—Textiles and Apparel and Cooperation in the Prevention of Circumvention

This chapter reflects the U.S. concern over textile transshipment. Enterprises wishing to export textiles and apparel from Singapore, or wishing to participate in Singapore's Outward Processing Arrangement, will have to register with the Government of Singapore and will be subject to certain detailed recordkeeping requirements and to unannounced semi-annual inspections, the results of which will be made available to the United States.

Each Party is required to take all steps necessary to ensure full enforcement of its own laws related to circumvention; to ensure full cooperation in enforcement of the other party's laws related to circumvention; and to prevent circumvention by providing its officials with appropriate legal authority and by maintaining and enacting necessary laws with civil, criminal and administrative penalties.

An annex to the chapter sets forth the procedures for special textile and apparel bilateral emergency actions which may include the suspension of further reductions of duty or duty increases (not to exceed MFN rates) for a two year period that may be extended for two additional years with compensation. In addition, the Parties agree to review the textiles and apparel rules of origin to see if different rules of origin should be applied to particular goods to address the availability of fibres, yarns or fabrics and to permit the eventual harmonisation of the textiles and apparel rules of origin under Part IV of WTO Rules of Origin Agreement.

### 8. Chapter 6—Technical Barriers to Trade

This chapter encourages the Parties to enhance cooperation in areas of technical regulations, standards, and conformity assessment procedures by promoting the use of international standards, including implementing Phases I and II of the APEC Mutual Recognition Arrangement for Conformity Assessment of Telecommunications Equipment. Each Party is required to designate a Technical Regulations contact point to coordinate these efforts.

### 9. Chapter 7—Safeguards

This chapter sets forth the procedures for establishing safeguards if reduced or eliminated duties lead to increased imports of originating goods in such numbers in absolute number or relative to domestic production as to cause substantial cause of serious injury to a domestic industry. When safeguards are imposed, duty reductions may be suspended or duties may be increased to MFN rates.

The procedures require notification to the other party upon initiation of a safeguard investigation, and consultations with the other Party as far in advance as practicable. The chapter incorporates Articles 3 and 4.2(c) of the WTO Agreement on Safeguards. Safeguards may be maintained for a maximum period of two years with a two year extension, but are required to be liberalized at regular intervals, if conditions permit. In critical circumstances, safeguard measures may be taken on a provisional basis not to exceed 200 days. If safeguards are imposed, the party applying them is required to provide mutually agreed upon trade liberalizing compensation.

Each party retains rights under Article XIX of GATT 1994 and the WTO Agreement on Safeguards, but a party may exclude originating goods of the other party from global safeguards if such imports are not a substantial cause of serious injury or threat thereof.

### 10. Chapter 8—Cross Border Trade In Services

The chapter on cross-border services provides substantial market access on the basis of national treatment and MFN. It uses a "negative list" approach. That is, all cross-border services are covered by the Agreement unless they are listed in an annex. Most FTAs only cover services that are listed in an annex. It should be noted that this chapter does not apply to financial services (Chapter 10), government procurement (Chapter 13), or to air services, with some exceptions. If a covered service has qualification requirements, the technical standards and licensing are to be objective and transparent.

Unless permitted in the annex, neither Party may maintain or adopt quotas, monopolies, exclusive service suppliers, an economic needs test or employee limits for covered services. Furthermore, neither Party may require residency or representative offices for a cross-border service, unless set forth in the annex. The Agreement requires the Parties to freely permit transfers and payments of salaries, profits and funds taken abroad to consume a service, interest, royalties, contract payments, investments. However, this may be suspended in certain cases, such as bankruptcy, judgments, etc.

The chapter permits the denial of benefits where an enterprise is owned or controlled by a non-party that does not have a substantial business in the

territory of the other party, or where the enterprise is owned or controlled by a non-party and the Party does not maintain diplomatic relations with the non-party or maintains sanctions against the non-party.

The chapter contains transparency requirements in the development and application of regulations similar to those discussed above. It also encourages the development of mutually acceptable professional standards.

### 11. Chapter 9—Telecommunications

Each Party agrees to ensure that enterprises of the other Party have access to, and use of any public telecommunications network. This access is to be provided, "unbundled." That is, an enterprise is only required to pay for the services it requires. The Parties are required to ensure that enterprises that are given such access protect the confidentiality of proprietary information relating to suppliers and end users of public telecommunications services. The Parties are to ensure that major suppliers provide co-location wherever possible for necessary interconnection or access.

The Parties are to ensure that any regulatory body is separate and independent of any supplier of telecommunications services and that its decisions are impartial with respect to all interested parties. Parties are required to divest ownership interests in public telecommunications suppliers.

The Agreement sets forth transparency requirements for licensing and rulemaking, and procedures for resolving disputes that are then subject to judicial review.

Suppliers of telecommunications are to have the flexibility to choose the technologies they use, including mobile services, as long as their services are capable of interconnection so that end-users of different technologies may communicate with each other.

### 12. Chapter 10—Financial Services

This chapter opens up the financial services markets in the territories of both Parties. The chapter requires a Party to provide national treatment and market access for investments in the establishment, acquisition, expansion, management, conduct, operation, or disposition of financial institutions and investments in financial institutions in its territory.

Except for reservations set forth in the annexes, a Party may not require financial institutions of the other Party to engage individuals of any particular nationality as senior management or other essential personnel. However, a Party may require that a simple majority of the Board of Directors of a financial institution of the other Party be nationals or residents of that Party.

Parties are permitted to take action for prudential reasons to protect investors, depositions, policy holders, and others to whom a fiduciary duty is owed.

The Parties agree to transparency in regulations and policies governing the activities of financial institutions and cross-border financial services, and agree to specific procedures regarding rulemaking, applications, administrative decisions, and inquiry mechanisms. Access to payment and clearing systems is to be provided, as is expedited offering of insurance services.

A "Financial Services Committee" is to be established which will supervise the implementation of this chapter, and participate in the dispute settlement mechanism established for financial services. Financial services disputes are to be heard before panelists who have experience or expertise in financial services law or practice. They are to be impartial and objective. When a dispute affects only the financial services sector, a Party may only suspend financial services benefits; and when a dispute affects only a sector other than the financial services sector, a Party may not suspend financial services benefits.

### 13. Chapter 11—Temporary Entry of Business Persons

With limited exceptions, each Party agrees to grant the temporary entry of business persons listed in Annex 11A, although visas or other documents may be required. Measures governing temporary entry are to be applied expeditiously using transparent criteria to avoid impairing or delaying trade in goods or services.

In order to ensure regulatory transparency, each Party is required to maintain or establish contact points to respond to business inquiries. The transparency requirements for the adoption of regulations that are discussed in the other chapters are repeated in this chapter. Parties are required to make timely decisions on applications for temporary entry and inform applicants of the status of the application. Prior to entry into force of the FTA, the Parties agree to provide each other information on procedures relating to processing applications so the other Party may become acquainted with those requirements.

The Parties agree within six months after entry to publish explanatory materials for business persons in a consolidated document. The Parties will also establish "Contact Points on Temporary Entry" to meet, exchange information, develop facilitation measures, monitor implementation of the chapter, and provide data to the other Party upon request. In the case of temporary entry of business persons, dispute settlements under Chapter 20 are limited to matters involving a pattern or practice and the business person has exhausted all available administrative remedies or more than one year has passed without a final determination in an administrative proceeding, and the delay is not attributable to the business person.

Pursuant to Annex 11A, each Party is to grant temporary entry to the business persons for up to 90 days without work authorisation if they are

otherwise qualified. Temporary entry is to be granted to the following categories of business persons:

- Traders and Investors;
- Intra-company transfers of persons who are managerial, executive, or who have specialised knowledge. A Party may require one year employment within the past three years in these categories;
- Professionals (and training for professionals) who possess the requisite credentials for their profession. A Party may establish numerical limits for this category and may establish certain salary criteria.

### 14. Chapter 12—Anticompetitive Business Conduct, Designated Monopolies, and Government Enterprises

Each Party agrees to adopt or maintain measures to proscribe anticompetitive business conduct. Although designated monopolies and government enterprises are permitted, they must use commercial considerations in the purchase and sale of goods or services and act in a manner consistent with the chapter's objectives, except for government procurement. The Parties agree to cooperate on competition law and policy development. In order to ensure transparency, Parties are required to make available, upon request of the other Party, public information concerning enforcement measures, information concerning government enterprises and designated monopolies, and exemptions from anticompetitive measures.

### 15. Chapter 13—Government Procurement

In the area of government procurement, the parties reaffirm their obligations under the WTO Agreement on Government Procurement and they agree to apply the APEC non-binding Principles on Government Procurement. They further agree to seek a multilateral agreement on transparency in government procurement to implement the Doha Ministerial mandate. Singapore has made additional commitments on non-discrimination in government procurements, based on a "negative list." The annexes set forth exclusions and lower monetary thresholds than at present. The applicable thresholds are subject to an indexing formula to account for inflation.

### 16. Chapter 14—Electronic Commerce ("e-commerce")

The Parties recognise the importance of "e-commerce" and the importance of avoiding barriers to its use and development. The Agreement prohibits a Party from applying customs duties, fees or charges on the importation or exportation of digital products by electronic transmission. When a customs value is required for carrier media bearing digital products, it shall be determined based on the media without regard to the cost or value of digital products

stored on the media. In order to encourage transparency, each Party is required to publish or otherwise make available its laws, regulations and measures relating to e-commerce. A joint statement on e-commerce, released with the text of the Agreement, indicates that the Parties believe that the private sector should lead development; that the Parties should avoid imposing unnecessary regulations; that government action, when needed, should be transparent; that the Parties will encourage self regulation through codes of conduct; and cooperation among all countries will assist in the construction of a seamless environment for e-commerce. The joint statement also sets forth goals in a variety of fields.

### 17. Chapter 15—Investment

The Agreement provides a secure, predictable legal framework for investors. Each Party agrees to provide national treatment to investors of the other Party and treatment no less favourable than the most favourable treatment accorded to investors of any non-Party ("most favoured nation treatment"). If there is an expropriation of property, it must be for a public purpose, non-discriminatory, and must result in payment of prompt, adequate, and effective compensation equal to the fair market value.

Each Party agrees to permit transfers freely and without delay into and out of territory and into freely usable currency at the prevailing market rate. A Party may restrict transfers for

- bankruptcy, insolvency or creditors;
- issuing, trading or dealing in securities;
- financial reporting and recordkeeping;
- criminal or penal offences;
- ensuring compliance with orders or judgments in judicial; or,
- administrative proceedings.

Neither Party may impose or enforce listed performance requirements, commitments or undertakings in connection with the establishment, acquisition, expansion, management, conduct, operation, or disposition of an investment.

The "negative list" approach is utilised for investments. That is, all forms of investment are protected unless specifically exempted.

Senior management of an enterprise may not be required to be of any particular nationality. However, a Party may require a majority of the board to be resident in a Party's territory or of particular nationality, provided it does not materially impair the investor's ability to exercise control over its investment.

A Party may deny benefits to an enterprise investor of the other party if the enterprise is controlled by persons of a non-Party with which the denying Party does not maintain diplomatic relations, or against which it maintains sanctions that would be violated or circumvented if benefits were accorded. A

Party may also deny benefits if the enterprise has no substantial business activities in the territory of the Party and it is controlled by persons of a non-Party or the denying Party.

In the event of an investment dispute, resolution will initially be sought through consultation and negotiation. If that is unsuccessful, the Agreement establishes a dispute settlement mechanism based on various arbitration agreements. Arbitration requests may be filed by a claimant on its own behalf under the ICSID[14] Convention if the Parties are Parties to the ICSID Convention; under the ICSID Additional Facility Rules if one is Parties is a Party to the ICSID but the other is not; under UNCITRAL[15] arbitration rules or any arbitration institution if both the claimant and respondent agree. The Agreement sets forth conditions and time limitations on seeking arbitration and procedures governing the selection of arbitrators, the conduct of the arbitration and the transparency in arbitration proceedings.

The Agreement is accompanied by various side letters which concern customary international law, expropriation, land expropriation, and an appellate mechanism, all of which are an integral part of the Agreement.

### 18. Chapter 16—Intellectual Property Rights

The Agreement provides a high level of protection to intellectual property rights ("IPR") and builds on existing TRIPS commitments, while enhancing enforcement.

Each party is required to give effect to articles 1-6 of the Joint Recommendation on Well Known Marks (1999, WIPO) and the Trademark Law Treaty (except for Articles 6 and 7 for Singapore) and is required to ratify or accede to:

- 1974 Brussels Convention on Satellites
- 1991 Convention on Protection of new varieties of plants
- 1996 WIPO Copyright Treaty
- 1996 WIPO Performances and Phonograms Treaty
- 1984 Patent Cooperation Treaty

Furthermore, each Party shall make "best efforts" to ratify or accede to:

- 1999 Hague Convention on Industrial Designs
- 1989 Protocol relating to Madrid Agreement on International Registration of Marks.

#### *Trademarks*

Trademark protection is very broad and also covers service marks, collective marks and certification marks. Parties may include geographical indications

[14] International Centre for Settlement of Investment Disputes.
[16] United Nations Commission on International Trade Law

and "scent" marks in this category. Well-known marks are generally protected even a mark is used for goods and services other than those registered for the mark.

The Agreement requires government involvement in resolving disputes between trademark owners and domain names on the Internet, an important provision to prevent "cyber-squatting" of trademarked domain names, according to USTR. Trademark registration is streamlined by allowing applicants to use their own national offices.

### *Copyrights*

The Agreement recognises copyright problems in the digital era, and gives control over all reproduction, including permanent or temporary on-line uses of materials to the authors or other copyright owners. The Agreement also protects against unauthorised retransmission of television signals, whether by terrestrial, cable or satellite methods.

Copyright owners will be protected for extended terms under the Agreement. Protection will be provided for a term not less than the life of author plus 70 years; if not based on the life a person, 70 years from the end of the calendar year in which the work was first published; or if not published within 50 years from creation, not less than 70 years from the end of the calendar year of creation.

The Parties agree to increase the protection of copyrighted works using advanced technologies to prevent infringement by establishing civil and criminal offences. The increased protection will cover circumvention of technological measures that control access as well as manufacturing, importing, distribution, offering devices to the public or trafficking in the devices, products, components or services which are promoted, advertised or marketed to circumvent effective technology measures, or have only limited commercially significant purpose or use other than circumvention. Expanded protection is also provided for encrypted program-carrying satellite signals. There are exceptions for certain non-profit organisations and public libraries or archives.

### *Patents*

Under the terms of the Agreement, patent protections are expanded and patents are to be available for all fields of technology. Terms of patent protection are to be extended to compensate for unreasonable delays (over four years from filing or two years from examination) in processing patent applications.

In the case of certain regulated products (pharmaceuticals and agricultural chemicals), the Parties agree to keep confidential any information which is needed for ensuring the safety and efficiency of the product prior to marketing for five years (pharmaceuticals) or 10 years (agricultural chemicals).

Transparency in the protection and enforcement of IPRs is provided in a variety of ways. Decisions on the merits of an application for protection should be in writing with statements of the reasons upon which the decisions are based. In addition, the Parties will publish all laws, regulations, procedures, final judicial and administrative decisions of general application and publicise information and statistics on its efforts to have effective enforcement.

The Agreement requires the Parties to establish civil and administrative remedies including seizure of devices and products, damages (on suggested retail price of legitimate good or service), recovery of court and attorney fees, and the destruction of devices involved in an IPR violation. In addition, the remedies may include compensation for injury and profits, and ordering the identification of third parties involved in the violation.

The Agreement expands border protection of IPR. For example, each Party is required to permit competent authorities to act *ex officio* without the need for a complaint. Where authorities determine that imported goods are counterfeit or piratical, they will be authorised to inform the rights holder of the names and addresses of the consigner, importer and consignee of the goods as well as the quantity detained. Goods that are counterfeit or piratical are to be destroyed. The Agreement provides that Parties will cooperate with each other in preventing violations.

Parties are required to establish criminal penalties and procedures for willful counterfeiting or piracy on a commercial scale which include imprisonment as well as a high monetary fine in addition to providing for the seizure, forfeiture and destruction of offending goods, related materials, implements, assets traceable to the violation and any related documents.

The Agreement provides legal incentives and protections to internet service providers who cooperate with copyright holders.

Singapore agrees to establish control procedures for manufacturing optical discs by requiring manufacturing licenses, special code (source ID) marking, recordkeeping, and inspections.

Singapore has agreed to discontinue compulsory licenses under Articles 143-146 of the Singapore Copyright Act. Parallel imports of pharmaceuticals will be required to comply with all product identity, safety, quality, integrity, manufacturing practices and other health and safety requirements.

### 19. Chapter 17—Labour

Both Parties reaffirm their obligations as members of the International Labour Organization and agree to strive for consistency with internationally recognised labour rights. The Agreements makes it clear that it is inappropriate to weaken or reduce the enforcement of domestic labour laws in order to encourage trade or investment.

The Parties are required to ensure access to administrative, quasi-judicial, judicial or labour tribunals and to ensure that procedures are transparent, fair and equitable. The Agreement also establishes a formal Labour Cooperation Mechanism.

### 20. Chapter 18—Environment

Each Party agrees that its laws will provide high level of environmental protection that will not be waived to encourage trade or investment. The Agreement requires transparency in procedural matters and requires appropriate sanctions for violations. The Agreement permits interested parties to request investigations and seek remedies and injunctions. In addition, each Party is required to establish a mechanism for public participation and for sharing best practices.

### 21. Chapter 19—Transparency

This chapter is intended to ensure transparency in carrying out any of the Agreements provisions, although it seems to duplicate the requirements contained in individual chapters. The Parties agree to designate contact points to facilitate communications between the Parties on any matter in the Agreement. The Parties agree to promptly publish laws, regulations, procedures and administrative rulings of general application, or otherwise make them available, most likely via the internet or optical discs. To the extent possible, the Parties will publish proposed regulations in advance with an opportunity for public comment and they agree to notify the other party of any measure being considered which may materially affect operation of the FTA or the other Party's interests.

Each Party will establish Review and Appeal procedures that are impartial and independent and in which parties to the proceeding will have the right to support or defend positions. Decisions will be based on evidence and submissions of record or a record compiled by an administrative authority.

### 22. Chapter 20—Administration and Dispute Settlement

The Agreement establishes a Joint Committee to supervise implementation of the Agreement. The specific responsibilities of the Joint Committee are rather broad and are set forth in this chapter.

This chapter also sets forth the general dispute settlement procedures for those chapters not having specific mechanisms. If consultations fail to resolve a dispute within 60 days, the Parties may resort to either WTO or FTA procedures. Under FTA procedures, panels consist of three panel members, one of whom is the chairman selected from a contingent list of five individuals

who serve three year terms. The Agreement contains model rules of procedure which provide for:

- at least one hearing;
- initial and rebuttal submissions;
- written versions of oral statements and written responses; and
- procedures to protect confidential information.

Initial reports are due within 150 days, followed by a final report to be issued within 45 days. A public report is to be released within 15 days.

If the Parties are unable to agree upon implementation of the final report within 45 days, the Parties are required to begin negotiations on compensation. If no compensation agreement is reached within 30 days, or there is a failure to observe the terms of the negotiated agreement, the aggrieved Party may give notice that it will suspend the application of benefits of equivalent effect. Compensation is to be paid into a fund to pay for trade facilitation initiatives, except in the case of Labour or Environment chapters in which cases, the compensation is to be used to fund labour or environment issues. The Parties may not establish a private right of action against the other Party under its domestic law.

### 23. Chapter 21—General and Final Provisions

This chapter contains exceptions to the Agreement, including those needed for reasons of essential security or to fulfill it obligations relating to maintenance or restoration of international peace and security. The chapter also provides, with certain exceptions, that any tax convention to which the parties are signatories supersedes the FTA if there are conflicts. Each Party reaffirms its commitments to anti-corruption through effective measures, including deterrent penalties against bribery and corruption.

The Agreement permits any country or group of countries to accede to it if the Parties agree.

# 7. United States-Chile Free Trade Agreement

***Stuart P. Seidel***

## 1. Introduction

The United States – Chile Free Trade Agreement ("the Agreement") is a comprehensive trade agreement. It is the sixth Free Trade Agreement ("FTA") negotiated by the United States and its first with a South American country.[1] On the other hand, Chile has negotiated FTAs with the other NAFTA countries and its trading partners in Latin America, Europe and South Korea.[2] The U.S. is Chile's largest trading partner. In 2001, there was nearly US$8.8 Billion in bilateral trade in goods and services. Although negotiations have been on-going since December 2000, the U.S.-Chile FTA and the U.S.-Singapore FTA (the negotiations of which were completed at approximately the same time) are the first FTAs to be completed after approval of Trade Promotion Authority (also called "fast-track") by the U.S. Congress as part of the Trade Act of 2002. Among other provisions, the Trade Promotion Authority legislation requires trade agreements to meet certain negotiating objectives.

At the end of January 2003, the U.S. Congress was officially notified of the intention of the Bush Administration to sign the Agreement. The official signing may occur 90 days thereafter. After signing, the Agreement and any necessary implementing or conforming legislation and statements of administrative action will be submitted to the Congress for approval. Under the terms of Trade Promotion Authority, Congress may hold hearings and review the FTAs, but may only vote in favour of, or against, the FTA. It may not amend the texts of the agreements. It is hoped that Congressional action is completed in a time frame to permit the Agreement to come into force on 1 January 2004

The full text of the agreement was released to the public on 3 April 2003 via internet posting on the website of the U.S. Trade Representative ("USTR")

[1] The others are the US-Canada FTA, NAFTA, US-Israel FTA, US-Jordan FTA and the US-Singapore FTA which was submitted to the U.S. Congress at the same time. The US-Canada FTA has been suspended while NAFTA is in effect. The U.S. also has a "Bilateral Trade Agreement" with Vietnam that covers many of the typical FTA subjects.

[2] Between 1990 and 1999, Chile negotiated FTAs based on the NAFTA structure with Canada and Mexico, and entered into "Acuerdo De Complementación Económica" agreements with most of its Latin American trading partners. In 2002, it negotiated agreements with the European Union and South Korea and, in 2003, with the EFTA countries.

and an announcement and links at the Chilean Ministry of Foreign Affairs, Directorate General of International Economic Relations.[3]

Brief public summaries and fact sheets were made immediately available upon conclusion of the Agreement. Additional detailed summaries were made available to the public in early March. As part of the negotiation and review process, U.S. negotiators held more than 100 meetings with 700 advisors from business, farm groups, labour unions, environmental groups, consumer organisations, and state governments to discuss and seek their advice, on U.S. negotiating positions.[4]

In January 2003, the confidential draft texts of the two FTAs were submitted to private sector advisors for review, as mandated by U.S. legislation. The advisors are members of 31 industry advisory committees that are required by legislation to file reports with USTR after a 30 day review period. During the review period, the industry representatives were permitted to review, but not download, print or copy the text, from a secure website maintained by the USTR. This process reportedly made it difficult to review or discuss provisions with those who were experts in specific areas covered by the FTAs.

The 31 advisory committees, which are chartered by the U.S. Congress, include:

- a broad-based Advisory Committee for Trade Policy and Negotiations (ACTPN);
- three policy advisory committees: trade and environment, labour and agriculture;
- five technical advisory groups on specific agricultural groups (ATACs);[5]
- 17 industry sector advisory committees (ISACs);[6]
- four industry functional advisory committees (IFACs);[7] and,
- an intergovernmental policy advisory committee (IGPAC).

The committee members were asked to examine each FTA from the various interests represented within each chartered committee and the objectives set by the U.S. Congress. The advisory reports[8] were submitted at the end of February. With only one exception, all of the advisory committees that submitted

[3] http://www.ustr.gov/new/fta/Chile.htm and http://www.direcon.cl/frame/acuerdos_internacionales/f_bilaterales.html

[4] http://www.ustr.gov/releases/2003/03/03-13.htm

[5] The ATACs are: animal and animal products; fruits and vegetables, grains; feed and oilseeds; sweeteners; and tobacco, cotton and peanuts.

[6] The ISACs are: Aerospace, Capital Goods, Chemicals and Allied Products; Consumer Goods; Electronics and Instrumentation; Energy; Ferrous Ores and Metals; Footwear, Leather and Leather Products; Building Products; Lumber and Wood Products; Nonferrous Ores and Metals; Paper and Paper Products; Services; Small and Minority Business; Textiles and Apparel; Transportation, Construction and Agricultural Equipment; and Wholesaling and Retailing.

[7] The IFACs are: Customs Matters; Standards; Intellectual Property Rights; and Electronic Commerce.

[8] The full advisory committee reports are available at http://www.ustr.gov/new/fta/Chile/advisor_reports.htm

reports supported the results of the negotiations, although there are several reports that include dissenting views. The one report that was universally negative regarding both the Chile and Singapore FTAs came from the Labour Advisory Committee. Another committee was unable to submit a detailed report because a lawsuit by environmental groups prevented a member from joining the committee and the committee could not meet until a replacement member was named, not allowing sufficient time for a proper review. The Textiles and Apparel ISAC report reflected the divergent views between the fibre, yarn and textile members who favoured the "yarn forward" rules but were concerned about high Tariff Preference Levels, and the apparel members who were unhappy with what were believed to be complicated origin rules.

After the negotiations with Chile were completed, U.S. and Chilean lawyers began reviewing the Agreement for legal clarity and consistency, both within the Agreement and between the English and Spanish texts, so it is possible that certain provisions will be revised prior to the official signing.

The Agreement consists of 24 separate chapters. A major theme throughout the Agreement is transparency which is reflected in provisions that urge:

- the advance publication of proposed regulations;
- an opportunity for comment by interested parties or the public at large;
- publication of adopted rules, which to the extent practicable, address the comments received; and,
- delayed effective dates for final regulations.

Some chapters have additional transparency requirements which are discussed in more detail below. In addition, the Agreement recognizes the digital age in many ways that are also discussed below.

## 2. Comparison with the Other U.S. Trade Agreements

In comparing the U.S. Chile Free Trade Agreement to other trade agreements that the United States has negotiated, several points should be noted:

- The North American Free Trade Agreement ("NAFTA") was completed during the Uruguay Round negotiations which resulted in the creation of the WTO and its multi-lateral agreements, and was deeply influenced by those negotiations;
- NAFTA was a tri-lateral agreement negotiated by three countries, each of which had a federal structure consisting of states or provinces with substantial rights under the respective constitutional structure. This was reflected in some of the reservations, exceptions and non-conforming provisions. Since that time, Chile has negotiated separate FTA's with Mexico and Canada.

- Canada and the United States followed the common law while Mexican jurisprudence was founded on civil law principles. This required adjustments to various transparency and related provisions. Chile is also a civil law country.
- Canada and the United States were already developed economies, while Mexico was a developing country. Chile currently receives preferential treatment for some of its products under the U.S. Generalized System of Preferences regime.
- The U.S.-Jordan FTA was intended to put Jordan on a par with Israel and so is closely patterned after the earlier U.S.-Israel FTA, rather than NAFTA. The Chile FTA generally follows the NAFTA model.
- The U.S.-Vietnam Bilateral Trade Agreement ("BTA") was intended to fully normalise trading relationships between two former foes and to assist Vietnam in meeting WTO membership requirements.

For the reasons mentioned above and others (e.g., adoption of WTO multilateral and plurilateral agreements, stage of economic development, trade agreement experiences), the U.S.-Chile FTA differs from earlier U.S. trade agreements in several respects. The Agreement is generally patterned after NAFTA, although there are some provisions that address unique problems, such as the Chilean price banding for agricultural products, GSP parity, and the elimination of Chile's 50% surcharge on used goods. Although many products are entitled to benefits immediately upon entry into force, other products receive phased in benefits over a 12 year period. In addition, matters previously covered in side letters with other countries have been incorporated into the agreement (e.g., environment and labor provisions).

Agricultural interests and subsidies were a concern during the U.S.-Chile negotiations and provisions were drafted to address those concerns through the use of trigger prices and special safeguard provisions, not found in the U.S.-Singapore FTA. Chile's price banding will be phased out. In addition, there are procedures for the mutual acceptance of agriculture and marketing standards and for mutual recognition of beef grading standards.

The Agricultural Policy Advisory Committee (APAC), one of the advisory committees, believes that the FTA will improve U.S. agricultural exports and open up Chilean markets, while providing a sensible timetable for elimination of agricultural tariffs. Sanitary barriers, which can be major hurdles to agricultural trade, are addressed in the Sanitary and Phytosanitary chapter.

The U.S.-Jordan FTA is based on the U.S.-Israel FTA and, except for textiles and apparel, uses the rather subjective "substantial transformation test" rules to establish origin for purposes of obtaining preference. The Chile Agreement follows the NAFTA precedent of using objective rules based on a

shift in tariff classification, although the NAFTA rules for certain industries and commodities are far more complex. The Advisory Committee on Trade Policy and Negotiations (ACTPN) commented on the increased costs associated with different origin rules and suggested that a regional approach be taken in future FTAs.

The Chile Agreement departs from the NAFTA and Jordan FTA origin certification models. In both those agreements, the foreign producer or exporter is responsible for providing a required Certificate of Origin in a prescribed format. The Chile Agreement allows the certification to be made by the importer, exporter or producer without mandating a prescribed format. Regional value content rules have also been simplified over those set forth in NAFTA, and the *de minimis* value for non-originating materials has been increased to 10%, from 7% in NAFTA and the Singapore FTA.

The textile and apparel provisions in the Chile Agreement reflect U.S. concerns over transshipment and establish procedures for bilateral emergency actions when there is a surge in imports because of duty elimination. In addition, there are provisions relating to treatment of "sets" and tariff preference levels for non-originating cotton and man-made fibers. The Customs Administration chapter includes specific obligations relating to transparency and trade facilitation, including expediting clearance of express couriers, and encourages the use of technology and automation.

The U.S.-Jordan FTA does not have a chapter on investment because the U.S. and Jordan had negotiated a separate bilateral treaty covering that topic in 1997, and a framework agreement on trade and investment two years later. The Vietnam BTA addresses investments in Chapter IV and in an exchange of letters between the parties. The Chile Agreement lists non-conforming measures at the national level in schedules, but local non-conforming measures are generally grandfathered. Chile is permitted to impose capital transfer restrictions for a limited time for certain types of speculative capital. In the area of services, both the Jordan FTA and Vietnam BTA identify specific sectors or requirements that are included under the agreements. The Chile Agreement takes a "negative list" approach. That is, the agreement covers all financial services and cross-border services unless they are covered by a reservation, exception, or listed in a non-conformity schedule.

The telecommunications provisions are significant in that they require access to public communications networks in an "unbundled" manner. This means that an enterprise is only required to pay for the services it requires. The Agreement's e-commerce provisions ensure that customs duties will not be applied to electronically transmitted digital products.

The Chile Agreement includes substantial commitments in the area of intellectual property rights protection, although not as extensive as those in

the U. S.-Singapore FTA. In addition to requiring the accession or ratification of a number of international agreements or recommendations, the Agreement requires the adoption of specific civil and criminal remedies and *ex officio* border enforcement of intellectual property rights. The Agreement also includes provisions on digital encryption devices and protection, encrypted satellite signals and internet domains.

The transparency provisions throughout the agreement are also very extensive. Posting via the internet is recognized as an acceptable means of publication of government guidelines and information.

U.S. Trade Promotion Authority ("fast track") legislation sets forth negotiating goals and objectives for future trade agreements. The Singapore and Chile Agreements were the first two such agreements to be subject to review for consistency with the legislation. Although all the private sector advisory groups (except for the Labor Advisory Committee) have recommended approval of the agreements, their reports contain comments from individual members that dissent from the committee reports or suggest that future agreements address what they believed might be shortcomings in certain areas when applied to other countries. These comments frequently reflect the view that the Agreement's text is acceptable for an FTA with Chile but that the provisions should not necessarily set a precedent or become a template for future agreements. Some of the areas in which concerns were expressed are:

- The scheduling of duty elimination for sensitive products, such as some agricultural goods, certain chemicals or those goods being eased out of subsidies or support programs;
- The definition of "expropriation";
- Sanitary and phytosanitary problems are not all resolved;
- Inclusion of sugar in the market access negotiations;
- Restrictions on energy services in the exploration and processing of liquid or gas hydrocarbons found in ocean waters offshore;
- Transfer of capital restrictions;
- Restrictive rules of origin for textiles;
- *Unavailability of dispute settlement procedures in certain areas (*e.g.*, portions of the labor and environment chapters);*
- Protection of workers' rights—the Agreement only requires compliance with local laws;
- Delayed implementation of some of the transparency provisions;
- Greater rights in the U.S. for foreign investors than U.S. investors have;
- Non-inclusion of simplified visa procedures for temporary business visitors;
- Reservations for certain services, such as health care;

- Failure to have one set or origin rules for all FTAs;
- Failure to provide funding or resources for capacity building; and,
- Failure to address patent delays due to ministries of health procedures.

It should be noted that the above concerns are not shared by all members of the particular advisory committee involved. Some members, often the majority, take the view that the Chile FTA should set the standard for all future FTAs entered into by the U.S.

Other countries negotiating FTAs with the U.S. should review the private sector advisory committee reports that have been posted on the USTR website.[9]

A chapter-by-chapter summary of the Agreement follows:

### 3. Chapter 1—Establishment of a Free Trade Area

This chapter establishes a Free Trade Area between Chile and the U.S. consistent with Article XXIV of GATT, 1994 and Article V of GATS and sets forth the objectives of the Agreement. In addition, the chapter reaffirms existing rights and obligations under existing agreements, including the WTO Agreement.

### 4. Chapter 2—General Definitions

This chapter defines certain terms of general application which are used throughout the Agreement. Many chapters contain further definitions of terms used within those chapters.

### 5. Chapter 3—National Treatment and Market Access for Goods

With certain exceptions, the Agreement requires that goods of one Party imported into the other Party's territory be given the same treatment as goods of that Party ("national treatment"). Customs duties will be eliminated progressively according to schedules annexed to the Agreement. The U.S. has also agreed to eliminate all duties on non-agricultural products originating in Chile that are designated in the future as eligible under the U.S. Generalized System of Preferences ("GSP"), except those which only apply to least developed beneficiary countries. Chile has agreed to cease the application of its 50% surcharge for used goods that originate in the U.S. The Parties will consult on accelerating the schedules.

The WTO Valuation Agreement will be applied to all transactions necessitating a customs valuation. In addition, the agreement provides that the value of imported carrier media, such as computer disks, will be based on the media. The chapter also requires each Party to permit duty-free entry for a variety of goods that will remain in the territory of a Party for a temporary period or which are of negligible value, regardless of their origin. The list

[9] Id. The advisory reports on the U.S.-Chile FTA may be found at: http://www.ustr.gov/new/fta/Chile/advisor_reports.htm .

includes professional equipment ("tools of the trade"), goods intended to be displayed or demonstrated at exhibitions or fairs, commercial samples, advertising materials, and goods for sports purposes.

Duty deferral and drawback programs will be reduced in stages beginning in year 8 of the Agreement and will be eliminated in year 12. Chile will progressively reduce its luxury tax on automobiles and increase the threshold to which it is applied, eventually eliminating it altogether.

The Agreement also provides that goods reentered in a Party's territory after repairs or alterations in the other Party, which do not change the article into a different commercial item, are not subject to duty, regardless of origin. The Agreement generally prohibits a Party from imposing import restrictions on the goods of the other Party or export restrictions on goods destined to the other Party, although there are provisions to prevent circumvention of trading bans involving non-Parties. Originating goods from Chile will be exempt from the U.S. merchandise processing fee and export taxes are prohibited unless they are also imposed on domestic goods.

The Parties agree to recognize and protect certain distinctive beverage products. Chile will prohibit the sale of "Bourbon Whiskey" and "Tennessee Whiskey" unless it is lawfully manufactured in the United States. The U.S. is required to prohibit the sale of "Chilean Pisco," "Pajarete" and "Vino Asoleado" unless it is lawfully manufactured in Chile.

The Parties agree to work in the WTO towards the elimination of agricultural subsidies, and to not introduce or maintain such subsidies on agricultural goods destined to the other Party. The section also contains provisions for limited agricultural safeguard measures on certain goods if the good enters a Party's customs territory below a "trigger price" set forth in Annex 3.18. Safeguard measures may not be used on agricultural goods that have achieved duty-free status or increases a zero in-quota duty on a good subject to a tariff-rate quota. A procedure is establishing for mutual acceptance of agriculture and marketing standards and for the mutual recognition of beef grading standards.

Section G is devoted to textiles and apparel and reflects concerns over textile surges and illegal transshipment. Procedures are established for bilateral emergency actions when there is a surge in imports caused by the elimination of a duty which causes serious damage, or an actual threat, to a domestic industry producing a like or competitive good. These actions cannot exceed 3 years and cannot be taken beyond a period ending 8 years after the elimination of duties.

This section also contains any exceptions to the Chapter 4 rules of origin with respect to textiles and apparel, such as *de minimis* rules, treatment of sets and non-originating cotton and man-made fibre fabrics entitled to tariff preference

levels ("TPL"). TPL certificates of eligibility may be required from importers. The Parties are required to provide full cooperation in: enforcing their laws, regulations and procedures affecting textiles and apparel; ensuring accuracy of claims of origin; and preventing circumvention. The section also establishes procedures for verifications of origin claims relating to textiles and apparel.

Furthermore, the Parties agree to review the textiles and apparel rules of origin to see if different rules of origin should be applied to particular goods to address the availability of fibres, yarns or fabrics.

Section H establishes a Committee on Trade in Goods to promote trade between the Parties, including consideration of accelerating tariff elimination; and to address trade barriers including non-tariff measures.

## 6. Chapter 4—Rules of Origin

There are several methods under the Agreement for a good to qualify as an "originating" good that receives preferential treatment. These are:

a. the good is wholly obtained or entirely produced in the territory of one or both of the Parties;
b. the good is produced entirely in the territory of one or both of the Parties and
    i. each of the non-originating materials used in the production of the good undergoes an applicable change in tariff classification, or
    ii. the good otherwise satisfies any applicable regional value content or other requirement, and the good satisfies all other applicable requirements of Chapter 4; or
c. the good is produced entirely in the territory of one or both of the Parties exclusively from originating materials.

As with other FTA's, a good or material is not considered to be originating by virtue of having undergone simple combining or packaging operations or mere dilution with water or another substance that does not materially alter the characteristics of the good or material.

Annex 4.18 permits certain used goods that are disassembled into individual parts and then processed and reassembled ("remanufactured"), to qualify for preferential treatment.

When regional value content is required, it may be calculated using a "build-up" or "build-down" method. In calculating the value of materials, various additions and deductions are permitted. There are provisions for accessories, spare parts, and tools to be considered as materials. The origin of fungible goods may be determined by the use of various inventory methods. The rules allow the accumulation of originating goods or materials from one or more producers and from one or both Parties.

With the exception of certain designated products, the Agreement permits origin to be conferred on a good that does not undergo a change in tariff classification if the value of all non-originating materials does not exceed 10% of the adjusted value of the good (the "*de minims*" rule).

An importer claiming preferential treatment must make a written declaration and may be required to submit a certificate of origin or other information demonstrating that a good qualifies as an originating good. A certificate of origin is valid for 4 years, need not be in a prescribed form, and may be submitted electronically. It may be issued by the importer, exporter or producer. As in NAFTA, an importer may submit a claim for preferential treatment up to one year after importation.

The importer must maintain records for up to five years and the claims are subject to verification. If the certificate of origin was issued by an exporter or producer, the issuing party must also maintain records for five years.

No certificate of origin or supporting documentation is required to claim preferential treatment for goods valued at $2,500 or less (or a higher value established by the importing Party) unless the importation is considered to have been carried out to evade compliance with the Party's laws governing claims of origin under the Agreement.

The Parties are required to establish common guidelines for the interpretation, application and administration of the origin rules.

### 7. Chapter 5—Customs Administration

The Agreement has specific, concrete obligations on how customs procedures are to be conducted. These are intended to provide openness and transparency to the customs processing of goods. All Customs laws, regulations, and administrative procedures must be posted on the internet or other computer-based telecommunications network. The Agreement further requires each Party to designate one or more contact points for public inquiries and to publicise the contact information on the internet. Proposed regulations are to be published in advance with an opportunity for public comment.

In the area of trade facilitation, each Party is to adopt procedures that provide for release of imported goods within a time not greater than required to ensure compliance, but to the extent possible, within 48 hours of arrival of the goods at the port of arrival. Customs authorities may require reasonable security guarantees prior to release. To expedite release, the Parties agree to use automation and to have their authorities use risk analysis and targeting, to focus customs enforcement activities on goods considered to be high risk while facilitating clearance of low risk goods.

In order to encourage cooperation between the Parties, the Agreement states that a Party will endeavour to provide the other Party with advance

notice of any significant modification of its administrative policy or any other development related to its import laws or regulations that is "likely to substantially affect the operation of the agreement." The Agreement further provides for mutual assistance in enforcement activities and technical cooperation on improving risk assessment techniques, and in simplifying and expediting customs procedures. Cooperation in specific cases involving confidential information may be dependent on written assurances of confidential treatment of the requested information for the purposes specified in the request.

The Agreement provides for expedited and simplified clearance for express shipments based upon pre-arrival information and electronic data processing. Release of express shipments is normally to occur within six hours of submission of the required documents, provided the shipment has arrived.

The Agreement requires each Party to maintain civil and administrative penalties and where appropriate, criminal penalties, for violations of its customs laws and regulations governing classification, valuation, origin, and preference eligibility.

The Agreement requires the customs authorities, upon the request of an importer or exporter, to provide written advance rulings on tariff classification, customs valuation, drawback, country of origin, and the qualification of a good for preferential treatment under the Agreement. The requirements for making such ruling requests are to be published. Once a request is received, the customs authorities are to act expeditiously and decide the matter within 150 days. A ruling will be valid for at least three years provided the facts and circumstances remain the same.

To ensure consistency, rulings are to be made publicly available subject to confidentiality requirements. Decisions of customs authorities will be subject to at least one level of independent administrative review plus judicial review.

### 8. Chapter 6—Sanitary and Phytosanitary Measures

The Parties affirm their existing rights and obligations under the WTO SPS Agreement and agree to establish a Committee on Sanitary and Phytosanitary Matters within 30 days after the date the Agreement enters into force. The Committee's objectives are to enhance the implementation of the SPS Agreement, protect human, animal, and plant life and health and enhance cooperation and facilitate trade. Except for the establishment of the Committee, there are no new obligations in this chapter.

### 9. Chapter 7—Technical Barriers to Trade

This chapter encourages the Parties to enhance cooperation in areas of technical regulations, standards, and conformity assessment procedures by promoting the use of international standards. Each Party is required to designate a Technical Regulations contact point to coordinate these efforts.

The Agreement requires a Party to explain why it will not accept the technical regulations or conformity assessments of the other Party as the equivalent of its own requirements where the law otherwise permits acceptance of foreign technical regulations or recognition of foreign standards.

To insure transparency, persons of the other Party are to be permitted to participate in the development of standards, technical regulations and conformity assessment procedures. Where the Parties follow Article 2.9 or 5.6 of the WTO TBT Agreement, persons are to be accorded at least 60 days to comment on such proposals. The comments are to be published electronically or otherwise made available at the same time as the final standards are adopted. These provisions must be implemented as soon as practicable, but not later than five years from the date of entry into force of the Agreement.

To enhance cooperation, the Parties agree to establish a Committee on Technical Barriers to Trade to monitor the implementation and administration of the chapter's provisions.

### 10. Chapter 8—Trade Remedies

This chapter sets forth the procedures for establishing safeguards (other than tariff rate quotas or quantitative restrictions) during the transition period if reduced or eliminated duties lead to increased imports of originating goods in such numbers in absolute number or relative to domestic production as to cause substantial cause of serious injury, or threat thereof, to a domestic industry. When safeguards are imposed, duty reductions may be suspended or duties may be increased to MFN rates.

The procedures require notification to the other party upon initiation of a safeguard investigation and at other stages in the matter. The chapter incorporates Articles 3 and 4.2(c) of the WTO Agreement on Safeguards. Safeguards may be maintained for a maximum period of three years including any extension, but are required to be liberalized at regular intervals. If safeguards are imposed, the party applying them is required to provide mutually agreed upon trade liberalizing compensation.

Each party retains rights under Article XIX of GATT 1994 and the WTO Agreement on Safeguards with regard to global safeguards.

Each Party retains its rights and obligations under the WTO Agreement with regard to the application of antidumping and countervailing duties.

### 11. Chapter 9—Government Procurement

In the area of government procurement, the parties recognize the importance of conducting government procurement in an open and transparent manner. The chapter's provisions generally apply to contractual procurements by the governmental entities listed in the annex. The Agreement requires

national treatment and non-discrimination with respect to goods, services and suppliers of the other Party in covered procurements.

The Parties are required to publish measures of general applicability that pertain to covered procurements. In addition, for each covered procurement, a Party must publish an advance notice that describes the details of the procurement and any conditions and evaluation factors that apply. The technical requirements are to be published electronically or by other means. Technical specifications may not be drawn in a manner that would create an unnecessary obstacle to trade between the Parties. Tenders are to be written and the procedures for selection are to be open. Upon request, unsuccessful parties are entitled to be told the reasons for non-selection.

To ensure integrity in the procurement process, Parties are required to adopt measures that make it a criminal offence for procurement officials to solicit or accept gifts and for persons to offer, promise or give anything in order to obtain or retain business. The Agreement has provisions that protect confidential business interests against improper disclosure. The Agreement establishes a Committee on Procurement to assist in the implementation of the Agreement. The annexes set forth covered entities and exclusions and the monetary thresholds that apply. The applicable thresholds are subject to an indexing formula to account for inflation.

### 12. Chapter 10—Investment

The Investment chapter is modeled on NAFTA, but also draws on bilateral investment treaties and customary international law. The Agreement provides a secure, predictable legal framework for investors. The term "investment" is broadly defined to include all forms of investment including: enterprises, securities, debt, intellectual property, concessions and contracts. There are six basic protections to investors:

- Each Party agrees to provide national treatment to investors of the other Party and treatment no less favorable than the most favorable treatment accorded to investors of any non-Party ("most favored nation treatment").
- If there is an expropriation of property, it must be for a public purpose, non-discriminatory, and must result in payment of prompt, adequate, and effective compensation equal to the fair market value.
- Neither Party may impose or enforce listed performance requirements, commitments or undertakings in connection with the establishment, acquisition, expansion, management, conduct, operation, or disposition of an investment.
- Senior management of an enterprise may not be required to be of any particular nationality. However, a Party may require a majority of the

board to be resident in a Party's territory or of particular nationality, provided it does not materially impair the investor's ability to exercise control over its investment.

- Each Party agrees to permit transfers freely and without delay into and out of territory and into freely usable currency at the prevailing market rate. However, a Party may restrict transfers for
  - bankruptcy, insolvency or creditors;
  - issuing, trading or dealing in securities;
  - criminal or penal offences;
  - financial reporting and recordkeeping;
- ensuring compliance with orders or judgments in judicial or administrative proceedings.
- So-called "minimum standard of treatment" in conformity with customary international law.

The "negative list" approach is utilised for investments. That is, all forms of investment are protected unless specifically exempted.

A Party may deny benefits to an enterprise investor of the other party if the enterprise is controlled by persons of a non-Party with which the denying Party does not maintain diplomatic relations, or against which it maintains sanctions that would be violated or circumvented if benefits were accorded. A Party may also deny benefits if the enterprise has no substantial business activities in the territory of the Party and it is controlled by persons of a non-Party or the denying Party.

Certain "non-conforming measures" which apply at the national level are set forth in schedules. Local non-conforming measures are generally grandfathered without having to be identified. However non-conforming measures may not in the future be made more inconsistent with the Agreement, and if they are liberalized in the future the liberalization may not be reversed.

The U.S. has exempted legislation relating to nuclear power, broadcasting, mining, customs brokers and air transportation. Chile is permitted to impose capital transfer restrictions for 12 months for certain types of speculative capital. The Agreement permits the Parties to adopt measures to ensure that investments are consistent with environmental protection goals.

In the event of an investment dispute, resolution will initially be sought through consultation and negotiation. If that is unsuccessful, the Agreement establishes a dispute settlement mechanism based on various arbitration agreements. Arbitration requests may be filed by a claimant on its own behalf under the ICSID[10] Convention if the Parties are Parties to the ICSID Convention; under the ICSID Additional Facility Rules if one is Parties is a

[10] International Centre for Settlement of Investment Disputes.

Party to the ICSID but the other is not; under UNCITRAL[11] arbitration rules, the Inter-American Convention[12] or any arbitration institution if both the claimant and respondent agree. The Agreement sets forth conditions and time limitations on seeking arbitration and procedures governing the selection of arbitrators, the conduct of the arbitration and the transparency in arbitration proceedings.

The Agreement is accompanied by various annexes which concern customary international law, special dispute settlement provisions under Chilean law, expropriation, and an appellate mechanism, all of which are an integral part of the Agreement.

### 13. Chapter 11—Cross Border Trade In Services

The chapter on cross-border services provides substantial market access on the basis of national treatment and MFN; however, it does not apply to financial services, air services, government procurement, or to state supported subsidies or grants, with some exceptions. If a covered service has qualification requirements, the technical standards and licensing are to be objective and transparent.

Unless permitted in the annex, neither Party may maintain or adopt quotas, monopolies, exclusive service suppliers, an economic needs test or employee limits for covered services. Furthermore, neither Party may require residency or representative offices for a cross-border service, unless set forth in the annex.

The chapter permits the denial of benefits where an enterprise is owned or controlled by a non-party that does not have a substantial business in the territory of the other party, or where the enterprise is owned or controlled by a non-party and the Party does not maintain diplomatic relations with the non-party or maintains sanctions against the non-party.

The chapter contains transparency requirements in the development and application of regulations that are in addition to the requirements in the Chapter on Transparency. For example, to the extent possible, Parties are to address comments received in response to draft regulatory proposals and provide a reasonable time before the regulations take effect. The Agreement also encourages the development of mutually acceptable professional standards.

### 14. Chapter 12—Financial Services

This chapter opens up the financial services markets in the territories of both Parties. The chapter requires a Party to provide national treatment and market access for investments in the establishment, acquisition, expansion,

[11] United Nations Commission on International Trade Law.
[12] Inter-American Convention on International Commercial Arbitration.

management, conduct, operation, or disposition of financial institutions and investments in financial institutions in its territory. Cross border insurance commitments are as extensive as possible while recognizing regulatory sensitivities for particular means or supply.

Except for non-conforming measures set forth in the annexes, a Party may not require financial institutions of the other Party to engage individuals of any particular nationality as senior management or other essential personnel. Neither Party may require that more than a minority of the Board of Directors of a financial institution of the other Party be nationals or residents of that Party.

Parties are permitted to take action for prudential reasons to protect investors, depositions, policy holders, and others to whom a fiduciary duty is owed.

The Parties agree to transparency in regulations and policies governing the activities of financial institutions and cross-border financial services, and agree to specific procedures regarding rulemaking, applications, administrative decisions, and inquiry mechanisms. Access to payment and clearing systems is to be provided, as is expedited offering of insurance services.

A "Financial Services Committee" is to be established which will supervise the implementation of this chapter, and participate in the dispute settlement mechanism established for financial services. Financial services disputes are to be heard before panelists who have experience or expertise in financial services law or practice. They are to be impartial and objective. When a dispute affects only the financial services sector, a Party may only suspend financial services benefits; and when a dispute affects only a sector other than the financial services sector, a Party may not suspend financial services benefits.

### 15. Chapter 13—Telecommunications

This chapter combines elements of NAFTA Chapter 13, GATS Telecommunications Annex and the WTO reference paper.

Each Party agrees to ensure that enterprises of the other Party have access to, and use of any public telecommunications network. This access is to be provided, "unbundled." That is, an enterprise is only required to pay for the services it requires. The Parties are required to ensure that enterprises that are given such access protect the confidentiality of proprietary information relating to suppliers and end users of public telecommunications services. The Parties are to ensure that major suppliers provide co-location wherever possible for necessary interconnection or access. Measures must be adopted to prevent anti-competitive practices.

The Parties are to ensure that any regulatory body is separate and independent of any supplier of telecommunications services and that its

decisions are impartial with respect to all interested parties. Parties are required to divest ownership interests in public telecommunications suppliers.

The Agreement sets forth transparency requirements for licensing and rulemaking, and procedures for resolving disputes that are then subject to judicial review.

Suppliers of telecommunications are to have the flexibility to choose the technologies they use, including mobile services, as long as their services are capable of interconnection so that end-users of different technologies may communicate with each other.

### 16. Chapter 14—Temporary Entry of Business Persons

With limited exceptions, each Party agrees to grant the temporary entry of business persons listed in Annex 14.3, although visas or other documents may be required. Measures governing temporary entry are to be applied expeditiously using transparent criteria to avoid impairing or delaying trade in goods or services.

The general transparency requirements for the adoption of regulations and the establishment of points of contact which are contained in other chapters apply to this chapter as well. Parties are required to make timely decisions on applications for temporary entry and inform applicants of the status of the application. Prior to entry into force of the FTA, the Parties agree to provide each other information on procedures relating to processing applications so the other Party may become acquainted with those requirements.

The Parties agree within six months after entry to publish explanatory materials for business persons in a consolidated document. The Parties will also establish a "Committee on Temporary Entry" to meet, exchange information, develop facilitation measures, monitor implementation of the chapter, and provide data to the other Party upon request. In the case of temporary entry of business persons, dispute settlements under Chapter 20 are limited to matters involving a pattern or practice and the business person has exhausted all available administrative remedies or more than one year has passed without a final determination in an administrative proceeding, and the delay is not attributable to the business person.

Pursuant to Annex 13.3, each Party is to grant temporary entry to the business persons without work authorization if they are otherwise qualified. Temporary entry is to be granted to the following categories of business persons:

- Business visitors
- Traders and Investors;
- Intra-company transfers of persons who are managerial, executive, or who have specialised knowledge. A Party may require one year employment within the past three years in these categories; and,

- Professionals (and training for professionals) who possess the requisite credentials for their profession. The U.S. has agreed to allow 1,400 initial applications in this category.

### 17. Chapter 15—Electronic Commerce ("e-commerce")

The Parties recognise the importance of "e-commerce" and the importance of avoiding barriers to its use and development. The Agreement prohibits a Party from applying customs duties, fees or charges on the importation or exportation of digital products by electronic transmission. When a customs value is required for carrier media bearing digital products, it shall be determined based on the media without regard to the cost or value of digital products stored on the media.

This chapter is subject to any other relevant provisions that apply throughout the Agreement, such as transparency and dispute settlement. The Parties agree to provide non-discriminatory treatment. The Parties agree to share information and experiences on their laws, regulations and programs affecting

e-commerce, including data privacy, consumer confidence, cyber security, electronic signatures, intellectual property rights and e-government programs. The Agreement states that Parties believe that the private sector should lead development; that the Parties should avoid imposing unnecessary regulations; that government action, when needed, should be transparent; that self regulation through codes of conduct should be encouraged; and cooperation among all countries will assist in the construction of a seamless environment for e-commerce.

### 18. Chapter 16—Competition Policy, Designated Monopolies, and State Enterprises

Each Party agrees to adopt or maintain measures to proscribe anticompetitive business conduct. The Parties are required to maintain an authority that will be responsible for enforcing their national competition laws on a non-discriminatory basis, subject to independent review. Although designated monopolies and government enterprises are permitted, they must use commercial considerations in the purchase and sale of goods or services and act in a manner consistent with the chapter's objectives, except for government procurement. The Parties agree to cooperate on competition law and policy development. In order to ensure transparency, Parties are required to make available, upon request of the other Party, public information concerning enforcement measures, information concerning government enterprises and designated monopolies, and exemptions from anticompetitive measures.

## 19. Chapter 17—Intellectual Property Rights

The Agreement provides a high level of protection to intellectual property rights ("IPR") and builds on existing TRIPS commitments, while enhancing enforcement.

Each party is required to ratify or accede to the following international agreements by the dates shown:

- Patent Cooperation Treaty (1984) by 1 January 2007
- Convention on Protection of new varieties of plants (1991) by 1 January 2009
- Trademark Law Treaty (1994) by 1 January 2009
- Brussels Convention on Satellites (1974) by 1 January 2009

Each Party is to undertake "reasonable efforts" to ratify or accede to the following agreements

- Patent Law Treaty (2000)
- Hague Agreement Concerning the International Deposit of Industrial Designs (1999)
- Protocol relating to Madrid Agreement on International Registration of Marks (1989)

To provide transparency, each party is required to ensure that all laws, regulations and procedures concerning protection or enforcement of intellectual property rights, and all final judicial decisions and administrative rulings of general application are published or made publicly available (via the Internet, for example) to enable rights holders and the other Party to become acquainted with them.

### *Trademarks*

Trademark protection is very broad and also covers collective marks, certification marks, geographical indications and scent marks. Well-known marks are generally protected even if a mark is used for goods and services other than those registered for the mark.

The Agreement requires government involvement in resolving disputes between trademark owners and domain names on the Internet, an important provision to prevent "cyber-squatting" of trademarked domain names, according to USTR. Trademark registration is to be streamlined by allowing applicants to use electronic processing to the maximum degree practicable.

The Agreement requires the Parties to provide the legal means to identify and protect geographical indications of persons of the other Party, particularly wines and spirits. Applications or petitions for geographical indications must be published for purposes of allowing opposition.

### *Copyrights*

The Agreement recognizes copyright problems in the digital era, and gives control over all reproduction, including permanent or temporary on-line uses of materials to the authors or other copyright owners. However, the right to authorize or prohibit the public broadcasting through analog communication and free over-the-air broadcasting is left to domestic law. The Agreement also protects against devices which allow the unauthorized decoding of encrypted program-carrying satellite signals.

Copyright owners will be protected for extended terms under the Agreement. Protection will be provided for a term not less than the life of author plus 70 years; if not based on the life a person, 70 years from the end of the calendar year in which the work was first published; or if not published within 50 years from creation, not less than 70 years from the end of the calendar year of creation.

In order to ensure that all national government agencies use only legally authorized software, the Parties agree to issue appropriate laws, orders, regulations or executive decrees to regulate the acquisition and management of software for government use.

The Parties agree to increase the protection of copyrighted works using advanced technologies to prevent infringement by establishing civil and criminal offenses. The increased protection will cover circumvention of technological measures that control access as well as manufacturing, importing, distribution, offering devices to the public or trafficking in the devices, products, components or services which are promoted, advertised or marketed to circumvent effective technology measures, or have only limited commercially significant purpose or use other than circumvention. The Agreement permits limited exceptions for certain scientific purposes, non-profit organisations and public libraries or archives. Expanded protection is also provided for encrypted program-carrying satellite signals.

### *Patents*

Under the terms of the Agreement, patent protections are expanded and patents are to be available for all fields of technology. New legislation, protecting plants is to be developed with public participation within 4 years of the date of entry into force of the Agreement. At the request of an applicant, terms of patent protection are to be extended to compensate for unreasonable delays (over five years from filing or three years from examination) in processing patent applications.

In the case of certain regulated products (pharmaceuticals and agricultural chemicals), the Parties agree to keep confidential any information which is needed for ensuring the safety and efficiency of the product prior to marketing for five years (pharmaceuticals) or 10 years (agricultural chemicals).

The Agreement requires the Parties to establish civil and administrative remedies including seizure of devices and products, damages (on suggested retail price of legitimate good or service), recovery of court and attorney fees, and the destruction of devices involved in an IPR violation. In addition, the remedies may include compensation for injury and profits, and ordering the identification of third parties involved in the violation.

The Agreement expands border protection of IPR. For example, each Party is required to permit competent authorities to act *ex officio* without the need for a complaint. Where authorities determine that imported goods are counterfeit or piratical, they will be authorised to inform the rights holder of the names and addresses of the consigner, importer and consignee of the goods as well as the quantity detained. Goods that are counterfeit or piratical are to be destroyed. The Agreement provides that Parties will cooperate with each other in preventing violations.

Parties are required to establish criminal penalties and procedures for willful counterfeiting or piracy on a commercial scale which include imprisonment as well as a high monetary fine in addition to providing for the seizure, forfeiture and destruction of offending goods, related materials, implements, assets traceable to the violation and any related documents.

The Agreement provides legal incentives and protections to internet service providers who cooperate with copyright holders.

Certain provisions requiring legislation or additional financial resources have delayed effective dates.

### 20. Chapter 18—Labour

Both Parties reaffirm their obligations as members of the International Labour Organisation and their commitments under the *ILO Declaration on Fundamental Principles and Rights at Work* and agree to strive ensure that internationally recognised labor rights are recognised and protected by domestic law. The Agreement makes it clear that it is inappropriate to weaken or reduce the enforcement of domestic labor laws in order to encourage trade or investment.

The Parties are required to ensure access to administrative, quasi-judicial, judicial or labor tribunals and to ensure that procedures are transparent, fair and equitable. The Parties are required to promote public awareness of their labor laws. The Agreement also establishes a formal Labour Affairs Council comprised of cabinet-level representatives or their designees, and a Labour Cooperation Mechanism.

### 21. Chapter 19—Environment

Each Party agrees that its laws will provide high level of environmental protection that will not be waived to encourage trade or investment. A cabinet-

level Environmental Affairs Council is established to discuss implementation and progress of this chapter. The Agreement permits interested parties to request investigations and seek remedies and injunctions. The Agreement requires transparency in procedural matters and requires appropriate sanctions for violations. In addition, each Party is required to establish a mechanism for public participation and for sharing best practices. The Agreement also recognises the importance of multilateral environmental agreements and paragraph 31(i) of the *Doha Ministerial Declaration* and agree to consult on the extent to which the outcome of the WTO talks will impact the Agreement. A separate Annex identifies specific areas of environmental cooperation and commits the Parties to pursue a bilateral Environmental Cooperation Agreement.

### 22. Chapter 20—Transparency

This chapter is intended to ensure transparency in carrying out any of the Agreements provisions, although some chapters have additional requirements. The Parties agree to designate contact points to facilitate communications between the Parties on any matter in the Agreement. The Parties agree to promptly publish laws, regulations, procedures and administrative rulings of general application, or otherwise make them available. To the extent possible, the Parties will publish proposed regulations in advance with an opportunity for public comment and they agree to notify the other party of any measure being considered which may materially affect operation of the FTA or the other Party's interests.

Each Party will ensure that its administrative proceedings are administered in a consistent, impartial and reasonable manner; that parties who are directly affected are given reasonable notice and afforded a reasonable opportunity to present facts and circumstances. The Parties are required to establish or maintain review and appeal procedures that are impartial and independent and in which parties to the proceeding will have the right to support or defend positions. Decisions will be based on evidence and submissions of record or a record compiled by an administrative authority.

### 23. Chapter 21—Administration

The Agreement establishes a Joint Free Trade Commission comprised of cabinet-level personnel or their designees to supervise implementation of the Agreement. The specific responsibilities of the Commission are rather broad and are set forth in this chapter.

### 24. Chapter 22—Dispute Settlement

This chapter sets forth the general dispute settlement procedures for those chapters not having specific mechanisms. If the dispute is the subject of a

WTO agreement or another FTA, the Parties may choose which forum will apply. If consultations fail to resolve a dispute within 60 days (15 days for perishable goods), the Parties may request a meeting of the Free Trade Commission established under chapter 21. If the Free Trade Commission fails to resolve the issue, either Party may request an arbitration panel. Under FTA procedures, arbitration panels consist of three panel members, one of whom is the chairman. Each member and the chairman are selected from a roster of 20 individuals, 6 of whom are non-Party nationals. The Agreement contains model rules of procedure which provide for:

- at least one hearing;
- initial and rebuttal submissions;
- written versions of oral statements and written responses;
- consideration of input from non-governmental entities; and,
- procedures to protect confidential information.

Initial reports are due within 120 days, followed by a final report to be issued within 30 days. A public report is to be released within 15 days.

If the Parties are unable to agree upon implementation of the final report within 45 days, the Parties are required to begin negotiations on compensation. If no compensation agreement is reached within 30 days, or there is a failure to observe the terms of the negotiated agreement, the aggrieved Party may give notice that it will suspend the application of benefits of equivalent effect. Compensation is to be paid as a monetary assessment or into a fund to pay for trade facilitation initiatives. The Parties may not establish a private right of action against the other Party under its domestic law.

### 25. Chapter 23—Exceptions

This chapter contains exceptions to the Agreement, including those needed for reasons of essential security or to fulfill it obligations relating to maintenance or restoration of international peace and security. The chapter also provides, with certain exceptions, that any tax convention to which the parties are signatories supersedes the FTA if there are conflicts.

Article XX of GATT 1994 and its interpretive notes are incorporated *mutatis mutandis* into the FTA for purposes of chapters 3-7. Article XIV of GATS and its footnotes are incorporated *mutatis mutandis* into the FTA for purposes of chapters 11, 13 and 15. It is understood that Article XX(b) of GATT and Article XIV(b) of GATS include environmental measures necessary to protect human, animal or plant life or health. Article XX (g) of GATT applies to measures relating to the conservation of living and non-living exhaustible natural resources.

The Parties will not be required to furnish information the disclosure of which would be contrary to their essential security interests, or which would

impede law enforcement or would be contrary to the privacy protection of individual financial accounts.

Any measures imposed for balance of payments purposes must result in consultations and must follow GATT obligations.

### 26. Chapter 24—Final Provisions

This chapter provides that the annexes, appendices and footnotes are an integral part of the Agreement, which may be modified by mutual agreement of the parties after completion of applicable legal procedures. If a WTO provision that is incorporated by reference in the Agreement is amended, the Parties agree to consult on whether to amend the Agreement. Unless otherwise agreed by the Parties, the Agreement will enter into force 60 days after the exchange of written notification that domestic procedures have been completed. Termination requires 180 days notice. The English and Spanish texts are equally authentic.

# 8. Reform of the EU's Agricultural Policy

*Chris Milner*

## 1. Context

European farm ministers announced on 26 June what they claim represents a fundamental reform of the EU's Common Agricultural Policy (CAP). Certainly the principles underpinning the reforms are a radical change with the past. Franz Fischler, the EU's agricultural commissioner described the reforms as the 'beginning of a new era', and the EU press release starts with the sentence 'EU fundamentally reforms its farm policy to accomplish sustainable farming in Europe'. In headline terms – the breaking of the link between farm subsidies and production levels and the lowering of support prices for some major products – the reforms appear to confront the major internal and external challenges to the existing CAP arrangements.

The CAP currently costs around •43 billion a year (about 40% of the total EU budget). Some member states have long objected to the cost of the arrangements, and to the inefficiencies associated with paying farmers to produce unwanted food. The prospect of a major enlargement of the EU, including of entrants with major agricultural sectors, has intensified budgetary concerns. Although the CAP benefits are not currently on offer to the new entrants, pressures for uniformity of treatment within a common policy will no doubt persist post-accession. With the current CAP arrangements, extension to the new members would definitely be unsustainable in budgetary terms. The current reforms seek to introduce new financial disciplines, but the budgetary time bomb of enlargement has not necessarily been diffused.

The external criticisms of the CAP come from other industrial countries and from the developing countries, who are excluded from the large EU market by trade barriers or hurt by world prices depressed by subsidised EU exports or undercut in their own or others' markets by subsidised EU farmers. Agricultural trade liberalisation was in fact on the agenda for the first time during the last multilateral trade negotiations (the Uruguay Round). Many of the developing countries have been dissatisfied both with the limited reforms agreed to and with the amount of reform actually implemented following that round of negotiations. They have been even more determined as a result to use the current Doha Round of trade negotiations to bring about fundamental reform and improved market access. The negotiations have, however, already been delayed by EU resistance, and it is suggested that the survival of the Round is at risk if no progress is made this autumn at the Cancun meeting of

trade ministers. The current reforms are presented by the EU as strengthening the EU's negotiating hand in these World Trade Organisation (WTO) trade talks. Again the headline reforms – 'de-coupling' and reduced price supports – appear to make the prospect of concessions by the developing countries and other industrial countries (especially the USA) more likely. It will be the detailed, actual implications of the reforms for world prices and EU market access, however, that fashion the attitudes and positions of the other 'actors' and the progress of the trade talks.

## 2. The Announced Reforms in Summary

- *De-coupling from production*

Farmers will receive a single farm payment from 2005, based on the average level of subsidies in the last 3 years (2000-2). This payment will in general no longer be linked to the amount of production or be related to individual product premiums.

The new system will apply principally to arable production, but will also cover the beef and sheep sectors and be extended later (from 2008) to dairy production.

Note two important deviations from the above reforms. First, member states may delay the move to single farm payments until 2007. Second, member states may maintain some production-based subsidies if they deem it necessary to reduce the risk of land abandonment. For arable crops per hectare payments of up to 25% of the existing levels can be made. Similarly production-related payments (of varying percentages of current levels and including upto 100%) can be used by member states in the livestock sector.

- *New coupling to the environment and standards*

Full granting of the single farm payments and other direct payments will now be linked to satisfying of a number of environmental, food safety, animal and plant health, and animal welfare standards.

- *New incentives for rural development*

Incentive payments will be available to farmers who participate in schemes to improve environmental and product quality and to meet new production standards. Support will also be available to producer groups for product quality enhancement schemes.

- *Reduction in direct payments for larger farmers*

In order to fund the above rural development measures, direct payments to larger farmers (with direct payments over •5000 per year) will reduce

(with the exception of the outermost regions). These reductions or 'modulations' of direct payments will rise from 3% in 2005 to 5% from 2007.

- *Strengthening overall financial discipline*

The fixing of a ceiling for CAP expenditure (at approximately current levels) means that a financial discipline mechanism will have to be introduced from 2007.

- *Revisions to specific price and market policies*

The reforms maintain some and amend some specific price support measures in the arable and dairy sectors; the details are set out in table 1 below. There is also a commitment to future reforms of the olive oil, tobacco and cotton sectors.

## 3. Assessment of the Reforms

The CAP was the product of a deal between France and Germany in 1962, which gave generous EU support for in particular French agriculture and access to the large German market in return for Germany's access to the French market for its manufactured goods. With the objective of stimulating production and eliminating food shortages (and providing stable market conditions and higher incomes for an important domestic constituency), the CAP used a mixture of guaranteed prices through intervention buying and customs duties to restrict imports from outside the EU to achieve this. This indirect method of income support for farmers imposed costs on both consumers in the form of higher food prices and on tax payers in terms of national contributions to the EU budget (to fund the implicit subsidies on products purchased at EU intervention prices and sold at the lower world price). This market organisation, combined with generous grants to farmers and technological progress, soon encouraged excess production in Europe and resulting in downward distortions to world prices. Attempts have been made from the late 1970s to reform the CAP, by using quantity limits on guaranteed prices to limit overproduction, CAP spending increases and co-incidentally the distortions to world prices. These attempts were increasingly recognised to be insufficient to control CAP spending and limit the market distortions, and external pressures for eliminating explicitly or implicitly subsidised EU exports and improving access for imports to the EU have intensified. Further changes during the 1990's cut guaranteed prices, restricted production through the setting aside of land and began to shift support towards farmers rather than farm products. The current reforms, the tone and direction of which had been signalled in the mid term review of the CAP published in 2002, continue this shift toward direct income support for farmers and seek to

## Table 1: Summary of Specific Pricing and Marketing Reforms in the Arable and Dairy Sectors

| *Sector* | *Revisions* |
|---|---|
| **ARABLE** | |
| - **Cereals** | • Current intervention price maintained<br>• Seasonal correction to interventions price reduced by 50%<br>• Rye to be excluded from intervention system, but with transitional support given |
| - **Protein crops** | • Current supplement maintained and converted into crop specific area payment (subject to an overall limit) |
| - **Energy crops** | • Aid proposed, subject to an area maximum |
| - **Durum wheat** | • Supplement in traditional production zones de-linked from production, except member state may keep 40% of supplement tied to production<br>• Specific aid for other regions will be phased out<br>• New premium introduced in traditional zones to improve quality used for semolina and pasta production |
| - **Starch potatoes** | • 40% current payment to producers will be included in single farm payment, remainder continued as a crop specific payment |
| - **Dried fodder** | • Direct support to growers will be integrated into single farm payments; national quantity ceiling will apply<br>• Processing aid fixed from 2004/5 |
| - **Rice** | • One step reduction in intervention price by 50%<br>• Intervention limits set<br>• Direct aid will be increased; partly through single farm payment and partly through crop-specific aid |
| - **Nuts** | • Introduction of annual flat rate payment, for fixed national areas<br>• Aid can be supplemented by member states up to a maximum amount per hectare |
| **DAIRY**<br>(Quota system prolonged until 2014/15, with following revisions:) | |
| - **Milk sector** | • Intervention price for butter will be reduced by 25% (progressively from 2004 to 2007)<br>• Intervention purchases for butter will be suspended above falling limits.<br>• Intervention price for skimmed milk powder cut by 15% (progressively from 2004 to 2006) |

reduce the costs of the CAP bureaucracy and the administrative complexities faced by farmers.

*Assessment in principle*

De-coupling of farm income support from production and the greater freedom for farmers to choose the product mix in the light of less regulated market conditions is clearly a fundamental change in the principles underpinning the EU's agricultural policy. A policy of de-coupling is desirable on both efficiency and equity grounds. With the breaking of the link between the subsidy and the amount produced of a particular commodity, the farmer's decision about what and how much to produce is, as it should be, based on the costs of production and market price of the output. The change should improve allocative efficiency in EU farming (improving the amount and distribution of land allocated to alternative commodities or activities) and the productive efficiency of EU farmers (improving the usage of land, capital and labour and product quality), with farmers responding to market pressures and incentives rather than seeking to maximise subsidy receipts determined by administrative rules. Of course the size and composition of the EU farm sector should change. This is partly because the market signals about product mix and production levels will be different to administratively-set incentives, and partly because there will be greater uncertainty about market conditions than was the case under the current administrative rules. This will impose adjustment costs on the sector, towards which tax payers can be expected to have to make compensation contributions. The speed and extent of the adjustment will depend on how, for instance, planning restrictions affect land-use changes and on how well the new single farm payments system provides incentives to maintain environmental quality and the visual amenity of the rural landscape. Clearly reduced production of specific crops and the 'de-commissioning' of land could encourage farmers to allow some environmental degradation. The current reform proposals do require, however, that the single farm payments will be conditional upon compliance with statutory environmental and other standards.

De-coupling, in isolation from any other changes in the CAP, can be expected to lower EU production and exporting (especially of cereals) and to stimulate EU and world prices. DEFRA's estimates of the impact of de-coupling proposals included in the 2002 mid-term review of the CAP indicate 5-10% falls in cereal, beef and sheep production, and rises in world prices of cereals of up to 5%. In the case of cereals, in particular, reduced EU exports and higher world prices would provide definite benefits for non-EU, including developing country, exporters. Given that EU import duties on cereals are generally viewed to be a binding constraint on imports, de-coupling will do nothing to improve access to the EU market for non-EU cereal exporters.

(Note that the current CAP reforms leave all the EU's tariff and other import barriers wholley unaltered.)

*Assessment in practice*

Whether the potential benefits of de-coupling identified above will actually be delivered depends critically upon:

i) how much de-coupling is actually achieved
ii) how much reduction in EU market price support is actually introduced by the changes to the commodity regimes.

Both of these issues need to be critically considered.

De-coupling is required to start in 2005 (or by 2007 at the latest), but only initially for arable production. The beef and sheep sectors will be later, the arrangements for dairy, olive oil, tobacco and cotton are still to be set, and the special sugar regime does not appear to be covered by the reform proposals. More critical, however, ultimately than as yet incomplete sector coverage is the fact the reforms do not require full de-coupling. As reported earlier, the reforms allow member states to retain some production-based subsidies to avoid land abandonment. Given the reluctance of some member states (eg France and Ireland) to agree to the reforms, there is a high probability that these coupled subsidies will be retained by these countries to placate their large farming lobbies, and by other member states who would not wish to be less supportive to their farmers than other members. Even with lower per unit subsidies than previously, an incentive to produce upto similar quantity limits (for intervention support) as currently apply may exist. In which case the reduction of EU export and world price distortions may be substantially more muted than the 'in principle' assessment above suggests. A similar scenario is possible even if member states do not take up the option of partial de-coupling. The proposals for the single farm payments require that the payments are conditional on compliance with various environmental, food safety, animal health and welfare standards. If the conditions are specified in terms, for example, of the maintenance of land use and specified land areas for specific purposes, then there is a risk that the payment is effectively re-linked to production.

A more optimistic scenario emerges if the take-up of partial coupling to production by member states were to be limited and if the conditionality for the single farm payments does avoid re-linking to the production. But even in this setting the distortions to EU production, exports and world prices would be sensitive to the detail of the changes in the EU marketing and price regimes for specific commodities, and to how much reduction in market price support emerges. For a range of products the reforms are yet to be set, and the outcome must remain uncertain. Even for those products for which the market

organisation reforms have been announced, the picture is mixed and the net effects unclear. The devil is in the detail! For rice a substantial reduction in the intervention price is planned, and this may well bring the EU intervention price down to at least world prices. By contrast the proposals leave the intervention price for cereals unaltered. At the current exchange rate for the euro, this intervention price is above current world prices and has resulted in the reintroduction of export refunds since December 2002.

There are overall budgetary constraints on the ability of the EU to maintain both direct payments to farmers and (at least for long periods of time and across a large product range) large market price supports which diverge markedly from export (world) prices. Although the reforms are intended to bring EU intervention prices down over time, the outcome will be fashioned by how the member states (especially the reluctant reformers such as France) react to the new environment. This uncertainty is compounded by the uncertainty surrounding how the new member states will be treated by CAP post-enlargement and how their entry will affect EU market conditions. Note, further, that the EU farm budget has not been cut (only capped in principle), and that national policy makers faced with lobbying and electoral pressures may be less financially disciplined than is planned or look for new instruments of agricultural protection (eg the further extension and importance of sanitary and Phyto-sanitary (SPS) measures in regulating imports). Further it is widely argued that the 'dirty tariffication' of non-tariff measures (eg variable import levies, minimum import prices etc) as part of the Uruguay Round agriculture agreement meant that the EU's bound tariffs were set higher than the tariff-equivalents of the non-tariff measures and higher than the applied tariffs. This gives the EU the opportunity to vary applied tariffs within these high bound ceilings.

## 4. Implications for the Developing Countries

The CAP reforms only have direct implications for the developing countries to the extent that changes in EU agricultural production and exporting bring about changes in the world prices of the agricultural and food exports of the developing countries. In themselves the reforms do nothing to alter the terms of access to the EU market; tariffs and other non-tariff barriers (NTBs) on agricultural imports are unaltered. The reform may of course have indirect effects. Efficiency and other dynamic benefits of reform might increase incomes and growth in the EU and elsewhere, and have positive affects on the EU's demand for developing country exports (agricultural and non-agricultural). Similarly the reforms might have implications for the longterm prospects for agricultural market access in both the EU and other industrial country markets by influencing the outcome of the Doha Round trade negotiations. We consider

this last issue in the section below, and focus here on the static and dynamic implications of CAP reform for the developing countries.

EU reform-induced rises in world prices of agricultural and food products would help some developing countries and groups in developing countries and harm other developing countries and groups in developing countries. Consider the simple analytical framework below:

**Effect of Rise in World Agricultural Prices:**

| | ***Net food-importing developing country*** | ***Net food-exporting developing country*** |
|---|---|---|
| **Food producers** | + | + |
| **Consumers** | - | (-) * |
| **Net effect** | - | + |

(* foreign as well as home consumers)

General rises is world agricultural prices would benefit food-exporting developing countries and food producers in all developing countries, but harm food-importing developing countries and food consumers in developing countries. If there were across-the-board rises in world prices resulting from CAP reform, it would be relatively easy to list the gaining and losing developing countries on the basis of whether they were net food-exporters or -importers. In practice, of course, it is rather more difficult to predict who will gain and lose, and over what time scale. The reforms to beef, sheep and dairy products will come later than those in the arable sector. Even if we concentrate on arable products, which developing countries are net gainers and which net losers will depend on the weights of specific crops in each countries' imports and exports and on the world price effects in those specific crops. Given that many developing countries (especially in the Commonwealth) are often fairly specialised in their export production (and certainly more specialised therefore in food exports than food imports), it is possible to be a net food exporter and still lose in net terms from the reforms if the price increase effects to imports dominate those to exports.

Some of these harmful effects may be offset in the longer term by positive income effects in the EU and other countries. This could increase the demand for the exports of developing countries in general. But this is a less certain

effect, and would require the reforms to have substantial effects on EU production and incomes and on world prices.

## 5. Implications for the Doha Round

Without prejudging the outcome, WTO members committed themselves in the Doha Declaration to comprehensive negotiations aimed at fundamental reforms which:

- improve market access through substantial reduction in tariffs
- substantially reduce domestic supports that support trade
- reduce, with a view to phasing out, all forms of export subsidies.

At the start of the negotiations the EU would have been viewed as a major target of the developing country proponents of agricultural liberalisation; the EU accounting for 80% of export subsidies by value, having bound tariffs of 178% for dairy products, 76% for meat products and 82% for wheat, and having large production-related domestic support expenditures. After the announcement of these reforms the EU is likely to be much less defensive in the forthcoming WTO trade negotiations in Cancun (later this year). Given an apparently more protected US agriculture sector post- the US Farm Bill, the EU will no doubt want to seek to put the spot light on the US and other OECD countries, and will seek offers on agriculture from these countries and the large developing country importers. In headlines terms definitely, and probably with some substance, the EU can assert that the CAP reforms will give substantial unilateral reduction of domestic supports that distort trade and will result in a corresponding substantial reduction in subsidised exports. As argued earlier in this article, this interpretation may be challenged by other countries. They may feel (or adopt a negotiating position) that the de-coupling of farm payments will be less in practice than is claimed by the EU. They may in turn be reluctant to accept that the new farm payments should be placed in the 'green box' (ie where they would be deemed non-, or minimally, trade-distorting) or in the 'blue box' (production-limiting programmes) and resistant to the idea therefore that they should be excluded from the Aggregate Measure of Support calculations for the EU. Of course concentration on such contentious issues, rather than market access issues, may well be in the negotiating interest of the EU. The reluctant farm reformers in Europe in particular (eg France and Ireland) may well be anxious to avoid substantial improved market access on top of the announced CAP reforms. Resistance to further liberalisation may be stiffened by the fact that there is the prospect of other adjustment pressures in the European agricultural sector resulting from EU enlargement.

It is not clear therefore whether the announcement of the EU's farm reforms gives an impetus to the WTO negotiations, on agriculture in particular or to the talks in general given the single undertaking approach adopted, or

whether it will make it more difficult to negotiate reciprocated concessions. The empirical evidence suggests that the greatest welfare gains to the developing countries would come from liberalisation of the agriculture and food sectors, both in developed and their own markets. But there is not necessarily commonality of interest in the negotiations. Developing country agricultural exporters are keen to gain improved market access and have world prices stimulated by reduced domestic supports and exports subsidisation by the OECD countries. By contrast, the developing country importers are likely to be less enthusiastic about world price rises and about reducing their own bound agricultural tariffs (even if this would be a source of significant own welfare gain). Similarly some developing countries would see their preferences eroded in specific markets if there were multilateral tariff reductions in the agriculture sector. If the above argument that the EU may be reluctant to make concessions on market access applies, then it will be particularly important that there are significant offers from developing countries on their own liberalisation. The support of the developing country importers for such a common negotiating strategy is likely however to be dependent on appropriate safeguards being part also of the negotiating position. The continuation of special and differential treatment (allowing smaller and slower tariff reductions) and improvement relative to the Uruguay Round agreement on practical measures to compensate negative effects of reform on least developed and net food importing countries may well be required to maintain the cohesion of the developing countries as the Doha Round negotiations progress.

**Summary Conclusions**

- Reforms, represented by the EU as 'fundamental', have been announced by the EU. By 'de-coupling' farm subsidies from production levels and by lowering support prices, the reforms in principle at least go a considerable way to responding to the internal and external pressures for liberalising the farming sector and reducing the costs on consumers and tax payers. The reforms might be viewed therefore as providing a significant boost to the prospects for successful negotiation of multilateral liberalisation of agriculture as part of the ongoing Doha Round.
- This article warns against premature adoption of this optimistic interpretation of the nature and implications of the CAP reforms. The CAP budget has not been reduced and there may in practice be less 'de-coupling' of domestic supports from production than is apparently the case. EU member states will be allowed to continue to use some production-related support, while the single farm payments which will be linked to environmental and other standards requirements may

re-introduce implicit links to production depending on how the requirements are set. Further it should be recognised that the existing administrative marketing arrangements for agricultural products will remain. The detail in practice of how intervention prices are set relative to world prices will continue to determine EU production and export volumes.

- Given continuing budgetary pressures to limit over-production in Europe, it is likely that the reforms will bring about some improvements in the matching of production levels to consumer needs, and some reduction in the depressing effect of EU over-production on world prices. The net-food exporting developing countries may well benefit from this, but the actual gainers and gains can not be identified until the detail of the new regime is actually implemented. But there may also be net-food importing developing countries that will lose out as a result of rises in world prices.
- Differing interests across developing countries on agriculture trade reform, combined with the disagreement that can be expected between the EU and USA about the extent of domestic support each will have post their latest reforms, does mean that the upcoming WTO trade negotiations at Cancun may not be smooth despite the announced CAP reforms. It must be emphasised that the CAP reforms themselves do nothing directly to affect market access to the EU. EU trade barriers to imports from outside the EU remain unaffected. Developing country exporters will need to work hard to keep the developing countries united around the position of tariff liberalisation in agriculture and to persuade the EU (and other OECD countries) that they can cope with further liberalisation of their farming sectors.

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