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# Abbreviations and symbols

APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of South-East Asian Nations
CEFTA	Central European Free Trade Agreement
CIS	Commonwealth of Independent States
ECU	European currency unit
EFTA	European Free Trade Association
EU	European Union
FDI	Foreign direct investment
GDP	Gross Domestic Product
GNP	Gross National Product
IMF	International Monetary Fund
LAIA	Latin American Integration Association
MERCOSUR	Southern Common Market
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Cooperation and Development
TOT	terms of trade
UNCTAD	United Nations Conference on Trade and Development
c.i.f.	cost, insurance and freight
f.o.b.	free on board
n.a.	not available

## The following symbols are used in this publication:

...	not applicable
0	figure is zero or became zero due to rounding
\$	United States dollars

Billion means one thousand million.

Minor discrepancies between constituent figures and totals are due to rounding.

Unless otherwise indicated, (i) all value figures are expressed in US dollars; (ii) trade figures include the intra-trade of free trade areas, customs unions, regional and other country groupings; (iii) merchandise trade figures are on a customs basis, and (iv) merchandise exports are f.o.b. and merchandise imports are c.i.f. Data for the latest year are provisional.

# Chapter One Overview

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# Chapter One

## Overview



## The current situation and the WTO's response

Financial and economic turmoil has shaken much of the world in the last few months, affecting most of Asia and Russia in particular, and presenting new challenges for many other countries. This crisis calls for a sense of collective responsibility, as urgently as at any other time in the post-war period. From the perspective of the global trading system, this means three things. First, it requires a clear and continuing commitment by governments to the multilateral trading system and a firm resolve to resist protectionism. Second, a fresh impetus toward trade liberalization would contribute to the resolution of the crisis and would send a positive signal to the markets. Third, renewed efforts to bring the countries outside the system, including Russia and China, into the World Trade Organization would help to complete the global economic architecture for which the need has been so strongly demonstrated.

The difficulties facing the world economy pose serious policy challenges. Millions have seen the value of their assets sharply deteriorate. The economies of many Asian nations and Russia will contract in 1998. Many jobs will be lost in the countries most severely affected by the current crisis. In the past, governments have sometimes responded to recession and rising unemployment by implementing policies that restricted imports of goods and services. History tells us that this has been a major mistake. The growing economic crisis of the late 1920s became a full-blown recession when governments closed their borders to trade, making the pain more severe and the recovery slower. Today, with national economies ever more connected, and with 25 per cent of global output now being exported, resort to protectionism would be more costly still. Developing countries, with a trade/GDP ratio of 38 per cent, depend even more than advanced economies on trade to sustain growth. Nations cannot hope that their exports will be freely accepted in foreign markets or that capital and technology will flow freely across borders, unless they accept their own share of responsibility in addressing the current global economic difficulties. This applies to developed and developing countries alike.

Resisting protectionism is vital – but it is not enough. Pressing on with trade liberalization is essential to restore health to the world economy. If the momentum in the direction of liberalization stops, recession becomes a real prospect. The continued dynamism of the trading system is a necessary precondition for economic recovery in Asia and for buttressing the economies of Russia, Latin America and other parts of the world. Global trade in goods and services is the circulatory system of the world economy. If this system fails, the patient will not improve, no matter which macroeconomic medicine is prescribed.

It is fortunate in this context that the WTO already has an impressive agenda, combining implementation, further negotiations and the preparation of key decisions about the future development of the system, which are to be taken at next year's third Ministerial Conference in the United States. As they prepare for that meeting, a top priority for WTO Members will be to consider whether to extend this negotiating agenda and in what direction – whether, for example, to launch negotiations on trade and investment, trade and competition and transparency in government procurement. A number of Members want to see industrial goods included as well, and other issues such as the interface between trade and the environment have also been promoted as possible elements of a broader negotiating agenda.

The process of working towards agreement on these and other related issues should help to focus attention on the contribution the trading system can make to renewing confidence and growth. However, it will not do so automatically. The commitments already undertaken offer both reassurance in our present problems and a launching pad for future progress, but only if we can maintain the vision and the resolve to act on them fully and energetically. The need is greater than ever for governments to maintain their adherence to the rules of the system and to work constructively within it.

The evolution of the WTO over the past year provides encouraging evidence that its Members recognize and are willing to act on this need. The outstanding example is the commemoration of the 50<sup>th</sup> anniversary of the multilateral trading system in May 1998 – an event which brought together world leaders and ministers from every region, every background and every stage of development. This was far more than a ceremonial occasion. It demonstrated how far the world has come towards constructing a truly global economic system. Even during this period of significant change and uncertainty, not a single speaker at the 50<sup>th</sup> anniversary meeting questioned the validity of multilateral trade or of the WTO. Even if each one had a different perspective, reflecting different backgrounds and historical



experiences, all the leaders present saw the multilateral trading system as indispensable to growth and stability in our interdependent world.

This positive message was reinforced by the results of the second WTO Ministerial Conference, also held in Geneva in May. Governments reaffirmed their commitment to the multilateral system and their rejection of protectionism. They also agreed on a detailed work programme aimed at preparing the ground for the decisions that will need to be taken at the next Ministerial. Implementation of this work programme began with a special session of the General Council in September.

Furthermore, the outstanding negotiating success of the past year underlines the value governments place on maintaining trade liberalization in difficult times. The Agreement on Trade in Financial Services concluded in December 1997, when much of Asia was already in crisis, resulted in the submission of 56 schedules of trade liberalization commitments representing 70 WTO Members. This has brought the number of WTO Members with commitments in financial services to 102. The new commitments contain significant improvements, particularly in permitting suppliers of financial services to establish a commercial presence in other countries. Limitations on foreign equity holdings in enterprises supplying services have also been relaxed or eliminated. More generally, market access improvements were made in all three of the major financial service sectors – banking, securities and insurance.

The past year has also seen increased emphasis on the importance of thorough, timely implementation of existing commitments. This was a major theme of the second Ministerial Conference, and of the Ministerial Declaration it produced. It is accompanied by a general recognition that more needs to be done to assist Members – especially developing and transition economies – as they undertake the demanding adjustments implementation requires. The WTO's technical cooperation programmes are being expanded, thanks notably to the contribution of a few Members who have voluntarily provided significant extra funds to augment the limited resources available in the WTO's regular budget. It is now necessary to increase significantly the resources available for these activities under the WTO's regular budget, which now cover only 20 per cent of the programme, while maintaining these additional contributions will remain essential to improving our efforts in this key area. Whereas improvements and adjustments are constantly introduced, other approaches and ways of providing technical cooperation need to be explored. One idea is "outsourcing" them, that is subcontracting to outside services. What is needed is an approach that would facilitate an increased and improved WTO response to ever-growing demands for technical cooperation.

Significant action has also been taken during the past year to improve the participation of least-developed countries in the trading system and their access to its opportunities. In October 1997, a high-level meeting for the least-developed countries was held in Geneva in fulfilment of a decision by the first Ministerial Conference. This produced not only a renewed awareness of the difficulties of the least-developed countries, but also a renewed commitment to address them urgently and a concrete action plan in order to do so. The priorities of the least-developed countries themselves are the guiding principle of this action plan, which also involves close cooperation with other international agencies.

One striking way in which the integration of least-developed countries into the trading system can be advanced is to ensure they have immediate access, through the new information technologies, to knowledge and advice about it. This is why over the past year the WTO, with assistance from the World Bank and financial contributions from a number of Members, has been working to provide computer equipment and skills and put in place the necessary infrastructure so that least-developed countries can have inter-active contact with the WTO in Geneva and with many other resource centres around the world. Such centres have been established in around 30 trade ministries of least-developed and developing countries in Africa and Asia. The centres are actively using their internet access for regular communications through electronic mail and to download working documents from WTO database resources.

Along with a more active programme of outreach to its membership, the WTO has recently been working to improve contact and communication with society as a whole. One positive side was the dialogue established at the Ministerial meeting in May with some 152 non-governmental organizations for whom facilities, information and briefings were provided as part of the conference organization. This is part of a pattern of closer contact with NGOs, within guidelines set down by Members, that the Secretariat has been developing. Other significant moves in this direction were the well-attended trade and environment seminar held in early 1998, a package of measures to improve WTO transparency and openness announced by the Director-General in July and an intensified pattern of contact with representatives of civil society. In July the Director-General met with NGO leaders to discuss ways of establishing a closer contact within the guidelines set down by Members. Improvements in other areas – such as derestriction of documents – are also

under consideration by Members, and a proposal for a high-level meeting on trade and environment is under discussion.

A higher political profile for trade, especially in the current difficulties, has also been evident in the WTO's growing role in international economic consultations. Starting from the Director-General's participation in the Lyon G7 Summit in 1996, the fundamental importance of the multilateral trading system in promoting growth and stability has been increasingly recognized. In May 1998, the Director-General was invited to take part in the G8 Finance and Foreign Ministers Meeting in preparation for the Birmingham Summit, and immediately beforehand he addressed G15 Trade Ministers in Cairo. Earlier this year he also attended the Summit of the Americas in Chile. The WTO is now regularly invited to participate in ministerial meetings of major regional groupings, such as APEC and MERCOSUR.

In parallel with this evolution, the WTO's cooperative relationship with the IMF and the World Bank has developed on the basis of the agreements signed in 1996 and 1997 respectively with the two institutions. Financial turmoil makes this relationship all the more important. Greater global coherence in policy-making is not only a logical but a necessary next step in this age of interdependence. As we begin to address the growing gap between the rules of international trade and the rules needed to manage the many other facets of global integration, the WTO can contribute to the international architecture in several important ways:

- First, and most obvious, the WTO provides a powerful bulwark against protectionist pressures.
- Second, the WTO can help to advance and anchor necessary economic reforms in the affected economies.
- Third, continuing the momentum towards universal membership of the system would obviously enhance the WTO's ability to provide a stable foundation for the global trading system, particularly during times of economic stress. The current crisis makes no distinction between WTO Members and others, and we cannot afford to maintain a situation where millions of people and their governments are outside the benefits and responsibilities of the trading system.
- Finally – perhaps most importantly – the WTO can help provide the response to the central governance challenge of our new global age: the fact that governments answer mainly to national constituencies, while increasingly the economic system must answer to global needs. The experience of the WTO, and the way it works through binding commitments reached by consensus, gives some guidance as to how these systemic gaps might be bridged. Building upon this experience – and expanding it to other policy areas which now transcend borders – will of course not be easy. Yet if Asia's current turmoil is any indication of the risks of inaction, then the challenge of building a more stable international system is clearly well worth the effort.

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## The outlook for trade in 1998

Since the outbreak of the Asian crisis in mid-1997, forecasters have continued to lower their projections on trade and output growth for 1998. Trade in volume terms is expected to grow at about 4 per cent in 1998, or somewhat less than one half the rate recorded for 1997. As far as global output is concerned, pre-crisis projections from the IMF were for growth in excess of 4 per cent. This would have been a high rate in historical terms. Subsequent downward revisions in the forecast have been significant, and a GDP growth rate of about 2 per cent is now considered more likely. The deepening of the crisis in South-East Asia, combined with Japan's largely unanticipated fall into recession in the first half of 1998, are the main factors in the downward adjustment of global trade and output projections. Recent events in Russia will almost certainly lead to a further reduction in output and trade growth, although the magnitude of this effect remains uncertain.

The situation in Asia has contributed to falling commodity prices and the reversal of capital flows between emerging markets and industrial countries, and these factors have had a beneficial effect on growth in North America and Western Europe. Oil-importing countries have benefited from lower energy prices. The deterioration of global trade and output growth is therefore the result of a much steeper than predicted slowdown in Asia, only partly offset by stronger than predicted internal demand growth in the United States and continental Europe. In considering these forecasts for trade and output growth for 1998, it is important to note that considerable uncertainty prevails in regard to world economic developments in the coming months.

Turning from volume to value data, world merchandise trade is likely to stagnate and perhaps even decline somewhat if the dollar and oil prices remain close to their July 1998 levels in the second half of 1998. The dollar was trading at .751 SDR/\$ at the end of June, a

level higher than any annual average level since 1989. In trade-weighted terms, the effective dollar exchange rate is at its highest level since 1986. On the assumption that crude oil prices remain at the low levels reached in June 1998 for the second half of the year, the annual average price for the whole of 1998 would fall by more than 30 per cent, to \$13.1 per barrel – the lowest nominal value since 1979. In real terms, oil prices would have reached their lowest level for more than 25 years, or in other words since the first oil price shock in 1974.

The regional structure of trade will change markedly in 1998. Asia's share of trade, which increased sharply throughout the 1990s, will decrease in particular on the import side. Declining shares will be also observed for the Middle East and Africa, falling to new record low levels. North America, Latin America and to a lesser extent Western Europe are likely to record export and import growth above the global average, especially on the import side. There are, however, some risks for Latin America. Strong appreciation of effective exchange rates, together with much weaker commodity prices, could affect investor confidence in the second half of 1998. Capital inflows, which were still strong in the first half of 1998 (boosted by privatization programmes), could be significantly lower in the second half.

Regions and countries whose exports predominantly comprise fuels and metals – such as the Middle East and Africa – will suffer a contraction of their export earnings. The very sharp contraction of intra-Asian trade in the first half of 1998 might be attenuated in the second half. However, the latest values available for June/July do not indicate that import contraction has come to an end. Intra-Asian trade will be one of the most depressed regional trade flows in 1998, having been one of the most dynamic for more than 10 years prior to the crisis. While Asian exports to the rest of the world remain relatively strong, imports from outside the region continue to fall, leading to a substantial increase in the overall trade surplus of the region. The counterparts of the rising trade surplus of Asia are mainly found in the increased merchandise trade deficits of the faster growing regions (North America, Latin America and Western Europe), and not least in the oil-exporting countries (principally in Africa and the Middle East).

As for the product composition of world trade in 1998, the steep fall in oil prices will sharply lower the share of fuels, which, at 8 per cent of total trade in 1997, was already at only one third of its 1981 historic peak. Metals and many other primary products, which experienced a marked decline in prices and demand, will record a further decrease in their trade share. Although dollar prices for manufactured goods fell in the first half of 1998, price and demand trends remained more favourable than for primary products. Consequently, the share of manufactured goods will reach a new record level, accounting for four fifths of world merchandise trade.

The growth of trade in commercial services is expected to decelerate markedly in 1998, although by less than merchandise trade. The main reasons why services trade will expand faster than merchandise trade are that prices have declined less, and trends in demand have been more favourable. North America and Western Europe have a larger share in world services trade than in merchandise trade and the trade of both regions is expanding faster than that of Asia.

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## Trade in the international economy: a longer term perspective

As noted above, financial sector disruptions and macroeconomic pressures are at the core of current economic difficulties. Addressing these problems is a precondition for the restoration of stability and resumed growth, and trade policy is a critical element of the solution. A central feature of the economic history of the post-war period has been the growing role of international trade as a source of employment and growth. Trade has expanded faster than output by a significant margin in the last 50 years. While real output has grown at an average annual rate of 3.7 per cent from 1948 to 1997, the comparable figure for trade is 6 per cent. In other words, trade flows have multiplied by a factor of 17, while output has grown six-fold. Along with rapid technological developments – especially in information-related technologies, telecommunications and transportation – trade has been a driving force behind globalization, contributing to the enormous benefits that have flowed from mutual inter-dependence among nations. Increased trade has been significantly aided by the market-opening measures of governments. The last decade or so has seen many countries, developed and developing, progressively opening their markets to trade and investment. The ratio of imports and exports to GDP has risen from 16.6 per cent to 24.1 per cent between 1985 and 1997 in developed countries, and from 22.8 per cent to 38 per cent in developing countries during the same period.

A broad range of empirical studies conclude that open trade policies are conducive to growth. The conclusion appears to hold regardless of the level of development of the

countries concerned, challenging the notion that a certain level of development is required before the benefits from trade can be fully realized. One study, for example, finds that greater openness to trade was associated with more than two percentage points in annual GDP growth over several years for a sample of developing countries, as compared with the growth performance of countries that have maintained closed economies. Several factors account for this relationship. Most notably, trade allows countries to specialize at what they do best, it facilitates the dissemination of productivity-enhancing technology, and it creates an environment in which foreign direct investment can make a strong contribution to growth. The positive impact of foreign investment on growth appears greater in outward-oriented countries than inward-oriented ones.

The evidence from studies, which confirms much of the theory in this area, makes a compelling case for engagement in the world economy and active participation in the multilateral trading system. Chapter Four examines this evidence in detail. But an important point to bear in mind is that trade liberalization and an open trade regime are not the only ingredients of economic success. Other policy-related factors of great importance include a sound macroeconomic environment, institutional certainty and a stable and predictable system of government.

The gains from trade liberalization should not only be seen through a narrow economic lens. Trade has also been a vehicle for promoting broader political objectives, especially peace and stability. Trade establishes mutually beneficial links among nations, creating interest in cooperation. It cements relationships among disparate peoples and societies, lessening the risk of conflict, and it strengthens the commitment of governments to rules in place of *realpolitik*. These ideas were very much on the minds of the architects of the multilateral trading system in the aftermath of the Second World War, and they are no less important today.

At the present moment there are a growing number of voices against globalization. But globalization is not a policy to be judged right or wrong. It is a process driven by a much deeper current of technological and economic change. Its impact on the world economy depends on how we manage it, and on the qualities of our policy response. With a quarter of global output now exported, no country has an interest in closing off markets or weakening its economic ties with the rest of the world. No country, developing and developed alike, has an interest in cutting itself off from the flows of technology or capital from outside.

The point is that to slow down or stop globalization would be to suffocate this potential and to retard its progress – especially the aspects of this progress which are so important to creating a more equitable world trading system. The advent of an increasingly interdependent global economy has enormous potential to generate growth, to spread the benefits of modernization, and to weave a more stable and secure planet. But it also challenges the status quo. It demands that countries adapt. The real issue is not the debate about globalization but to see how technological progress can be better channelled to promote more growth, more trade and greater modernization – and so help the world economy to re-emerge from its present difficulties.

# Chapter Two

## World trade in 1997 and in the first half of 1998



# World trade in 1997 and in the first half of 1998

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## Main features

Despite the turmoil in world capital markets, the global economy and trade expanded at an outstanding pace in 1997. Both GDP and trade growth were higher in 1997 than at any time in the 1990s. The increasing gap between trade and output growth rates in 1997, together with a further surge in foreign direct investment (FDI), indicate continued integration of national markets into the global economy. Increased integration inevitably means that disturbances in one country or region can have an impact elsewhere – a fact of which the world has become sharply aware in recent months, as financial crises and lower growth in Asia have affected economic conditions in other regions. These developments emphasize the need for careful and well-directed policies, based on adequate international cooperation. Among the policies that are important in reducing contagion and avoiding a downward spiral in the world economy are the maintenance of open markets for trade, the restoration of financial stability and the development of adequate regulatory frameworks in the financial sector.

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### **Strong and broadly based trade and output growth in 1997**

Strong global GDP growth in 1997 was largely attributable to the economic performance of the Americas, together with the recovery in Europe. These developments offset weaker growth in those regions which had fallen back from their above-average growth performance in 1996, namely Asia, Africa and the Middle East. One indicator of the broad-based economic expansion is the large number of countries which recorded positive per capita income growth. Out of a sample of 153 countries, 126 recorded an increase in their per capita income levels.

Robust economic growth contributed to the general acceleration of trade growth in all regions. The motor of the global trade expansion in 1997 was the Americas. Both North America and Latin America recorded a surge in imports linked to strong demand growth. The recovery in Western Europe also led to faster import growth which, however, remained below the global average. All three major sectors – agriculture, mining and manufacturing – experienced sharply higher trade growth, despite the fact that agricultural output expansion decelerated from its record growth performance in 1996.

The excess of trade over output growth, which decreased in 1996, widened again in 1997 as trade growth exceeded GDP growth by a factor of three. The margin of trade over output growth was again most pronounced in the Americas, as it has been throughout the 1990s.

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### **Prices, exchange rates and trade values**

Price changes in the major product groups (agriculture, mining, manufactures) showed a markedly lower variation than in 1996. Dollar prices declined between 4 and 7 per cent for all product groups. Due to the strong appreciation of the US dollar vis-à-vis the currencies of major traders in continental Europe and Asia, dollar prices at the regional level – even for the same product group – can differ markedly. It remains to be seen to what extent these sharp price differences will be maintained in the medium term. The large share of intra-regional trade, the widespread practice of involving trade in regional currencies and differences in cyclical demand are the main factors which limit the pass-through effect of the strengthened dollar on regional export and import prices. This “shock absorber” effect has been stronger in Western Europe where countries have cooperated closely in their macroeconomic objectives as a prelude to the establishment of a single currency.

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### **Capital flows, foreign direct investment and trade**

The year 1997 saw a further increase in global private capital flows, and a surge in foreign direct investment of more than one fifth. Increased capital flows throughout the 1990s have in many cases contributed to dynamic trade growth. This is particularly evident in the case of foreign direct investment, which registered a flow of some US\$400 billion in 1997. The importance of FDI in developing Asia's trade growth is well recognized. The strongest increase in FDI inflows last year and in the 1990s, however, were recorded by Latin America and the transition economies.

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### **Financial crises in Asia cloud the prospects for the world economy**

The contraction of economic activity in Asia, sparked by the financial crisis in a number of South-East Asian countries and the largely unanticipated recession in Japan, have created a

more sombre business climate worldwide. Reverse capital flows from emerging markets have led to downward pressure on interest rates in the United States and Western Europe and have contributed to a booming stock market in these countries in the first half of 1998. Recent falls in stock market indices, reflecting not only perceptions of prospects in Asia, but also economic crisis in Russia and the fear of contagion in other emerging markets, have raised the spectre of a more generalized contraction in demand and economic downturn worldwide. It is already clear that 1998 will feature sharply lower trade and output growth rates than 1997, but it is more difficult to anticipate the depth or duration of the slowdown, or how severe the effects will be in the regions that are currently the most resilient – the United States and Western Europe.

The repercussions of the financial crises in various countries on global trade in goods and services are only felt after a time lag. Import contraction in Asia in the latter half of 1997 left its mark first on intra-regional trade and on commodity markets which depend largely on the Asian market. Prices for fuels and metals started to weaken considerably in late 1997. Exporters to Asia have, in general, been more affected so far than import-competing industries faced with increases in Asian exports. In this respect it is worth noting that Asia is a large net importer of services. The marked decline in Asia's tourism expenditure is only one part of this picture. This situation will change as Asia's exports pick up in the context of general economic recovery, and as import demand becomes more buoyant.

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### Recent trade developments

Information on merchandise trade available for the first half of 1998 indicates a decline in the dollar value of world merchandise exports. The decrease is due both to a stronger decline in dollar prices and to lower volume growth. The value of Asia's imports fell by about 15 per cent, while exports decreased by 8 per cent. Japan's merchandise exports decreased slightly less (-7 per cent) and its imports fell somewhat more than the Asian average rates. Its merchandise trade surplus rose by US\$17 billion to nearly US\$50 billion. The Asia (5)<sup>1</sup> countries recorded a small decrease in their exports and a contraction in their imports by one third. Their combined merchandise trade balance shifted from a deficit of US\$19 billion to a surplus of US\$39 billion. The moderate fall in exports hides a very strong volume increase, as dollar export prices have fallen considerably. The volume increase has been tentatively estimated at 18 per cent, about three times faster than global trade. Western Europe's trade surplus eroded as imports continued to rise while exports decreased in dollar terms. The growth of trade in value terms in North America and Latin America slowed markedly in the first half of 1998, but remained the highest globally. The strength in import volume growth in the Americas and Western Europe moderated the downward trend in global trade expansion.

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## World trade in 1997

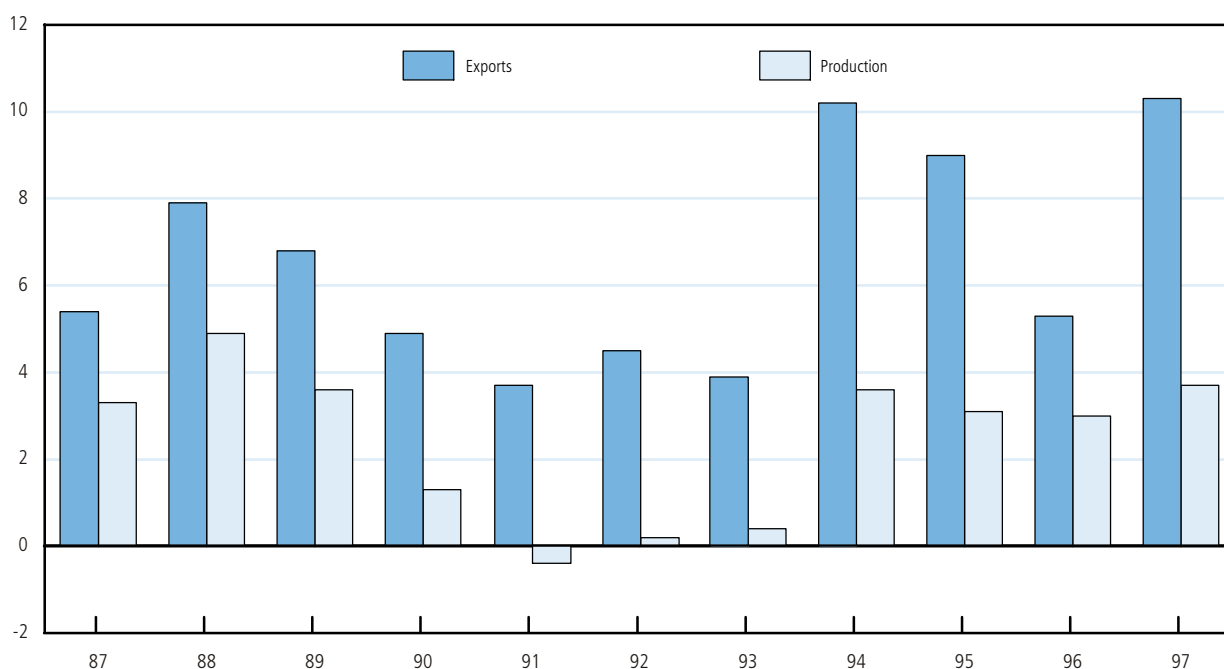
### I. Global trade developments

In 1997, world merchandise trade growth accelerated sharply in volume terms. Merchandise exports rose by 10 per cent, stimulated by an increase of 3½ per cent in merchandise production. Growth in both trade and output matched that of 1994, which was the best performance this decade (Chart II.1). Manufacturing output expanded by 4½ per cent, the highest annual growth rate in the 1990s (Table II.1). Mining production also expanded faster than in the preceding year. Only agricultural production slowed sharply from its record high growth level in 1996. The regions with the highest growth in 1996 – Asia and Africa – recorded the sharpest slowdown in 1997. In contrast to the divergent sectoral output developments, sharply higher trade expansion led to an acceleration of export growth in all sectors. Agricultural export volume rose faster due to higher shipments from North America, Latin America and Asia. Exports of mining products, which consist largely of fuels, rose by 5 per cent, two times faster than in the preceding year. Trade in manufactures rose at twice the rate recorded in 1996 and almost three times faster than output. Dynamic growth in world trade of manufactures was favoured by the surge of manufactured imports into North America, Latin America and, to a lesser extent, Western Europe.

The value of world merchandise exports amounted to US\$5300 billion in 1997, an increase of only 3 per cent over 1996. The strong acceleration in the volume of trade cannot be observed in the trade values, as the dollar price decline of 6½ per cent in 1997 was much steeper than that of 1996. Lower prices are due to a combination of low domestic inflation rates, the appreciation of the dollar vis-à-vis the currencies of major traders in Western Europe and Asia, and weaker primary commodity prices. The decline in dollar prices in 1997 was the strongest since 1950. It was also the second year in a row that the prices of

<sup>1</sup>These are the five countries most directly affected by the financial crisis that began in July 1997 – Indonesia, Republic of Korea, Malaysia, Thailand and the Philippines.

Chart II.1

**Growth in the volume of world merchandise trade and production, 1987-97**

manufactures declined faster than those of primary products. Despite the relatively stronger price decline, manufactured goods still recorded higher nominal export growth than mining and agricultural products (Table II.2).

The growth in value of world exports of commercial services decelerated markedly from the previous year, but still matched that of merchandise exports in 1997. Travel receipts recorded the strongest deceleration among all commercial services categories. The limited price information available for services trade points to a decrease in the dollar prices of commercial services. The price data are, however, too limited to determine with accuracy the volume growth of commercial services.

## II. Merchandise trade by product

Among the 14 product groups identified in this report (Chart II.2), one half recorded faster value growth in 1997 than in 1996. Exports of the two agricultural product groups – food and (agricultural) raw materials – recorded lower export values in 1997 than in the preceding year. Trade in fuels stagnated, following a 23 per cent rise in 1996. Ores and minerals, as well as non-ferrous metals, are the only primary product groups which recorded

Table II.1

**Growth in the volume of world merchandise exports and production by major product group, 1990-97**

(Percentage change)

	Annual average			
	1990-97	1995	1996	1997
<b>World merchandise exports</b>	<b>6.5</b>	<b>9.0</b>	<b>5.5</b>	<b>10.0</b>
Agricultural products	4.5	4.0	3.0	6.5
Mining products	4.5	9.0	2.5	5.0
Manufactures	7.0	9.0	6.0	11.5
<b>World merchandise production</b>	<b>2.0</b>	<b>3.0</b>	<b>3.0</b>	<b>3.5</b>
Agriculture	2.0	2.0	4.5	1.5
Mining	2.0	2.0	2.5	3.5
Manufacturing	2.0	3.5	2.5	4.5
<b>World GDP</b>	<b>2.0</b>	<b>2.0</b>	<b>2.5</b>	<b>3.0</b>
Excluding transition economies	2.5	2.5	3.0	3.0

Note: World merchandise production differs from world GDP in that it excludes services and construction. World GDP is calculated by using weights based on GDP in 1990 prices and exchange rates.



Table II.2

**Growth in the value of world exports by major product group, 1990-97**

(Billion dollars and percentage change)

	Value 1997	Annual average 1990-97	1995	1996	1997
<b>World merchandise exports<sup>a</sup></b>	<b>5300</b>	<b>7.0</b>	<b>19.5</b>	<b>4.5</b>	<b>3.0</b>
Agricultural products	580	5.0	17.0	1.5	-1.0
Mining products	598	3.0	18.0	13.5	1.0
Manufactures	3927	7.5	19.0	3.5	4.0
<b>World exports of commercial services</b>	<b>1310</b>	<b>8.0</b>	<b>15.0</b>	<b>6.5</b>	<b>3.0</b>

<sup>a</sup> Including unspecified products.

Note: The statistics for exports of commercial services and for exports of merchandise are not directly comparable, primarily because the former are taken from balance-of-payments statistics and the latter from customs statistics.

faster growth in 1997 than in 1996. Different growth performance among the primary product categories is largely due to divergent price developments. Export prices of food and fuels, which increased sharply in 1996 – against the general trend of weaker prices – recorded a decrease in 1997. Non-ferrous metals and ores – other than iron ore – experienced a sharp price fall in 1996 and a recovery in 1997 (Table II.3). For manufactures, all product groups registered positive growth and a majority of them even faster growth than in the preceding year. Chart II.2 shows the annual growth rate for 1997. With the exception of one product group – ores and minerals – all product groups recorded lower nominal growth in 1997 than throughout the 1990-97 period. The difference is due to weaker prices and exchange rate developments.

Office and telecom equipment, comprising computers, semi-conductors and consumer electronics, was the most dynamic product category in world merchandise exports last year, as well as in the 1990-97 period. With a share of nearly 13 per cent, the value of this product category is greater than that of agricultural products (10.9 per cent), mining products (11.3 per cent) and automotive products (9.4 per cent). Strong nominal growth in the office and telecom equipment sector was associated with fast absolute price declines,

Chart II.2

**Growth in the value of world merchandise trade by product group, 1997**

(Percentage)

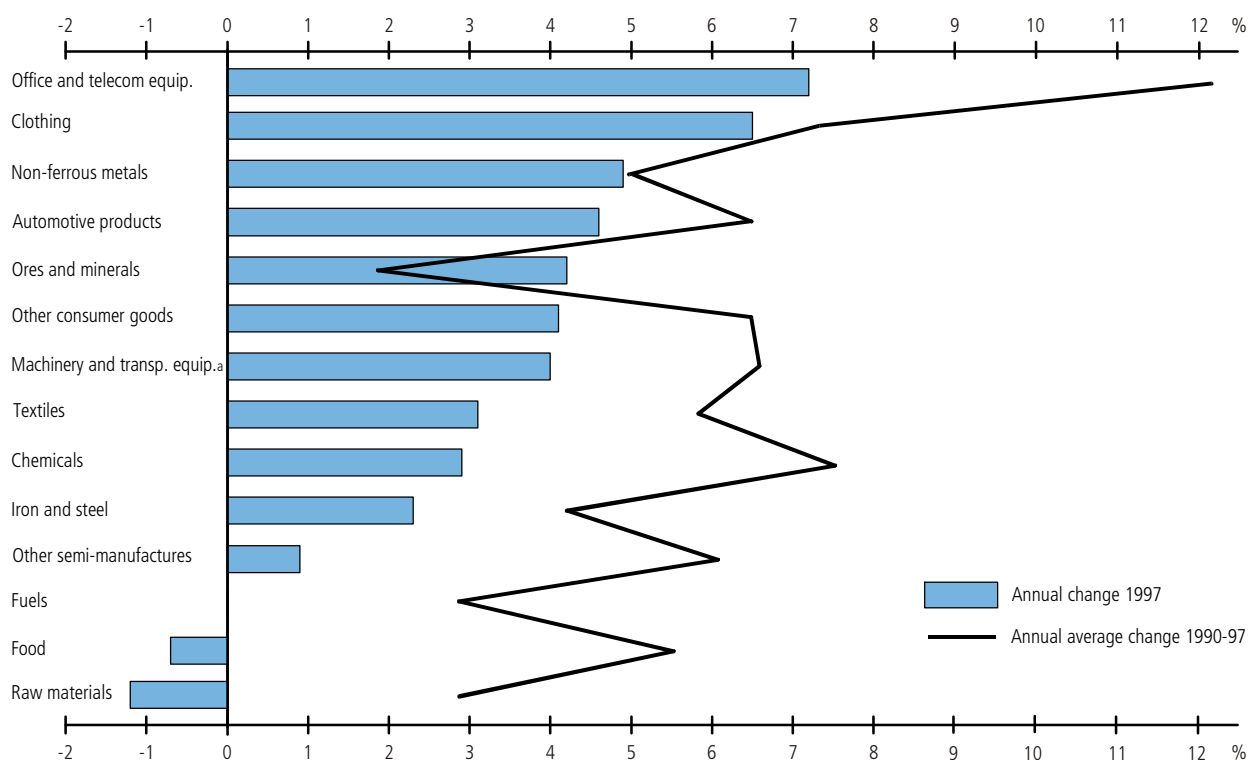
<sup>a</sup> Excluding office and telecom equipment and automotive products.

Table II.3

**Export prices of primary commodities, 1995-98**

(Percentage change)

	1995	1996	1997	1998 Jan-Mar	1998 Apr-June
<b>Food, beverages and tobacco</b>	<b>6</b>	<b>6</b>	<b>-3</b>	<b>-6</b>	<b>-16</b>
Cereals	17	20	-23	-16	-17
Oil seeds, oils, fats, cake and meals	8	11	0	-7	-12
Meat	-17	-1	4	-9	-11
Coffee	2	-24	38	5	-33
Agricultural raw materials	5	-4	-8	-19	-23
Minerals and non-ferrous metals (excl. petroleum)	19	-11	3	-13	-15
Non-ferrous metals	23	-16	4	-18	-21
<b>All non-fuel primary commodities</b>	<b>8</b>	<b>-1</b>	<b>-3</b>	<b>-12</b>	<b>-18</b>
Crude petroleum	8	18	-5	-33	-28
<b>All primary commodities</b>	<b>8</b>	<b>3</b>	<b>-4</b>	<b>-17</b>	<b>-20</b>

indicating that this product category was one of the principal factors behind the strong volume growth of world merchandise trade. In 1997, the electronic industry recovered from its slowdown in 1996. Asia, which supplies nearly 50 per cent of world office and telecom exports, recorded a below-average rate of expansion. Within Asia, export growth rates differed markedly. Among the major suppliers, Japan, Singapore, Malaysia and the Republic of Korea expanded their exports far less rapidly than the smaller suppliers such as China and the Philippines, indicating a process of re-location within Asia. North America and Latin America experienced sharply higher export and import growth than Asia. However, both remain large net importers, as does Western Europe. Asia's net exports of office and telecom equipment (about \$106 billion) are twice the size of Asia's net clothing trade and similar in size to the net fuel exports of the Middle East.

Clothing exports rose by 6½ per cent, the second largest increase of all product groups in 1997. Throughout the 1990-97 period, the value of clothing shipments expanded by 7½ per cent, as fast as all manufactures combined. Export growth rates differed sharply among regions: increases above 10 per cent for Asia and Latin America contrasted with a decline of 2 per cent for Western Europe. While the dollar value of Western Europe's and Asia's clothing imports decreased, North America accounted for the bulk of increased clothing imports. On a country level, the outstanding developments are the rise of China's exports by more than one quarter, and the increase in imports of the United States and the United Kingdom by 15 per cent. China has strengthened its role as the world's largest clothing supplier. Since 1990, the share of China in world exports has doubled from nearly 9 per cent to 18 per cent in 1997. Correspondingly, the combined share of Hong Kong, China, the Republic of Korea and Chinese Taipei shrank over the same period from approximately 20 per cent to 10 per cent.

Exports of automotive products rose by 4½ per cent in 1997, which was the same rate as in the preceding year. The near stagnation of Western Europe's export and import dollar values hides a marked recovery in its automobile production and trade volumes. Japan's imports of automobiles declined sharply, while its exports rose by 6½ per cent. North America, the largest net importer of all the regions, expanded both its exports and imports by about 10 per cent. Latin America and the transition economies recorded even stronger export and import growth. Among the leading traders in automotive products, export growth was very high for the United States and Brazil. Their dynamic export performance was linked to the strong import growth of Canada, Mexico and intra-MERCOSUR transactions. The share of automotive products in world trade remained at 9.4 per cent, unchanged from 1990.

Chemical products accounting for 9.2 per cent of world merchandise exports, expanded at close to the average rate of 3 per cent of world exports. Western Europe, with a share of 58 per cent, still remains the largest regional supplier, although its market share has decreased steadily since 1990. In 1997, Western Europe's chemical exports and imports decreased slightly while those of North America increased by somewhat more than 10 per cent. Asia, which like North America is a net importer of chemicals, recorded faster export growth than import growth.

Exports of fuels stagnated in value terms in 1997, at US\$435 billion. Given declining fuel prices, this represents a volume increase in the order of 5 per cent. The Middle East, which is the largest net exporting region (US\$112 billion), also experienced stagnating exports in value terms. Among the other net exporting regions, Africa (US\$42 billion) and Latin America (US\$22 billion) recorded a slight increase, while the transition economies (US\$23 billion)

reported a decrease in their exports. On the import side, the regional differences are more pronounced. Asia and North America registered a 5 per cent increase in fuel imports, and Western Europe's fuel imports decreased by about 4 per cent.

### III. Merchandise trade by region

#### Value developments

The growth in the dollar value of merchandise exports and imports differed markedly among the major regions. Besides divergent trends in regional demand, exchange rate developments and private capital flows had a major impact on nominal trade values. Although the outbreak of financial turmoil in Asia started to have an impact on trade flows in the second half of 1997, the global repercussions still remained rather limited. In 1996, the strong increase in fuel prices was the single most important factor, next to demand trends, in explaining the differences in regional trade growth. In 1997, North America and Latin America not only recorded their highest economic growth in the 1990s, but their trade values benefited, on average, from a sharp real appreciation of their currencies. Asian economies and continental West European countries experienced, in general, a sharp depreciation of their currencies. Although Western Europe's GDP growth strengthened, it remained much weaker than world economy as a whole. With the onset of the financial crisis, Asia's economic growth slowed sharply, in particular in the second half of 1997, but was still close to the global average.

Latin America recorded an increase in exports of about 10 per cent and an import surge of 17½ per cent. The acceleration of import growth was broadly based across the region, as 14 countries reported import growth in excess of 10 per cent (Mexico and Argentina experienced import growth in excess of 20 per cent). One important feature in the strength of Latin America's trade performance was the continuation of large capital inflows, particularly foreign direct investment, which was stimulated by privatization programmes in many countries. A large majority of Latin American countries recorded faster import than export growth, resulting in a further widening of their merchandise trade deficits (Table II.4).

North America's merchandise trade value expanded three times faster than world trade with exports up by 9 per cent and imports up by 10½ per cent. North America's exports to Latin America rose very fast (by 23 per cent), while they increased at about the average rate to Western Europe and Africa. Shipments to the Middle East and Asia rose by less than 5 per cent. Exports to Japan declined, those to China and Australia/New Zealand rose less than

Table II.4

#### Growth in the value of world merchandise trade by region, 1990-97

(Billion dollars and percentage)

Exports (f.o.b.)					Imports (c.i.f.)			
Value	Annual change				Value	Annual change		
1997	1990-97	1996	1997		1997	1990-97	1996	1997
<b>5300</b>	<b>6.8</b>	<b>4.3</b>	<b>3.2</b>	<b>World</b>	<b>5470</b>	<b>6.8</b>	<b>4.9</b>	<b>3.0</b>
903	8.2	6.4	9.2	North America	1100	8.0	6.2	10.3
279	9.8	12.3	10.4	Latin America	319	14.7	11.4	17.5
110	15.2	21.1	14.7	Mexico	113	15.9	25.5	23.6
169	7.0	7.1	7.8	Other Latin America	206	13.3	2.6	14.5
2276	4.8	3.6	-0.9	Western Europe	2263	4.1	3.3	-0.8
2105	4.9	3.5	-0.8	European Union (15)	2070	4.1	2.9	-1.1
826	6.6	5.9	3.1	Extra-EU (15) trade	787	4.5	4.5	2.4
179	6.6	6.7	3.5	Transition economies	193	6.9	13.5	8.8
90	7.2	2.6	6.9	Central/Eastern Europe	118	11.6	15.2	5.6
66	...	9.3	-4.2	Russian Federation	49	...	0.9	13.2
123	2.7	12.7	2.0	Africa	127	4.7	-0.3	3.2
30	3.7	2.5	5.8	South Africa	33	8.7	-1.4	9.3
47	0.3	24.7	1.4	Major fuel exporters <sup>a</sup>	26	1.4	-7.0	0.6
164	2.9	13.9	-0.4	Middle East	144	5.5	7.0	1.6
1379	9.3	0.6	5.4	Asia	1321	9.3	4.8	0.2
421	5.6	-7.3	2.5	Japan	339	5.3	4.0	-3.0
183	16.7	1.5	20.9	China	142	15.1	5.1	2.5
351	12.8	4.7	5.2	Asia (5) <sup>b</sup>	367	11.9	7.6	-3.2

<sup>a</sup>Algeria, Angola, Congo, Gabon, Libya and Nigeria.

<sup>b</sup>Indonesia, the Republic of Korea, Malaysia, Philippines and Thailand.

3 per cent, while shipments to the Asian developing countries rose 6½ per cent, despite the financial turmoil in the second half of 1997.

Western Europe was the only region that recorded a slight absolute decline in the dollar value of its exports and imports last year. If trade is measured in ECU terms, however, nominal exports and imports rose by over 11 per cent. Exchange rate changes also explain why intra-West European trade shrank 3 per cent, despite the recovery in the region's economy. West European exports to Latin America and the transition economies rose by about 12 per cent, stimulated by strong import demand in the countries concerned. Shipments to North America and the Middle East expanded by 9 per cent and 5 per cent respectively, roughly in line with market growth. Western Europe's exports to Africa continued to decrease slightly for the second year and those to Asia decreased by 3½ per cent. Exports to Japan fell by more than 10 per cent, much faster than to other Asian countries. Exports of automotive products to Japan, which had more than doubled between 1992 and 1996, fell by 20 per cent. Western Europe's imports from North America, Latin America and developing Asia increased by between 7½ and 10 per cent. Import growth from North America was particularly strong in chemicals and aircraft. While Western Europe's food imports from North America decreased, they rose by more than 15 per cent from Latin America. Food accounts for nearly one half of Western Europe's imports from Latin America. The strikingly different import growth rates of food products from different regions is explained by the product composition of these trade flows and diverging price trends. Cereals, an important component of North America's shipments to Western Europe, experienced a price decline last year of more than 20 per cent, while the price for coffee – an important product in Latin America's food shipments to Western Europe – rose by nearly 40 per cent. The dollar value of Western Europe's imports from Africa and the Middle East decreased slightly, as the decline in fuels and agricultural products was not offset by rises in other product categories. Western Europe's imports from Japan benefitted from the recovery of European car demand. Automotive products, which account for one fifth of Western Europe's imports from Japan, rose by 13½ per cent, while all other products combined were up by 3½ per cent.

For the second year in a row, the transition economies recorded a marked excess of import growth over export growth. Given their modest economic recovery in 1997, the strength of import growth is explained principally by the surge in foreign capital inflows, both bank credits and foreign direct investment. Russia, Hungary and Poland, which all benefitted from strong capital inflows, recorded import growth above 10 per cent. The Czech Republic, which was shunned by foreign investors last year, had to cut back its imports in 1997. Transition economies' exports to Western Europe grew by 7 per cent, the highest growth rate among all major destinations. Consequently, Western Europe's share in the exports of the transition economies rose to a new peak level of 60 per cent of total exports. The high growth rate of bilateral trade flows also reflects the deepening of the European integration. Exports to other transition economies grew slightly above average, while exports to Asia – in particular China – recorded a steep decline.

Africa's exports and imports expanded at about the same pace as global trade. Exports to Western Europe, accounting for a 50 per cent share, declined in 1997. Africa's exports to North America and Asia rose by 7 per cent. Exports to Latin America continued to grow strongly for the third year in a row (up 20 per cent in 1997). Since 1990, Latin America and Asia have increased considerably in importance as destinations for African exports. While the region has made some progress in the diversification of its markets, the product composition of its trade is still dominated by fuels and other primary products. Import developments in 1997 and throughout the 1990-97 period indicate a similar trend as for exports – a reduction of the predominant role of Western Europe and closer ties with other regions, especially Asia, North America and Latin America.

The trade of Middle Eastern countries stagnated in dollar terms in 1997, after strong growth in the preceding year. Export growth by destination varied considerably, with an increase of about 10 per cent to Asia and North America, and stagnation in the case of Western Europe. The 1997 growth pattern reflected a medium-term trend, which has steadily lifted Asia's share in the exports of the Middle East, from 40 per cent in 1990 to more than 50 per cent in 1997. The corresponding relative decline can be found in exports to Western Europe which, at a 21 per cent share, remained the second largest export market for the Middle East. Import growth from the major supplier regions of Western Europe, Asia and North America expanded at about 5 per cent. Western Europe maintained its share in the Middle East's imports at about 45 per cent, Asia at about 25 per cent and North America at below 20 per cent.

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### **Volume developments**

The marked acceleration in the volume growth of world merchandise trade in 1997 contrasts with the deceleration of trade growth measured in dollar terms. The reason for this

exceptionally large divergence is the 6½ per cent fall in dollar prices, the largest recorded since 1950. The outstanding trade growth recorded in 1997 matched that of 1994 and represents the highest annual rate of growth for more than two decades. This record volume growth can be attributed primarily to high global output growth, supported in some regions by large capital inflows and in particular by the global surge in foreign direct investment, which exceeded 20 per cent.

All major regions (for which price data are available) reported higher export and import growth in 1997 than in the preceding year. Volume growth of imports exceeded that of exports by a large margin in Latin America and the transition economies. In Asia and Western Europe, however, growth of exports exceeded that of imports. External demand tended to reflect domestic output trends in these two regions. The strongest import growth – twice the global average – was registered in Latin America, which also experienced the largest excess of import growth over export growth. Asia recorded the highest export growth and the lowest import growth of all regions in 1997 (Table II.5).

North America's high import growth was fuelled by strong domestic investment and consumption growth. The investment boom led to a surge in capital goods imports, while the rise in consumption was reflected in a sharp increase in imports of passenger cars and clothing. Exports were stimulated by the strength of intra-NAFTA trade and a boom in shipments to Latin America.

For the second year in a row, Latin America's imports grew two times faster than the global average. The three largest importers in the region – Mexico, Brazil and Argentina – increased their imports between 19 per cent and 30 per cent. Fifteen out of 17 countries in the region recorded an import growth rate above the global average. The volume of Latin America's exports was considerably less buoyant and less broadly based than the import expansion. Mexico's export growth – one of the highest in the world, not only last year but also throughout the 1990s – was two times faster than the export growth of all other Latin American countries combined. NAFTA membership and the economic boom in North America, which accounts for the bulk of Mexico's exports, are the major factors behind Mexico's very strong export performance.

The high import growth of the transition economies contrasts with the improved, but still meagre, GDP growth of the region, which did not exceed 2 per cent. The largest gap between import and output growth was recorded for the Russian Federation. The Baltic States, Hungary and Poland, which all experienced strongly expanding output and high FDI inflows, also sharply increased their imports. Export growth in the region benefitted from the recovery in Western Europe and in the Russian Federation.

Western Europe's trade growth accelerated in 1997, largely due to the economic recovery of the region. But export and import growth remained below the global trade growth rate, and regional output growth was also below global GDP growth. For the fifth consecutive year, Western Europe's growth of exports exceeded that of imports, reflecting the relatively moderate economic growth rate of the region.

Stimulated by strong demand outside the region and favoured by weaker domestic demand, Asia's export volume expanded faster than world trade, while imports recorded the lowest growth of all regions. Japan and China recorded the strongest acceleration in exports,

Table II.5

### Growth in the volume of world merchandise trade by selected region, 1990-97

(Annual percentage change)

Exports					Imports			
Average 1990-97	1995	1996	1997		Average 1990-97	1995	1996	1997
<b>6.5</b>	<b>9.0</b>	<b>5.5</b>	<b>10.0</b>	<b>World</b>	<b>7.0</b>	<b>9.0</b>	<b>5.5</b>	<b>9.5</b>
7.5	9.0	6.5	11.0	North America	8.0	7.5	5.5	13.5
9.0	12.0	11.0	11.5	Latin America	13.0	4.5	11.5	21.0
14.5	25.5	19.0	19.0	Mexico	13.0	-15.0	22.5	26.5
6.0	8.5	5.5	9.5	Western Europe	5.0	7.5	5.0	7.5
6.0	8.5	5.5	9.5	European Union (15)	5.0	7.0	5.0	7.5
5.0	15.5	6.0	10.0	Transition economies	4.5	15.0	13.0	16.0
7.5	10.0	3.5	12.0	Asia	9.0	14.0	5.0	6.0
2.5	4.0	-0.5	9.5	Japan	5.5	12.5	2.5	2.5
13.5	17.5	9.0	17.0	Asia (5) <sup>a</sup>	11.5	19.5	7.5	2.5

<sup>a</sup>Indonesia, the Republic of Korea, Malaysia, Philippines and Thailand.

Note: Separate volume data are not available for Africa and the Middle East, although estimates for these regions have been made in order to calculate a world total.

while the highest growth rates in volume terms (above 20 per cent) were reported by China, the Republic of Korea and the Philippines. Japan and the Asian (5) countries reported a moderate increase in import volumes, for the year as a whole, despite their contraction in the second half of the year. Thailand, the country which was first affected by the crisis, recorded a substantial fall in imports in 1997. Australia, Chinese Taipei, India and the Philippines, however, recorded import growth rates well above the global average.

#### IV. Commercial services trade

The expansion of world trade in commercial services slowed down in 1997 compared to the previous year. Differences in regional economic growth, together with major exchange rate changes, principally in respect of the dollar vis-à-vis West European and Asian currencies, shaped the evolution of commercial services trade in 1997. Exports of commercial services are estimated to have grown by 3 per cent, less than half the rate recorded in 1996 and the 1990-97 period average. The three major regions in world commercial services trade – Western Europe, Asia and North America – all recorded a deceleration in the growth of their exports and imports. Export growth exceeded import growth in all three regions. The counterpart to this development has been an excess of import growth over export growth in all other regions combined. In Latin America and Africa, imports expanded at more than twice the rate of exports (Table II.6).

North America, the largest net exporter of all regions, expanded its commercial services exports and imports by 7 per cent and 6 per cent respectively in 1997. This was more than two times faster than global services trade growth. Last year's deceleration of North American commercial services trade growth arose in the "other commercial services" category (i.e. other than transport or travel). Within that residual group, the large subcategory of royalties and license fees registered very weak growth in 1997, both in respect of receipts and expenditures.

Western Europe, which accounts for about 45 per cent of world commercial services exports and imports, saw its commercial services trade stagnate in 1997. Within Western Europe, however, a marked difference could be observed between declining exports and imports of continental Western Europe and very strong growth of both exports and imports for the United Kingdom and Ireland. Given that economic growth in the United Kingdom was stronger than on the continent, it should be expected that import growth would be higher than export growth in the United Kingdom. While this expectation was confirmed by developments in the transportation and travel categories, it was not the case for "other commercial services". Within the latter group, it was the exceptionally strong export growth of financial services (both insurance and banking) which lifted the growth of exports above that of imports. Mainly due to the strong growth of financial services exports and the strength of the Pound Sterling vis-à-vis the other European currencies, the United Kingdom established itself as Western Europe's largest commercial services exporter, second only to the United States in global terms.

In Asia, commercial services exports slowed to a 5 per cent annual growth rate, but still rose faster than world services trade. No general downward trend could be observed among

Table II.6

#### Growth in the value of world trade in commercial services by selected region, 1990-97

(Billion dollars and percentage)

Exports				Imports				
Value	Annual change			Value	Annual change			
1997	1990-97	1996	1997	1997	1990-97	1996	1997	
<b>1310</b>	<b>8</b>	<b>7</b>	<b>3</b>	<b>World</b>	<b>1295</b>	<b>7</b>	<b>5</b>	<b>2</b>
259	8	9	7	North America	186	6	7	6
51	8	5	9	Latin America	66	10	7	18
598	5	4	1	Western Europe	557	5	4	-1
531	5	5	0	European Union (15)	516	6	3	-1
28	6	8	3	Africa	39	5	0	8
298	12	9	5	Asia	356	10	7	2
68	7	4	3	Japan	122	5	6	-5
37	11	9	0	Hong Kong, China	23	11	4	6
78	18	16	7	Asia (5) <sup>a</sup>	93	18	14	4

<sup>a</sup>Indonesia, the Republic of Korea, Malaysia, Philippines and Thailand.

Note: Separate reliable data are not available for the transition economies and the Middle East, although estimates for these regions have been made to calculate a world total.

the Asian economies. Stagnation or contraction in commercial services export values were reported by Hong Kong, China, Australia, Thailand and New Zealand, in contrast to the very high growth reported by the Republic of Korea and China. Methodological changes in data collection may have contributed to these high growth rates. Asia's imports of commercial services rose by 2 per cent in 1997, not faster than world trade for the first time since 1990. The marked slowdown in Asia's commercial services imports can be attributed to stagnating or declining expenditure in Japan, the Republic of Korea, Australia, Thailand, Malaysia and New Zealand. Japan's commercial services imports, which account for more than one third of Asia's commercial services imports, decreased by 5 per cent, the first annual decrease registered in more than a decade.

Largely due to its exceptionally strong economic growth, Latin America was by far the most dynamic regional importer of commercial services in 1997. Commercial services imports rose by 18 per cent, more than two times faster than exports. Brazil and Mexico, which account for nearly one half of Latin America's imports, reported import growth of 36 per cent and 16 per cent respectively. Latin America, in contrast to all other regions, reported higher export growth in 1997 than in the preceding year. This was the result of very strong acceleration in some countries (e.g. Brazil, Chile and Venezuela), only partially offset by lower rates for others (e.g. Mexico, Argentina and Peru).

Africa's commercial services exports expanded at 3 per cent, the average global rate for 1997. The strong expansion of services receipts in Africa's two largest services exporting countries – Egypt and South Africa – was balanced by a stagnation or decrease in receipts in the third and fourth largest exporting countries, Tunisia and Morocco. Africa's imports of commercial services are tentatively estimated to have increased by 8 per cent. It should be noted that this positive growth rate is attributable to the exceptional import expansion reported by Egypt (52 per cent). Excluding Egypt, which is Africa's largest services importer, the services imports figure for all other African countries indicated stagnation.

Developments of commercial services trade by product category in 1997 confirmed the trend prevailing so far in the 1990's – namely, transportation and travel services expanded less dynamically than the third category of "other commercial services" (see Table II.7).

Table II.7

**Growth in the value of exports of commercial services by category, 1990-97**

(Billion dollars and percentage)

	Value	Annual change			
	1997	1990-97	1995	1996	1997
<b>All commercial services</b>	<b>1310</b>	<b>8</b>	<b>15</b>	<b>7</b>	<b>3</b>
Transportation	320	5	13	2	2
Travel	430	7	15	7	1
Other commercial services	560	9	16	9	6

This trend was accentuated in 1997, as the latter category of commercial services expanded by 6 per cent, at twice the average rate of all commercial services. Travel expenditure recorded the smallest increase in growth among all the three services categories in 1997, but with marked regional differences. While Japanese, German, Dutch and Belgium tourists reduced their expenditure in dollar terms by more than 10 per cent, those from the United Kingdom and the United States increased their expenditure by 11 per cent and 7 per cent respectively. Transportation services, the smallest and usually the least dynamic category, resisted the downward trend and expanded by 2 per cent, which was the same rate as the preceding year. One reason for the relative strength of transportation services exports was the improved situation for sea transportation, which benefitted from an increased volume of crude oil trade.

In order to analyse the subcategories in the category "other commercial services", the detailed data of the six leading commercial services traders have been reviewed. On the basis of this sample data, it appears that financial services (including insurance and banking services), construction services, and computer and information services are the subcategories which have expanded by more than the average rate of 6 per cent. Communication services, cultural and recreational services, royalties and license fees, and other business services increased by less than 6 per cent. Exports of some of these subcategories stagnated in 1997.

## V. Leading traders of merchandise and commercial services

The group of 25 leading exporters and importers of world merchandise trade and commercial services in 1997 accounted, in each case, for at least 80 per cent of the world total. The share of the leading exporters continues to exceed that of leading importers for both merchandise trade and commercial services. There was little change in the concentration of trade throughout the 1990s, as the shares of the top 25 traders have not changed. Not surprisingly, a considerable overlap exists in respect of the leading exporters and importers for both merchandise trade and commercial services, and only 30 countries figure among them (Table II.8, Table II.9).

Among the leading traders, the most dynamic countries in 1997 (and throughout 1990-97) were China and Mexico. Last year, China entered the group of the ten leading exporters of merchandise and that of the ten leading importers of commercial services. For the first time, Mexico's exports exceeded those of Spain and its imports exceeded those of Chinese Taipei. The United States enhanced its leading position in merchandise trade and commercial services – for both exports and imports – as its trade expanded two to three times faster than the global average in 1997. Strong trade growth brought Indonesia and Ireland as new

Table II.8

### Leading exporters and importers in world merchandise trade, 1997

(Billion dollars and percentage)

Exporters	Value (f.o.b.)	Share	Annual percentage change		Importers	Value (c.i.f.)	Share	Annual percentage change	
			1990-97	1997				1990-97	1997
United States	688.7	12.6	8	10	United States	899.0	16.0	8	9
Germany	511.7	9.4	3	-2	Germany	441.5	7.8	3	-4
Japan	421.0	7.7	6	2	Japan	338.8	6.0	5	-3
France	289.5	5.3	4	0	United Kingdom	308.2	5.5	5	7
United Kingdom	281.5	5.2	6	8	France	268.4	4.8	2	-5
Italy	238.2	4.4	5	-5	Hong Kong, China	213.3	3.8	14	6
Canada	214.4	3.9	8	6	retained imports <sup>a</sup>	52.4	0.9	8	10
Netherlands	193.8	3.5	6	-5	Italy	208.1	3.7	2	0
Hong Kong, China	188.2	3.4	13	4	Canada	201.0	3.6	7	15
domestic exports	27.3	0.5	-1	0	Netherlands	177.2	3.1	5	-4
China	182.7	3.3	17	21	Belgium-Luxembourg	155.8	2.8	4	-3
Belgium-Luxembourg	168.2	3.6	5	-1	Korea, Rep. of	144.6	2.6	11	-4
Korea, Rep. of	136.2	2.9	11	5	China	142.4	2.5	15	3
Singapore	125.0	2.7	13	0	Singapore	132.4	2.4	12	1
domestic exports	72.4	1.3	11	-1	retained imports <sup>a</sup>	79.9	1.4	9	0
Chinese Taipei	121.9	2.6	9	5	Spain	122.7	2.2	5	1
Mexico	110.4	2.4	15	15	Mexico	113.3	2.0	16	24
Spain	104.3	1.9	9	2	Chinese Taipei	113.2	2.0	11	12
Sweden	82.7	1.5	5	-3	Malaysia	79.0	1.4	15	1
Malaysia	78.4	1.4	15	1	Switzerland	76.0	1.3	1	-4
Switzerland	76.2	1.4	3	-6	Australia	65.8	1.2	7	1
Russian Federation <sup>b</sup>	66.3	1.2	...	-4	Sweden	65.4	1.2	3	-2
Australia	62.9	1.2	7	4	Brazil	65.0	1.2	16	14
Austria	58.6	1.1	5	1	Austria	64.8	1.2	4	-4
Thailand	57.4	1.1	14	3	Thailand	63.6	1.1	10	-14
Indonesia	53.5	1.0	11	7	Russian Federation <sup>b</sup>	48.8	0.9	...	13
Ireland	53.1	1.0	12	9	Turkey	48.5	0.8	12	13
Total of above	4665.0	85.4	7	3	Total of above	4557.0	80.9	7	3
<b>World<sup>c</sup></b>	<b>5460.0</b>	<b>100.0</b>	<b>7</b>	<b>3</b>	<b>World<sup>c</sup></b>	<b>5630.0</b>	<b>100.0</b>	<b>7</b>	<b>3</b>

<sup>a</sup> Retained imports are defined as imports less re-exports.

<sup>b</sup> Data exclude trade with the Baltic States and the CIS. Including trade with these states would lift Russian exports and imports to \$87.4 billion and \$67.6 billion respectively.

<sup>c</sup> Includes significant re-exports or imports for re-export.



entrants into the group of leading merchandise exporters and of leading services importers. Under the impact of currency variations, the trade growth of many countries in continental Western Europe was low or negative, while that of the United Kingdom was well above the global average. Five countries (Germany, the Netherlands, Belgium, Luxembourg and Switzerland) recorded declining export and import values for both merchandise and services trade. Japan, the leading trader in Asia, reported export growth at about the global average rate and import contraction for both merchandise and commercial services trade. Singapore, one of the fastest growing traders in the 1990s, experienced virtual stagnation in exports and imports for both merchandise and services trade. The Republic of Korea and Thailand were the only two Asian countries among the leading traders which experienced lower imports for both merchandise and commercial services trade, but an increase in exports. Despite the often marked deceleration of trade growth of developing economies in Asia in 1997, their average growth for the 1990-97 period remains, for all of them, well above the global average.

Table II.9

### Leading exporters and importers in world trade in commercial services, 1997

(Billion dollars and percentage)

Exporters	Value	Share	Annual percentage change		Importers	Value	Share	Annual percentage change	
			1990-97	1997				1990-97	1997
United States	229.9	17.5	8	7	United States	150.1	11.6	6	7
United Kingdom	85.5	6.5	7	12	Japan	122.1	9.4	5	-5
France	80.3	6.1	3	-3	Germany	120.1	9.3	6	-5
Germany	75.4	5.8	6	-4	Italy	70.1	5.4	5	5
Italy	71.7	5.5	6	4	United Kingdom	68.6	5.3	6	9
Japan	68.1	5.2	7	3	France	62.1	4.8	3	-5
Netherlands	48.5	3.7	7	-1	Netherlands	43.8	3.4	6	-2
Spain	43.6	3.3	7	-1	Canada	35.9	2.8	4	1
Hong Kong, China	37.3	2.8	11	0	Belgium-Luxembourg	32.1	2.5	4	-3
Belgium-Luxembourg	34.0	2.6	5	-2	China	30.1	2.3	33	34
Singapore	30.4	2.3	13	2	Korea, Rep. of	29.0	2.2	16	0
Canada	29.3	2.2	7	2	Austria	27.4	2.1	10	-10
Austria	28.5	2.2	...	...	Spain	24.3	1.9	7	1
Switzerland	25.6	2.0	4	-2	Chinese Taipei	24.1	1.9	8	2
Korea, Rep. of	25.4	1.9	16	12	Hong Kong, China	22.7	1.8	11	6
China	24.5	1.9	23	19	Sweden	19.5	1.5	2	4
Turkey	19.2	1.5	14	49	Singapore	19.4	1.5	12	1
Australia	18.2	1.4	9	1	Brazil	19.0	1.5	16	36
Sweden	17.6	1.3	4	5	Russian Federation	18.7	1.4	...	0
Chinese Taipei	17.0	1.3	14	5	Australia	18.2	1.4	5	0
Denmark	16.5	1.3	4	1	Thailand	17.2	1.3	16	-11
Thailand	15.9	1.2	14	-5	Malaysia	16.8	1.3	18	0
Philippines	15.1	1.2	27	17	Indonesia	16.1	1.2	15	9
Malaysia	14.5	1.1	21	4	Ireland	15.0	1.2	17	12
Norway	14.3	1.1	2	2	Denmark	14.7	1.1	6	-1
Total of above	1086.0	82.9	7	3	Total of above	1037.0	80.1	6	1
<b>World</b>	<b>1310.0</b>	<b>100.0</b>	<b>8</b>	<b>3</b>	<b>World</b>	<b>1295.0</b>	<b>100.0</b>	<b>7</b>	<b>2</b>

Note: Figures for a number of countries and territories have been estimated by the Secretariat. Annual percentage changes and rankings are affected by continuity breaks in the series for a large number of economies, and by limitations in cross-country comparability.

# Chapter Three

## Developments

### in trade policy



# Developments in trade policy

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## Introduction

Since the last WTO Annual Report, conditions for trade and trade-related policy-making have become considerably more difficult. The effects of the financial and economic crisis affecting emerging markets and of the economic downturn in Japan are far from fully worked through. They are having a serious impact on the pattern of world economic growth, and hence, on trade and on commodity markets (Chapter Two). Although there has been some backtracking in trade liberalization, the multilateral trading system – as seen in the development of trade policies – seemed, in September 1998, to be standing up well to the turbulence in financial and trading markets.

The most serious developments affecting trade prospects during the past year were the dramatic fall in import demand in the crisis-ridden countries, resulting from recession and devaluation, and the worsening domestic economic situation in Japan. As described more fully in Chapter One and Chapter Two, these have already had major effects on trade flows and balances in goods, on commodity prices, and on trade, investment and production of commodities and of some manufactures and services, particularly high-technology products such as computer chips, and tourism. These trends, if unchecked, are likely to have serious consequences for world economic growth and trade in 1998 and into 1999.

During the past year, the general drive towards multilateral, regional and unilateral market opening has continued. There have been no fundamental reversals in trade policy direction even in those WTO Members most directly affected by the financial crisis, and there was, as of September 1998, little evidence of serious closing of markets in the rest of the world. These are welcome signs that the trading system contains robust checks and balances against arbitrary actions. However, there have been some increases in trade-defence measures in a few Members, with a view to forestalling increases in imports seen as “unfair”, and other such developments are expected; developments in these areas will require careful monitoring.

A significant trade-related policy development was the introduction by Malaysia, in early September, of wide-ranging exchange controls, including a requirement that all trade accounts should be paid in foreign currency. So far, however, no other countries have followed suit, and many have even made clear their intentions not to introduce such restrictions.

During the past year, autonomous trade liberalization efforts generally continued – including in most of the Asian crisis countries – and several major advances were made in multilateral trade liberalization of goods and services on an MFN basis. However, the pace and scope of regionalism has also gathered force. In this connection, it is important that the multilateral principle of non-discrimination remains the driving force in international trade policies.

In this Chapter, we seek first to illustrate the evolution of trade policies through developments in the WTO system, as well as in selected WTO Members, based on Trade Policy Reviews conducted since the last Annual Report<sup>1</sup>; second, to examine the effects of the Asian crisis on trade policy trends; and third, to trace developments in regional agreements and their effects on (and challenges for) the multilateral trading system.

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## Developments in trade and trade-related policies

The Secretariat has repeatedly noted the sea-change that has taken place in Members' attitudes to trade and trade-related policies. Greater market-orientation, with tariffs, rather than quantitative measures, becoming the main protective instruments, has become widespread; as a result of the Uruguay Round, comprehensive tariffication has replaced quantitative restrictions on agricultural products, and moves are underway to reduce or eliminate the major non-tariff barriers affecting many sectors of trade; services trade has been brought into the multilateral system; bilateral approaches to trade have been brought under multilateral control; regular reviews of individual WTO Members' trade policies have brought greater transparency into the trading system; and the improved dispute settlement mechanism has shown its worth.

Trade policy reform works best under a number of clearly defined conditions, including:

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<sup>1</sup>Between August 1997 and July 1998, Trade Policy Reviews were conducted of Benin, Chile, India, Mexico, the European Union, Malaysia, Japan, the Southern African Customs Union, Nigeria, Australia and Hungary.

- stable long-term policies (including macroeconomic and structural policies) that give industries time to adjust to trade liberalization and provide both transparency and scope for policy monitoring;
- absence of exceptions that can lead to major policy slippages;
- closing of loopholes that can offer alternative forms of protection;
- a clear, transparent framework for policy development and monitoring;
- and a mutually supportive process of unilateral, regional and multilateral liberalization and deregulation.

One essential element that should be added to these conditions is the objective of non-discrimination in treatment, both among foreign suppliers and between domestic and foreign suppliers and investors, embodied in the WTO principles of most-favoured-nation and national treatment.

In general, the momentum of trade liberalization by WTO Members has continued in the past year. WTO commitments are generally being respected; the dispute settlement procedures are fulfilling their role; and regular monitoring of trade policies in the Trade Policy Review Mechanism is proving effective in increasing transparency and peer pressure.

Following the Uruguay Round, the process of multilateral liberalization of trade in goods and services has continued on a sectoral basis. New commitments have been undertaken by 44 participants on goods, including two non-members of the WTO, in the WTO Declaration on Trade in Information Technology Products (the ITA)<sup>2</sup>, by 70 Members on services in the Agreement on Trade in Financial Services<sup>3</sup> and by 78 in the Agreement on Telecommunications Services.<sup>4</sup> In addition, 22 Members have made new "zero for zero" commitments on a range of pharmaceutical products.<sup>5</sup> These agreements extended the package of commitments undertaken in the Uruguay Round and will significantly enlarge the scope of duty-free trade in industrial goods and of liberalized trade in two important service sectors.

In addition, the "integration" of textiles and clothing under the Agreement on Textiles and Clothing (ATC) has continued, with the second stage underway from 1 January 1998. In the first two stages a total of 33 per cent of Members' textiles and clothing imports was brought fully under GATT 1994 rules; where the integrated products were subject to quotas, these were removed. The third stage of the integration process under the ATC, reaching 51 per cent of imports by volume, will begin on 1 January 2002, with all remaining products to be fully integrated on 31 December 2004, when the Agreement terminates. Growth rates for the remaining quotas, maintained by Canada, the European Union, Norway and the United States, have also been increased at the beginning of each of the first two stages. Norway will eliminate virtually all its remaining restrictions by the end of 1998. The use of the ATC's transitional safeguard mechanism has decreased considerably, from 24 occasions in 1995 (by the United States) to eight in 1996 (seven by Brazil, one by the United States), two in 1997 (by the United States) and two up to the end of July 1998 (by Colombia).

The outcome of these events, together with the Uruguay Round tariffication of non-tariff measures on agricultural products and the ongoing phasing-in of tariff reductions on industrial products in general, is that the scope of quantitative restrictions maintained by industrialized countries has been dramatically reduced, and that the average level of tariffs on manufactures is steadily declining. However, tariffs on textiles, clothing and footwear remain generally higher than average levels, and tariffication in agricultural and agro-industrial products has – while increasing transparency and clarity – led to extremely high levels of duty in many instances.

In addition to the autonomous tariff reforms undertaken by the majority of developing economies, the incidence of the classic non-tariff measures (quantitative restrictions, import licensing, etc.) in developing countries has declined sharply, although non-automatic licensing still applies to a minor, but significant, share of tariff lines in some countries. The share of bound tariffs increased markedly as a result of the Uruguay Round; but most developing countries continue to maintain significant gaps between "ceiling" bound and applied rates, giving them flexibility for tariff increases within WTO rules. More emphasis is also being placed by some developing Members on safeguard or anti-dumping procedures, including reference price mechanisms as noted below; however, the use of such contingency measures has not negated the overall movement towards liberalization. Since the application of safeguard, anti-dumping and countervailing measures generally tends to fall in periods of healthy economic growth and rise in times of stagnation or recession, the use of these types of measure by all WTO Members in the next year must be carefully monitored.<sup>6</sup>

The monitoring of policies undertaken by the Trade Policy Review Body has confirmed that the combined effects of the multilateral liberalization undertaken in the Uruguay Round and its subsequent sectoral negotiations, regional agreements in which some provisions may be extended on an MFN basis, and autonomous trade reforms (some under the aegis of IMF and/or World Bank programmes), have kept the process of market opening on track and that, despite some minor deviations from the process, no major reversals have taken place.<sup>7</sup> Reviews have also stressed the desirability of pursuing external liberalization and domestic

<sup>2</sup>The Declaration on Trade in Information Technology Products (ITA), in force from 1 July 1997, commits participants to eliminate customs duties and other charges by 1 January 2000 (up to 2005 for some products from some developing countries) on information technology products (computers, including printers, scanners, monitors, hard-disk drives, etc; semiconductors; semiconductor manufacturing equipment; software; scientific instruments; and telecommunications equipment). All figures in this paragraph count member States of the European Union individually.

<sup>3</sup>The Agreement on Trade in Financial Services will enter into force as the Fifth Protocol to the GATS on 29 January 1999.

<sup>4</sup>The Agreement on Telecommunications Services entered into force as the Fourth Protocol to the GATS on 5 February 1998.

<sup>5</sup>Canada, Czech Republic, the EU, Japan, Norway, Slovak Republic, Switzerland and the United States. "Zero for zero" commitments (implying duty-free access) under the Uruguay Round already covered ranges of pharmaceutical products, construction equipment, medical equipment, steel, furniture, agricultural equipment, beer, distilled spirits, toys and paper.

<sup>6</sup>Semi-annual reports to the WTO indicate some new initiations of anti-dumping measures on certain speciality steel items in the European Union and Canada in the period up to June 1998; in September 1998, the steel industries in the United States and Canada submitted a new range of anti-dumping cases.

<sup>7</sup>A complete set of the concluding remarks by the Chairperson of the TPRB in reviews conducted in the period is contained in Chapter Five, Annex II, of this Report.

deregulation in parallel, in order to ensure that the benefits of external competition are extended to the internal market. Thus, as well as traditional areas of trade policy such as tariffs and other border measures, reviews have examined topics such as privatization or demonopolization of state-owned industries or service suppliers, marketing boards, etc.; conditions for competition in government procurement (irrespective of whether a Member under review is a member of the Plurilateral Agreement); or the structure of domestic taxation of goods and services, and of incentives for exports or investment. Reviews have also, in some cases, shown the need for more effective regulation (for example, in financial services) to ensure greater stability for trade and investment.

Many of these points can be illustrated by the reviews undertaken in 1997 and early 1998 of the European Union and Japan, which together account for almost one half of the value of world trade and whose policies have undeniably important effects on the trade conditions and trade policies of others.

The review of the European Union (EU) in December 1997 showed that the creation of the Single Market had significant positive economic effects for most Members by creating a more secure and stable trade environment. Third countries benefited from the lowering of tariffs on an MFN basis under Uruguay Round concessions, the agreement on trade in information technology products (ITA), other "zero for zero" concessions such as on pharmaceuticals, liberalization of financial and telecommunications services, internal harmonization of industrial standards and public health norms. However, the importance of the EU in world trade makes other Members all the more sensitive to any trade-distorting aspects of its policies. Thus, concerns were expressed about the extension of the network of preferential agreements, leading to the creation of an ever-widening preferential area with increasingly harmonized and "cumulative" rules of origin; continuing restrictions and highly differentiated treatment in agriculture; and the network of national and Community-wide state aids to industry. The expansion of the EU's network of regional agreements, and their trade-creating or diverting effects, were also issues in the reviews of Cyprus and Hungary.

The review of Japan in February 1998 – coming at a time of stagnation and looming recession, with the Asian financial crisis both affecting, and being affected by, Japan's own poor economic performance – raised serious questions about the effectiveness of the economic stimulation measures being applied and stressed the links between macroeconomic and structural reform, deregulation and market stimulation. The TPRB clearly spelled out the dangers for the Asian and world economies of Japan's continuing stagnation, and stressed the need for stimulation of the economy through fiscal and structural reforms, and continuing domestic deregulation and reform, particularly of the financial sector, as essential complements to trade liberalization and to each other. At the same time, it recognized that Japan, like the EU and many other WTO Members, had continued to liberalize trade on an MFN basis through Uruguay Round concessions, participation in the ITA and other sectoral initiatives; indeed, Japan had made a commitment, under APEC provisions, to accelerate the application of its Uruguay Round concessions by up to two years.

The Asian financial crisis was also at the heart of the review of Malaysia in December 1997, and will be central to the reviews of Indonesia and Hong Kong, China, to be conducted in autumn 1998. When reviewed, Malaysia had just announced in its budget for the 1998 fiscal year a number of selective measures aimed at reducing imports and increasing exports of goods and services. The package included increases in import duties on selected consumer goods, including cars and a number of consumer durables; construction materials and heavy machinery used in construction; imports of such machinery were also to be subject to government approval, granted only if machinery was not available locally. The selective tariff increases remained within the margins permitted by WTO "ceiling" bindings. The discussion of this point showed a clear division of views between Members who believed that the imposition of any trade-restricting measures gave wrong signals to traders and investors, and those who believed that the WTO system should provide a flexible and supportive environment to Members facing economic difficulties as a result of factors beyond their control.

More recently, in September 1998, Malaysia introduced a package of general exchange control measures, the stated aim of which was to insulate the economy from currency speculation and external "contagion". These are mainly financial-sector measures, but include a provision that all settlement of exports and imports must be made in foreign currency.

In other reviews, the TPRB was at pains to emphasize the links between stable macroeconomic policies, trade liberalization and economic growth, and the role of trade liberalization and deregulation in structural reform programmes. Examples include:

- For Mexico, stress was placed on the benefits from stable fiscal and monetary policies in its recovery from the financial crisis of 1995, during which there was no major reversal of

trade policy (although tariff increases were introduced in 1995 on textiles, clothing and footwear); the MFN liberalization of 1200 tariff lines of inputs and machinery; and the need to integrate export-oriented "maquiladora" industries more closely with the domestic economy.

More recently, Mexico has, during 1998, strengthened its armoury of selective measures against "unfair" trade practices by introducing an ex-post price inspection and monitoring system for imports "of items and from countries in which there may be a presumption of possible unfair practice or under-invoicing"; a system of advance notice of importation applying to textiles, clothing, chemicals, steel, bicycles, ceramics, footwear, glassware and timber; and a technical requirement that all imports of footwear should bear permanent labels, in addition to the establishment of special customs offices for footwear.<sup>8</sup>

- Chile was praised for its remarkable economic growth, which was combined with growing social equity and reduction of unemployment and inflation. With the causes and effects of the Asian crisis in mind, Members also recognized that Chile's compulsory deposit scheme for short-term portfolio investment funds might be a useful economic stabilizer that may provide a lesson for others.<sup>9</sup>

In September 1998, the Chilean House of Representatives passed a bill which would reduce Chile's uniform tariff from 11 to 6 per cent between 1999 and 2003. This will reduce the margin between the terms of access for MFN and free-trade area partners (Chile's MFN rates of duty are bound at 35 per cent).

- India's economic reforms, and their contribution to healthy economic growth, were commended. The TPRB welcomed India's substantial tariff reforms and the ongoing reduction in the number of products subject to restrictive import licensing (subject to a phase-out programme agreed with most of its main trading partners), while noting that import licensing was still heavily concentrated on consumer goods.<sup>10</sup> The emphasis of India's trade policy on export promotion was queried and the need for domestic deregulation to complement trade liberalization was stressed.

Since the review, India's trade policy orientation has moved further in the direction of domestic protection and export promotion, with the introduction in the 1998 budget of a "special additional duty" of 4 per cent, with exceptions for inputs used in the production of exports.<sup>11</sup> Although the government's stated aim is still to align India's tariffs with average ASEAN rates by the year 2000, overall tariffs remain high. India recently announced that it would be removing QRs on 2000 specified items for SAARC countries as of 1 August 1998.

## The Asian financial crisis and the multilateral trading system

The repercussions of the Asian financial crisis, which began in mid-1997, became evident in trade flows in early 1998. All international estimates since the beginning of the crisis have tended to underestimate the depth of the downturn in economic growth and in trade. It is now clear that, with a substantial reduction in world economic growth, there will be an overall slowdown in the US dollar value of world trade in 1998, stemming from a lack of demand in Asian markets and a general decline in world oil and other commodity prices;<sup>12</sup> and that the slowdown will be concentrated more in certain areas of the world than in

<sup>8</sup>SECOFI press releases 518.26, 576.27 and 582.17, Mexico City.

<sup>9</sup>However, it was reported in July 1998 that, to encourage an inflow of funds and support a deteriorating balance of payments, Chile had reduced the percentage of short-term funds required to be deposited.

<sup>10</sup>A WTO Dispute Settlement Panel between India and the United States regarding India's import restrictions was still in progress at the time of writing (WT/DS90/8, dated 18 November 1997). Agreements on the phase-out of import restrictions on an MFN basis by 2002, concluded with Australia, Canada, the European Union and Switzerland have been notified to the WTO (documents WT/DS/91/8 and Corr. 1, 92/8, 94/9 and 96/8).

<sup>11</sup>This issue was discussed under "Other Business" in the WTO General Council meeting of July 1998 (document WT/GC/M/29).

<sup>12</sup>As noted in Chapter Two, the price changes in world markets and the devaluation of Asian currencies have meant that movements in the volume and US dollar value of many trade flows have differed significantly.

Table III.1

### GDP performance in selected Asian economies, 1996-98

(Annual percentage change)

		1996	1997	1998 (projection)
ASEAN	Indonesia	8.0	4.6	-15.0
	Malaysia	8.6	7.8	-6.4
	Philippines	5.7	5.1	-0.6
	Singapore	6.9	7.8	0.0
	Thailand	5.5	-0.4	-8.0
	Other Asia	India	7.5	5.6
	Republic of Korea	7.1	5.5	-7.0
	Japan	3.9	0.8	-2.5
	Hong Kong, China	4.6	5.3	-5.0
	China	9.6	8.8	5.5

Source: IMF, *World Economic Outlook*, October 1998.

### Box III.1: The recession in the Republic of Korea

The recession in Korea following the Asian financial crisis has had dramatic consequences, both for the level of production and employment, and for the balance, structure and direction of trade.

In August 1998, the Ministry of Finance and Economy's monthly Economic Bulletin reported that on a year-on-year basis, despite an increase in exports, industrial production was 13.7 per cent lower in May 1998 than a year earlier; manufacturing industry was operating at around two thirds of capacity; construction orders were down by over 62 per cent from the previous year; inventories had declined with the fall in output; and consumer goods sales had fallen by over 28 per cent. Employment in manufacturing had fallen by 14½ per cent. Overall, imports declined by nearly 37 per cent in US dollar value in January-May, compared to 1997, and imports of consumer goods by 43 per cent; even more worryingly, the US dollar value of letters of credit opened for future imports had fallen by more than half.

These recessionary trends resulted in an improvement of some US\$24 billion in Korea's merchandise trade balance (on a balance-of-payments basis) for January-May 1998, and of US\$28 billion in the current account of the balance of payments for the same period. The dollar value of exports to the United States and the European Union grew by 12 and 15 per cent, respectively, while imports from both of these sources fell by 38 per cent. By contrast, exports to Japan, South-East Asia and China fell by 14, 15 and 2.4 per cent in US dollar value respectively compared with the same period of 1997, while imports from these sources declined by over 40 per cent from Japan, 32 per cent from South-East Asia and 30 per cent from China.

Source: Republic of Korea, Economic Bulletin, August 1998.

others, in particular in oil exporting countries, Asia and the Pacific, North America, the Middle East, and other commodity producing regions.<sup>13</sup> This reflects the existing geographical pattern of Asia's trade.<sup>14</sup>

The effects of the crisis are clearly most serious in the former "Asian tiger" economies themselves. Some (e.g. Indonesia, Republic of Korea) are in very serious recession, with a swing of 23 percentage points in Indonesia's GDP growth rate between 1996 and 1998, and millions newly unemployed (Table III.1).<sup>15</sup> The crisis in the former "tigers" has been seriously exacerbated by the deepening downturn and lack of effective demand in Japan.

The effects of the crisis on neighbouring economies are also becoming apparent; thus, GDP growth in China (which, with a non-convertible currency, is largely insulated from speculative attack) is estimated to be slowing to 5½ per cent; GDP of Hong Kong, China is projected to decline by 5 per cent in 1998 and the authorities have had to take strong measures to maintain the "peg" of the Hong Kong dollar against the US dollar; and Australian government estimates project a slowdown in GDP growth by about 1 per cent as a result of the crisis. Even the United States' economy, previously growing at annual rates of over 3 to 4 per cent, slowed markedly in the second quarter of 1998, bringing projections of slower growth for the year overall, with exports of goods and services declining in value in the first two quarters.

These developments are not surprising. The combination of rapid economic growth with increasing integration among Asian economies, and particularly with Japan, was a source of remarkable economic transformation from the late 1980s onward, aided by the process of globalization and foreign investment, initially from Japan but subsequently also from the United States, Europe, Australia and the developing Asian markets themselves.<sup>16</sup> Asian economies became much more integrated into world markets and, particularly, in regional trade and investment, with an increasing ratio of trade to GDP and a growing share of intra-industry trade. At the same time, the degree of financial integration was also increasing and the speed of financial flows growing.<sup>17</sup> It could, therefore, be expected that any developments, positive or negative, in any of the Asian economies would have substantial effects on the others and on their trading partners.

### Reaction of the multilateral system to the Asian crisis

One consequence of the Asian crisis has been a sharp change in the apparent external competitiveness of the exports of the countries affected. The reversal in capital flows and sharp real depreciation of the major Asian currencies vis-à-vis the US dollar and European monies (Chart III.1) has been a cause of major changes in the trade balances of the countries concerned: in general, the trade and current accounts have shown lower deficits or increased surpluses resulting from a sharp downturn in imports. As expected, such depreciation initially made exports cheaper and imports more expensive; however, the high import-content of many East Asian exports and the difficulties of access to credit resulting from the banking sector crisis have dampened the normally stimulating effects of devaluation on exports. An additional factor inhibiting the growth of the quantity of exports has been physical constraints (absence of container and shipping capacity stemming, in part, from lack of imports). On the other side, the reductions in export prices benefit consumers

<sup>13</sup>IMF projections, published in the World Economic Outlook, October 1998, estimate a GDP growth rate of 2 per cent for the world in 1998, down from a projection of 4½ per cent before the crisis. An average fall of over 10 per cent in GDP for four ASEAN countries (Indonesia, Malaysia, the Philippines and Thailand), 6 per cent for Russia and 2½ per cent for Japan are projected.

<sup>14</sup>Over 50 per cent of Asia's exports, and around 55 per cent of its imports, are from the region. A quarter of North America's exports and a third of its imports are from Asia: for the Middle East, the relative shares are one half and one quarter. Asia accounts for lower shares overall of trade of Europe, Latin America and Africa, although individual countries' shares vary considerably. (See International trade statistics, WTO, 1998, Appendix Table A2).

<sup>15</sup>The ILO has recently estimated that the economic crisis would throw almost 7million Indonesians into unemployment by end-1998 and bring 48 per cent of the population below the "absolute poverty" level by the same time.

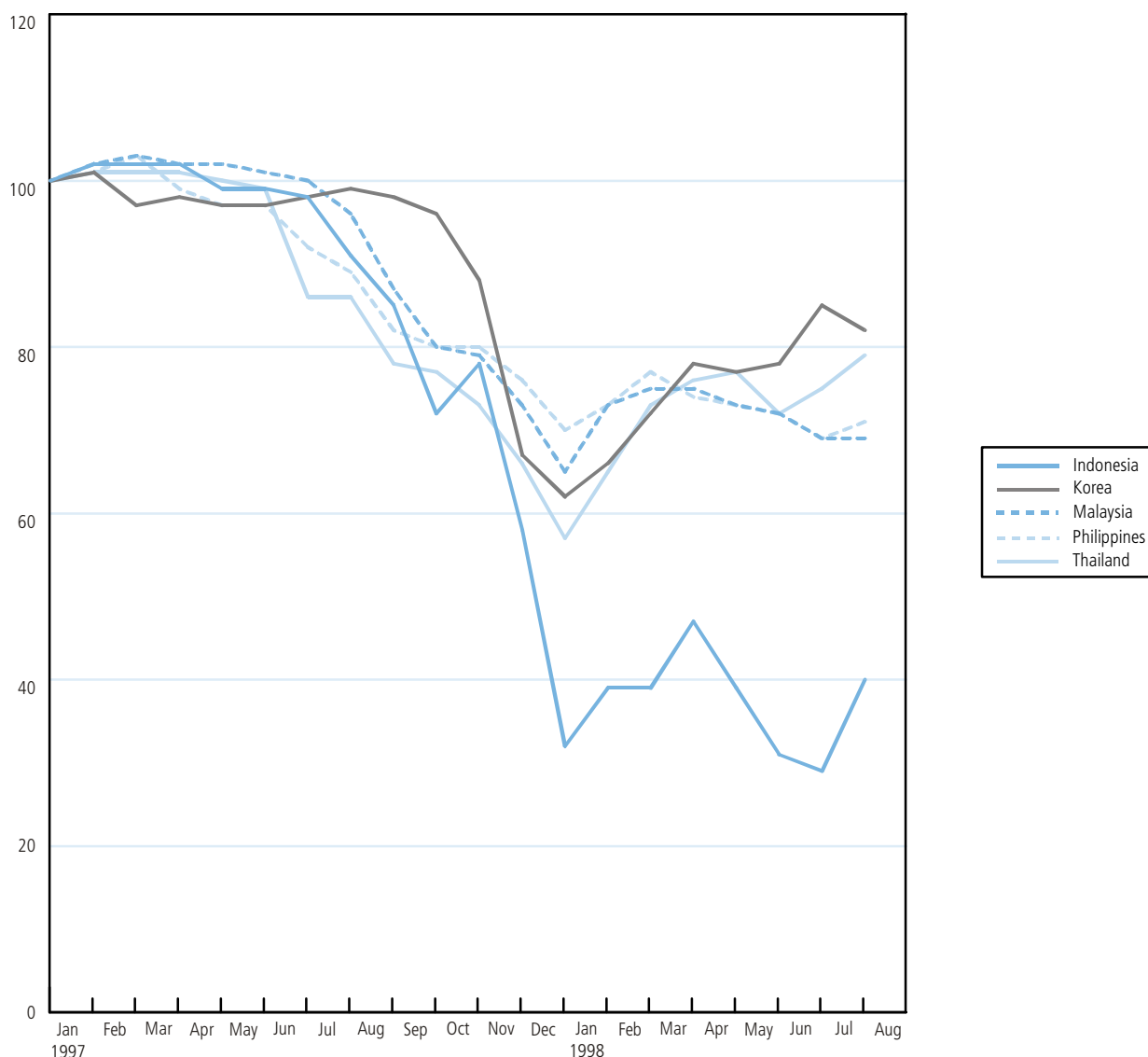
<sup>16</sup>The share of East Asian sources in Japan's merchandise imports grew from 33 per cent in 1993 to 36 per cent in 1996. In the same period, the share of the United States declined slightly to 23 per cent while that of the European Union increased to 14 per cent. Intra-industry trade (the import and export of goods classified in the same product category) accounted in 1996 for some 37 per cent of total Japan's merchandise trade, up from around 27 per cent in 1993.

<sup>17</sup>IMF data show that, between 1994 and 1996, the value of net external financing inflows to developing Asia, except China, Hong Kong, China, India, Korea and Singapore, virtually doubled from US\$32.4 billion to US\$63.4 billion. Two thirds of the flow in 1996 was in the form of external borrowing from banks and other non-official sources (IMF, World Economic Outlook, May 1998).

Chart III.1

**Evolution of Real Effective Exchange Rates of Asia (5), 1997-98**

(January 1997 = 100)



Source: J.P. Morgan.

and relieve inflationary pressure in major importing countries such as the United States and the United Kingdom whose economies were, in early 1998, operating at near full capacity.

At the outset of the Asian crisis, fears were expressed that the resulting downturn in those countries directly affected might lead to an upsurge in protectionism. However, well over one year after the beginning of the crisis, there is still little sign of mounting protectionism, either from the countries in South-East Asia directly affected by the crisis, or from other countries importing from the region. On the contrary, most countries in Asia have accepted, either unilaterally, as part of IMF-sponsored adjustment programmes, or as a result of recent sectoral negotiations in the WTO and in APEC, substantial liberalization – and commitments to further liberalization – of their trade and investment policies.

Indonesia, the WTO Member most severely stricken by the crisis, has undertaken the greatest liberalization of its trade. In the WTO, Indonesia improved its commitments in financial services, and introduced a comprehensive trade package under its IMF programme. The package provides, inter alia, for the liberalization of agriculture, the virtual elimination of non-tariff barriers to trade, the removal of restrictions on exports and the liberalization of investment. If these reforms are implemented in accordance with the agreed timetable, Indonesia will have one of the most liberal trade policy regimes of all developing countries by the turn of the century. The Republic of Korea undertook to remove restrictive import licensing requirements on 113 tariff items, improve the transparency of import certification procedures, set a timetable for the phasing-out of trade-related subsidies, eliminate the



discriminatory “import diversification programme”, and considerably liberalize foreign direct investment. Korea also made substantial new commitments in the recent WTO negotiation on financial services, and agreed that it would bind in the WTO commitments made on accession to the OECD. A revision of its latest schedule is soon to be tabled. Thailand also participated in the WTO Financial Services Agreement and has taken steps to further liberalize foreign investment. In addition, it has cut tariffs on raw materials in order to mitigate the rise in the costs of imported inputs caused by the depreciation of its currency.

Following the crisis, some Asian countries have increased levels of tariff protection selectively and generally within the flexibility allowed by bindings under the WTO agreements. These measures give cause for concern to the extent they may distort the pattern of production and trade. Thus, Malaysia and Thailand introduced selective import duty increases for fiscal reasons.<sup>18</sup> As noted, Malaysia has also introduced wider exchange restrictions which affect both trade and financial flows. The Philippines has, within its overall policy commitment to achieve a uniform applied rate of 5 per cent by January 2004, adjusted the pace of reduction or increased duty rates on some sensitive items (including some textiles and clothing, wood products, and CKD vehicle kits) while reducing some other tariff rates. Generally, however, South-East Asian countries have not extensively used the leeway allowed by the gap between bound and applied tariffs to raise the latter. (In the case of Indonesia, the government could in theory increase its average applied tariff by 25 per cent without breaching its WTO obligations.) Other WTO Members in the region, such as Singapore and Hong Kong, China, have continued to pursue their traditionally open trade policies; and there is no evidence of any new trade restricting measures by China itself.

So far, no substantial or widespread defensive reaction has occurred in the rest of the world. During the early stages of the crisis, fears were expressed that trading partners would take defensive actions in the shape of anti-dumping or safeguard measures against an upsurge of imports from the countries in crisis. In the event, the upsurge of exports has not yet materialized, and neither have such defensive actions on any large scale.<sup>19</sup>

That this is so is a tribute both to the good sense of governments and to the strength of multilateral and regional rules. The WTO agreements, by strengthening the conditions under which protective actions can be taken by any WTO Member, ruling out “voluntary” export restraints and more effectively disciplining the use of other safeguard measures, have prevented arbitrary abuse of the system; and in Asia, the disciplines introduced by ASEAN and APEC, also based on WTO rules, create a solid basis of disincentives to negative policy reactions in the region. Moreover, few governments in power today in advanced or developing countries would see an advantage in a return to autarkic policies; the shock-absorbing nature of an open multilateral trading system is well recognized.

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## Developments in regional groups and their relationship to the multilateral trading system

During the past year, the steady march towards the strengthening of regional trade agreements has continued on all continents. Examples include:

- In Africa, the southern cone is moving towards closer integration on a free-trade-area basis through the Southern African Development Community (SADC); within the group, the SACU member States are renegotiating their customs union relationships. In other parts of Africa, there is also a revival of regional integration. For example, in West Africa, the new Economic and Monetary Union (WAEMU, in French UEMOA) plans to bring into effect a common external tariff, a joint Commission and many of the elements of the European system (a common currency in the shape of the CFA franc already exists). The East African Cooperation member States (Kenya, Tanzania and Uganda) have continued their renewed movement towards an eventual economic and monetary union, with a common currency. The COMESA grouping, with 20 member States, remains the largest regional entity in Africa, with the objective of establishing a customs union and common external tariff.

- In the Americas, the process of completing MERCOSUR continues, and an agreement was signed in April 1998, among 34 countries, to establish the Free Trade Area of the Americas (FTAA) by a target date of 2005. A number of agreements have been concluded among individual countries in the region or involving pre-existing sub-regional groupings, usually to be fully implemented before that date. Thus, for example, MERCOSUR has signed agreements with the Andean Community (to initiate a full free-trade agreement by 2000), with the Central American Common Market (to begin a tariff reduction programme leading towards a free-trade agreement), as well as free-trade agreements with Bolivia and Chile. The Andean Community itself has agreed to move to a common market by 2005, and signed a framework agreement with Panama which is aimed at the latter's full incorporation into the Community. Among the NAFTA parties, Canada has signed a free-trade agreement with

<sup>18</sup>In the context of its 1998 budget, Malaysia decided to increase import duties on selected consumer goods, including cars, and a number of durables, construction materials and heavy machinery used in construction. Tariff increases in Thailand concern essentially some luxury goods and steel.

<sup>19</sup>However, during 1998, some WTO Members – e.g. Australia, Brazil and Mexico – have reinforced their anti-dumping procedures; MERCOSUR member States introduced a 3 percentage point tariff increase from 1 January 1998, partly to compensate for reductions in Argentina's statistical tax; and in September 1998 Brazil announced a series of administrative and technical measures, applied through health and other quality control procedures covering certain agri-food and manufactured products, aimed at increasing the competitiveness of domestic production vis-à-vis imports.

Chile while Mexico is engaging in deeper trade integration with some South-American partners.

- In Asia, despite the crisis, the fundamental principles and mechanisms of the ASEAN process of integration have not been put into question and the objectives of the ASEAN free-trade area (AFTA) remain on track. APEC senior officials have agreed to complete a "fast-track" trade liberalization programme for nine priority sectors by November 1998 (initially envisaged for June).<sup>20</sup> In Central Asia, five newly independent republics (Kazakhstan, Kirghizistan, Tadjikistan, Turkmenistan and Uzbekistan) have joined with Iran, Pakistan and Turkey to develop trade links.

- In Europe, the process of EU enlargement has been confirmed with an agreement to integrate, as a first step, the Czech Republic, Estonia, Hungary, Poland, Slovenia and Cyprus in the internal market. The EC also maintains its customs union with Turkey and the conclusion of "new generation" free-trade agreements with other trading partners in the Mediterranean region has been stepped up. Anchored to these moves, a number of agreements have been signed, or are at an advanced stage of negotiation, between EFTA member States and countries in Central and Eastern Europe and the Mediterranean.

Among inter-continental integration initiatives, the APEC Forum remains a unique case. Unlike other regional groupings, APEC does not seek to establish a customs union or free-trade area, but rather to reduce tariffs and other barriers to trade on an MFN basis, through individual and collective action plans, developed in mutual consultation. The aim is to reach free trade by 2010 for developed and 2020 for developing countries.

Most other inter-continental initiatives involve the European Union. The renegotiation of the Lomé Convention has begun, with free-trade agreements representing one of the options put forward by the EU as a possible way to renew the trade component of the partnership; a new FTA is being negotiated with South Africa and free-trade agreements are foreseen with MERCOSUR and Canada; and there is periodic discussion of a free-trade arrangement between the EU and the United States under the Transatlantic Economic Partnership.

Just over 100 regional trade agreements in force as of June 1998 have been notified to the WTO or, previously, to the GATT. In addition, a considerable number of other agreements have not yet been notified, but are nonetheless in force (even if not always fully implemented). Most of these involve developing countries and fall under the aegis of the "Enabling Clause".

It is clear that the political impetus to conclude regional trade agreements is not diminishing and is, if anything, increasing. Several factors can be invoked to explain this trend. One is mainly political in nature: this has probably been the major factor, for example, bearing on the desire for closer economic and political cooperation that has prevailed in Europe since the end of the cold war. Another factor is that, in a globalizing world economy, many governments appear to perceive that size counts; this can provoke fears that remaining small and unaligned on a regional scale may place their producers at a disadvantage vis-à-vis their larger scale competitors.

This argument may be valid where economies of scale cannot be achieved at a national level, but care must be taken by governments to keep their eyes firmly on the global marketplace and not be seduced into believing that producing at a regional level is an adequate substitute; this route can all too easily lead to demands for protection of the regional market (overall or in specific sectors) and to the emergence of globally uncompetitive enterprises (in effect, leading to import substitution at the regional, as against the national, level).

In recent years, unlike the situation in the 1960s and 1970s, the processes of unilateral, regional and multilateral liberalization of trade have gone ahead side by side, and one of the positive elements is the desire of many parties to use regional agreements to "lock in" and even extend the multilateral liberalization achieved in the Uruguay Round. Thus, for example, the process of unilateral trade liberalization and tariff reform in Latin America, including reductions in tariffs and the elimination of quantitative and other restrictions on an MFN footing, has been coincident with the revival of regional trade agreements, such as MERCOSUR, and with bindings under the Uruguay Round. Similarly, the expansion of the EU's network of agreements with EFTA, Central and Eastern European countries and the Mediterranean has gone alongside the commitments to tariff reductions made by the EU in the Uruguay Round, including the "zero for zero" commitments and tariff elimination under the Information Technology Agreement. Again, commitments to phase out trade restrictions on goods and services have in some cases been made on an MFN basis in the context of entry to a regional group.

Generally, it can be argued that the closer a regional entity comes to being a single market, and the more closely regional and multilateral liberalization can be combined or coordinated, the more likely it is that the internal free movement of goods and services will benefit outsiders as well as insiders. Harmonization or unification of regulations within a

<sup>20</sup>The priority sectors are telecommunications, chemicals, energy, environmental goods and services, fish, forest products, gems and jewellery, medical equipment, and toys.

regional entity or among regional groupings (in fields such as customs documentation, internal taxation, intellectual property, government procurement, state aids, rules of origin, standards, health regulations, banking and insurance regulations or competition policies) may create better trading conditions not only for regional partners but also for other WTO Members. On the other hand, changes in national rules or procedures in an acceding country resulting from entry to a regional group may have the opposite effect if the harmonization of the "outsider's" rules increases the interest of its domestic producers in trading with regional partners rather than MFN partners.

The continuing spread of regional integration could change the face of the multilateral trading system considerably in the next decade, and affect the balance of negotiating interests in new sectoral or comprehensive trade negotiations. This will depend partly on how far regional groups achieve a single (or at least a coordinated) voice in international fora such as the WTO. It is not impossible to envisage a trade negotiation where the majority of European countries speak on many issues with one voice; where the MERCOSUR has a unified negotiating position on many, if not all, significant issues; where Asean – or even a larger group of APEC members – present a coordinated position on particular areas; and where many of the WTO Members outside these integrating groups formulate their negotiating postures with one eye, at least, on the larger entities. In addition, regional entities whose internal trade legislation in goods or services have progressed further along the road of liberalization than those of their partners would be in a very strong multilateral negotiating position vis-à-vis the others.

There is still a risk that the spread of regional agreements may lead to discrimination becoming the rule, rather than the exception, in international trade relations. Trade within NAFTA, the EU, EFTA, CEFTA and MERCOSUR is equal to some 36 per cent of world exports and these five groups account for 70 per cent of world exports overall. A significant number of countries, including many of the poorest and least-developed countries, still lie outside regional groupings and may face both high tariff barriers to entry and increasing discrimination through the application of such measures as rules of origin. To prevent the further spread of discrimination, it is important to reaffirm both the most-favoured-nation and the national treatment principles underlying the WTO agreements, and to ensure that MFN and regional trade liberalization go hand-in-hand and cover all sectors.

There is therefore a balance to be struck among autonomous, regional and multilateral trade-policy agendas. Unilateral trade liberalization, "bound" at regional or multilateral level, helps to stabilize the course of trade policies and ensure that policy reversals are minimized. Regional and multilateral trade negotiations may, in turn, complement one another. For example, multilateral negotiations on agriculture, set in a broader context, may be more feasible than regional negotiations because of the larger balance of interests involved; regional negotiations on a sectoral or topical basis may extend, or pave the way for, negotiations at a multilateral level. And an ongoing process of multilateral liberalization side by side with regional agreements helps to minimize trade diversion and discrimination.

Such considerations will be significant in any new multilateral negotiations. The major challenges for the system in the next few years will be to maintain momentum towards multilateral trade liberalization, despite the possible effects of the Asian crisis; to maintain the pre-eminence of the multilateral trading system in a rapidly changing world of regional agreements; and to ensure that the benefits of trade liberalization are both evenly spread and universally recognized.

# Chapter Four Globalization and trade

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## I. Introduction and summary

The year 1998 marks five decades of the multilateral trading system. For 50 years, the GATT and now the WTO have provided the framework for the conduct of trade relations in a world of growing complexity and interdependence – a world where trade has increased seventeen-fold since the founding of the system and foreign direct investment has grown five-fold in the last decade alone. At the same time, the forces of globalization have brought extraordinary new opportunities. It is true, of course, that the upward trend in world output and trade has not been even or uninterrupted throughout the post-war period. Indeed, there have been times of difficulty and disruption, posing serious challenges for policy makers. The current economic crisis, affecting much of Asia and Russia, and exerting pressure on the economies of many other countries in different regions, constitutes one of the most challenging sets of circumstances to have confronted the world economy in many decades. The financial crisis in South-East Asia, the recession in Japan, slower growth in Asia more generally, as well as in various countries in other regions, and the economic crisis in Russia, have combined to create economic conditions in which the global economy could enter a period of contraction. If judicious policies are brought to bear, however, calming the fears of investors and restoring stability in the financial sector, there is a good chance that while the world economy will suffer slower growth, accompanied by a painful adjustment process in some countries, a deep global depression is avoidable.

Part of the policy challenge today directly concerns trade. It is essential that governments resist the temptation to reverse their trade liberalization commitments. If they yield to protectionist pressures, or succumb to the short-lived illusion that trade restrictions might be part of a solution, they will aggravate the economic downturn and prolong the recovery phase.

The multilateral trading system has played a key role in promoting growth and new opportunities in the post-war period, and it has evolved continually in response to the challenges of globalization. The liberalization process has moved beyond its primary concern with the removal of tariffs and quantitative trade restrictions on goods at the border to focus more closely on an ever-growing range of policy measures affecting the terms and conditions of market access, such as standards and regulations, subsidy practices, trade in services, and intellectual property protection. Policy areas like investment and competition are receiving increasing attention. The powerful influence of information and communication technology in bringing nations closer together is finding expression in the WTO's activities, for example through negotiations to liberalize basic telecommunication services and trade in information technology products, and through a work programme on electronic commerce. Yet at the core of this web of growing complexity and multi-faceted challenges, the multilateral trading system retains its primary mission – that of promoting rules-based trade liberalization with a view to raising standards of living.

As globalization has taken hold and the need for cooperation among nations in many inter-related policy areas has intensified,

concern has grown in some quarters about the costs of liberalization, and of technology-driven interdependence and economic specialization. The benefits of globalization, while widely recognized as very considerable in the aggregate, have not been evenly spread – technological progress and trade liberalization have not always been good news for all economic groups and individuals. Change has implied dislocation for some, requiring relocation or retraining. For others, a mismatch between their skills and the demands of an evolving economy have squeezed incomes. Fostering development and guarding against the marginalization of low-income countries also poses a continuing challenge. Other concerns have also emerged, such as the implications of increased trade and international competition for the quality of the environment and the relationship between trade and labour standards. Worries have also been expressed in regard to the implications of globalization for national sovereignty and the capacity of societies to exercise choice and determine their future.

On the occasion of the 50<sup>th</sup> anniversary of the trading system, the special topic of the WTO's Annual Report is devoted to an examination of the process of globalization, the way in which trade liberalization has contributed to this process, and the main policy challenges confronting governments as they manage change and safeguard the benefits of growing global interdependency.<sup>1</sup>

## Organization of the chapter

The rest of the chapter is divided into three more sections. The next section (Section II) discusses the nature of globalization and the key economic forces that drive the globalization process. It begins by reviewing income, trade and investment growth in the post-war period, tracing the increasing prominence of trade and foreign investment in overall global economic activity. The section then goes on to consider the key driving forces of globalization – technological progress, policies favouring trade liberalization and market-opening more generally, and the increasing internationalization of business. Technological developments have probably been the single most important factor leading to the internationalization of economic activity. Advances in transport, telecommunications and information-related technology have been of fundamental importance. At the same time the explosion of trade and foreign investment that has characterized recent years would not have occurred in the absence of the movement towards economic and trade liberalization tendencies that has become increasingly generalized. The GATT/WTO trading system has played an important role over the years in creating the preconditions for liberalization. It should not be forgotten, of course, that the positive trends in trade, investment and growth have been punctuated by difficult episodes from time to time, as exemplified for example, by the current economic difficulties. Finally, the business sector has taken advantage of technology and a more open policy environment to spread production processes all over the globe. Enterprises have blurred distinctions between trade and investment as alternative means for accessing markets, creating a complementarity that has reinforced economic interdependence among nations. Firms have increasingly relied on outsourcing across national frontiers as a means of cutting costs and increasing efficiency, thereby further fusing national economies.

<sup>1</sup>Other recent treatments of these issues include IMF (1997a), World Bank (1997a), OECD (1998) and WTO (1998).

Section III focuses specifically on the contribution of trade liberalization to globalization. It first puts trade liberalization into a broad political context, discussing how increased trade integration cements relations among nations, contributing to peace and reducing the range of circumstances in which conflict is likely to occur. Section III then goes on to examine the underlying mechanisms and relationships through which trade contributes to increased income and wealth. This discussion also covers a good deal of empirical work that has been undertaken in this area. The chapter discusses the role of international specialization in increasing productive efficiency. It considers how market imperfections and economies of scale affect the scope for gains from trade, and addresses the case that has been made for targeted trade restrictions in the presence of these market features. The section concludes that the theoretical case that can be made for protection in these circumstances has limited practical application. There is also a discussion of how trade protection can be associated with costly and wasteful activities by special interests seeking protection at the expense of the economy at large. Finally, Section III explains why the largest income gains from trade arise via the dynamic effects of the growth process itself, where investment and technology play a key role.

Section IV considers a range of policy challenges arising from trade liberalization and the process of globalization more generally. It is noted that there are a number of issues relating to questions such as the distribution of benefits, environmental quality, aspects of social policy, sovereignty and the links between trade and the financial sector that merit careful attention in their own right. Moreover, if these issues are not adequately addressed, it will become increasingly difficult to sustain support for the multilateral trading system. The approach in this section is to identify briefly the nature of various policy issues and challenges and then consider how far they are related to trade policy. In many cases, it is shown that links to trade policy are tenuous or less far-reaching than sometimes argued. But even where trade is the proximate cause of a problem, a further question that must be asked is how far trade policy and the WTO are the appropriate instruments to address such a problem. Typically, trade policy is not the best instrument for the problem at hand. Separate subsections deal with the costs of adjustment, trade, wages and social cohesion, trade and the problems of marginalization of some low-income countries, the relationship between trade and the environment, trade and labour standards, trade and the financial system, and about trade, sovereignty and the role of the state.

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## II. The globalization of economic activity

### A. Globalization, trade and growth

Globalization is a multi-faceted concept insofar as it describes both economic phenomena and their social, political and

distributional consequences. This section is concerned essentially with the economic aspect of globalization, which can be measured through the flows of goods, services, and capital and migration around the world. Statistics show that expanding trade and capital flows, in an appropriate regulatory environment, have generally coincided with strong growth and political stability, especially for those economies which have welcomed liberalization and technological change.<sup>2</sup>

Trade growth has consistently outpaced overall economic growth for at least 250 years, except for a comparatively brief period from 1913 to 1950 (Chart IV.1). Between 1720 and 1913, trade growth was about one-and-a-half times GDP growth.<sup>3</sup> Slow GDP growth between 1913 and 1950 – the period with the lowest average economic growth rate since 1820 – was accompanied by even slower trade growth, as war and protectionism undermined international trade. This period included the Great Depression. During this time trade declined by an unprecedented 60 per cent in volume terms as countries tried to “export” their economic crises, including unemployment, through protectionist trade barriers.

The last 50 years have seen trade expand faster than output by a significant margin, increasing the degree to which national economies rely on international trade in overall economic activity. On an annual average basis, merchandise exports grew by 6 per cent in real terms from 1948 to 1997<sup>4</sup>, compared to an annual average output growth of 3.7 per cent. Put differently, trade multiplied by the factor 17, while GDP grew approximately six-fold during this period. In the case of manufactures, trade multiplied 30 times, while GDP grew eight-fold. A similar picture of intensified international economic engagement is readily discernible from figures on foreign direct investment.

Unfortunately, data are not available for the whole period from 1948, but annual FDI expanded almost 17-fold between 1973 and 1996, from US\$21.5 billion to almost US\$350 billion.<sup>5</sup> This implies an annual average growth rate of over 12 per cent. FDI stocks jumped from US\$165 billion at the end of 1973 to US\$3,205 billion in 1996.

It is not only foreign direct investment that has expanded rapidly. Other – short-term and long-term – capital flows have also grown, particularly in the last few years. The average daily turnover in foreign exchange markets, for example, has increased from about US\$200 billion in the mid-1980s to well over US\$1.2 trillion in 1996. This figure corresponds to 85 per cent of all countries’ foreign exchange reserves and illustrates the difficulties countries face when they want to influence their exchange rates.<sup>6</sup>

Growth trends in trade and foreign investment are reflected in the growth of international transport. In 1948, merchandise shipped internationally is estimated to have amounted to 490 million metric tons. In 1997, 4,491 metric tons, or 10 times as much, was shipped. As for air transport, the number of kilometres flown grew almost 23 per cent per year between 1958 and 1997. Measured in freight tons per kilometre, the estimated annual average growth rate over this period was 13 per cent. Growth in “transport” of information over telecommunication networks has been even faster.

It follows from the statistics reported above that countries typically rely on trade to a greater degree today than at any time since the second World War, and probably at any other time in history. The phenomenon of globalization has encompassed many countries and has been widely shared. In developed countries, openness measured by the ratio of trade to GDP increased from 16.6 to 24.1 per cent between 1985 and 1997. In developing countries this indicator rose from 22.8 per cent to 38.0 per cent over the same period.<sup>7</sup> Faster growth in developing countries explains why their share in world trade has increased

<sup>2</sup>The role of short-term capital flows may be somewhat more ambiguous, as illustrated by the debate on policies relating to the capital account that has followed the South-East Asia financial crisis. This issue does not fall within the scope of this report.

<sup>3</sup>de Melo and Grether (1997).

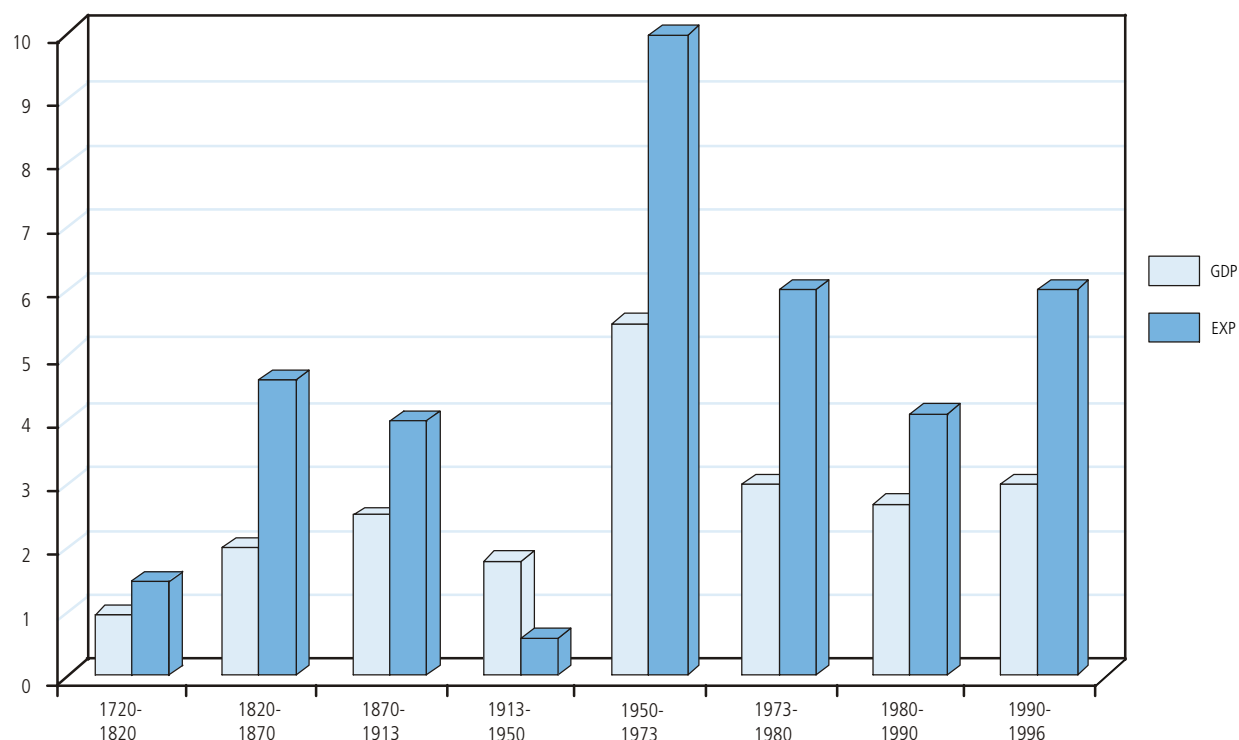
<sup>4</sup>WTO (1998).

<sup>5</sup>UNCTAD (1997a).

<sup>6</sup>IMF (1997a).

<sup>7</sup>World Bank (1998).

Chart IV.1

**Export and GDP growth: 1720-1996**

Source: de Melo and Grether (1997).

from less than one quarter to almost 30 per cent over the same period.

These global figures mask some regional differences. The shares of Western Europe and North America in world imports remained relatively stable over the period, ranging from between 40 per cent and 46 per cent for Western Europe and between 15 per cent and 20 per cent for the United States. Asia's share of world trade increased from about 15 per cent in 1948 to 27 per cent in 1996. At the same time, the trade shares of Latin America and Africa fell from 11 and 8 per cent in 1948 to 5 and 2 per cent in 1996, respectively. Central and Eastern Europe gained in share between 1948 and 1968, and then experienced a decline, which accelerated sharply in the 1990s in the first years of restructuring following the fall of the Berlin Wall. It should be noted, however, that despite the decline in the relative share, the value of trade increased many times over in all regions.

Finally, the composition of trade has changed dramatically during the period under review, particularly in respect of agriculture and manufacturing. Agricultural exports accounted for almost 47 per cent of total merchandise exports in 1950, and their share had dropped to 12 per cent by 1996. Manufactures, by contrast, accounted for 38 per cent of exports in 1950. This share increased to 77 per cent by 1996. The share of mining products in total merchandise exports has remained more stable, with fluctuations over the period reflecting mainly price

movements, particularly in the case of oil. When services are included in this comparison, it is noteworthy that services trade in OECD countries increased at almost twice the rate of merchandise trade between 1980 and 1995. By 1995, services trade exceeded US\$1 trillion, representing 23 per cent of total world trade.<sup>8</sup> It should be noted that the figures for services refer only to cross-border trade and not to the sales of foreign enterprises that have established a commercial presence in the importing market.

The impressive trade growth of recent decades has been accompanied by high GDP growth, and Section III below will outline in more detail the links between the two. At this point, it should only be noted that world GDP, measured in constant prices and adjusted for population growth, increased by an annual average of 2 per cent per year from 1948 to 1997. This is a high rate by historical standards – per capita income growth averaged less than half that rate (or 0.9 per cent per year) in the period 1820-1913. The growth performance over the last five decades, however, has been uneven. From the post-World War II reconstruction phase to the first oil price rise in 1973, per capita GDP grew at almost 3 per cent. After growth slowed markedly in the context of the two oil price shocks, the 1989-96 period saw per capita growth increase again to about significant one-and-a-half per cent, and this performance has improved further in the latter part of the 1990s. A significant success story has been the experience of a number of highly-trade-oriented developing countries, mostly in Asia, with average growth rates between 5 per cent and 7 per cent per year since the beginning of the 1960s. As a result, poverty in Asia has been reduced dramatically. Between 1975 and 1995 alone, poverty was cut in half. The recent financial crisis in part of the region may reverse some of these gains.<sup>9</sup> By contrast, countries with less trade orientation show a relatively poor growth record.<sup>10</sup>

<sup>8</sup>WTO (1997a). There is still potential for catch up in services trade. A world trade share of roughly one quarter compares to a world output share of over 60 per cent.

<sup>9</sup>See Ahuja et al. (1997).

<sup>10</sup>World Bank (1997b).

If we put these findings into a more long-term historical perspective, we can see that international trade has often played a critical role in the development of countries or regions, at least since the middle ages. City states such as Genoa, Amalfi and Venice have seen their economies rise and decline with their fortunes in trade. Trade has also been recognized as a crucial element in the industrialization process. The damaging effect of trade protection has long been recognized. In 1898, for example, Sir Robert Giffen observed that: "In new countries you cannot promote new manufactures (...) by means of protective duties; in old manufacturing countries you cannot, because such countries, if they are to make way at all, must manufacture for export."<sup>11</sup>

The changing composition of world trade has also been accompanied by a shift in production structures and the composition of national GDP. Most output and employment growth in industrial countries during the past 25 years has taken place in sectors with rapidly changing technology and in services sectors.<sup>12</sup> At the same time, many developing countries have shifted towards producing manufactures for which industrial countries were formerly the main suppliers, such as clothes, metal products or consumer electronics. The growth of manufactured exports from developing countries has been dramatic. Indeed, a significant degree of trade and globalization-related adjustment has already taken place, as the production and trade structure has evolved.

Despite the cold war, the post-1945 period has also witnessed a period of political stability and peace for most countries, unprecedented in this turbulent century. There have been no full-fledged wars between industrial countries during this period. This exceptional record is unfortunately marred by the experience of international and civil conflicts in many of the poorest countries. The way in which trade fits into this picture will be discussed briefly in Section III below.

## B. The forces driving globalization

In economic terms, three key tendencies can be identified as the driving force of globalization. The first, and perhaps most profound influence, is technological change. Second, an increasing number of governments have pursued liberalization policies, opening markets and removing regulatory obstacles to economic activity. Third, the combination of new technologies and freer markets has enabled the business sectors in a growing number of countries to internationalize their activities, weaving an ever more intricate web of inter-linked activities around the globe. Between them, these forces have made nations more economically interdependent, creating unprecedented opportunities as well as new economic, political and social challenges.

<sup>11</sup>Giffen, Sir Robert (1898). Given the obvious benefits of unhampered trade, Giffen was (perhaps overly) optimistic about the future course of trade policies: "Protectionist policy is thus opposed by the force of circumstances, and another generation or two will probably see the last protectionist politician, not only in England, but throughout the world."

<sup>12</sup>Cooper (1997).

<sup>13</sup>Rogowski (1989).

<sup>14</sup>These examples are cited from Wolf (1997).

<sup>15</sup>TU (1997).

<sup>16</sup>Forrester Research (1997).

<sup>17</sup>Wolf (1998).

<sup>18</sup>de Melo and Grether (1997).

<sup>19</sup>For more details on this subject, see Bacchetta et al. (1998).

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## 1. Technological change

Since the industrial revolution of the late 18<sup>th</sup> and early 19<sup>th</sup> century, technical innovations have led to an explosion of productivity and slashed transportation costs. The steam engine presaged the arrival of railways and the mechanization of a growing number of activities hitherto reliant on muscle power. Later discoveries and inventions such as electricity, the telephone, the automobile, container ships and pipelines altered production, communication and transportation in ways unimagined by earlier generations. More recently, rapid developments in computer, information and communications technology have further shrunk the influence of time and geography on the capacity of individuals and enterprises to interact and transact around the world. And the process of technological innovation is set to continue, not only in information-related sectors. New waves of technological innovation will continue to raise incomes and enrich lives. Biotechnology and miniaturization inherent in microelectrochemical systems, for example, will spawn completely new activities and industries in the years ahead.

Technical progress has cut transportation and communication costs dramatically since the industrial revolution. Railway transport reduced the costs of trading goods by 85 to 95 per cent in the 19<sup>th</sup> century. Similarly, steam ships and new navigation channels like the Panama Canal reduced the costs of maritime transport.<sup>13</sup> More recently, the unit costs of sea freight have declined by almost 70 per cent in real terms in the last 10 to 15 years. Unit costs of air freight have fallen by 3-4 per cent per year over the same period.

The fastest changes, however, have been experienced in the information technology and the telecommunications sectors. The cost of a unit of computing power, for example, fell by 99 per cent between 1960 and 1990.<sup>14</sup> World annual sales of personal computers have topped the 50 million mark and now exceed the sales of cars. One billion telephone and mobile phone connections now exist worldwide.<sup>15</sup> After the year 2000, 300 million people, or 5 per cent of the world's population, are expected to be connected to the Internet.<sup>16</sup> Productivity growth in the information technology sector, at almost 5 per cent per year over the 1973-93 period in OECD countries, has been five times as high as overall productivity growth. As a result, this sector now accounts for one quarter of economic growth in the United States.<sup>17</sup>

As technical progress has extended the scope of what can be produced and where it can be produced, and advances in transport technology have continued to bring people and enterprises closer together, the boundary of tradeable goods and services has been greatly extended. Before the industrial revolution, trade was largely limited to low-weight, high-value items such as spices, gold, and cloth. Railways, container ships and pipelines gave a massive boost to trade in bulk products.<sup>18</sup> More recently, cheap travel and telecommunications have allowed many more services to be traded from tourism to financial services. Electronic commerce over the Internet is the latest development in the emergence of an increasingly borderless global economy. It is estimated that some 300 million Internet users will be participating in electronic commerce by the turn of the century, an activity that by then will amount to more than US\$300 billion.<sup>19</sup> The development of this medium poses important policy challenges for governments as they seek to ensure the realization of the considerable economic benefits that can accrue from electronic commerce without compromising their public policy objectives.

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## 2. Trade and investment liberalization

Continuing liberalization of trade and investment has made for an ever more unencumbered policy environment for economic



relations among nations. Liberalization has allowed new technologies to be exploited in globalized markets on a worldwide scale.<sup>20</sup> Many countries have moved inexorably towards greater reliance on international markets, to provide conditions favourable to growth and development. Liberalization has focused on trade and investment regimes and a range of regulatory issues, and the GATT/WTO trading system has played a central role in the process.

The GATT/WTO system has brought about significant progress in the reduction or elimination of border barriers to trade through eight rounds of multilateral trade negotiations. Tariffs in industrial countries have come down from high double digits in the immediate post-war period to less than 10 per cent in the late 1960s, and less than 4 per cent once the Uruguay Round is fully implemented. At the same time, most quantitative restrictions on trade, except those imposed for health, safety or other public policy reasons, have been removed. Following the Uruguay Round, textiles and clothing and agriculture are being brought within the multilateral framework and subject to progressive liberalization. The Uruguay Round also introduced new disciplines for the protection of trade-related intellectual property rights. Rules on trade and investment in services have been developed under the auspices of the General Agreement on Trade in Services (GATS). Governments have also embarked on services trade liberalization within the GATS framework. Recent agreements on basic telecommunications and financial services have boosted the trend towards more open services markets. On the goods side, post-Uruguay Round commitments to eliminate tariffs on a broad range of information technology products have also helped in preparing national economies for the opportunities and challenges of the 21<sup>st</sup> century.

It is hard to assess accurately the overall economic contribution of the results of a trade negotiation like the Uruguay Round. This is both because of difficulties intrinsic to measurement methodologies and because in practice many different factors, which cannot all be easily and accurately taken into account, influence economic outcomes. Some attempts have nevertheless been made through simulation analysis to gauge the economic impact of the Uruguay Round. Various estimates of the Uruguay Round conclude that when fully implemented, the trade liberalization agreed by governments could boost world income by up to 1 per cent per year, or in other words by US\$200-500 billion. World trade volumes are estimated to increase by 6-20 per cent. More than one third of the benefits are expected to derive from liberalization of textiles and clothing and another one third from liberalization of other manufactures. Agricultural liberalization contributes a further 10-30 per cent. Not surprisingly, the countries that liberalize more are expected to gain more. It should be noted that these estimates do not include liberalization of trade in services.

Globalization has also been promoted by the widespread liberalization of current and capital account transactions and the development of international financial markets. Over 140 countries now subscribe to the IMF's Article VIII, which stipulates free current account transactions. This figure is more than double the figure in 1990 and includes more than three

quarters of all IMF members.<sup>21</sup> Capital account and exchange transactions have been liberalized in many countries since the 1970s, so that exchange rates and interest rates have become increasingly market driven, and new financial instruments have emerged.<sup>22</sup> These factors have facilitated international trade through the more ready availability and affordability of financing.

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### 3. The internationalization of business activity

Lower trade barriers and liberalization more generally have allowed more and more companies to globalize production structures through investment abroad, which in turn has provided a further stimulus to trade. On the technological side, increased information flows and the greater tradability of goods and services have profoundly influenced production location decisions. Businesses are increasingly able to locate different components of their production processes in various countries and regions and still maintain a single corporate identity. As firms subcontract parts of their production processes to their affiliates or other enterprises abroad, jobs, technologies, capital and skills are transferred around the globe.

Fewer and fewer products can be produced competitively today solely on the basis of national inputs. For the production of a particular car, for example, manufactured by one of the large US auto firms, no fewer than nine countries are involved in some aspect of production, marketing and selling.<sup>23</sup> Thirty per cent of the car's value goes to Korea for assembly, 17½ per cent to Japan for components and advanced technology, 7½ per cent to Germany for design, 4 per cent to Taiwan and Singapore for minor parts, 2½ per cent to the United Kingdom for advertising and marketing services, and 1½ per cent to Ireland and Barbados for data processing. This means that only 37 per cent of the production value of this "American" car is generated in the United States. This example illustrates why a well-functioning world economy depends so strongly on open trade and investment regimes.

How significant is production sharing in world trade? One measure of the phenomenon is the share of affiliate output of multinational corporations in world output. The latter accounted for an estimated 7½ per cent of world GDP, and about 20 per cent of world manufacturing output in 1995.<sup>24</sup> Yeats (1988) estimated global production sharing by calculating the share of components and parts in world exports. He concluded that global production sharing accounts for more than US\$800 billion, or some 30 per cent of world trade in manufactured products. Moreover, trade in components and parts is growing significantly faster than trade in finished products, highlighting the increasing interdependence of countries through production and trade. It is important to note that these data do not include trade in services, where similar trends are also on the increase. Finally, a particular form of production sharing of crucial importance to some developing countries is assembly activities. Developing countries import components and parts, and then re-export them in assembled form to the original country. Such arrangements may include duty-free treatment of the components and parts incorporated in the final products. According to Yeats, this activity represented more than 40 per cent of manufactured exports from the Dominican Republic, El Salvador, Haiti, Jamaica and Mexico.

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<sup>20</sup>As discussed in section IV, however, governments also need to contribute to the proper management of the change and dislocation inherent in globalization, if the process is to be adequately sustained through public support.

<sup>21</sup>IMF (1997b).

<sup>22</sup>IMF (1997a).

<sup>23</sup>This example is cited in David (1997).

<sup>24</sup>World Bank (1997a).

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## III. The contribution of trade liberalization

For the five decades of its existence, the GATT/WTO has stood for trade liberalization. Indeed, this has been a primary objective, and the GATT/WTO's achievements in this regard are at the core

of its success as an institution. On the occasion of the 50<sup>th</sup> anniversary of the multilateral trading system, it is perhaps as well to remind ourselves of the basic rationale for promoting trade liberalization. Why does trade liberalization matter? As discussed in Section II, the willingness of governments to open markets progressively to foreign competition, and to keep them open, has been a key element in the realization of the benefits of globalization. This section focuses on the political and economic rationale underpinning the pursuit of open markets.

## A. Trade, political stability and the multilateral trading system

It is sometimes forgotten that trade is part of a global strategy to promote both economic prosperity and political stability. In the 1940s and 1950s, in particular, trade was seen as a key element in maintaining and promoting peace among nations. This was one of the central factors behind the drive towards multilateral free trade. President Truman of the United States, for example, argued in 1947 that trade and peace “are inextricably linked”.<sup>25</sup> Primarily for this reason, he strongly supported the establishment of the then-planned International Trade Organization.<sup>25</sup> At least three reasons can be given as to why trade and peace are closely inter-related, and why integration through trade promotes world peace. First, trade reduces the likelihood of conflict by establishing vested interests in the welfare and prosperity that trade has helped to bring about. Second, trade generates information about other countries and cultures and builds relationships among people across countries. Third, trade helps to build peace-oriented structures, including international rules. In short, mutually beneficial contact fosters cooperation, not conflict.

Other factors are obviously crucial to the preservation of peace. The quality of education and the nature of the political system are two examples. Moreover, the causal links between trade and peace may be indirect. Trade makes countries and many individuals richer, thereby raising the likelihood that democracy will prevail. Democratic societies with pluralistic decision-making processes are less likely to go to war than autocratic societies where demagoguery holds sway. Extremism and bellicosity will typically be more marginal than mainstream when a broad public participates in decision-making.

Historically, most wars have been driven at least in part by an economic motivation. Before the industrial revolution, wars were largely about redistributing existing wealth. Countries fought over land or access to precious primary products. Trade routes and trade monopolies have been a source of conflict since the middle ages. Some three centuries of colonialism, affecting many far-flung corners of the world, have been intimately tied up with the protection of trading interests and access to natural resources. In more recent times, control of natural resources still seems to be an important motive for war in some regions of the world.<sup>26</sup>

<sup>25</sup>See US Department of State (1947).

<sup>26</sup>See Collier and Hoeffler (1998).

<sup>27</sup>This effect has already been recognised in the 19<sup>th</sup> century by Alexis de Tocqueville (1990). In modern terms, he argued that “the more people trade, the more interrelated become their interests and the more similar become their interests and values. Therefore, no country can harm another without hurting its own itself. (...) Therefore, democratic and more wealthy countries hardly wage war against each other.”

<sup>28</sup>See Kenwood and Lougheed (1984) and Gardner (1969).

But since the industrial revolution, the economic costs of war have increased, in part for trade-related reasons. Income and wealth have become increasingly dependent on physical and human capital rather than on land, natural resources or trading monopolies – a trend to which trade has made a significant contribution. Rapid growth in labour and capital productivity have stimulated the creation of new wealth through the accumulation of physical and human capital. This has made the redistribution of wealth through wars relatively less interesting. Reduced transportation costs have also facilitated trade among nations, creating a stronger interest in preserving the conditions under which the gains from specialisation through trade may be realized. These trends have greatly raised the costs of military conflict in terms of the potential destruction of wealth and capital. And the larger the share of trade in an economy, the larger the potential costs from conflict-related trade disruptions.

Integration through trade and investment, coupled with technical progress, have resulted in ever increasing business travel, tourism, and intensified international communications through telecommunications, television broadcasts and so on. These contacts generate knowledge about other societies. Human relationships across borders and cultures emerge. This reduces misunderstandings and prejudices and enhances mutual understanding, making it more difficult for governments to secure public support for wars.<sup>27</sup> Trade with communist countries during the cold war was seen by many as an investment in peace.

But trade does not only change the information base of societies about other countries, and promote interpersonal relationships. It also changes political structures and institutions. Trade results in the formation of trade associations including producers and traders, and government structures, such as trade ministries. These institutions owe their existence to trade and become “vested interests” in maintaining trade and preventing armed conflict. In other words, they shift the internal political equilibrium towards openness and peace.

Finally, how important is prior commitment at the international level to a set of trade rules in ensuring that trade and trade liberalization contribute to peace and stability? Trade issues can become a source of international instability and conflict if policies are not bound in a multilateral context. Protectionist measures and trade policy reversals negatively affect foreign producers, thus raising tensions among countries. The absence of mechanisms to address disagreements arising from trade protection has contributed to military conflicts in the 19<sup>th</sup> century and first half of the 20<sup>th</sup> century.<sup>28</sup> For instance, trade protection caused serious adjustment problems and dislocations during the Great Depression, as jobs disappeared and people’s livelihoods were threatened. This triggered further protection and competitive devaluations, leading to a complete collapse in trade. A decline of 60 per cent in trade volumes in the early 1930s is now seen as an important reason for the depth of the depression at that time and the rise of nationalism, which ultimately led to World War II.

In light of these experiences, the multilateral trading system has to be understood as part of a post-war order for which the promotion of peace was among the prime objectives. The multilateral trading system is designed partly with this in mind. The consensus rule reduces the scope for coercion and strengthens the role of small countries. Durable rules binding tariffs and liberalization commitments increase the predictability of market access. The dispute settlement mechanism has elements of an international judiciary which rules trade policy behaviour, thereby lessening the scope for destructive conflict. By establishing non-discrimination as the bedrock of the system, the MFN rule helps to take the politics out of trade, allowing rules to

prevail over power. MFN also reduces the uncertainty emanating from shifting negotiating power and international coalitions, and imparts a sense of fairness in trade policy. It also makes it more costly for governments to reverse trade policy commitments. National treatment prevents conflicts arising from the circumvention of trade liberalization through domestic policies. Safeguard provisions are intended to control and limit protectionist back-tracking, while at the same time recognizing that overriding domestic considerations may require a temporary suspension of commitments. And progressive liberalization helps to focus countries' energies on competing in increasingly open world markets, where the size of the economic pie is growing and there is less interest in redistributing existing wealth than in a stagnant world.

## B. Trade liberalization and economic welfare

The rest of this section explores the economic mechanisms through which trade liberalization raises income and wealth.<sup>29</sup> It seeks to explain how trade improves welfare, looking both at the foundations of the case for trade liberalization, and empirical studies that largely confirm the arguments in favour of open markets.

### 1. Technological change

One can distinguish between two sources of "classical" gains from trade, those that stem from pure exchange and those that stem from specialization. In either case, countries gain from trade since it allows them to exploit differences in tastes, technology or factor endowments to their mutual advantage. These differences give rise to countries' comparative advantages in trade.

Consider first the gains from pure exchange. Whenever two parties, be they individuals or countries, evaluate their endowments differently, there is scope for mutually beneficial exchange. Each party foregoes certain consumption (exports it) in order to obtain what is more desirable (what is imported). The differences in valuations may arise where tastes are the same but endowments vary, but they may also be due to pure differences in tastes. In either case, consumers are motivated to engage in trade with other nations.

More important from an empirical standpoint are gains from specialization in production. If countries specialize in the products they produce most efficiently, global production of all products can increase. All countries can thereby gain. This is the familiar law of comparative advantage, and is one of the most

<sup>29</sup>The rest of this section draws on WTO (1998).

robust propositions in economics. The principle of comparative advantage is seemingly simple, yet often misunderstood. Its core is the observation that there is potential from trade for all trading partners, regardless of how countries compare absolutely. The economic literature identifies two important reasons why productive efficiency might differ across countries – differences in technology and in factor endowments. The principle of comparative advantage states that everyone can benefit from trade even if some countries are less efficient in all activities or have smaller endowments of all factors. All that is required for there to exist the possibility of mutual gains from trade are differences in the degree of relative efficiency across production, or in the relative endowments of factors between countries. Since no two countries are the same in these aspects, the case for specialization through trade is a general case, applying to all countries.

So far, only the possibility for gains from trade has been discussed. But in order for these global gains to be fully realized, international exchange must not be hindered through artificial barriers, and productive resources must be allocated correctly. The fundamental cost of protectionism stems from the fact that it provides individual decision makers with wrong incentives, drawing resources into protected sectors rather than sectors where a country has its true comparative advantage. The classical role of trade liberalization, identified centuries ago, is to remove such hindrances, thereby increasing income and growth.

Focusing on trade liberalization in a particular market and ignoring for a moment the interactions between this market and other markets, the effect of a tariff reduction can be described as follows. When the tariff is eliminated, the domestic price tends to fall to the world level. The fall in price stimulates demand, while simultaneously reducing domestic supply. Imported quantities increase. Consumers will be the main beneficiaries because the liberalization will allow them to consume more at a lower price. Let us now decompose the gains to consumers. One part of the consumer gain is a transfer from producers who see their profits decline. A second part of it is a transfer from taxpayers, as tariff revenue previously accruing on imports will diminish. However, economists have shown that there is a third part which is a net gain from trade liberalization. In other words, the losses to producers and taxpayers are less than the gains to consumers. Or inversely, protection involves gains to producers and taxpayers which are smaller than the costs to consumers. The net loss from protection is often referred to as the dead-weight loss of tariffs.

The estimated cost of the current low level of tariffs in the United States, for example, is marginal – just a fraction of

#### Box IV.1: Trading costs

Recent studies have emphasized the potential for liberalization initiatives to reduce trading costs substantially.<sup>a</sup> Trading costs are less transparent trade barriers such as customs procedures, product standards and conformity certifications, licensing requirements, and related administrative sources of trading costs.

Estimates of trading costs can only be approximate. Nonetheless, they provide some sense of the magnitudes involved. In the context of the EC single market program, elimination of internal customs procedures and related administrative streamlining were projected to reduce trading costs by up to 2 per cent of the value of trade. Globally, UNCTAD has argued that trading costs represent 7 to 10 per cent of the cost of delivered goods. Like the EC, UNCTAD also estimates that simple trade facilitation measures could reduce these costs by 2 per cent of the value of trade. The Australian Industry Commission has estimated potentially higher savings in the context of APEC, ranging from 5 to 10 per cent of the value of trade. Under more modest facilitation initiatives, the Japanese Economic Planning Agency again has estimated such savings at 2 per cent in an APEC context.<sup>b</sup> The elimination of these losses would spell very considerable benefits accumulated over time.

<sup>a</sup> See Baldwin and Francois (1997), Smith and Venables (1988).

<sup>b</sup> See EC (1988), UNCTAD (1994), Industry Commission (1995) and Economic Planning Agency (1997).

1 per cent of GDP.<sup>30</sup> The real gains are instead to be found in the removal of other barriers to trade, such as quotas, contingent protection, licensing schemes, exchange restrictions, content requirements, and a myriad of hybrid measures.<sup>31</sup> In fact, the evolution of the GATT system can be viewed, in part, as an effort to keep abreast of the move from tariffs to these non-tariff measures of protection. Such measures carry welfare implications that are potentially far greater (and more complex) than the discussion above of tariffs suggests. Moreover, certain administratively imposed measures can also raise significantly the costs of trading (Box IV.1).

The WTO Agreement, and the GATT before it, prohibits the use of quantitative restrictions on trade, preferring tariffs instead where barriers to trade are maintained. There is a solid economic rationale for this choice of instrument. To see how the welfare implications from quantitative restrictions differ from those of tariffs, consider a quota as an alternative to a tariff. For the sake of comparison, assume that it is “equivalent” to the tariff, in the sense that it allows the same amount of imports as the tariff. There will still be a gap between the world price and the

domestic price because the restriction of imports drives up the domestic price. The price difference, which is equal to the equivalent tariff, is referred to by economists as a “quota price wedge”. The quota price wedge multiplied by the value of imports at world prices provides a measure of the value of the quota license. This amount is no longer collected as a tax but goes to the holder of the quota license. This “economic rent” can go to foreigners, which is the case with voluntary export restraints (VERs) or when the holder of the license is a foreign exporter. In the United States, for example, nearly all of the principal quota programmes have involved rents that accrued to foreigners.<sup>32</sup> But rents may also be appropriated by domestic importers. In either case, lobbying activities are likely to be generated.<sup>33</sup> While tariff protection (and related contingent protection measures) is also subject to lobbying, quota rents make the lobbying process potentially more profitable for the successful petitioner, so we can expect more resources to be consumed in lobbying for protection when quota rents are involved.

The elimination of a quota produces effects which are similar to those induced by tariff liberalization.<sup>34</sup> The domestic price falls to the world level and the imported quantity increases. Again, the main beneficiaries are consumers. Their gains come at the expense of producers and licence holders, who lose their rents. If the quota rent was appropriated domestically, the net result for the liberalizing country is equal to the gain from eliminating an equivalent tariff. However, if the quota rent accrued to foreigners, the gain to the liberalizing country of relaxing the quota is larger than the gain from eliminating an equivalent tariff because the net gain to the country includes both the dead-weight loss and the rent which is transferred from foreigners.

In general, the dead-weight loss of quantitative restrictions is estimated to be between 10 and 20 times larger than the dead-weight loss of tariffs for the country levying these barriers. The long run dead-weight loss from quota restrictions on US imports was estimated at 0.2 per cent of 1971 GDP by Magee (1972). Among all US quantitative restrictions, those resulting in the largest dead-weight loss around 1990 were the VERs on textiles and apparel. Recent estimates of the dead-weight loss associated with these VERs range between 0.05 and 0.1 per cent of 1990 US GDP.<sup>35</sup>

The value of rents arising from quotas can be even more substantial than the dead-weight losses referred to in the previous paragraph. Hufbauer and Elliot (1994) estimate that they are on average approximately twice as large as the corresponding dead-weight losses.<sup>36</sup> The US MFA quotas on textiles and apparel, for instance, have been estimated to reduce US welfare by 8 billion US dollars and foreign countries’ welfare by an additional 5.5 billion US dollars.<sup>37</sup>

Overall, Hufbauer and Elliot (1994) have estimated the potential consumer gain if the US eliminated all tariffs and quantitative restrictions at around 1.3 per cent of US GDP in 1990.<sup>38</sup> The potential consumer gain from liberalization in Japan was estimated to be slightly larger than for the US at somewhere between 2 and 4 per cent of GDP.<sup>39</sup>

The estimates discussed so far are “partial equilibrium” estimates, which means that they do not take into account the interactions between various markets. Using a “general equilibrium” methodology which can capture such interactions, various studies have estimated the cost of protection for the most protected industries in the United States.<sup>40</sup> The overall welfare gain from the simultaneous liberalization of all significant US trade restraints was estimated at 0.3 per cent of GDP.<sup>41</sup> Similarly, studies of Tokyo Round tariff cuts reported estimated static gains of between 0.3 and 0.5 per cent of GNP for the participant countries.<sup>42</sup> A similar range of estimates is reported in the literature on the Uruguay Round.<sup>43</sup>

<sup>30</sup>See Magee (1972), Cline et al. (1977) or Hufbauer and Elliot (1994). Most empirical estimates of this kind have been made in the United States, which is why the results reported here are focused mainly on that country.

<sup>31</sup>For a discussion of non-tariff instruments and their measurement, see Laird (1997).

<sup>32</sup>See Feenstra (1992).

<sup>33</sup>It may be noted that the scarcity rents associated with quotas will accrue to government if the quotas are auctioned.

<sup>34</sup>There is a considerable literature concerning the (non-)equivalence of quotas and tariffs which is not covered in this report.

<sup>35</sup>The higher figure, which is an average of estimates from various studies using different methods, is from Markusen et al. (1995) while the lower estimate is from Hufbauer and Elliot (1994).

<sup>36</sup>On the other hand, according to Markusen et al. (1995), the quota rents – most of which accrue to foreigners – are generally of the same size as the dead-weight losses.

<sup>37</sup>See Markusen et al. (1995) as well as the studies by Hamilton (1990), Trela and Whalley (1990), USITC (1995), and Hanson and Reinert (1997).

<sup>38</sup>It should be borne in mind that this is a gross figure and that the measured benefit to consumers from liberalization must be adjusted for the loss to producers of reduced protection. The net national welfare gain in this study is probably less than one half of the gross figure.

<sup>39</sup>See Sazanami, Urata and Kawai (1995).

<sup>40</sup>See de Melo and Tarr (1992) and USITC (1995). General equilibrium models combine assumptions regarding the behaviour of economic agents with observed patterns of production and consumption in order to assess the effects of prospective policy changes. General equilibrium models, designed to take into account the interplay between product and factor markets, can go further than partial equilibrium analyses in several respects. For instance, these models can capture the ramifications that trade liberalization in one particular industry can have in other industries. And general equilibrium models can also be employed to study the impact of broader trade liberalization exercise, where trade barriers are reduced simultaneously in many sectors.

<sup>41</sup>See USITC (1995). Other studies find similar results.

<sup>42</sup>See Deardorff and Stern (1979) and Whalley (1982).

<sup>43</sup>See Appendix Table 1 at the end of this Chapter. As discussed below, the gains are higher when imperfect competition and increasing returns are taken into account.

These estimates of the gains from trade liberalization are small relative to what most economists intuitively expect them to be. But the measures discussed so far do not capture all the costs associated with protection. In what follows, we enlarge the discussion concerning the structural effects of trade liberalization, while Section C below considers the growth effects. These more encompassing analytical approaches suggest significantly higher costs to countries of maintaining protectionist policies.

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## 2. Trade and investment liberalization

The discussion so far has considered the benefits of trade liberalization in the context of perfect competition and constant returns to scale. In other words, it has been assumed that markets are made up of a myriad of small players with perfect knowledge, none of whom can influence market outcomes, and that the unit costs of production are invariant with respect to the level of output. In practice, monopolistic power may well be present and trade can impose some discipline on such power. Similarly, improved market access may allow firms to exploit economies of large scale production. Under imperfect competition and in the presence of economies of scale, the analysis of the effects of trade policy becomes quite complex. In principle, the gains from trade could be either smaller or larger when economies of scale and imperfect competition are included in the analysis. However, the evidence suggests that in the presence of imperfect competition and/or economies of scale, trade liberalization leads to gains which may be two to three times larger than those estimated under perfect competition.

The main problem in the presence of a monopoly, or of other forms of imperfect competition, is under-production. Firms with market power typically benefit from restricting their output in order to achieve higher prices. This will result in inefficiency, since the price at which monopolistic producers sell their products exceeds marginal cost, i.e. the cost of the last unit produced. If monopolistic power was attenuated and additional units of the good were supplied, this would generate benefits to consumers which exceed the resource cost of producing them. Trade liberalization is likely to impose competitive pressures on protected monopolistic firms, and the stronger presence of foreign firms following liberalization will induce the monopolistic incumbent firms to lower prices and increase output. As a result, market supply increases, and consumers' willingness to pay for additional consumption becomes better aligned with the associated production costs.

An increase in production following trade liberalization may bring even more gains if technology exhibits economies of large scale production. Economies of scale arise, for example, in situations where firms have large fixed costs. If such costs can be spread over a larger number of produced units, average costs are driven down. Effects which arise in conjunction with either the

presence of economies of scale and/or the presence of imperfect competition may be characterized as "pro-competitive" effects.

Numerous studies have assessed the effects of trade liberalization in the presence of imperfect competition and economies of scale.<sup>44</sup> In their pioneering work, Harris and Cox (1984) found that unilateral free trade would yield zero welfare gain to Canada under the assumptions of perfect competition and constant returns to scale, while the same liberalization would increase GNP by 4.1 per cent when these assumptions were dropped. Their results gave rise to a lively debate concerning the magnitude of the gains associated with pro-competitive effects. Two main conclusions have emerged from the work in this area. First, there is now a broad consensus that the gains from trade liberalization are significantly larger when imperfect competition and economies of scale are incorporated in the models than when they are not.<sup>45</sup> Second, as expected, the magnitude of the gains is sensitive to the specification of the models.

Econometric studies in this area have also confirmed the intuition that industries which are more exposed to trade have lower profit (price-cost) margins, suggesting less monopolistic power and greater benefits to consumers. Roberts and Tybout (1996), summarizing the results of five case studies of semi-industrialized countries, report that in every country studied, a relatively high industry-wide exposure to foreign competition is associated with lower cost-price margins and that this effect is concentrated in large plants.

Another important role of trade is to increase the range of products available. This has direct positive effects for consumers who can consume products which are better tailored to their demands, and who may also enjoy variety per se. It also has positive indirect effects, since firms are able to purchase intermediate inputs with the desired specifications. In general, studies suggest that the gains from liberalization are larger when product diversification is taken into account.<sup>46</sup>

Yet another mechanism which intervenes if product diversity is drawn into the picture is quality upgrading. Because trade restrictions limit the number of units that can be sold in an export market, one observed response of exporters has been to upgrade products, so that more value can be squeezed into the existing quota.<sup>47</sup> Dinopoulos and Kreinen (1988) have estimated that quality upgrading following US import restrictions led to an increase of European automobile prices in the United States of about one third, costing the United States roughly US\$3.4 billion.

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## 3. The gains from less "rent-seeking"

So far the gains from trade liberalization resulting from more scope for specialization and larger markets have been discussed. One of the underlying assumptions was that the political process surrounding trade policy formulation does not, in and of itself, use up any resources. However, efforts to secure or defend protection are far from costless. Producers, in particular, may spend resources on securing trade protection in order to generate above-normal profits, or rents for the protected industry.<sup>48</sup> Once protected, producers are likely to invest resources in preserving their rents through lobbying against liberalization. While some of these resources may constitute transfers from consumers to producers, a large part is simply wasted. The incentive to gain rents through protection has been analyzed by Tullock (1967) and the activity has been termed "rent-seeking" by Krueger (1974). If trade liberalization is perceived as credible and difficult to reverse, protectionist interests are less inclined to invest resources in rent-seeking. The contribution of the multilateral trading system in strengthening trade policy commitments should not be ignored in this regard.

<sup>44</sup>See the surveys by Richardson (1989), Vousden (1990) and Pomfret (1992).

<sup>45</sup>See the surveys cited above and Francois and Roland-Holst (1997). This result holds for both developed and developing countries. See, for instance, the study of Cameroon by Devarajan and Rodrik (1991).

<sup>46</sup>See, for example, Francois and Roland-Holst (1997).

<sup>47</sup>See Feenstra (1988a,b).

<sup>48</sup>There are numerous ways in which economic actors can influence the political process to gain protection. They range from taking decision-makers out for dinner, to paying for law firms and other professional lobbyists, and to placing advertisements in newspapers or on television.

The gains from trade liberalization as discussed in the previous sections are underestimated insofar as they do not include gains from reduced rent-seeking.

What are the costs of rent-seeking? In her original 1974 study of rent-seeking, Krueger estimated the welfare costs of protectionist rent-seeking for import licences in Turkey and India. She found that these costs amounted to 7 per cent of GDP in the case of India and to 15 per cent of GDP in the case of Turkey in the late 1960s. In Turkey, wholesale prices for imports requiring licenses were on average seven times as high as the c.i.f. import price, and the total value of the rents to importers was three times as high as the total c.i.f. value of licensed imports. A later estimate by Mohammed and Whalley (1984) suggests that trade-related rent-seeking in India absorbed "only" 4 per cent of GDP in the early 1980s, after liberalization in the late 1970s.

These studies estimate the rents created through controls and assume that the whole transfer is spent through rent-seeking. The estimates therefore constitute an upper limit for rent-seeking costs. However, even if the actual costs are only a fraction of these figures, they illustrate the considerable costs that may arise from rent-seeking activities, and the potential gains from liberalization which curtails rent-seeking activities. The resources saved from such liberalization should be added to the static welfare gains from liberalization.

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#### 4. Is there a case for targeted intervention policies?

Three cases in which it has been argued that trade liberalization could reduce a country's welfare are considered here. The first is where a large country manipulates its "terms of trade". The second is the infant industry argument for protection. The third is the strategic trade policy case. In each instance, we show that while in theory there may be a case for intervention, it appears that empirically the scope for such policies to have significant welfare effects is small. Moreover, the theoretical gains would be very difficult to realize in practice.

It has sometimes been argued that tariffs can be used to influence favourably the international terms of trade (TOT) of a country at the expenses of its trading partners. This argument applies when countries are large enough to exercise some power over the market. The basic idea is that when a large country imposes a tariff, the response of exporters to this market is to absorb some of the tariff themselves by lowering the pre-tariff price. In principle, such beggar-thy-neighbour action could increase national welfare if the TOT gains outweigh consumer losses.

From the importing country perspective, this implies that a tariff liberalization may actually reduce welfare. However, the empirical evidence tends to show that the gains to an importing country from manipulating the TOT are generally small, even in the case of very large trading countries. Most studies of gains from trade liberalization that include TOT effects have focused on the United States and the European Union. In a study of the cost of protection for the United States, Hufbauer and Elliot (1994) show that the world price of imports in the protected sectors would rise by a weighted average of 9 per cent following unilateral liberalization. The authors estimate the TOT losses for the United States at around 0.001 per cent of GDP. Comparing this figure with their total estimate of net welfare gains from liberalization of around 0.2 per cent of GDP, it is clear that the

welfare loss linked to TOT deterioration is extremely small, even in the case of a large country such as the United States. de Melo and Tarr (1992) have also estimated the costs of TOT deterioration following a unilateral trade liberalization by the United States. Their estimate of the welfare loss linked to the TOT deterioration reduces the net welfare gain from liberalization by as much as 10 per cent. Moreover, the risk of imposing too high a tariff, which may lead to excessive consumer losses in the importing country, appears to be relatively high given the amount of information that is needed to avoid this outcome. The reciprocal aspect of multilateral tariff reductions within the GATT/WTO framework allows countries to avoid possible TOT losses linked to unilateral tariff reductions. The idea is that as countries simultaneously reduce their tariffs on different goods, the terms-of-trade effects will cancel out, leaving only the efficiency gains from trade liberalization.

A second argument in favour of protection which is important in the debate over the role of trade policy in economic development is the so-called infant industry protection argument. According to this argument, developing countries have a potential comparative advantage in certain industries, but new producers in developing countries cannot compete with established producers in the industrial countries. Temporary protection is thus warranted to allow the new industry to become strong enough to compete with well-established producers. Various reasons why private investors would not develop the industry without government support have been discussed. They all rely upon some form of market failure to justify government intervention. That is, they are all predicated on the existence of a situation in which an unregulated market fails to ensure an optimal outcome. It has been argued, for instance, that because of the absence of financial institutions and the defects of capital markets, low initial profits in certain industries represent an obstacle to investment even if the long-term prospects are good.

The most elaborated versions of the infant-industry argument are those in which foreign producers are already established in the other markets and contribute to the inability of local producers to enter the market. Two such cases have been considered in the literature. In both of them, it is the existence of barriers to the entry of new firms which prohibits the development of a local industry in a developing country and these barriers are the consequence of the fact that some firms are already established. In the first case, potential entrants are at a disadvantage because costs fall with cumulative production over time as firms gain experience and as a base of skilled workers is accumulated. Pioneer firms in such a new industry generate social benefits for which they are not compensated, and they might not enter without some form of government intervention. In the second case, the barrier to entry is the consequence of imperfect information. The problem appears when consumers cannot observe the characteristics of the product so that they have to rely on reputation as an indication of product quality. In such a case, established producers enjoy an advantage relative to potential entrants just because they have entered the market earlier.

Certain reservations may be noted with respect to the argument that trade protection should be used to encourage the development of infant industries. First, the nature of the market failure makes trade policy an inferior or ineffectual intervention. Trade protection is inefficient because it is preferable to deal with market failures as near as possible to their source. Indirect measures generally create unintended distortions of economic incentives ("by-product distortions") elsewhere in the economy.<sup>49</sup> Thus, capital market failures shall be addressed directly in that market, and learning-by-doing should be encouraged through

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<sup>49</sup>The domestic market failure argument is a special case of what economists refer to as the "second best" theory. The basic principle of this theory is that the elimination of a distortion in one particular market is not necessarily desirable if there are other markets which do not work properly.

direct support of education and training, and not through trade restrictions. It should also be noted that Grossman and Horn (1988) have shown that trade protection may not be able to deal with the infant industry externality or market failure at all, even in an indirect manner. Second, it is in any case very difficult for governments to identify the industries which warrant special treatment, simply because they lack adequate information. Moreover, there is a risk that temporary protection becomes permanent, as what was initially a development policy is captured by special interests. The severity of this risk depends on the nature of the decision-making process in the country concerned.

Let us now turn to the third set of arguments which have been used to justify activist trade policies. The strategic trade policy literature has demonstrated that, at least in theory and in the presence of imperfect competition and/or scale economies, governments can use trade policy to increase national welfare at the expense of trading partners. It has been shown, for example, that in cases where average production costs are decreasing as output increases, protection against imports can contribute to the promotion of exports.<sup>50</sup> Suppose that a firm's variable costs of production are lower, the larger its output. Then, if a country puts up a trade barrier, the firm's output will increase as a result and its costs will fall. Competing foreign firms will experience the opposite. The lower variable costs of local firms will enhance their competitiveness in other markets. Under certain conditions, such a policy may improve national welfare. The theoretical literature provides various other examples of trade policy interventions that may increase national welfare.<sup>51</sup>

The empirical literature, however, raises doubts about this result. Baldwin and Krugman (1988), for instance, show that Japanese protection of its semiconductor industry was not a successful case of strategic trade policy. Their results show that without Japanese protection, both the United States and Japan would have reached a higher level of welfare. Also, in the first detailed econometric study of strategic trade policy, Berry et al. (1997) show that the US VERs on automobiles from Japan resulted in net welfare losses to the United States of 3 billion dollars.<sup>52</sup> The increase in US firms' pure profits (10.2 billion dollars) was more than offset by US consumers' losses (13.1 billion dollars).<sup>53</sup> An important conclusion from this literature is thus that any gains from strategic trade policies are likely to be small.<sup>54</sup>

In addition, while the strategic trade literature suggests that modest tariffs and/or subsidies, if imposed unilaterally, might yield modest increases in national welfare, Krugman (1987) and others have argued that free trade is still the preferable policy in practice. First, the gains from strategic trade policy intervention,

if any, are typically small. Second, in practice it will be almost impossible to achieve these gains, since the difficulties in implementing targeted strategic trade policies are enormous. The theoretical prescriptions are extremely sensitive to behavioural assumptions and to the values of elasticities and other parameters. Sufficient information concerning these matters is typically not available. Third, targeting the expansion of some sectors de facto implies targeting the contraction of others. The expansion of one sector drives up factor prices and attracts scarce resources, which tends to contract the activity of other sectors. Fourth, policies often involve losses for partner countries and thus the possibility that these countries retaliate. This could give rise to situations where the outcome for both countries is inferior to the free trade outcome. Finally, opening the door to special interests is risky, because once special privileges have been granted to targeted groups, it may be difficult to resist pressure from other lobbies. A multilateral commitment to liberal trade policies is an effective way to resist pressures of special interests.

### C. Trade liberalization and growth

Mounting evidence suggests that the greatest benefits of trade liberalization do not accrue immediately but over time, through stimulating investment activities and economic growth. Even small changes in growth rates may dominate the static gains that we have focused on so far. To appreciate the significance of policies that foster economic growth, it may be useful to consider how long it takes to double the income at various growth rates. For example, with 1 per cent annual growth it takes almost 70 years to double income. If economic reforms could spur growth from 1 to 2 per cent, incomes would instead double in 35 years.<sup>55</sup> And 2 per cent is still a very modest growth rate, at least for developing countries with a lot of catch-up potential. Indeed, prior to the recent financial crisis, the East Asian "tigers" registered growth rates in the order of 6 to 7 per cent for several decades following economic deregulation and integration into the world economy. At such growth rates, income doubles roughly every 10 years.

While the success of dynamic developing economies depends on many factors, including large investment in physical and human capital<sup>56</sup>, there is little doubt that outward-orientation has been pivotal. In fact, most empirical studies find positive feedback from the openness of the trade regime to economic growth. As depicted in Chart IV.2, the World Bank (1987) classified 41 developing economies into four categories on the basis of trade orientation: (1) strongly inward-oriented, (2) moderately inward-oriented, (3) moderately outward-oriented, and (4) strongly outward-oriented. The trade orientation was then compared with average per capita growth over three periods, 1963-73, 1974-85 and 1986-92. (The last period was added by the IMF(1993).) The chart is highly suggestive: outward-oriented countries grow faster on average than inward-oriented countries.

The growth bonus is less than suggested by the chart, however. The study does not control for other factors, and the openness indicator may capture the joint influence of the trade regime and omitted variables that are correlated with the trade regime. For example, the soundness of the trade regime is likely to be correlated with the overall soundness of economic policies, which also influences growth. Indeed, studies that control for other variables find a less pronounced impact of the trade regime per se, but still a significant one. The empirical evidence is reviewed below. It may be useful, however, to start with the underlying theory: what drives economic growth, and where does trade fit into this story?

<sup>50</sup>See Krugman (1984).

<sup>51</sup>See Helpman and Krugman (1989).

<sup>52</sup>Previous empirical studies of strategic trade policies typically used different methodologies, in particular simulations of calibrated models.

<sup>53</sup>Figures are in 1983 dollars. In current dollars, the amounts would be around 50 per cent higher.

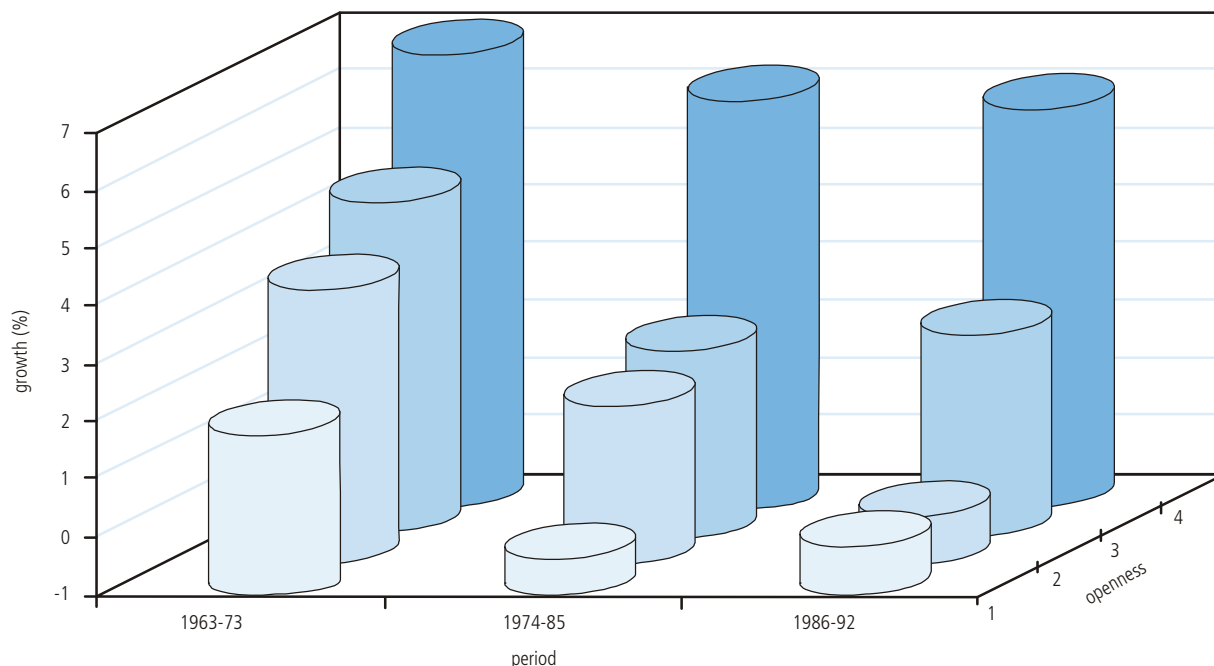
<sup>54</sup>Some numerical evidence concerning the Boeing-Airbus case suggests that the rents available for shifting are modest. See the stylized representations in Krugman (1987), Katz and Summers (1989) and Klepper (1990). See also Dixit (1988) and Krishna, Hogan and Swagel (1994).

<sup>55</sup>The number of years to double the income is approximately 70 divided by the growth rate.

<sup>56</sup>The savings rates of the Asian tigers are in the range of 35 to 45 per cent of GDP; roughly twice the world average and four times the savings rates of some least-developed countries.

Chart IV.2

### The relationship between the openness of the trade regime and the growth in per capita income in a sample of 41 developing countries



Source: World Bank (1987); IMF (1993).

#### 1. Trade and growth in traditional growth models

Traditional (neo-classical) models of economic growth view capital accumulation as the engine of growth.<sup>57</sup> Investments are assumed to be financed in full out of domestic savings.<sup>58</sup> The domestic savings rate is thus critical for economic growth. Countries that save more will be able to invest more and will hence grow more. Investment will at first give high returns, which will diminish as the economy builds up its capital stock. This is because of diminishing returns, which become more severe as the economy becomes more fully invested. The growth rate will therefore fall as the country grows richer.

The model identifies two basic reasons why different countries may not achieve the same per capita income, even in the long-run. First, factor productivity may differ for various reasons, the most obvious being differences in human capital. Human capital and per capita income are strongly correlated.<sup>59</sup> Other variables that affect productivity and growth include public expenditures (negative correlation with growth overall but positive for certain subcategories of expenditures, such as education and infrastructure), inflation (negative correlation for

high inflation rates), the rule of law (positive correlation), labour market rigidities (negative correlation), financial sector development (positive correlation), and the openness of the trade regime (positive correlation).<sup>60</sup> Second, per capita income increases with the capital intensity of the economy and thus indirectly with the savings rate. Huge differences in savings rates, ranging from less than 5 per cent of GDP in some of the poorest countries in the world to more than 45 per cent in some East-Asian countries, are a key factor explaining cross-country variations in growth rates and per capita incomes. As long as these differences remain, incomes are unlikely to converge in the world. Indeed, as discussed in Section IV below, income is so far only converging among countries with similar socio-economic data (human capital, government policies, savings rate, etc.), just as predicted by the theory.

Trade liberalization can affect economic growth in these models indirectly. Essentially, any policy that increases the efficiency of the economy, including trade liberalization, will lead to temporarily higher growth as the additional income translates into higher savings and investment.<sup>61</sup> The process is essentially a dynamic version of the celebrated Keynesian multiplier where an injection of public money could raise GDP by more than the initial injection by stimulating the economy, especially in times of widespread unemployment. The investment multiplier effect is too small, however, to explain the differences in growth between open and closed economies. Another link between trade and growth emerges in multi-sector versions of the model.<sup>62</sup> In this setting, opening up to trade, and the restructuring of the economy that goes with it, can underpin growth for several decades just as it has done for East Asia. The limits to growth are defined by the availability of domestic savings and foreign investment to finance the expanding sectors, and the risk of saturating the world market. However, once the economy is restructured, growth rates will inevitably fall again to more normal levels. The good news is that the country may then no

<sup>57</sup>The neo-classical growth model is foremost associated with Solow (1956) – the “Solow” model.

<sup>58</sup>Of course, in reality countries may finance temporary investment booms by borrowing abroad, that is, by running a current account deficit. However, deficits must be followed by surpluses in order to service the debt. In other words, investment can only exceed savings temporarily.

<sup>59</sup>See Mankiw, Romer and Weil (1992).

<sup>60</sup>See Barro (1998) for a review of empirical growth studies.

<sup>61</sup>See Baldwin (1989).

<sup>62</sup>See Deardorff (1974).



longer be poor, or at least not as poor as before the trade reforms.<sup>63</sup>

It should be stressed that nothing in this class of models suggests that trade liberalization will stimulate growth permanently. The growth impulse will eventually fade out once the economy is restructured and integrated into the world economy. Yet, empirical evidence suggests that open economies grow faster than closed economies for prolonged periods of time, possibly longer than can be explained by the dynamics of the traditional growth model. One reason could be that international competition forces firms to be more innovative and open to foreign ideas and technologies, while protection may foster complacency and technological stagnation. Such links are absent in traditional growth models which treat technological change as an exogenous or independent process that does not respond to market forces and public policies. This is of course an abstraction from reality, as shown by the "growth-accounting" literature which attributes a large share of growth to technological progress, especially in developed countries where traditional capital accumulation is no longer the engine of growth.<sup>64</sup> Thus, while older growth models can explain some empirical observations, such as income convergence among groups of similar countries, it provides little explanation of persistent differences in growth or of the way these differences are related to trade policy. We shall now turn to a more recent set of models that provide fresh insights on these issues.

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## 2. Trade and growth in new growth models

The last two decades have seen important developments in growth theory. The focus has been on transforming the traditional assumption of exogenous (independent) productivity growth (driven by unexplained technological changes) into an endogenous (dependent) market-driven process. These models are therefore known as "endogenous growth models". They have been used to study the growth implications of a wide range of policies, including taxes, public expenditures, education policies and trade policies.<sup>65</sup> This sub-section provides an overview of the literature that is directly applicable to the trade and growth nexus. It must be stressed, however, that trade is only one element of the growth equation. As already noted, the vast number of variables that are correlated with growth suggest that the growth performance of a country depends on

the overall quality of economic and social policies, including good education, macroeconomic stability, openness to foreign direct investment, the rule of law, flexible labour markets, good infrastructure, and so on. Open trade policies will certainly not make up for shortcomings in other areas.

One way of linking productivity growth with market forces is through a simple process of learning-by-doing: the more a country produces of a certain product, the better that country becomes at producing it. One example is the assembly of airframes or computer chips, where costs are known to fall dramatically as production experience is accumulated. Trade enters into this picture in two direct ways. First, a country will learn more quickly in the sectors that expand, and more slowly in the sectors that contract. The net effect on growth depends on the scope for learning in expanding sectors relative to contracting sectors. Second, if trade facilitates the diffusion of technology, and there is increasing evidence in this direction, countries will not just learn from their own production experience, but also from that of their trading partners.

Countries with a head-start in dynamic industries will initially gain more from trade liberalization by gaining a larger share of these sectors. However, other countries that specialize in traditional and mature industries will share the gains indirectly because of falling import prices of products with rapid productivity growth. For example, falling prices of computers and other high-tech products reduce the import bill of countries that specialize in mature and traditional industries. The conclusion of the model is that all countries benefit in the long run from increasing international specialization because of faster learning and productivity growth. This is especially the case if trade facilitates the diffusion of technology and knowledge between countries.

Learning-by-doing models are somewhat special in that learning is just a by-product of production. In reality, learning is not merely incidental, because firms also devote substantial resources to research and development (R&D) in order to find new or improved ways of producing things (process innovation) and new and improved things to produce (product innovation). R&D expenditures can exceed 2 per cent of industrial value added in advanced countries, and sometimes much more, and the trend is generally upward.<sup>66</sup>

A number of recent models view R&D as the engine of growth.<sup>67</sup> A key assumption of these models is that R&D generates two related types of output. The first type is the new process or product itself. By assumption, the innovator is granted an exclusive right of commercialization, for example, through a system of patent protection. Legal protection of intellectual property rights is necessary to allow innovating firms to recoup the R&D outlays, and hence engage in R&D in the first place. The second type of output is comprised of the technical information that is embedded in these products, which may be far more difficult to appropriate. For example, even if a medicine is protected by a patent, the inventor may not be able to prevent rival pharmaceutical companies from learning the basic principles. An analysis of the chemical composition ("reverse engineering") and a review of the patent application and supporting documentation may uncover essentially everything that there is to know about the medicine. This information may in turn allow rivals to develop competing medicines that are different enough to fall outside the original patent. It is this interplay between innovation, dissemination of embedded technology, and subsequent innovations that is the engine of growth in this class of models.

Any policy that affects the incentive to invest in R&D will also affect economic growth. A case in point is patent protection for the purpose of stemming property right infringements that

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<sup>63</sup>The analysis becomes considerably more difficult once models of individual countries are connected to a full dynamic general equilibrium model of the world. In this case, trade may stimulate investment and growth in one set of countries and reduce investment and growth in another set of countries. The individual growth effect depends in a complex way on comparative advantage, price changes with respect to investment goods, and savings behaviour. See Stiglitz (1970), Smith (1984) and Findlay (1995) for an analysis.

<sup>64</sup>See Madison (1987) for a review of the growth-accounting literature.

<sup>65</sup>For a general overview of the endogenous growth literature, see Barro and Sala-i-Martin (1995). For a comprehensive treatment of the trade and growth nexus, see Grossman and Helpman (1991). A less demanding overview is provided in Grossman and Helpman (1995).

<sup>66</sup>Grossman and Helpman (1995).

<sup>67</sup>Grossman and Helpman (1991) is the key reference.

undermine original research.<sup>68</sup> Other examples include government support of natural science education, basic research and dissemination of research. Other commonly used instruments are R&D subsidies or tax breaks for applied research by private firms. All these policy instruments work more or less directly on either the cost or revenue side of R&D activities. In addition, there are a number of indirect instruments that in one way or another interact with the incentive to invest in R&D, one example being trade policy.

As explained succinctly by Grossman and Helpman (1995): “Global integration presumably affects both the private incentives for and the social benefits from investments in technology. On the positive side, integration expands the size of the market and so the potential profit opportunities available to a firm that succeeds in inventing a new product or process. Also, ... a country that integrates itself into the world economy often can benefit from learning that takes place outside its borders. On the negative side, firms sometimes cite international competition as one of the major risks associated with investments in high technology and as an element in the case for greater government involvement in the development of new technologies.”

Trade liberalization may in this set of models spur innovation and growth in one set of countries and retard innovations and growth in another. A positive growth response is more likely for all participating countries if trade facilitates the dissemination of technology and knowledge. Otherwise, there are very few robust results that hold under different assumptions. The theoretical state of ambiguity is summarized by Grossman and Helpman (1995) in the following way: “When knowledge spillovers are localized – be they spillovers from learning by doing or spillovers from research discoveries – a small country or one that begins at a technological disadvantage may find that trade slows its technological progress, as competitive forces drive its resources into more traditional, slower-growing activities. On the other hand, when the learning process is characterized by dynamic scale economies, the scope for gains from international integration and trade may be many times larger than suggested in static models of trade. [T]he answers... hinge on the nature and extent of technological spillovers, about which empirical evidence is just beginning to accumulate.”

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### 3. Trade and growth: empirical evidence

Since theory cannot unambiguously resolve the issue whether trade liberalization, or economic integration more generally, spur

economic growth for each and every country, we shall now review the empirical evidence for further guidance. It should be noted at the outset that the empirical literature on trade and growth has to deal with a number of conceptual and data problems. The key problem is the measurement of the trade policy stance, which lies in translating the myriad of trade barriers across thousands of tariff lines into an overall “openness” index of the trade regime. The findings of various studies are summarized in Appendix Table II.

The simplest approach to distil the trade orientation of a country is to use actual trade flows as a proxy. The idea is that more liberalized economies experience faster export growth than less liberalized ones. A positive correlation between export and GDP growth is then taken as evidence that trade liberalization spurs economic growth. Such results have been found in several studies.<sup>69</sup> The obvious shortcoming is that trade flows are at best imperfect proxies for trade policy orientation. Small countries, for instance, tend to trade more than large countries both for scale economy and resource base reasons. However, studies that control for natural differences in trade propensity find once again a positive relationship between trade and growth, with a growth premium of outward orientation ranging from 0.2 percentage points for large manufacturing exporters to 1.4 percentage points for small primary exporters.<sup>70</sup> Another approach is to infer the trade orientation based on the deviation of actual exports from that predicted by a theoretical trade model. A positive difference between actual and predicted exports is taken as a sign of outward orientation, and vice versa. Studies based on this approach have also confirmed a positive relationship between the openness of the trade regime and economic growth.<sup>71</sup> Yet another approach has been to develop openness indexes on the basis of multiple criteria, such as the prevalence of non-tariff barriers, average tariff rates, deviation between black market and official exchange rates, and the prevalence of state trading enterprises. One such study found that open economies grow 2 to 2½ percentage points a year faster than closed economies, after controlling for other factors.<sup>72</sup> A related study found that open economies converge to higher income levels over time than closed economies do.<sup>73</sup> Yet another school measures trade orientation on the basis of the divergence between domestic and international prices. Countries with relative prices more closely aligned to world market prices were found to be growing significantly faster.<sup>74</sup> In particular, small, resource-scarce countries seem to be hurt by import restrictions, presumably because of greater dependence on foreign inputs in production.

The robustness (sensitivity) of the above results has been checked in several studies that use multiple indexes of trade openness. Regardless of the index, estimation technique and time-period, the relationship between openness and growth is in most cases found to be positive, and when negative, statistically insignificant.<sup>75</sup> There also seems to be a “virtuous circle” between trade liberalization, growth and further trade liberalization. Periods of high growth seem to provide an impetus for more open markets (presumably because it alleviates adjustment problems and reduces resistance to change), and more open markets in turn are conducive to growth.<sup>76</sup>

Some authors have questioned whether the positive linkage between trade and growth holds for the least-developed countries, arguing that a certain level of development is required before the benefits of international trade can be fully realized.<sup>77</sup> There are indeed some older studies which suggest that the trade and growth linkage is stronger for medium-income countries than for low-income countries.<sup>78</sup> However, this is probably a spurious finding related to a more consistent set of economic policies in medium-income countries, as well as to less frequent policy reversals before the growth effects have had a

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<sup>68</sup>Governments face a difficult trade-off in deciding the optimal length of a patent. On the one hand, the patent should last long enough to sustain the incentives for original R&D. On the other hand, patent protection should not be excessively long since the monopoly pricing supported by the patent squeezes out consumers from the market. For example, a new medicine may be beyond the reach of poor people until the patent expires and generic brands become available at lower prices. However, if generic brands are allowed in too early, the medicine may never see the light of day.

<sup>69</sup>Michaely (1977) and Feder (1983).

<sup>70</sup>Syrquin and Chenery (1989).

<sup>71</sup>Balassa (1985), Leamer (1988) and Edwards (1992).

<sup>72</sup>Sachs and Warner (1995).

<sup>73</sup>Proudman, Redding and Bianchi (1997).

<sup>74</sup>Barro (1991), Dollar (1992), Easterly (1993) and Lee (1993).

<sup>75</sup>Harrison (1995) and Edwards (1997).

<sup>76</sup>Harrison (1995).

<sup>77</sup>Heilleiner (1986).

<sup>78</sup>Michaely (1977) and Ram (1985).

chance to set in. Indeed, more recent studies that control for a larger set of variables affecting growth do not find a weaker relationship between trade and growth, even for the poorest of countries in Sub-Saharan Africa.<sup>79</sup>

There are also some studies that try to identify exactly why open economies grow faster than closed economies. One finding in line with the traditional growth models is that trade liberalization stimulates investment activities and thereby indirectly economic growth.<sup>80</sup> An open trade regime seems also to lead to higher quality investments. One study on 34 developing countries found that inflows of foreign direct investment had a positive impact on growth for outward-oriented countries, whereas no significant impact was found on inward-oriented countries.<sup>81</sup> There is also increasing evidence of trade-induced technology transfer, an important ingredient in endogenous growth models. One study found that domestic factor productivity was positively affected by the import-weighted sum of the trading partner's R&D expenditures.<sup>82</sup> Another study found that foreign R&D expenditures in one industry do not just improve domestic productivity in the same industry, but also in other industries connected by input-output linkages.<sup>83</sup> This finding supports the view that trade facilitates the dissemination of technology in the world, strengthening the conclusion that trade brings positive growth effects for countries that integrate into the world economy.

In summary, a broad range of different studies all arrive at the same basic conclusion – an open trade regime stimulates growth. Moreover, the empirical literature denies the basis for the pessimistic view that trade liberalization somehow compromises the growth prospects of developing countries. On the contrary, open developing countries outperform closed developing countries by a significant margin. Finally, to put things in perspective, an open trade regime is not a panacea for growth: other components of the economic policy regime must be right to unleash the full potential of the productive forces of the economy.

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## IV. Managing the challenges of trade liberalization

If globalization, and the trade liberalization that is part of it, bring such benefits in terms of higher incomes and enhanced opportunity, why does controversy characterize key aspects of the globalization debate? The reason is that any process of change, including change that offers betterment and greater opportunity for society as a whole, carries with it policy challenges. This section discusses these challenges. Three broad concerns are at the core of the case that is made against globalization. First, globalization carries distributional consequences. Trade liberalization creates winners and losers, and it matters little to the losers that their losses may be temporary or that the winners gain more than they lose. The globalization process is also associated in the minds of some with the notion of marginalization. Not all countries share fully in the benefits of

globalization, and the often unspoken assumption is that the marginalization of some countries is intrinsic to the globalization process itself.

Second, by fostering growth and development, the globalization process can cause unintended collateral damage to the environment. If environmental quality and the environmental costs of economic activity are ignored, considerable damage may be done. In these circumstances, growth and development will become unsustainable in the longer run. Third, globalization and trade liberalization are viewed by some as undesirably intrusive upon societies, attacking the diversity of social values among and within nations. One concern is that unbridled market forces will oblige countries to adopt lower standards in order to compete, and that regulatory permissiveness will replace sound public policy. This notion of a "race to the bottom" finds expression in the trade and environment debate, and in relation to labour standards. Fears of imposed uniformity also touch on matters of cultural diversity. In addition, there is the question of sovereignty, and the fear that globalization weakens national governments, rendering them less effective in carrying out their economic and social responsibilities.

### A. The adjustment challenges of trade liberalization

Trade liberalization can carry negative distributional consequences which are considered important enough for some groups to resist trade liberalization and demand protection. The key challenge here is to secure the larger overall gains from trade liberalization, despite the losses incurred by those affected by growing import competition. Addressing the concerns of the losers from trade liberalization, and especially of those least able to deal with the adverse effects of change, is essential in itself as a matter of public policy, but is also vital to the maintenance of political support for trade liberalization. Trade protection, however, is not the appropriate policy response to distributional challenges, since this would simply dissipate the greater aggregate gains from liberalization. The policy environment should provide safety nets and facilitate adjustment to a changing world, e.g. through human capital formation, and flexible labour and capital markets.

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#### 1. The costs of adjustment

Gains from trade liberalization are by necessity achieved through changes in patterns of production and consumption. As labour and capital shift between different uses, they may be unemployed for some time. As a result there may be temporary reductions in output and income. Such losses are likely to be larger, the more "specific" factors are to their previous employment and the more expensive and time-consuming it is to put them to a new use. A highly specialized technician in the production of steel, for example, may require considerable and time-consuming retraining before he or she can make a similar income in a different employment. Similarly, it can be time-consuming and costly to shift capital, for example, from being used for steel production to computer production. These costs are also called the "social costs of adjustment". They should be included in the cost-benefit calculus of trade liberalization.<sup>84</sup> They can be seen as an investment into more efficient production and consumption patterns, and it is worthwhile incurring these costs as long as they are smaller than the benefits from liberalization.

The standard measurement of social adjustment costs is the value of output that is foregone in the transition to new long-run production patterns as labour and capital are transitionally "unemployed".<sup>85</sup> Consider a country which liberalizes a single

<sup>79</sup>Martin (1992).

<sup>80</sup>Levine and Renelt (1992).

<sup>81</sup>Balasubramanyam, Salisu and Sapsford (1996).

<sup>82</sup>Coe and Helpman (1995).

<sup>83</sup>Keller (1997).

<sup>84</sup>A more extensive discussion of adjustment costs is provided by Matusz (1997).

<sup>85</sup>There are also other costs that are harder to quantify, such as the mental suffering of unemployed workers, which normally fall outside the realm of economic analysis.

industry. This industry is small relative to the rest of the economy, so repercussions on the rest of the economy are small. Suppose that it takes workers a year to find new employment after losing their jobs due to trade liberalization. Suppose also that during the adjustment process these workers could have produced output of US\$1 million had they been employed in their new long-run occupations. These are adjustment costs which have to be set against the static and dynamic gains from trade liberalization. To calculate the net gains from liberalization, one has to compare the yearly stream of these gains, suitably discounted – this is the “gross profit” of the liberalization – against the one-time investment (or social adjustment cost) of US\$1 million. As long as the net present value of the future gains from liberalization exceeds US\$1 million, liberalization is socially worthwhile. In theory, trade liberalization could entail a net welfare loss if costs are very large or the discount rate applied to future benefits is high.

Adjustment costs can also be considered from the point of view of individuals, who may have to adjust to trade-induced changes in their economic environment. If a steel worker or a farmer loses his livelihood because his output cannot compete against less costly imports, he or she has to look for a new job. These costs are referred to as private adjustment costs. These costs can be important, especially when one looks at their distribution from an equity perspective. There may be strong regional differences in adjustment costs. A region which exclusively relies on agriculture will experience much higher adjustment costs from agricultural liberalization than a well-diversified region which also offers employment in industry and services. Trade liberalization may also affect more strongly those segments of society which are least able to cope with adjustment, such as low-skilled workers with limited mobility. Moreover, low-skilled workers in industrialized countries are likely to have smaller financial cushions to deal with adjustment than their more highly skilled and better paid colleagues. Finally, some factor markets work more smoothly than others in redirecting resources which are freed up through liberalization. In countries with flexible labour markets, for example, it might be easier to find new employment than in countries with more inflexible labour market institutions. In fact, rigid labour markets can easily turn transitional unemployment into long-term unemployment, with large output losses and much social and personal hardship.

Private adjustment costs are very important from a political economy perspective. Even if they do not reverse the net gains from trade liberalization for society as a whole, they are often at the root of much of the resistance to trade liberalization by particular groups, such as farmers, steel workers or coal miners in industrial countries.

Empirical evidence tends to show that trade liberalization may entail non-trivial adjustment costs for certain groups. However, these costs are typically only a small fraction of the overall benefits from trade liberalization. Takacs and Winters (1990), for example, studied the likely effects of the removal of quantitative restrictions in the British footwear industry. They report that even in the most pessimistic scenario, the adjustment costs are very small compared to the potential gains from trade

liberalization – that is, slightly less than £10 million compared to £570 million.

Several studies report that replaced workers might earn substantially less in their new occupations, even several years after re-employment.<sup>86</sup> Other studies have estimated the temporary income loss. Bale (1976) found that the average income loss was US\$3,370 for a US worker who was displaced because of import competition during 1969-70, before taking into account such factors as trade adjustment assistance and unemployment insurance.

A more indirect way of assessing the magnitude of adjustment costs has been to estimate the share of the restructuring of trade that takes place within industries.<sup>87</sup> The authors observe that it is easier to move from one occupation to another in the same industry, rather than to switch industries. From this point of view, one should expect increased import competition between developed countries to be associated with relatively small adjustment costs, as much of the additional trade is intra-industry trade. The expansion of trade with developing countries, on the other hand, consists mainly of inter-industry trade which results in higher adjustment costs.<sup>88</sup>

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## 2. The policy responses to adjustment challenges

Some observers argue that private adjustment costs call for some form of government intervention on equity grounds, in contrast to social adjustment costs, which might require government measures on efficiency grounds. Independent of these observations, it is a political reality that adjustment costs are one of the key factors that create resistance to trade liberalization. The policy responses to adjustment costs have to deal with two challenges for workers displaced by trade liberalization: (i) mitigate the adverse effects of temporary income losses, especially on the least-advantaged groups in society through social safety nets or social insurance; and (ii) create or strengthen mechanisms which shorten the adjustment period and which allow re-entry into the labour force at a level commensurate with the previous position and earnings. Note that reversing or eschewing trade liberalization are not viable options if societies are to progress and benefit from globalization. On the other hand, many governments opt for a policy of gradual or progressive liberalization in order to cushion the impact of adjustment.

Many countries, especially developed countries, now have basic social safety nets in place which keep people out of poverty. These include unemployment insurance, social assistance, and adjustment assistance programmes which explicitly target those displaced by import competition. The trade adjustment assistance scheme of the United States, for example, provides cash benefits and retraining to workers who lose their job as a result of trade. It also provides extended unemployment insurance payments, also called Trade Readjustment Allowances, relocation expenses, job search assistance and worker retraining. Retraining or skill-upgrading is another important option for shortening the adjustment period and reducing the adverse impact on future earnings. A number of other countries, particularly in Western Europe, have also introduced such active labour market policies.

Many of these programmes, however, do not reach the target groups, and a careful design of such programmes is important for their success.<sup>89</sup> Most of the benefits from social programmes are targeted at the middle classes rather than the poor and do not effectively deal with the problems of those displaced by trade. Burtless, Lawrence, Litan and Shapiro (1998), for example, argue that United States trade adjustment assistance could be much improved at limited cost. They suggest a system of earnings supplements for a defined time-period, which would

<sup>86</sup>See Jacobson et al. (1993a,b). Mills and Sahn (1995) provide a more positive picture in a study of Guinea.

<sup>87</sup>Greenaway et al. (1994).

<sup>88</sup>Examples of other empirical studies, employing a variety of methods, are Baldwin, Mutti and Richardson (1980), de Melo and Roland-Holst (1994), Magee (1972), de Melo and Tarr (1990) and Mutti (1978).

<sup>89</sup>See Richardson (1982); Burtless et al. (1998).

serve as a partial income insurance. Subsidization of low wage workers and health benefits for the unemployed or those in jobs without health benefits would also mitigate the fears of trade-induced social decline and uncertainty.

Capital owners who see their capital stock devalued through import competition may also resist trade liberalization and demand compensation for the losses incurred. Sectors with high, fixed and immobile investments, like steel or agriculture, are particularly vulnerable to the sudden devaluation of their capital stock. Gradual liberalization, or a pre-commitment to liberalization in the future, facilitates adjustment for capital owners who can adjust their investment decisions more easily and shift out of declining sectors more gradually. It has been argued that this liberalization strategy has contributed to the political palatability of the EU's common market project implemented between 1986 and 1992.<sup>90</sup> The question of the appropriate timing and speed of trade liberalization is complex, however, and requires politically credible pre-announcements of gradual liberalization measures.

Governments have other regulatory means of dealing with trade-related adjustment. Social and economic institutions influence the willingness of people to adjust, and the ability of labour and education markets to provide the skills and jobs needed. The institutional setting varies across countries with different education and training systems, cultural expectations, social security systems, industrial relations, and labour market regulations. The flexibility of labour and credit markets seems to be of particular importance. If firms in sectors with potential for expansion do not have strong incentives to hire new employees, for instance because of administrative regulations or labour market constraints, adjustment will be more costly than otherwise. Likewise, firms will need to invest in order to exploit new opportunities, and this requires well functioning credit markets. The possibility of smooth adjustment also depends on the functioning of other markets. For example, the possibility for labour to find alternative employment may depend on the housing market. A well-functioning market for professional

education and training can also facilitate adjustment considerably.<sup>91</sup>

The GATT/WTO trading system is designed to accommodate the need for governments to manage adjustment. Under both the GATT and GATS, it is commonplace for governments to pre-commit to future liberalization. The GATS explicitly refers to the objective of progressive liberalization. Moreover, a range of temporary safeguard provisions exist that allow governments to arrest temporarily or postpone liberalization commitments in order to deal as necessary with the adjustment fallout occasioned by liberalization.

In summary, trade liberalization can create sizeable adjustment costs, and adverse distributional consequences. These costs, however, are typically far outweighed by the benefits from trade liberalization. Helping those who are hurt by trade liberalization builds much needed support for continuing trade liberalization. The gains from trade and of globalization in a broader sense are too high to be sacrificed because of the temporary adjustment costs which go with it. It is therefore important – for the benefit of open trading systems – to address this issue in an appropriate manner.

## B. Trade, wages and social cohesion

The previous section discussed the essentially temporary dislocation that can result from trade liberalization. The focus here is on longer-lasting shifts in income distribution that may or may not be associated with trade liberalization. The putative impact of trade liberalization on wages, income distribution and social stability has become a thorny subject for politicians, labour unions, interest groups and economists in industrialized countries. In particular, trade competition from low-wage developing countries is blamed for declining real wages of low-skilled labour in the United States and for increasing unemployment in continental Europe. This, in turn, undermines social cohesion and stability.<sup>92</sup> Trade, in other words, has social costs which – to some critics – tip the balance in favour of protection. This is another key challenge to trade liberalization which should not be taken lightly. However, most economists now agree that: (i) trade is not the main cause of real wage declines or unemployment in the industrialized countries; and (ii) trade protection is not a suitable policy response to relative or absolute declines in wages or increases in unemployment.

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### 1. The trade and wages debate

Economic theory suggests that countries rich in labour specialize in the production and export of labour intensive products, such as clothing, whereas countries rich in capital produce and export mainly (if not exclusively) capital-intensive products, such as computers.<sup>93</sup> If clothing is produced mainly with relatively unskilled labour, an increase in the tariff on imported garments increases the wages earned by unskilled workers. Inversely, the removal of tariffs on imported garments reduces the wages of unskilled workers.

Based on these arguments, fears are mounting that international trade is lowering unskilled workers' wages in the developed countries to the low wage levels of the developing countries. Free trade between the United States and Mexico, for example, could lead to lower wages in the United States for less-skilled workers. This is why there has been so much concern about the implications of NAFTA on wages.<sup>94</sup>

The debate has stimulated a large number of empirical studies on the subject. From this literature, it seems that factors other than trade explain most of the growing wage dispersion and unemployment observed in the United States and Western Europe respectively.<sup>95</sup> A number of studies suggest that

<sup>90</sup>See Schuknecht (1992).

<sup>91</sup>A number of OECD studies have dealt with the institutional setting and performance of different education systems.

<sup>92</sup>For more detail, see Bhagwati (1997); OECD (1997a); Rodrik (1997); and Burtless et al. (1998).

<sup>93</sup>It should be noted that this brief discussion concentrates on a single aspect of what is a much wider debate about the labour market effects of globalization, and country experiences differ widely. The emphasis here reflects the primary forms of the public debate in certain industrial countries.

<sup>94</sup>See Burtless (1995). A good discussion of theory and the empirical finding can be found in Leamer and Levinsohn (1995). Deardorff and Stern (1994) document different formulations of the theoretical constructs dealing with this issue (in particular, the Stolper-Samuelson theorem). Deardorff and Hakura (1994) also provide theoretical links between trade and wages.

<sup>95</sup>Burtless (1995) and Slaughter (1995) survey the disagreement among economists on this issue. For example, Borjas, Freeman and Katz (1992) and Borjas and Ramey (1993) assign a relatively important role to international trade on this issue, whereas Lawrence and Slaughter (1993), Bhagwati and Koster (1994) and Bhagwati (1994) find that trade mattered very little. Note that increased wage differentials (more significant in the United States) and unemployment (a more severe European problem) are essentially two faces of the same coin. The difference turns in large part on the workings of labour markets.

increased trade with developing countries accounts for maybe 10 to 20 per cent of the changes observed in wages and income distribution in the advanced economies. Stating this fact counterfactually brings home the point more forcefully: 80 to 90 per cent of the changes in wages and income distribution observed of late in OECD countries are attributable to factors other than trade with developing countries.<sup>96</sup> Feenstra and Hansen (1995), for example, find that outsourcing to foreign imported intermediate goods explains some 20 per cent of the shift towards skilled workers in the United States in the 1980s. Campa and Goldberg (1997) confirm the increase in outsourcing for the United States, Canada and the United Kingdom, but not Japan. In contrast, Slaughter (1995) finds that multinational outsourcing contributed very little to rising wage dispersion in the United States. Increased imports from developing countries can be linked to some erosion of production and employment in the developed countries for particular (low-technology) sectors. For instance, the OECD (1992, 1994) reports such effects for clothing, footwear, textiles, ferrous metals, wood and furniture, and food, drink and tobacco.

Growing wage differentials may not be due to trade but to growing demand for skilled labour as technological progress requires skilled instead of unskilled workers in many production processes. The increase in the use of and efficiency of computers can explain some 30 per cent of the shift towards skilled labour in recent years.<sup>97</sup> Other factors explaining growing wage dispersion or unemployment amongst the low-skilled include growing demand for goods with high skill contents, immigration of low-skill labour, labour market rigidities and other structural problems that constrain factor mobility. As Burtless et al. (1998) put it, "the most significant problem faced by underpaid workers in the advanced countries is not foreign competition. It is the mismatch between the skills that employers increasingly demand and the skills that many young adults bring to the labour market."

<sup>96</sup>OECD (1998); Krugman (1995).

<sup>97</sup>Feenstra and Hansen (1995).

<sup>98</sup>Hillman (1998).

## 2. Trade and social cohesion

The debate on trade and wages is closely related to another concern about the impact of trade: namely, how does trade affect social cohesion and stability? Even if evidence regarding the link between trade and wages is relatively weak, trade has undoubtedly accelerated social and economic change around the world. As the global environment becomes more competitive and technological progress continues, job security declines. Some people cannot cope with adjustment and this, together with inappropriate social and adjustment assistance, results in more poverty and social marginalization. The "have nots" who are unable to adapt to the rapidly changing world can be driven into misery, family break-ups and crime. Growing inequality and insecurity are also seen to undermine equality of opportunity and the ability of individuals to afford a "decent" life even when working.<sup>98</sup> Equality of opportunity and a "minimum decent living standard", however, are considered to be two of the basic pillars of democratic societies. Many would argue that societies cannot maintain stability and cohesion without fulfilling these two conditions.

The argument is sometimes advanced that trade and open markets are undermining social cohesion and stability. A problem with this kind of argument is that it often fails to identify the sources of change, such as technological advances, thus placing undue blame on trade for social tension. If we compare the degree of openness of economies with some indicators of social cohesion, such as the crime rate or the divorce rate, we find little correlation between them (Table IV.1). The most open economies such as Singapore or the Netherlands do not have a higher crime or divorce rate than countries which are less trade-oriented. The countries with the lowest trade shares, Japan and the United States, find themselves at opposite ends of the spectrum of social stability. This suggests that other factors must be much more important in explaining social cohesion and stability than trade and globalization.

The political process makes it easier to blame trade for social problems. Protection has the advantage for policy makers that, unlike education programmes, safety nets or retraining, it does not have to be financed with voter/taxpayer money. Protection is tangible action which provides visible benefits to vocal interest

Table IV.1

### Trade openness and social indicators in the 1990s

Countries	Exports & imports (% of GDP)	Homicide & injury purposely inflicted by other persons (per 100,000 persons)	Divorce rate (per 1,000 couples)
Singapore	324.2	1.8	n.a.
Netherlands	99.6	1.1	30
Switzerland	68.6	n.a.	33
New Zealand	60.5	1.5	38
Korea	58.8	1.6	n.a.
Chile	58.1	3.0	n.a.
Sweden	54.1	1.3	48
Canada	53.9	1.7	43
United Kingdom	49.2	0.9	42
Germany	47.5	1.2	33
France	44.0	1.1	39
Italy	39.9	2.2	8
Australia	38.2	1.8	35
United States	21.8	9.9	48
Japan	17.7	0.6	22

Source: IMF, International Financial Statistics (several issues); UN Demographic Yearbook (1995); UN Human Development Report (1997).

groups. Trade is also an easy scapegoat when it comes to allocating blame for unpopular reforms. Hence, the temptation is great for politicians to avoid a search for other answers to – usually complex – social problems. Voters' fears of poverty and instability, and politician's opportunism lead to declining public support for liberalization and a declining willingness by policy makers to stand up against the protectionist tide.

Few people would now deny, however, that trade accelerates social change, can reduce job security and, to some extent, may worsen the relative position of low-skilled workers. Policy responses to these phenomena are important, regardless of whether the root cause is trade, technology or something else. The appropriate policy response, however, does not reside in the trade sphere.

Policy recommendations typically focus on three objectives. First, adjustment to change must be made as costless as possible. Second, policies must be designed to encourage growth and increase the size of the economic pie. Third, social assistance and other transfer payments must be better targeted towards those people displaced by change. As stressed above, well-targeted safety nets and education and training opportunities are key to these objectives.

Education, training and retraining improve the ability of individuals to deal with change. A well-educated person who keeps his or her skills up to date is less likely to lose a job, and more likely to find one than a person with few or outdated skills. An old saying is that if you give a man a fish he can eat for one day, but if you give him a rod he has food for life. Education provides a rod instead of a fish. More human capital also means a bigger economic pie, as it stimulates economic growth. And as already mentioned, appropriate tax and credit policies and labour market liberalization facilitate adjustment.<sup>99</sup>

Finally, public information on the merits of trade and trade liberalization is very important. A clear contrast needs to be drawn between the long term benefits of liberalization for society as a whole, and the narrow, immediate benefits of protection for particular interest groups. Efforts to clarify these issues in public discourse would increase support for workable solutions such as improved education and retraining, adequate social insurance and sound credit and labour market policies. Trade would cease to be seen as the villain, or as the only or most important harbinger of change. Public support for protection would weaken, even where trade is clearly implicated in bringing about change.

## C. Trade and marginalization

Controversy has arisen over the distributional consequences of trade liberalization across countries. This is an important question because some critics claim that the trading system and the globalization process frustrate the integration of some developing countries into the international economy and contribute to an increasingly uneven income distribution in the world. There is, however, no evidence on the systematic marginalization of developing countries. World trade flows, for example, have not become more concentrated in the hands of a few countries. On the contrary, theory and empirical evidence suggest that small and less-developed countries potentially stand to benefit most from trade liberalization. It is rather the policy

environment, including openness to trade, which determines the degree of trade integration and whether countries move in the direction of income convergence or marginalization and impoverishment. External trade barriers maintained by trading partners affect the ability of some countries to benefit from trade, but this is not a wide spread problem for low-income countries. The GATT/WTO trading system seeks to address the particular challenges faced by developing countries as they seek to intensify their participation in the international economy. These include special and differential treatment, trade preferences and technical assistance for the implementation of trade rules. Recent initiatives in the WTO, in conjunction with other international agencies, have been designed to address the situation of the least-developed countries.

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### 1. The gains from trade, and the size and location of countries

There are at least four reasons why small countries potentially stand to benefit more from trade liberalization than larger ones. First, liberalization increases the size of markets in which firms operate. This will particularly benefit producers from small economies with limited domestic markets, as they may be able to exploit economies of scale and lower their production costs following liberalization in trading partner markets. Second, liberalization can break up monopolies which are more likely to exist in small economies. Third, trade enhances product diversity in small economies more than in large ones. Finally, the impact of liberalization on the transfer of productivity-enhancing technology is also likely to be greater in small countries. The smaller the country, the larger the fraction of know-how that has to be brought in from abroad. Part of this transfer typically occurs through trade.

The particular importance of trade and trade liberalization for smaller countries is evident from Chart IV.3. This chart illustrates for 127 countries that trade as a share of GDP and population size are negatively correlated, i.e. the smaller a country the greater its trade integration.

The "trade and geography" literature provides an interesting perspective on the question of how location affects the gains from liberalization. This literature discusses the forces which lead to geographical concentration of industries, and those which promote their dispersion.<sup>100</sup> The concentrating forces stem from so-called economies of agglomeration, i.e. the cost advantages from being geographically near other producers in the same sector. These economies typically arise from the interaction between firms. Firms located in close proximity with similar demand will enjoy a larger supply base of specialised products. It will also be easier in such circumstances to find employees with certain skills. Physical proximity may increase knowledge spillovers between firms. The standard example of this is Silicon Valley, where many producers of similar products are located near each other. The centrifugal forces stem from the fact that when firms locate in a given area, they will tend to drive up wages and rents, and this will make it less attractive for other firms to locate there.<sup>101</sup>

From this perspective also, trade liberalization is likely to offer greater potential benefits to poorer and smaller countries than to large and rich ones. Consider an industry located in a core region in industrial countries. Developing countries, and even some industrial countries located far away from the core, would be in the so-called periphery. The location in the core may be attractive to firms not only because of agglomeration economies, but also because of trade barriers which make it costly to serve the core market from the periphery. Consider now the impact of the unilateral removal of trade barriers by a "peripheral" country which features lower wages and economic rents than in the core. Liberalization makes it more attractive to produce in this

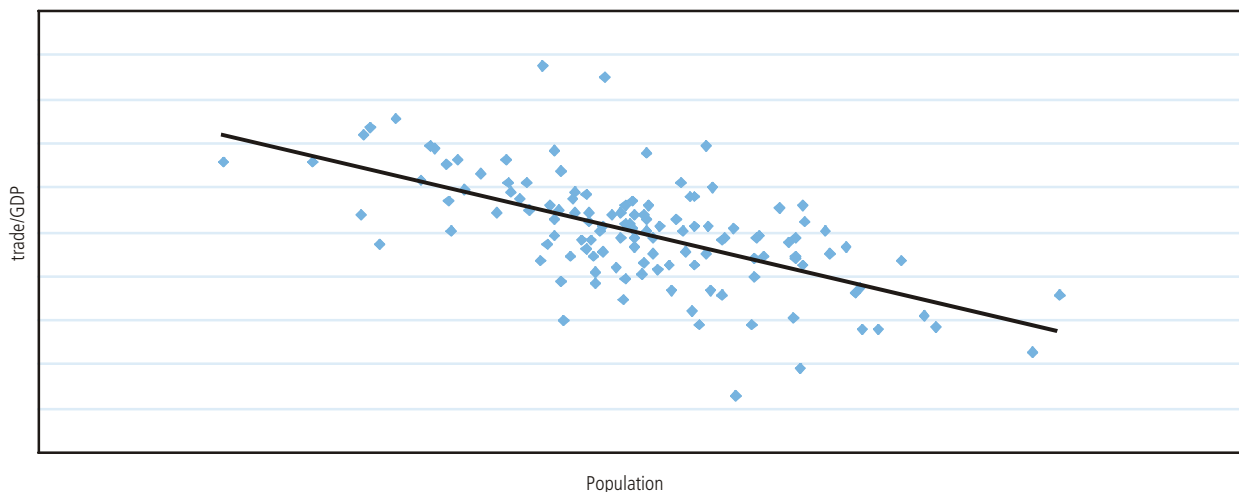
<sup>99</sup>OECD (1997a); Siebert (1997).

<sup>100</sup>For a survey, see Ottaviano and Puga (1997).

<sup>101</sup>See Hanson (1996), and Brülhart and Torstensson (1996) for empirical evidence on concentrating and centrifugal forces linked to reductions in trade costs through the creation of NAFTA and EU integration.

Chart IV.3

**Trade openness and population**



Source: World Bank (1998).

country as producers can benefit not only from lower labour costs and rents but also from cheaper imported inputs. If the core region were to follow suit and liberalize as well, this tendency would be reinforced, since products can now be sold to the core without trade barriers as well. It would then become even more profitable to locate in the periphery and export to the core.<sup>102</sup> If the periphery largely consists of developing countries, this approach predicts that the developing countries would benefit much more from liberalization than the rich countries.<sup>103</sup>

**2. Trade concentration and marginalization**

The claim that only a few countries have benefited from the rapid increase in trade in recent decades is based on the observation that the share in world trade of some regions has declined, and this is seen as part of the story of marginalization. Sub-Saharan Africa, for example, which accounted for 3.1 per cent of world exports in the 1950s, saw its share fall to 1.2 per cent by 1990, and Latin America saw its world market share decline as well. Western Europe, on the other hand, increased its share of world trade from 40 to almost 45 per cent over the same period.<sup>104</sup> In other words, critics claim that there is a built-in bias in the world trading system which led to a concentration of trade flows in the world.<sup>105</sup> Furthermore, critics argue that this bias has contributed to growing income inequality in the world.

These figures, however, provide a distorted picture. By definition, whenever one country's market share rises, another's has to decline, but this does not say anything about absolute trade. The latter has increased considerably even in those regions which saw their relative trade share decline. Furthermore, amongst the "winners", critics often forget to mention Asia whose share in world trade has increased by more than 25 per cent between 1985 and 1996, and where several increasingly

advanced countries started out as developing countries only a few decades ago. Three questions then need to be asked. First, can we observe an increase in the concentration of world trade flows? Second, has there been growing income inequality in the world? Third, what is the link between these and the international and domestic policy environment?

Regarding the concentration of trade flows, Low, Olarreaga and Suarez (1998) have studied the evolution of international trade flows across the world over the past 20 years for 127 developing and developed countries. As a first step, the authors excluded trade growth from the analysis and assumed that total trade remained constant. They found that there has been very little change in the concentration of world trade throughout the 1976-1995 period. More interestingly, if one incorporates the increase in international trade into the analysis, the concentration of world trade falls even more strongly throughout the period. This implies that the increase in world trade has been relatively more evenly distributed across countries and has improved the overall distribution of international trade in the world. The concentration indicator shows that world trade today is 50 per cent more evenly distributed than 20 years ago. From this, however, we cannot conclude that no countries have experienced marginalization in terms of their participation in international trade. We know that trade integration, especially of some African countries, has been declining. The study only demonstrates that there is no systematic marginalization of certain country groups, such as developing countries.

If we do not observe a systematic concentration of trade flows across the world, but a lack of trade integration of certain countries, what is at the root of this marginalization? Evidence on Sub-Saharan Africa by Ng and Yeats (1996) suggests that the decline in importance of this region in world trade is due to two main reasons. First, countries have lost competitiveness in their traditional export markets which, in turn, have been of declining relative importance in world trade. Second, these countries were unable to diversify their export base. As a result, many African countries, for example, are now highly dependent on relatively few export products and this dependence has even increased over the past three decades.

This loss of competitiveness and absence of diversification is mainly due to trade restrictions and policy interventions in their

<sup>102</sup>Puga and Venables (1997) and (1998).

<sup>103</sup>These findings are in stark contrast to claims by the earlier dependency literature which argued that smaller, poorer and more peripheral countries benefit less if at all from international trade as they are exploited by rich and poor country elites through established trade links and trade patterns.

<sup>104</sup>WTO (1997a).

<sup>105</sup>UNIDO (1996).



own economies, which created a bias against exports.<sup>106</sup> Import barriers in Africa are on average far higher than in developing countries in other regions with faster export growth. These barriers deter export-competitiveness through higher input prices and they contribute to the creation of inward-looking, uncompetitive production structures with a growth potential that is limited by the size of the domestic market. Sub-Saharan Africa's tariff average is three times higher than those of the fast growing East-Asian economies, and more than four times the OECD average. Similarly, non-tariff measures are more frequent in Africa than in other fast growing developing countries. Non-tariff measures affect 40 per cent of the low-income African countries' tariff lines, whereas they only affect 4 per cent of the tariff lines in fast growing developing countries and 3 per cent of tariff lines in OECD countries.<sup>107</sup> Moreover, during the Uruguay Round, OECD countries reduced their tariffs by almost 40 per cent, and many of the fast growing exporters also agreed to important reductions in trade barriers. On the other hand, Africa's commitments were relatively modest. The welfare estimates of the gains from Uruguay Round-induced liberalization suggest that those with the largest liberalization commitments will also experience the most gains from the Round.<sup>108</sup>

It is important to note that an open trade policy regime will not suffice in avoiding marginalization. Other domestic policies should also aim in the same direction. Most importantly, among these are policies that contribute to sound macroeconomic, political and institutional conditions. Low inflation, a well-functioning financial system, adequate infrastructure, the rule of law, and political stability are necessary to reap the full benefits from an outward-oriented trade policy.<sup>109</sup> The complementarity between foreign direct investment and trade is also well recognized.<sup>110</sup>

### 3. Income convergence

It is important to note that an open trade policy regime will not suffice in avoiding marginalization. Other economic policies must strive in the same direction. As discussed in Section III, economic growth is the outcome of generally sound economic policies, including macroeconomic stability, controlled inflation, the rule of law, well-developed financial systems, adequate infrastructure, good education system, and so on. All these variables are positively linked to economic growth.<sup>111</sup> Indeed,

there is nothing in economic growth theory that suggests that incomes in the world will converge irrespective of the policies of individual countries. What the theory tells us is that poorer countries which pursue sound policies consistently across a broad front will eventually catch up with the front runners. Put differently, when economic policies converge, incomes will also start to converge. This is called conditional convergence in the growth literature.

Data strongly support conditional convergence in per capita income, and equally strongly reject the alternative hypothesis of unconditional or absolute convergence. This can be seen with the naked eye in the attached charts. Chart IV.4 plots the average annual per capita growth rate between 1960 and 1990 for 104 countries against the per capita GDP in 1960.<sup>112</sup> If incomes converged unconditionally (regardless of the policies adopted by individual countries), the countries would line up nicely from left to right with the poorest country growing the fastest, the next-poorest growing a little bit slower, and so on all the way to the richest country that may not be growing at all. That is, we should expect a negative relationship between initial income and subsequent growth.<sup>113</sup> This is clearly not the case. On the contrary, the estimated coefficient is slightly positive, although not statistically different from zero. Thus, if anything, rich countries tend to grow faster on average than poor countries. However, there are huge differences among developing countries. Some developing countries, especially in East Asia until the recent financial crisis, have done extremely well, with average growth rates of 6 per cent or more over a 30-year period. In contrast, some of the poorest countries in the world have become poorer still, with negative growth.

Chart IV.5 plots the same relationship for EU and EFTA members. These countries are much more homogenous than the whole sample of countries in terms of government policies, technological capabilities, savings rates, and so on, and could therefore be expected to have more or less the same long-run income potential. Income convergence in this case is very pronounced. In fact, some 91 per cent of the growth performance over the period 1960 to 1990 is accounted for by a single variable, the initial GDP per capita. Poorer members of the EU-EFTA family have consistently outgrown the richer members, as predicted by traditional growth models.<sup>114</sup>

In summary, there is no evidence that incomes are converging in the world as a whole, nor is that to be expected according to traditional growth models, because of the wide differences in government policies, saving rates, population growth, human capital, and so on. That is, the preconditions for general income convergence are missing. If anything, the income distribution of the world has become more uneven over time. In this sample of 104 countries, the per capita incomes ranged from \$313 to \$9,895 in 1960, with an average of \$2,425. By 1990, incomes ranged from \$399 to \$18,054, with an average of \$5,130. The standard deviation of the sample (a measure of income dispersion) has increased from \$2,296 to \$5,115, and the coefficient of variation (the standard deviation divided by the mean) from 0.95 to 1.00. These indicators suggest, once again, that income distribution in the world has deteriorated over the last three or four decades.

According to these data, least-developed countries in the bottom end of the income distribution have made very little progress between 1960 and 1990. In contrast, some of the more advanced developing countries have done extremely well, with growth rates double or triple the world average. These countries are now in the middle and upper range of the global income distribution. Finally, the mature developed countries have continued to grow at about 2 per cent a year, and there is no marked slowdown in growth rates.

<sup>106</sup>Ng and Yeats (1996); Amjadi, Reinke and Yeats (1996); Low, Olarreaga and Suarez (1998).

<sup>107</sup>Ng and Yeats (1996).

<sup>108</sup>See Francois, McDonald and Nordström (1996) and UNCTAD (1997b).

<sup>109</sup>There are numerous studies on this subject. See, for example, UNCTAD (1997b) for a survey.

<sup>110</sup>WTO (1996).

<sup>111</sup>Barro (1998).

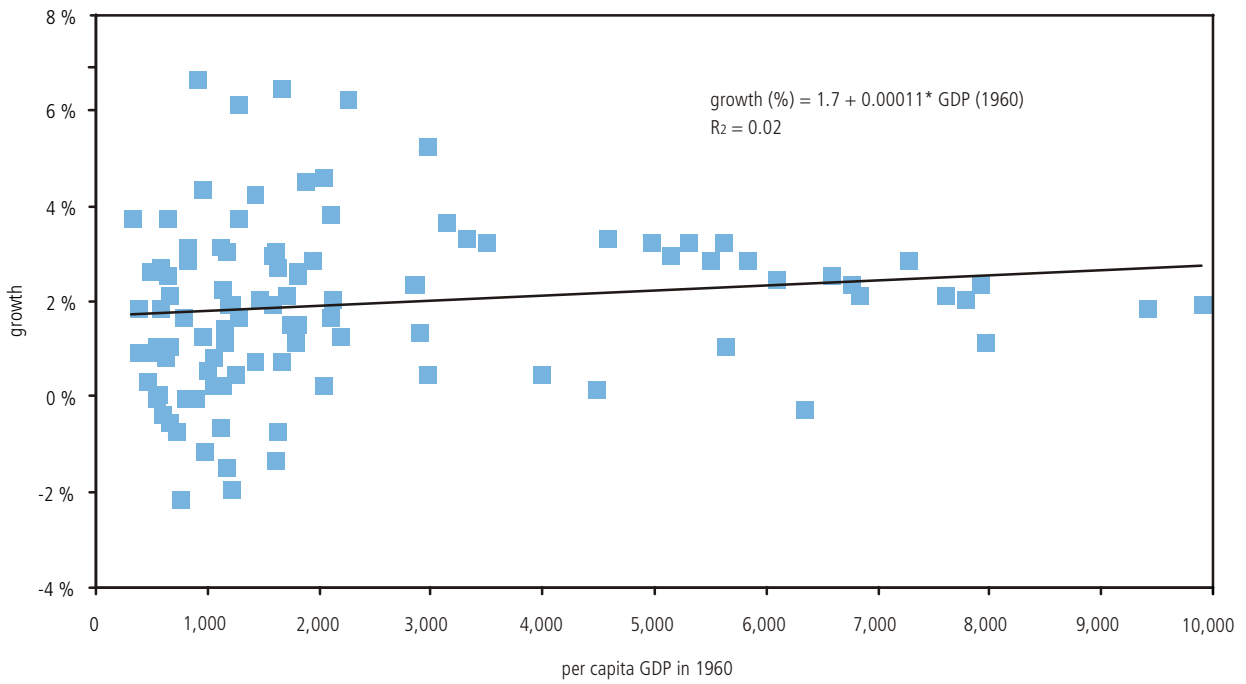
<sup>112</sup>Data are taken from the PENN Table, Mark 5.6, which can be downloaded from the homepage of the National Bureau of Economic Research ([www.nber.org](http://www.nber.org)).

<sup>113</sup>The negative relationship between the level and growth rate of income should in principle hold at every point in time. However, because growth rates vary during the business cycle, and since business cycles are not perfectly correlated across countries, empirical studies of growth tend to take a longer perspective in order to average out the influence of business cycle components.

<sup>114</sup>Many studies have also confirmed conditional convergence on regional data, for example, across the United States and Japanese prefectures. See Chapter 11 of Barro and Sala-i-Martin (1995).

Chart IV.4

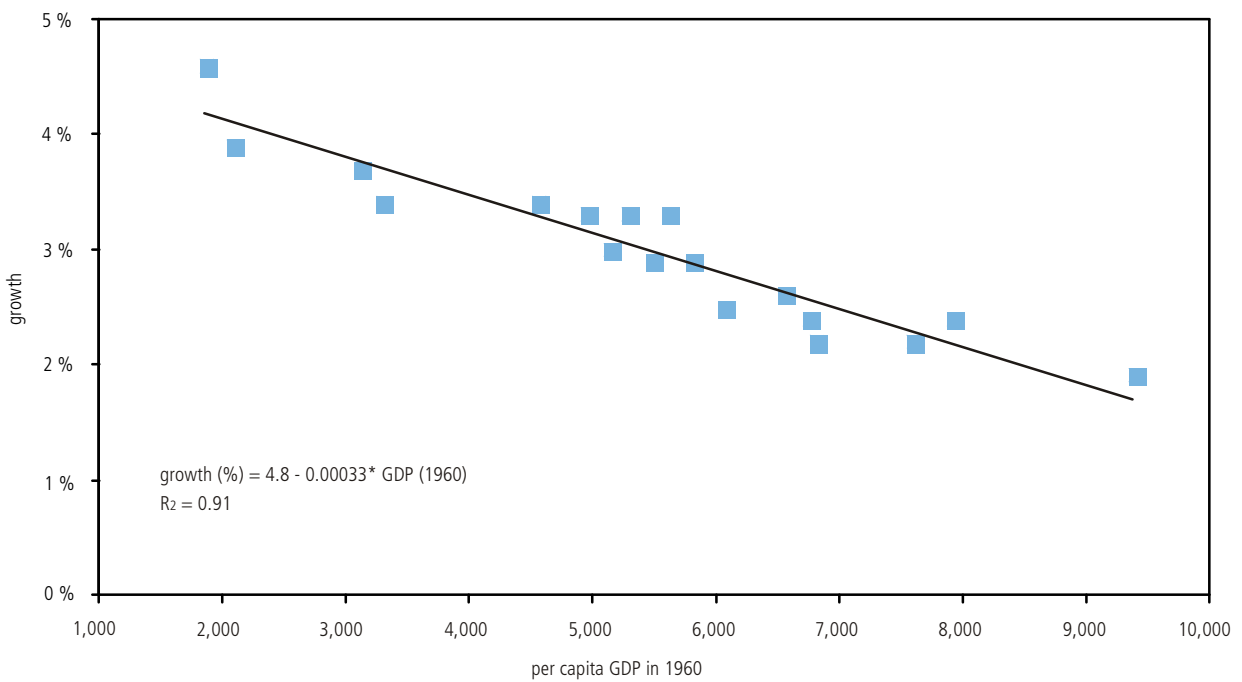
The relationship between per capita income and growth across 104 countries



Source: Data from the PENN World Tables ([www.nber.org](http://www.nber.org)).

Chart IV.5

The relationship between per capita income and growth across EU and EFTA



Source: Data from the PENN World Tables ([www.nber.org](http://www.nber.org)).

#### 4. Trade barriers and marginalization

What role have external trade barriers played in the marginalization of a number of developing countries? Although important barriers against developing country exports remain, these do not seem to have played a significant role in determining the export prospects of low-income countries in recent years. Trade barriers against Africa, for example, are on average much lower than against newly-industrialized Asia: European Union average tariffs facing Africa typically range from zero to five-tenth of 1 per cent. Average preference margins are in the range of 2 to 4 percentage points. In new industrialized Asia, Korea, for example, faces average tariffs of 7.8 per cent in the EU market. Japan and the United States grant preferences as well, although the margins tend to be smaller. Thus, if anything, protection in OECD countries on average should have enhanced Africa's position vis-à-vis other exporters.<sup>115</sup>

As already noted, this does not imply that market access for developing countries cannot be improved. WTO Members recognized that further improvements in market access for least-developed countries are important.<sup>116</sup> The existence of tariff peaks and tariff escalation in OECD tariff structures clearly affect certain developing countries. The Quad countries, for example, maintain large variation in tariff rates. Their tariff peaks exceed 350 per cent (effective tariffs) in some cases, and these typically affect major agricultural products, fruits, vegetables and fish, food industry, textiles and clothing, footwear, leather and travel goods, the automotive sector, consumer electronics and watches. These are sectors in which developing countries tend to have a comparative advantage. Once the Uruguay Round tariff cuts and reductions in non-tariff barriers are fully implemented, escalation should be reduced, although further efforts are clearly desirable.<sup>117</sup> Other areas for improving access to industrial country markets include technical regulations, product standards, sanitary and phytosanitary measures, and rules of origin.<sup>118</sup>

#### D. Trade and the environment

The debate has intensified in recent years on the links between trade and the environment, and the role the WTO should play in promoting environment-friendly trade. A central concern of those who have raised the profile of this issue in the WTO is that there are circumstances where trade and the pursuit of trade liberalization may have harmful environmental effects. Three main arguments are forwarded as to how this might occur.<sup>119</sup> First, trade can have adverse consequences on the environment when property rights in environmental resources are ill-defined or prices do not reflect scarcity. This situation results in production or consumption "externalities" and can lead to the abuse of scarce environmental resources and degradation, which is exacerbated through trade. Some of the pollution can be purely local, such as a very noisy factory. Other pollution can have global repercussions, for example, the excessive emission of green-house gasses, the destruction of rainforests, and so on. Critics argue that trade liberalization which encourages trade in products creating global pollution is undesirable.

The second argument linking trade and the environment is related to the first one. If some countries have low environmental standards, industry is likely to shift production of environment-intensive or highly-polluting products to such so-called pollution havens. Trade liberalization can make the shift of "smoke-stack" industries across borders to pollution havens even more attractive. If these industries then create pollution with global adverse effects, trade liberalization can, indirectly, promote environmental degradation. Worse, trade-induced competitive pressure may force countries to lower their environmental standards. The argument, in other words, is that trade liberalization leads to a "race to the bottom" in environmental standards.

The third concern by environmentalists about the role of trade relates more to social preferences. Some practices may simply be unacceptable for certain people or societies, so they oppose trade in products which encourage such practices. These can include killing dolphins in the process of catching tuna, using leg-hold traps for catching animals for their furs, or the use of polluting production methods which have only local effects.

On the other hand, it has also been pointed out that trade liberalization may improve the quality of the environment rather than promote degradation. First, trade stimulates economic growth, and growing prosperity is one of the key factors in societies' demand for a cleaner environment. Growth also provides the resources to deal with environmental problems at hand – resources which poor countries often simply do not have. Second, trade and growth can encourage the development and dissemination of environment-friendly production techniques as the demand for cleaner products grows and trade increases the size of markets. International companies may also contribute to a cleaner environment by using the most modern and environmentally clean technology in all their operations. This is less costly than using differentiated technology based on the location of production and helps companies to maintain a good reputation. Finally, the costs of meeting environmental regulations often accounts for only a small fraction of total production costs, so that this factor is unlikely to be at the basis of relocation decisions – other factors such as labour costs and the adequacy of infrastructure are much more important.

In practice, the impact of trade on the environment is largely an empirical question. Trade-related empirical studies have focussed largely on the role of trade in promoting "pollution havens" and the "race to the bottom", and the role of growing income in increasing demand for more environmental protection. Studies typically confirm the non-existent or very limited effect of standards on locational decisions by firms.<sup>120</sup> While Bartik (1988) finds small effects of environmental variables on the location decision of Fortune 500 companies in the United States during the 1970s, Levinson (1996b) concludes that regulatory stringency did not have a significant effect on US manufacturers in the 1980s. Xing and Kolstad (1996) find that environmental regulation in the United States has influenced FDI flows in the chemical industry. Eskeland and Harrison (1997), on the other hand, reject the possibility that US foreign investment overall is skewed towards industries with high costs of pollution abatement. Bouman (1996) finds a small correlation between compliance costs and capital outflows in Germany, while the opposite seems to hold for Japan.<sup>121</sup> Mani and Wheeler (1997) found that the observable growth of polluting industries in some developing countries is linked to the highly elastic demand for basic industrial products in the early stages of development in these countries, and not to the relocation of industries from high-standard countries. Moreover, as development progresses, some "dirty" industries may become less important. Low and Yeats (1992) reached a similar conclusion.

<sup>115</sup>See Ng and Yeats (1996).

<sup>116</sup>WTO (1997b).

<sup>117</sup>See UNCTAD (1997c); Daly and Kuwahara (1997).

<sup>118</sup>See WTO (1997b).

<sup>119</sup>For a survey of the literature, see Anderson and Blackhurst (1992); Baumol and Oates (1988), Esty (1994), Low (1992) and Swanson (1996).

<sup>120</sup>See Levinson (1996a).

<sup>121</sup>See Dasgupta, Mody and Sinha (1995).

Other studies have found a correlation between income levels and a cleaner environment in some areas.<sup>122</sup> The point at which countries' pollution levels start to decline, however, differs considerably across countries and pollutants. As environment-friendly techniques and products become cheaper and, hence, the trade-off between prosperity and environment diminishes, environmental policies are likely to become important at earlier stages of development than in the past.

The literature reviewed above suggests that trade may not specifically add in a significant way to environmental problems, beyond those that arise through economic activity generally. But whether this is the case or not, restrictive trade policy will rarely offer an adequate solution to problems of environmental degradation. The solution lies instead in the use of appropriate environmental policies, whether they entail assigning property rights, taxing or subsidizing, or applying regulatory remedies. Trade restrictions in these circumstances may exacerbate the environmental problem, since they could have the perverse effect of lowering the market price of the resource concerned, rather than raising it to reflect the true scarcity value. This could occur, for example, if trade restrictions on tropical wood lowered the price of the product, thereby encouraging its use in domestic production while at the same time making more attractive alternative uses of the land on which the tropical wood is grown. Proper management of the resource itself would be a much more effective policy in this case than trade restrictions. In some cases, environmental degradation can result from government programmes, such as subsidies. The elimination of subsidies can, for example, reduce green-house gas emissions if coal-fired power plants are then replaced by less polluting techniques. Subsidies and price controls have at times also encouraged over-fishing of the oceans and polluting agricultural production in the past.

Finally, trade policy is sometimes used as an enforcement mechanism in order to ensure that particular environmental policies are adhered to, notwithstanding the fact that trade itself may not be at the root of the environmental problem, and the underlying objective is not to limit trade per se. Economic analysis is not very helpful in providing guidance as to whether the use of trade restrictions in this manner is optimal.<sup>123</sup> From a political economy perspective, however, the question to ask is how effective different approaches are likely to prove in practice. In particular, if the option is between unilateral determinations and a multilateral approach built upon prior agreement among governments on environmental objectives and how to attain them, the latter is likely to be more effective. The continuing discussions in the WTO's Committee on Trade and Environment are important in clarifying what the role of the WTO should be in relation to the possible use of trade restrictions for environmental objectives.

## E. Trade and labour standards

The debate on the interaction between trade and labour standards is in many ways similar to the debate on trade and environmental standards. A concern expressed in some industrial

countries is that excessively low standards in certain countries will impose downward pressure on standards, or give the low-standard countries an unwarranted competitive advantage. Developing countries, on the other hand, fear that this argument may be used as a surrogate form of protection. As with environmental standards, the WTO was not designed to set labour standards. This was made clear in the Singapore Ministerial Declaration of December 1996, which also acknowledged the competence of the International Labour Organization (ILO) in the matter of labour standards. Specifically, the Singapore Ministerial Declaration concluded that (i) Members are committed to the observance of internationally recognized core labour standards, (ii) these standards should be addressed in the ILO, whose work the Members support, (iii) standards are promoted by growth and development, fostered through trade liberalization; and (iv) Members reject the use of labour standards for protectionist purposes, and agree that the comparative advantage of countries must in no way be put into question. Members of the ILO recently agreed on a Declaration of Fundamental Principles and Rights at Work<sup>124</sup>, in which ILO Members agreed to increase the scrutiny of adherence to core labour rights and reiterated the commitment in the Singapore Declaration not to use labour standards for protectionist purposes.

The debate on labour standards distinguishes between so-called basic labour rights and less commonly accepted standards. Basic labour rights are part of the ILO Conventions on human rights and labour standards and include the prohibition of forced labour, the freedom of association, the right to organize and bargain collectively, the elimination of child labour exploitation, and the non-discrimination in employment. Other less commonly accepted standards include minimum wages, limits on the hours worked and occupational safety and health standards. The following discussion focuses only on the basic standards.

The arguments of those favouring inclusion of basic labour standards in the WTO framework are very similar to those in the trade and environment debate. Trade could have adverse consequences on labour rights if individual countries disregard labour standards. Trade, it is argued, increases the demand for products produced with labour that does not enjoy adequate labour standards, and thereby encourages such practices. If poor working conditions are the main reason for a country's competitiveness, then international competition will induce companies to relocate to countries with weak, non-existent or unenforced labour standards. Countries with higher labour standards may be forced to relax their own standards in a "race to the bottom". Value judgements also play a role, when people argue that they are not willing to accept exchange of products which have been produced under morally unacceptable conditions. If trade has such adverse consequences on labour standards, critics argue, labour standards should become an integral part of the WTO framework.

On the other hand, a number of arguments suggest that trade can contribute to more stringent labour standards and their enforcement. Trade promotes economic growth, which in turn increases people's demand for better working conditions. Growth and prosperity also provide the means to finance improvements in labour standards, and to send children to school instead of factories. International companies are reluctant to provide inhuman working conditions or to use child labour for the fear of their reputation and boycotts. Finally, the production of exportable products today increasingly requires people with some skills, and safe and clean working conditions.

Empirical studies do not provide support for the claim that trade undermines labour standards.<sup>125</sup> Rodrik (1996) finds that comparative advantage related factors but not labour standard

<sup>122</sup>Interesting discussions on the environmental Kuznets curve include Grossman and Krueger (1995), Cole et al. (1997) and Suri and Chapman (1998).

<sup>123</sup>This study does not address legal questions regarding the use of trade restrictions for the enforcement of environmental objectives.

<sup>124</sup>See ILO (1998).

<sup>125</sup>For a survey, see Brown, Deardorff and Stern (1997).

variables explain world trade patterns. Aggarwal (1995) finds that labour standards are typically lower in sectors which are less export-oriented or produce non-traded goods and services. Lower labour standards do not allow countries to achieve higher import penetration in the United States, and, hence, there are no significant displacement effects in US industries as a result of poor labour standards. The OECD (1996) confirms these findings.

Most evidence suggests a positive link between trade and labour standards, mainly through trade's positive effect on income. Improvements in core labour rights tend to be correlated with sustained trade reform in developing countries.<sup>126</sup> Strengthening core labour standards improves economic performance in the longer term. Krueger (1996) finds that the prevalence of child labour declines sharply with national income. However, she does not find support for the claim that industrial country policy makers support labour standards simply for disguised protectionist reasons.

There is no economic justification for the total harmonization of all labour standards across countries. Different factor endowments, income levels and preferences may result in many different non-core standards across countries.<sup>127</sup> The case may well be different for core labour standards, which enjoy widespread public support in many countries, although details may differ again between countries on matters such as child labour. Finally, it is important to note that trade protection is typically not the best response in economic terms for promoting labour standards. International or domestic programmes which induce adherence to core labour standards through financial support, and the improvement of education infrastructure and labour markets, are likely to reduce the abuse of workers, without impeding trade and growth.<sup>128</sup>

## F. Trade and the financial system

The links between trade and finance have received more attention recently on account of the Asian financial crisis. Some have argued that trade can undermine financial sector stability and thereby the economy as a whole. Others emphasize the complementary relationship between trade and finance. On balance, it can be argued that the positive synergies between trade and finance dominate, and these are re-inforced through the stabilizing effect of the multilateral trading system on trade policies. A more cautious approach, however, may be warranted in financial services trade liberalization, where the latter should take place in the appropriate macroeconomic and regulatory policy environment.

### 1. The links between trade and finance

Trade depends effectively on functioning financial systems. Exporters need credits to bridge the time between production of their products and payment by the foreign buyer. Imports are often financed through credits until they are resold or transformed. The production process also requires financing. Without finance, economic activity and trade would be much impeded. The importance of finance is confirmed in the economic literature. A well functioning financial sector alone can add a full

percentage point to average economic growth on a permanent basis through its effect on economic exchange and resource allocation.<sup>129</sup>

Critics make two main arguments against trade liberalization and integration in the area of trade and finance. First, trade integration makes countries vulnerable to protection in other countries. Exporters who find their business opportunities curtailed through trade barriers may get into economic difficulties. As they are not able to service their loans any more, this puts pressure on the financial sector. If this happens during a period of general economic difficulties, it can contribute to the emergence of a financial crisis.

Second, financial stability can be undermined indirectly by growing trade. If trade encourages various types of capital flows – lending, equity participation or foreign direct investment – irrational, or even irresponsible investor behaviour, critics argue, can increase the volatility of capital flows and thereby undermine the financial sector. This concern is based on more recent experiences with financial crises. The latter have had serious repercussions on growth and employment in many countries, and most recently and prominently, in parts of South-East Asia. Critics see this as a reason for caution towards trade liberalization, especially in the financial services area (see below).

Trade can also exert significant positive effects on the functioning and development of the financial system. Growing trade creates a demand for more reliable and more sophisticated financial services. Foreign traders and investors, and domestic producers and traders find their costs of doing business inflated by poor financial systems. They therefore put pressure on the financial services sector and governments to improve products and policies. Empirical evidence points to a strong positive correlation between trade openness and financial sector development. Chart IV.6, for example, shows the correlation between trade openness and financial sector development rankings calculated by the World Economic Forum for 1996 in respect of 46 industrialized, transition and developing countries.

Some controversy enters the debate when it comes to the role of financial services trade. This includes, for example, the provision of lending and depositing, security trading, insurance, etc., by foreign financial institutions. On the one hand, foreign financial service providers can enhance the efficiency of institutions, the depth and breadth of financial markets, and transparency in the financial sector.<sup>130</sup> This helps to channel scarce resources from domestic sources and abroad into the best uses and, thereby, enhances production, trade and welfare.<sup>131</sup> On the other hand, foreign financial services can undermine the financial system, if they encourage volatile capital flows, or if the domestic and regulatory and supervisory regime cannot cope with the new situation.<sup>132</sup>

Experience with financial crises and their effect on trade and macroeconomic variables explain people's wariness about the financial system (Table IV.2). Trade and economic growth often deteriorate considerably during a financial crisis. In Bulgaria, Hungary, the Philippines and Sweden, export volumes declined significantly in the first year of the crisis, and economic growth declined in all sample countries of Table IV.2. If the crisis is resolved resolutely and exchange rate misalignments are corrected, however, trade and economic growth pick up again in most cases in the second year of the crisis.

This points to important prerequisites for yielding the full benefits from financial services trade liberalization which are discussed in detail in a WTO Special Study on financial services trade.<sup>133</sup> Financial services trade and financial sector stability are complementary if they are accompanied by a stable macroeconomic environment, adequate prudential regulation and supervision, and minimal political interference, such as

<sup>126</sup>See OECD (1996).

<sup>127</sup>See Brown, Deardorff and Stern (1997).

<sup>128</sup>See Brown, Deardorff and Stern (1997).

<sup>129</sup>See Levine (1997).

<sup>130</sup>See Kono and Schuknecht (1998).

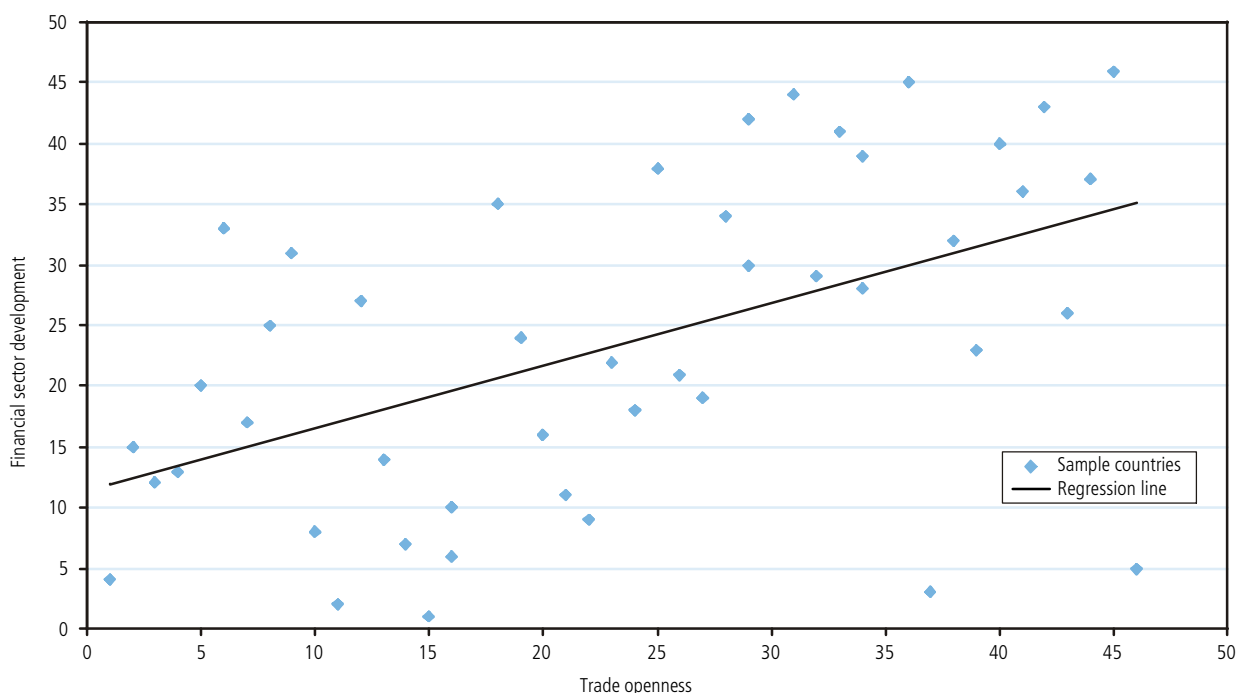
<sup>131</sup>See Francois and Schuknecht (1998); IMF (1998); Claessens and Glaessner (1997); Garcia-Herrero (1997).

<sup>132</sup>See Harris and Pigott (1997).

<sup>133</sup>See Kono et al. (1997).

Chart IV.6

**Trade openness and financial sector development**



Source: World Economic Forum (1997).

Table IV.2

**Financial crises and trade growth**

(Percentage)

	Change in export volumes			Change in import volumes			Real economic growth		
	Pre Crisis*	1st Year of Crisis	2nd Year of Crisis	Pre Crisis*	1st Year of Crisis	2nd Year of Crisis	Pre Crisis*	1st Year of Crisis	2nd Year of Crisis
Bulgaria	11.1**	-13.3	...	2.7**	-13.5	...	2.0**	-10.9	...
Hungary	1.2	-5.0	1.0	-0.5	5.5	-6.6	1.3	-11.9	-3.0
Malaysia	3.1	5.2	6.2	...	...	...	5.3	-1.0	1.1
Mexico	...	32.0	...	...	-21.0	...	2.1	-6.9	5.1
Philippines	9.2	1.6	4.8	5.2	-7.9	13.8	4.6	2.9	3.6
Sweden	2.4	0.0	-2.0	4.6	1.0	-7.0	2.0	-1.4	-1.7

Country (Crisis period): Bulgaria (1996-97), Hungary (1991-95), Malaysia (1985-88), Mexico (1995-96), Philippines (1981-87), Sweden (1984-91).

\* Pre-crisis values are the average 5 year growth rates before the crisis period.

\*\* 2 year average for 1994-95.

forced lending, which could undermine the soundness of financial institutions.<sup>134</sup>

How does the multilateral trading system affect the relationship between trade and finance? First, it should be noted that the WTO framework increases the stability and predictability of trade policies through tariff bindings and Members' various other trade policy commitments. Because of this framework, producers and traders are less likely to experience deteriorating business conditions as a result of the sudden and unexpected closing of markets. Therefore,

they are also less likely to burden the financial system through bad debt. In other words, the WTO framework helps to avoid the repetition of the Great Depression experience when financial sector problems were worsened by spreading protection.

A second point concerns the relationship between capital account liberalization and market-access commitments in services under the General Agreement on Trade in Services (GATS). Governments are committed to allowing capital account transactions to the extent that these are required by specific market-access commitments, although such capital flows may be curtailed in certain circumstances in order to safeguard the balance of payments or at the request of the International Monetary Fund. The GATS does not, therefore, call for capital account liberalization per se. Moreover, the GATS explicitly recognizes Members' right to proper prudential regulation and supervision (except as a form of hidden protection). The GATS

<sup>134</sup>While capital flows seem to have played a role in recent financial crisis in magnifying the problems, most observers agree that these flows are not the main cause of crisis (IMF, 1998; ADB, 1998). The policy debate on the appropriate regulatory response is still very much in flux and a more detailed discussion would go beyond the scope of this study.

also does not curtail Members' ability to pursue stable macroeconomic policies.<sup>135</sup>

In summary, well-functioning trade and financial systems are mutually beneficial. In the area of financial services, liberalization should take place within an appropriate policy framework. The absence of such a framework calls for a cautious approach.

## G. Trade and sovereignty

### 1. The role of the state

To sustain globalization and reap its full benefits, governments need to cooperate among themselves across a wide range of issues and perhaps to a greater degree than ever before. And competition is also a basic feature of globalization. Both the need to cooperate and the need to compete have been characterized by some as an assault on sovereignty, threatening the rights of individual societies to self-determination. This concern about sovereignty essentially takes two forms. One is political, referring to the reduced capacity of governments to respond to the wishes of their citizens without reference to international obligations. The second concerns the capacity of governments to fulfil their public policy obligations, such as redistributing income towards the unemployed, those in need of education, the elderly and the infirm.

The political concern about sovereignty and the right of individual societies to exercise choice raises the question of how sovereignty should be defined. It is arguable that by entering into international commitments in a globalizing world, governments are in effect exercising their sovereign rights, not surrendering them. Moreover, by using shared international commitments to influence the behaviour of other governments, it may be argued that individual governments are in effect extending their sovereign powers. It would seem, therefore, that sovereignty is only compromised by international commitments where such commitments entail coercion and are involuntary. Otherwise, international commitments are an exercise and extension of sovereignty. The economic concern about sovereignty, as noted, is that ruthless international competition will undermine governments' ability to secure the revenue which is necessary to finance government programmes in health, education, social assistance, etc. By undermining countries' ability to pursue their policy objectives, the argument goes, trade indirectly also undermines the sovereignty of nation states. We will argue that these fears are much exaggerated. There is no indication that governments' core functions are or will be compromised as a result of globalization. While the margin for domestic policy discretion in some areas like macroeconomic policies is likely to decline, trade and globalization also constrains other countries' policies.

### 2. The growth of government and international trade

The past 125 years have witnessed a strong expansion in the fiscal role of the state. In the first half of the 19<sup>th</sup> century, public spending was limited to financing the military and public administration, and economic policy-making was largely characterised by laissez-faire. Subsequently, many new tasks have been taken up by governments, and public spending has increased from about 10 per cent of GDP in the late 19<sup>th</sup> century

to over one quarter of GDP in 1960, and almost one half of GDP in the mid-1990s in industrialized countries.<sup>136</sup> Although there is now much debate on the "optimal" size and role of the state, few people would question a role of government in supporting the provision of physical infrastructure, basic health and education, and social assistance, in addition to its classic role in defence and public administration.

Simultaneously to the growth of government, international trade has become increasingly important. Economies have become more and more integrated as the international division of labour has progressed and trade barriers have come down. The old distinction between tradable and non-tradable sectors is breaking down as more and more goods and services have become tradable. Table IV.3 shows that the main industrial countries witnessed both a strong expansion of public spending and of international trade as a share of GDP. The sum of exports and imports as a share of GDP increased by about 50 per cent, from 47 per cent of GDP in 1960 to three quarters of GDP in the 1990s. Public spending increased by a similar proportion as trade increased from 28 per cent to almost 46 per cent of GDP. This means that countries increased public spending and expanded their international trade links.<sup>137</sup>

Table IV.3

#### Trade openness and public spending, 1960-1990s

(Percentage of GDP)

	OECD countries <sup>a</sup>			Newly industrialized countries <sup>b</sup>
	1960	early 1980s	1990s	1990s
Openness (exports + imports)	47.0	60.0	76.0	147.0
Public expenditure	27.9	43.1	45.8	18.6

<sup>a</sup> Sample of 17 countries as presented by Tanzi and Schuknecht (1997).

<sup>b</sup> Chile, Rep. of Korea and Singapore.

Source: IMF, International Financial Statistics (various issues); Tanzi and Schuknecht (1997).

### 3. The impact of trade on fiscal policy discretion

Those concerned with the impact of trade on the role of government typically argue that trade and globalization do two things to public finances. First, they undermine the tax base of countries. Producers today can choose almost freely where they want to produce as capital has become very mobile and trade relatively unimpeded. Producers will therefore pick the location with the best conditions, including taxation. In other words, countries compete over capital and also over highly qualified and well-paid labour. This drives down tax rates on the more mobile factors of production.<sup>138</sup> In the most extreme case, it could lead to a race to the bottom in tax rates, similar to the race to the bottom feared for environmental and labour standards.

Second, trade and globalization increase public expenditure obligations. We argued earlier that international trade may increase the need for social safety nets to cushion the impact of change on the least-advantaged groups in society. Furthermore, globalization calls for continuing retraining and skill-upgrading. For governments this may mean growing spending obligations for social assistance, training and active labour market policies.<sup>139</sup> While in the past, governments could, at least in the short term, resort to the deficit financing of fiscal obligations, globalization curtails this avenue. High deficits are often penalized by international financial markets through higher interest rates and less investor confidence.

<sup>135</sup>See Kono et al. (1997).

<sup>136</sup>See Tanzi and Schuknecht (1997).

<sup>137</sup>The development of modern tax systems replacing tariffs by income and domestic consumption taxes allowed not only a restructuring but even a significant increase in fiscal revenue (Kenwood and Lougheed, 1984).

<sup>138</sup>See Tanzi (1997).

<sup>139</sup>See Rodrik (1997).

This view of the impact of trade on government is rather one-sided. Trade integration and globalization can also strengthen the ability of governments to pursue their key roles through a number of channels. First, international trade contributes importantly to high and sustained growth in both industrialized and developing countries.<sup>140</sup> International trade creates the welfare and prosperity which finances today's government services. Contrast this with the situation in earlier centuries, when few people had basic education and the tithe was a cruel burden on many people. Many poor countries today cannot finance what we would call core government services.

Second, trade has indirectly facilitated the expansion of government services in that growth and technical progress allowed the development of more modern and less distortionary tax systems with a much broader tax base. It would have been unthinkable 200 years ago to have well-developed income and domestic consumption tax systems.

Third, the wealth and prosperity arising from trade allows a growing share of the population to live above subsistence and pay for private education or social insurance. Although this will never relieve governments of their role of supporting the least-advantaged groups in society, it potentially reduces pressure on public expenditure.

Fourth, while it is true that trade liberalization and globalization increase the impact of domestic policy problems, including high fiscal deficits, it should be noted that this constraint holds equally for any country. Trade-induced low fiscal deficits worldwide reduce real interest rates and free savings for the financing of investment.<sup>141</sup> These factors, in turn, help to create the jobs which are needed to put back to work those who are displaced by trade.

#### 4. The fiscal role of the state: empirical evidence

This discussion shows that there are countervailing forces influencing the fortunes of the state that emanate from international trade and globalization. The net effect is by no means certain and probably largely an empirical question. The empirical evidence does not provide convincing support for the claim that globalization undermines governments' ability to pursue their core functions. Revenue has increased strongly in industrialized countries in recent decades. Only the structure of revenue collection is changing. The trend of much of the 20<sup>th</sup> century towards higher taxes on income has reversed in recent years with corporate tax rates and top marginal income taxes coming down. At the same time, however, social security contributions and value-added tax rates have been rising.<sup>142</sup>

On the expenditure side, we have shown in Table IV.3 that trade integration has coincided with a strong increase in public spending. Consequently, some empirical studies show that trade growth is correlated with public expenditure growth, hence confirming the hypotheses that governments have grown to mitigate the instability arising from international trade. The evidence and the methodology to achieve these results, however, are not always convincing, and cause and effect are not clearly established in the observed relationship.<sup>143</sup> Total public spending is not correlated with trade openness across countries, and countries with big and small governments can be found both amongst the group of more closed and more open economies.

While there is little evidence that expanding international trade is undermining the role of the state, there are clearly signs

that tax competition, as well as pressure on governments to become "leaner" and more "efficient", are growing, and the scope for national policy discretion is declining in certain areas. These developments have some important implications for policy-making and policy reform, but they do not suggest that trade openness should be reversed.

Again, protectionism is not the first best choice to deal with fiscal challenges arising from trade liberalization and globalization. In fact, governments are already responding to these challenges in more appropriate ways. High marginal income tax rates and corporate tax rates are coming down while consumption taxes rise. Tax harmonization is being discussed, e.g. in the European Union and the OECD, to deal with harmful tax competition. This option, however, should be treated with considerable caution, as the fight against a "race to the bottom" in tax rates may be used as a pretext for introducing a tax cartel.

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## V. Conclusions

Globalization is a multi-faceted process, driven primarily by technological advances and the embrace of market openness by a growing number of countries. It has underpinned a period of increasing prosperity over the last 50 years, in which new opportunities have enriched the lives of millions. The multilateral trading system embodied in the GATT and subsequently the WTO has played a vital role in creating the conditions for continuing trade liberalization, maintaining stability in international trade relations, and broadening the participation of a growing number of countries in the international economy.

True, globalization has brought challenges in its wake. The international dimensions of the current financial crisis affecting much of Asia, Russia and potentially other countries demonstrates how intensified economic linkages oblige nations increasingly to share in each others' economic fortunes, in bad times as well as good, calling for a collective response. Constructive cooperation can, however, ensure that the current difficulties are relatively short-lived and that slower growth and the adjustment challenges posed by the crisis are effectively managed to avoid prolonged recession or even depression. As far as trade is concerned, the central challenge is to ensure that markets remain open and that the trading system remains dynamic, allowing countries to re-invigorate their economies and resume the trade growth that has been such a fundamental component of post-war prosperity.

Even when an economy is enjoying vigorous growth, the changes wrought by technological advances and specialization through trade must be properly managed. Change often implies dislocation and calls for appropriate policies to soften the impact of these effects on the individuals affected and to help them relocate. Similarly, marginalization of the globalization process has affected some countries. Concerns have arisen about the relationship between expanding trade and the environment and on questions relating to labour standards. These and other issues have been addressed in this chapter, against the background of a discussion of how trade liberalization contributes to income growth and development. While it is imperative that governments address seriously the dislocational, transitional and other effects of trade liberalization and the globalization process more generally, it is clear that trade restrictions are an inappropriate response to these challenges. On the contrary, historical experience and an impressive body of accumulated evidence show that open markets within a rule-based system are indispensable to future growth and prosperity.

<sup>140</sup>See Sachs and Warner (1995); World Bank (1997b).

<sup>141</sup>Low interest rates also help to keep fiscal deficits smaller.

<sup>142</sup>See Tanzi (1998).

<sup>143</sup>See Schulze and Ursprung (1998).



## Appendix Table I

## Overview of Uruguay Round assessment

Study/model	Base year/ projection year	Sectors liberalized/ model features	Income gains (per cent change)	Trade (per cent change)	Decomposition of world income effects (percentage of total measured impact)
Brown, Deardorff, Fox and Stern (1995) (University of Michigan model)	1990/1990	Manufacturing (tariffs only) Agriculture Services  Increasing returns to scale and imperfect competition in manufacturing.	USA: 0.3 to 0.9 Canada: 0.4 to 2.0 Europe: 0.3 to 0.9 Japan: 0.6 to 1.4 Australia and New Zealand: 1.2 to 3.6 Asian NICS: 2.4 to 3.6 Mexico: 0.1 to 2.8	Exports USA: 2.9 Europe: 3.2 Japan: 3.3	n.a.
Francois, McDonald and Nordström (1996) (GATT/WTO model)	1992/1992	Manufacturing Agriculture  Increasing returns to scale and imperfect competition under some specifications. Endogenous savings rates and savings-investment accumulation effects under some specifications.	World: 0.2 to 1.0 High estimates Canada: 0.7 USA: 0.6 EFTA: 0.2 EU: 0.5 Australia and New Zealand: 0.4 Japan: 0.4 China: 4.0 Latin America: 1.7 East Asia: 3.2 South Asia: 3.1 Africa: 1.4 Transition: 0.4	World: 5.7 to 14.5	Agriculture: 3 to 9 Primary: 3 to 7 Textiles and clothing: 35 to 61 Other manufacturing: 30 to 53
Harrison, Rutherford and Tarr (1996) (World Bank model)	1992/1992	Manufacturing Agriculture  Endogenous savings rate. Imperfect competition and (regional) increasing returns to scale in some versions.	World: 0.4 to 0.7 OECD: 0.6 USA: 0.5 EU: 0.7 EFTA: 0.7 Japan: 0.6 LDC: 0.2 China: 0.5 Latin America: 1.7 MEast/NAfrica: 1.7 SSAfrica: 2.0 South Asia: 2.0 Transition: 0.1 East Asia: 3.1	n.a.	Agriculture: 38 to 68 MFA quotas: 12 to 17 Manufacturing: 18 to 49
Hertel, Martin, Yanagishima and Dimaranan (1995) (GTAP model)	1992/2005	Manufacturing Agriculture  Exogenous projections of physical and human capital.	World: 0.9 US and Canada: 0.4 EU: 0.7 Japan: 1.0 NICs: 3.8 China: 1.5 Indonesia: 2.9 Malaysia: 21.5 Philippines: 6.6 Thailand: 4.5 Latin America: -0.1 SSAfrica: -0.5 South Asia: 1.9	Exports World: 59.0 US and Canada: 48.0 EU: 41.9 Japan: 22.3 NICs: 118.6 China: 217.5 ASEAN: 142.72 Latin America: 63.3 SSAfrica: 60.5 South Asia: 94.0	Agriculture: 5 MFA quotas: 14 Tariffs: 81

Goldin and van der Mensbrugghe (1996) (RUNS model - OECD and World Bank)	1985/2002	Manufacturing (tariffs only) Agriculture Exogenous projections of human capital.	Low-inc. Asia: 0.1 to 0.2 China: -0.1 to -0.2 India: 0.5 to 0.7 Up. Inc. Asia: 1.3 Indonesia: 0.1 Other Africa: -0.2 to -0.3 Nigeria: -0.1 South Africa: -0.4 Maghreb: -0.1 to -0.3 Mediterranean: -0.1 to -0.2 Gulf region: 0.0 to -0.2 Oth. Latin America: 0.0 to -0.3 Brazil: 0.4 to 0.3 Mexico: -0.4 to -0.5 United States: 0.0 to 0.1 Canada: 0.0 to -0.2 Australia and New Zealand: 0.0 to 0.1 Japan: 0.4 EU: 0.3 to 0.6 EFTA: 1.0 to 1.2 FSU: 0.0 to 0.1 Transition: 0.1	n.a.	n.a.
Haaland and Tollefsen (1994)	1985/1992	Manufacturing Services	World: 0.2 EU: 0.1 to 0.2 EFTA: 0.1 to 0.2 USA: 0.1 Japan: 0.6	n.a.	n.a.
Nguyen, Perroni and Wigle (1993)	1986/1990	Manufacturing Agriculture Services	World: 1.1 EU: 1.8 EFTA: 2.1 USA: 0.8 Japan: 2.0 Australia and New Zealand: 1.1 Canada: 0.9 Agr. exporters: 0.9 Agr. importers: 1.9 Centrally planned: 0.9	World: 20.2	Agriculture: 26 to 46 MFA quotas: 29 to 37 Tariffs: 24 to 37

Note: This table is based on "A User's Guide to Uruguay Round Assessments", J.Francois, B.McDonald and H.Nordström, WTO Working paper, ERAD-96-003, 1996.

## Cross-country evidences on the link between trade and growth

Source and country coverage	Trade Orientation Index	Results
Michaely (1977), developing.	Rate of growth of export shares.	<ul style="list-style-type: none"> <li>• Positive (rank) correlation between export and growth.</li> <li>• The link is more pronounced in a sub-sample of middle income countries.</li> </ul>
Feder (1983), semi-industrialized.	Export growth weighted by export shares.	<ul style="list-style-type: none"> <li>• GDP growth is positively associated with export growth.</li> </ul>
Syrquin and Chenery (1989), mixed.	Export shares of GDP controlling for country size and export specialization.	<ul style="list-style-type: none"> <li>• Growth rate higher for outward oriented countries in all sub-groups: small primary-goods exporters, large primary-good exporters, small manufacturing exporters, and large manufacturing exporters.</li> <li>• Outward orientation growth premium between 0.2 and 1.4percentage points.</li> </ul>
Balassa (1985), developing.	Trade orientation index defined on basis of difference between actual and predicted export.	<ul style="list-style-type: none"> <li>• Outward oriented countries grow faster.</li> </ul>
Edwards (1992), developing.	Leamer's (1988) index of openness based on the deviation between predicted and actual trade.	<ul style="list-style-type: none"> <li>• More open (less interventionist) countries tend to grow faster.</li> <li>• Above result confirmed by eight out of nine other trade policy indicators.</li> </ul>
World Bank (1987), developing.	Countries classified in four groups: strongly inward oriented, moderately inward oriented, moderately outward oriented, strongly outward oriented.	<ul style="list-style-type: none"> <li>• Outward oriented countries tend to grow faster.</li> </ul>
Sachs and Warner (1995), mixed.	Closed/open index based on five criteria (see text).	<ul style="list-style-type: none"> <li>• Open economies grow faster than closed economies by 2 to 2½percentage points.</li> <li>• Open economies have higher investment ratios, better macroeconomic balance, and a larger role of the private sector as the engine of growth.</li> </ul>
Proudman, Redding and Bianchi (1997), mixed.	Closed/open index on the basis of a number of measures of the stance of international trade policy.	<ul style="list-style-type: none"> <li>• Open economies are found to converge to higher levels of income.</li> <li>• These differences remain even after making allowance for differences in relative levels of investment.</li> </ul>
Barro (1991), mixed.	Price distortion index for investment goods. (Purchasing-power-parity deviation from sample mean for investment goods.)	<ul style="list-style-type: none"> <li>• Price distortions on investment goods reduce growth.</li> <li>• The coefficients suggest that one standard error increase in the PPP-deviation from the sample mean is associated with a reduction of growth with 0.4percentage points.</li> </ul>
Dollar (1992), developing.	Exchange rate distortions.	<ul style="list-style-type: none"> <li>• Average per capita growth in the least distorted quartile of (mostly Asian) countries was 2.9%; the next quartile had a growth rate of 0.9%, the third quartile -0.2%, and the most distorted quartile -1.3%.</li> <li>• Reduction of the real exchange rate distortion to the Asian level would add 0.7percentage points to Latin American growth and 1.8 percentage points to African growth.</li> </ul>
Easterly (1993), mixed.	Index measuring how much domestic relative prices are distorted away from world market relative prices.	<ul style="list-style-type: none"> <li>• Increased distortion reduces growth. One standard deviation increase in distortion reduces growth by 1.2percentage points.</li> </ul>
Lee (1993), mixed.	Index measuring the extent to which trade is distorted away from its free-trade level by real exchange rate and tariff distortions.	<ul style="list-style-type: none"> <li>• Less distortion is associated with higher growth.</li> <li>• Trade distortions reduce growth relatively more in small, resource-scarce countries than in large, resource-rich countries.</li> </ul>
Harrison (1995), developing.	Seven indexes: Trade liberalization (1960-84), (1978-88), Black market premium, Trade shares, Real exchange rate distortions, Movements toward international prices, Bias against agriculture	<ul style="list-style-type: none"> <li>• All statistically significant indexes show a positive relation between a liberal trade regime and GDP growth.</li> <li>• The causality between a liberal trade regime and growth runs both ways. Lagged values of growth are significant in explaining openness, and lagged values of openness is significant in explaining growth.</li> </ul>

Edwards (1997), mixed.	Nine indexes: Sachs-Warner's (1995) openness index, World Bank's (1987) outward orientation index, Leamer's (1988) openness index, black market premium, average import tariff on manufacturing, coverage of NTBs, Heritage Foundation index of trade distortions, collected trade taxes ratio, Wolf's (1993) index of import distortions.	<ul style="list-style-type: none"> <li>• The openness indexes are positively correlated with total factor productivity (TFP) growth, and the mirror image of trade distortion indexes are negatively correlated.</li> <li>• Trade is not the most important variable for explaining cross country differences in growth; initial GDP and human capital are more important.</li> <li>• Data exhibits conditional convergence.</li> </ul>
Matin (1992), Sub-Saharan Africa.	Four indexes: Trade shares, Black market premium, Trade liberalization index, Real exchange rate distortion.	<ul style="list-style-type: none"> <li>• All indexes that are statistically significant point to a positive relation between a liberal (less distortive) trade regime and growth.</li> <li>• The openness-growth performance link for Sub-Saharan Africa is as strong as in a control sample of other African countries.</li> </ul>
Levine and Renelt (1992), mixed.	Sensitivity analysis for multiple indexes with cross-country regressions.	<ul style="list-style-type: none"> <li>• Robust positive correlation between growth and the share of investment in GDP.</li> <li>• Robust positive correlation between the share of investment in GDP and the share of trade in GDP.</li> <li>• Two-link chain between trade and growth through investment.</li> </ul>
Gallup and Sachs (1998), mixed.	Sachs-Warner (1995) index.	<ul style="list-style-type: none"> <li>• The openness index is positively correlated with growth, controlling for other factors.</li> <li>• Moreover, geographical factors that make trade more costly reduce growth. Land-locked countries grow 0.9percentage points slower than coastal economies.</li> </ul>
Coe and Helpman (1995), OECD.	n.a.	<ul style="list-style-type: none"> <li>• Domestic productivity is positively affected by the import-weighted sum of the trading partner's R&amp;D stock.</li> </ul>
Keller (1997), OECD.	n.a.	<ul style="list-style-type: none"> <li>• Trade facilitates productivity transmission both within and between sectors.</li> </ul>
Balasubramanyam, Salisu and Sapsford (1996), developing.	World Bank openness indicator	<ul style="list-style-type: none"> <li>• Low trade barriers enhance the efficiency of FDI and indirectly growth.</li> </ul>

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# Chapter Five

## WTO activities

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## Part I

The World Trade Organization (WTO) is the legal and institutional foundation of the multilateral trading system. It provides the principal contractual obligations determining how governments frame and implement domestic trade legislation and regulations. It also serves as the platform on which trade relations among countries evolve through collective debate, negotiation and adjudication.

The WTO was established on 1 January 1995. Governments concluded the Uruguay Round negotiations on 15 December 1993 and Ministers gave their political backing to the results by signing the Final Act in Marrakesh, Morocco, on 14 April 1994. The "Marrakesh Declaration" affirmed that the results of the Uruguay Round would "strengthen the world economy and lead to more trade, investment, employment and income growth throughout the world". The WTO is the embodiment of the Uruguay Round results and the successor to the General Agreement on Tariffs and Trade (GATT). It held its first Ministerial Conference in Singapore from 9 to 13 December 1996.

At the end of July 1998, 132 countries and territories were Members of the WTO. Another 32 governments were engaged in negotiating their terms of entry with other WTO Members. Not only does the WTO have a potentially larger membership than GATT (128 by the end of 1994), it also has a much broader scope in terms of the commercial activity and trade policies to which it applies. The GATT covered trade in goods; the WTO covers trade in goods, trade in services and "trade in ideas" or intellectual property.

The essential functions of the WTO are:

- administering and implementing the multilateral and plurilateral trade agreements which together make up the WTO;
- acting as a forum for multilateral trade negotiations;
- seeking to resolve trade disputes;
- reviewing national trade policies;
- cooperating with other international institutions involved in global economic policy making.

The WTO Agreement contains 29 individual legal texts which lay out the procedures and rules for trade in services and goods and for enforcing intellectual property rights. The WTO also comprises the GATT 1994 Agreements on trade in goods. The structure of the WTO is dominated by its highest authority, the Ministerial Conference, composed of representatives of all the WTO Members. It is required to meet at least every two years and can take decisions on all matters under any of the multilateral trade agreements. The second WTO Ministerial Conference was held in Geneva, Switzerland, in May 1998 during the period covered by this annual report.

The day-to-day work of the WTO, however, falls to a number of subsidiary bodies, principally the General Council. The latter is composed of all WTO Members and reports to the Ministerial Conference. The General Council also convenes in two other forms – as the Dispute Settlement Body, to oversee the dispute settlement procedures, and as the Trade Policy Review Body, which conducts regular reviews of WTO Members' trade policies and practices. Other main bodies which report to the General Council are the Council for Trade in Goods, the Council for Trade in Services and the Council for Trade-Related Aspects of Intellectual Property Rights. Under these Councils are various committees, each responsible for administering specific agreements and preparing and adopting decisions for approval by the respective Council. This chapter provides an outline of the main activities of the WTO from 1 August 1997 to 31 July 1998.

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## I. WTO accession negotiations

An important task facing the WTO is that of making the new multilateral trading system truly global in scope and application. The 132 Members of the WTO (as of 31 July 1998) account for more than 90 per cent of world trade. Many of the nations that remain outside the world trade system have requested accession to the WTO and are at various stages of a process that has become more complex because of the WTO's increased coverage relative to GATT. With many of the candidates currently undergoing a process of transition from centrally planned to market economies, accession to the WTO offers these countries – in addition to the usual trade benefits – a way of underpinning their domestic reform processes.

During the period covered (1 August 1997 to 31 July 1998) the WTO received one new Member: Panama. WTO membership is open to any State or customs territory having full autonomy in the conduct of its trade policies. Accession negotiations concern all aspects of the applicant's trade policies and practices, such as market access concessions and commitments on goods and services, legislation to enforce intellectual property rights, and all other measures which form a government's commercial policies. Applications for WTO membership are the subject of individual working parties. Terms and conditions related to market access (such as tariff levels and commercial presence for foreign service suppliers) are the subject of bilateral negotiations. The following is a list of the 32 governments for which a WTO working party was established by 31 July 1998:

Albania, Algeria, Andorra, Armenia, Azerbaijan, Belarus, Cambodia, China, Croatia, Estonia, Former Yugoslav Republic of Macedonia, Georgia, Jordan, Kazakstan, Kyrgyz Republic, Laos, Latvia, Lithuania, Moldova, Nepal, Oman, Russian Federation, Samoa, Saudi Arabia, Seychelles, Sudan, Chinese Taipei, Tonga, Ukraine, Uzbekistan, Vanuatu and Vietnam.

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## II. Work of the General Council

### Main areas of the General Council's work

The General Council is the WTO body entrusted with carrying out the functions of the WTO, and taking action necessary to this effect, in the intervals between meetings of the Ministerial Conference, in addition to carrying out the specific tasks assigned to it by the WTO Agreement. As part of its task of overseeing the operation and implementation of the multilateral trading system embodied in the WTO Agreement, the General Council addressed the following matters during the period under review.

#### Preparations for the 1998 Ministerial Conference and the commemoration of the 50<sup>th</sup> anniversary of the multilateral trading system

One of the General Council's main priorities during the period under review was the preparations for the 1998 Ministerial Conference and the commemoration of the 50<sup>th</sup> anniversary of the multilateral trading system. In this connection the General Council took a number of decisions on logistical arrangements for these events and in the first months of 1998 attached a high priority to the substantive preparations for the two events. The preparatory process culminated with the finalization of the General Council report that was forwarded to the Second Ministerial Conference covering the work of the General Council and its subsidiary bodies and with the preparation of a Draft Ministerial Declaration and Draft Declaration on Global Electronic Commerce which were submitted to the Ministerial Conference.

#### Arrangements for effective cooperation with other international intergovernmental organizations

In October 1997 the General Council approved the draft texts of an exchange of letters as the basis for establishing relations between the WTO and the Office International des Epizooties.

In pursuance of the Decision of the General Council approving the agreements between the WTO and the IMF and the World Bank, the Director-General held consultations with Members in December 1997, under the auspices of the General Council, on matters relating to the implementation of the above-mentioned agreements, in the course of which a report by the Director-General on this matter was considered.

#### Transparency in WTO work

During the period under review the General Council devoted increased attention to the question of improving transparency in WTO work. The Director-General also addressed this matter on several occasions. As a follow-up to the 1998 Ministerial Declaration which recognizes the importance of enhancing public understanding of the benefits of the multilateral trading system and indicates Ministers' wish to consider in this context how to improve transparency in WTO operations, the General Council has intensified its work in this area.

## Waivers under Article IX of the WTO Agreement

During the period under review, the General Council granted a number of waivers from obligations under the WTO Agreement (see Table V.1).

In October 1997 the General Council conducted the review of waivers required under Article IX:4 of the WTO Agreement which provides that: "Any waiver granted for a period of more than one year shall be reviewed by the Ministerial Conference not later than one year after it is granted, and thereafter annually until the waiver terminates." The Article further provides that: "In each review, the Ministerial Conference shall examine whether the exceptional circumstances justifying the waiver still exist and whether the terms and conditions attached to the waiver have been met. The Ministerial Conference, on the basis of the annual review, may extend, modify or terminate the waiver." The General Council reviewed the following waivers: Canada – CARIBCAN (WT/L/185); Cuba – Article XV:6 (WT/L/182); EC – The Fourth ACP-EC Convention of Lomé (WT/L/186); United States – Andean Trade Preference Act (WT/L/184); United States – Caribbean Basin Economic Recovery Act (WT/L/104); and United States – Former Trust Territory of the Pacific Islands (WT/L/183). In so doing, the General Council considered reports on the implementations of the waivers submitted by the following governments: Canada (WT/L/236), Cuba (WT/L/231), the European Communities (WT/L/235), and the United States (WT/L/232-234).

Table V.1

### Waivers under Article IX of the WTO Agreement

During the period under review, the General Council granted the following waivers from obligations under the WTO Agreements which are still in effect.

Government	Type	Decision of	Expiry	Document
Argentina, Australia, Bolivia, Brazil, Brunei Darussalam, Canada, Colombia, Costa Rica, Czech Republic, Egypt, El Salvador, European Communities, Guatemala, Honduras, Hungary, Iceland, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Norway, Panama, Paraguay, Philippines, Poland, Singapore, Slovak Republic, Slovenia, South Africa, Switzerland, Thailand, Tunisia, Turkey, United States, Uruguay, Venezuela, Zimbabwe	Introduction of Harmonized System changes into WTO Schedules of Tariff Concessions on 1 January 1996 – Extension of Time-Limit	24 April 1998	31 October 1998	WT/L/268
Bangladesh	Implementation of the Harmonized Commodity Description and Coding System – Extension of Time-Limit	24 April 1998	31 October 1998	WT/L/264
EC/France	Trading Arrangements with Morocco – Extension of waiver	10 December 1997	31 December 1998 <sup>1</sup>	WT/L/250
Hungary	Agricultural export subsidies	22 October 1997	31 December 2001	WT/L/238
Nicaragua	Implementation of the Harmonized Commodity Description and Coding System – Extension of Time-Limit	24 April 1998	31 October 1998	WT/L/265
Sri Lanka	Implementation of the Harmonized Commodity Description and Coding System – Extension of Time-Limit	24 April 1998	31 October 1998	WT/L/266
Zambia	Renegotiation of Schedule – Extension of Time-Limit	24 April 1998	31 October 1998	WT/L/267

1. Or until the entry into force of the Euro-Mediterranean Agreement, whichever is the earliest.

## WTO Secretariat and senior management structure

In autumn 1997 the Director-General circulated a report on how the functioning and the operational efficiency of the WTO Secretariat might be enhanced to meet the challenges facing the Organization. The General Council considered on several occasions this matter which is still subject to discussions.

## Conditions of service of WTO staff

The General Council continued to attach importance to this matter. In April 1998 the General Council adopted a further decision on the question of conditions of service of WTO staff, and the Working Group mandated to present proposals in accordance with this decision is carrying out intensive work.

## Follow-up to the 1998 Ministerial Conference

In July 1998 the General Council initiated the preparations for its Special Session to be held in September in pursuance to the 1998 Ministerial Declaration which requires that a process be established under the direction of the General Council to ensure full and faithful implementation of the existing agreements, and to prepare for the Third Session of the Ministerial Conference. Also at the Special Session in September the General Council was required to establish a comprehensive work programme to examine all trade-related issues relating to global electronic commerce, including those issues identified by Members.

### **Box V.1: The 1998 Geneva Ministerial Conference**

#### **Trade Ministers launch preparations for 1999 Ministerial, standstill agreed on electronic commerce**

The Second WTO Ministerial Conference, held in Geneva on 18 and 20 May, launched a work programme to develop recommendations regarding implementation of existing WTO Agreements and the organization's future negotiating agenda. These recommendations will be submitted to the Third Ministerial, which the Ministers agreed would be held in the United States.

The Ministers also declared that Members will continue their current practice of not imposing customs duties on electronic transmissions, and established a comprehensive work programme in the WTO on global electronic commerce. The Third Ministerial will review the extension of this declaration as well as consider any recommendations for action arising from the work programme.

The Ministerial Declaration, adopted on 20 May, instructed the General Council to hold a special session in September 1998 to start a process "to ensure full and faithful implementation of existing agreements, and to prepare for the Third Session of the Ministerial Conference".

The General Council will also develop recommendations on "further liberalization sufficiently broad-based to respond to the range of interests and concerns of all Members, within the WTO framework".

In the work programme agreed by the Ministers, the General Council is to develop, among others, recommendations on ensuring that negotiations mandated under existing agreements, such as on agriculture and on trade in services, begin on schedule. It will also discuss possible future work on the subjects agreed for study at the first Ministerial in Singapore: the relationship between trade and investment, the interaction between trade and competition policy, transparency in government procurement, and trade facilitation. Other matters raised by Members will also be considered by the General Council.

In a separate Declaration, the Ministers instructed the General Council to establish a comprehensive work programme to "examine all trade-related issues relating to global electronic commerce". This work programme will take account of the needs of developing countries and the ongoing work in other international organizations.

#### **Ministerial Declaration, adopted on 20 May 1998, Geneva**

1. This Second Session of the Ministerial Conference of the WTO is taking place at a particularly significant time for the multilateral trading system, when the fiftieth anniversary of its establishment is being commemorated. On this occasion we pay tribute to the system's important contribution over the past half-century to growth, employment and stability by promoting the liberalization and expansion of trade and providing a framework for the conduct of international trade relations, in accordance with the objectives embodied in the Preambles to the General Agreement on Tariffs and Trade and the World Trade Organization Agreement. We agree, however, that more remains to be done to enable all the world's peoples to share fully and equitably in these achievements.
2. We underline the crucial importance of the multilateral rule-based trading system. We reaffirm the commitments and assessments we made at Singapore, and we note that the work under existing agreements and decisions has resulted in significant new steps forward since we last met. In particular, we welcome the successful conclusion of the negotiations on basic telecommunications and financial services and we take note of the implementation of the Information Technology Agreement. We renew our commitment to achieve progressive liberalization of trade in goods and services.
3. The fiftieth anniversary comes at a time when the economies of a number of WTO Members are experiencing difficulties as a result of disturbances in financial markets. We take this opportunity to underline that keeping all markets open must be a key element in a durable solution to these difficulties. With this in mind, we reject the use of any protectionist measures and agree to work together in the WTO as in the IMF and the World Bank to improve the coherence of international economic policy-making with a view to maximizing the contribution that an open, rule-based trading system can make to fostering stable growth for economies at all levels of development.

4. We recognize the importance of enhancing public understanding of the benefits of the multilateral trading system in order to build support for it and agree to work towards this end. In this context we will consider how to improve the transparency of WTO operations. We shall also continue to improve our efforts towards the objectives of sustained economic growth and sustainable development.
5. We renew our commitment to ensuring that the benefits of the multilateral trading system are extended as widely as possible. We recognize the need for the system to make its own contribution in response to the particular trade interests and development needs of developing-country Members. We welcome the work already underway in the Committee on Trade and Development for reviewing the application of special provisions in the Multilateral Trade Agreements and related Ministerial Decisions in favour of developing-country Members, and in particular the least developed among them. We agree on the need for effective implementation of these special provisions.
6. We remain deeply concerned over the marginalization of least-developed countries and certain small economies, and recognize the urgent need to address this issue which has been compounded by the chronic foreign debt problem facing many of them. In this context we welcome the initiatives taken by the WTO in cooperation with other agencies to implement in an integrated manner the Plan of Action for the least-developed countries which we agreed at Singapore, especially through the High-Level Meeting on Least-Developed Countries held in Geneva in October 1997. We also welcome the report of the Director-General on the follow-up of this initiative, to which we attach great importance. We commit ourselves to continue to improve market access conditions for products exported by the least-developed countries on as broad and liberal a basis as possible. We urge Members to implement the market-access commitments that they have undertaken at the High-Level Meeting.
7. We welcome the WTO Members who have joined since we met in Singapore: Congo, Democratic Republic of Congo, Mongolia, Niger and Panama. We welcome the progress made with 31 applicants currently negotiating their accession and renew our resolution to ensure that the accession processes proceed as rapidly as possible. We recall that accession to the WTO requires full respect of WTO rules and disciplines as well as meaningful market access commitments on the part of acceding candidates.
8. Full and faithful implementation of the WTO Agreement and Ministerial Decisions is imperative for the credibility of the multilateral trading system and indispensable for maintaining the momentum for expanding global trade, fostering job creation and raising standards of living in all parts of the world. When we meet at the Third Session we shall further pursue our evaluation of the implementation of individual agreements and the realization of their objectives. Such evaluation would cover, inter alia, the problems encountered in implementation and the consequent impact on the trade and development prospects of Members. We reaffirm our commitment to respect the existing schedules for reviews, negotiations and other work to which we have already agreed.
9. We recall that the Marrakesh Agreement Establishing the World Trade Organization states that the WTO shall provide the forum for negotiations among its Members concerning their multilateral trade relations in matters dealt with under the agreements in the Annexes to the Agreement, and that it may also provide a forum for further negotiations among its Members concerning their multilateral trade relations, and a framework for the implementation of the results of such negotiations, as may be decided by the Ministerial Conference. In the light of paragraphs 1-8 above, we decide that a process will be established under the direction of the General Council to ensure full and faithful implementation of existing agreements, and to prepare for the Third Session of the Ministerial Conference. This process shall enable the General Council to submit recommendations regarding the WTO's work programme, including further liberalization sufficiently broad-based to respond to the range of interests and concerns of all Members, within the WTO framework, that will enable us to take decisions at the Third Session of the Ministerial Conference. In this regard, the General Council will meet in special session in September 1998 and periodically thereafter to ensure full and timely completion of its work, fully respecting the principle of decision-making by consensus. The General Council's work programme shall encompass the following:
  - (a) recommendations concerning:
    - (i) the issues, including those brought forward by Members, relating to implementation of existing agreements and decisions;
    - (ii) the negotiations already mandated at Marrakesh, to ensure that such negotiations begin on schedule;
    - (iii) future work already provided for under other existing agreements and decisions taken at Marrakesh;
  - (b) recommendations concerning other possible future work on the basis of the work programme initiated at Singapore;
  - (c) recommendations on the follow-up to the High-Level Meeting on Least-Developed Countries;
  - (d) recommendations arising from consideration of other matters proposed and agreed to by Members concerning their multilateral trade relations.
10. The General Council will also submit to the Third Session of the Ministerial Conference, on the basis of consensus, recommendations for decision concerning the further organization and management of the work programme arising from the above, including the scope, structure and time-frames, that will ensure that the work programme is begun and concluded expeditiously.
11. The above work programme shall be aimed at achieving overall balance of interests of all Members.

#### **Declaration on global electronic commerce, adopted on 20 May 1998, Geneva**

Ministers,

Recognizing that global electronic commerce is growing and creating new opportunities for trade,

Declare that:

The General Council shall, by its next meeting in special session, establish a comprehensive work programme to examine all trade-related issues relating to global electronic commerce, including those issues identified by Members. The work programme will involve the relevant World Trade Organization ("WTO") bodies, take into account the economic, financial, and development needs of developing countries, and recognize that work is also being undertaken in other international fora. The General Council should produce a report on the progress of the work programme and any recommendations for action to be submitted at our third session. Without prejudice to the outcome of the work programme or the rights and obligations of Members under the WTO Agreements, we also declare that Members will continue their current practice of not imposing customs duties on electronic transmissions. When reporting to our third session, the General Council will review this declaration, the extension of which will be decided by consensus, taking into account the progress of the work programme.

### **Box V.2: Fiftieth Anniversary of the multilateral trading system**

A dozen world leaders joined trade Ministers in commemorating the 50<sup>th</sup> anniversary of the multilateral trading system held on 18-19 May at the Palais des Nations in Geneva. They paid tribute to GATT's contribution to world economic growth, and gave their respective visions of the trading system's future.

The WTO Director-General, Mr Renato Ruggiero, told the heads of state that "your presence here sends a powerful and much-needed message of confidence and commitment to the future within a system which truly belongs to us all".

In opening the commemoration, Swiss President Flavio Cotti said that from GATT, the world became aware that "open borders and non-discriminatory trade can be a force for international stability and peace, as well as prosperity". He added that "like our predecessors, whose vision and determination we are commemorating today, we need to look to the future – and to explain this future to the present".

US President Bill Clinton was the first head of State to speak on the evening of 18 May. He was followed on 19 May by Prime Minister Kjell Magne Bondevik of Norway; Prime Minister Ivan Kostov of Bulgaria; President Fidel Castro of Cuba; Mr. Jacques Santer, President of the EC Commission; President Fernando Cardoso of Brazil; President Nelson Mandela of South Africa; Crown Prince Sidi Mohammed of Morocco; Prime Minister Janez Drnovšek of Slovenia; Prime Minister Tony Blair of the United Kingdom; Prime Minister Daniel Kablan Duncan of Côte d'Ivoire; Prime Minister Edison C. James of Dominica; and Premier Romano Prodi of Italy.

At the Ministerial Conference in Geneva in May 1998, Ministers welcomed the initiatives taken by the WTO in cooperation with other agencies to implement in an integrated manner the Plan of Action for the LDCs, especially through the High-Level Meeting on LDCs.

### **Box V.3: High-Level Meeting on Integrated Initiatives for Least-Developed Countries' Trade Development, 27-28 October 1997**

Ministers at the WTO's first Ministerial Conference in 1996 expressed their concern over the marginalization of least-developed countries in the global economy and committed themselves to address this problem in a tangible way. As an immediate manifestation of their commitment Ministers adopted the Comprehensive and Integrated WTO Plan of Action for Least-Developed Countries.

In pursuit of the Plan of Action, a High-Level Meeting on Integrated Initiatives for Least-Developed Countries' Trade Development was held at WTO on 27 and 28 October 1997 and, in addition to WTO, organized by the International Trade Centre, UNCTAD and UNDP in close collaboration with the IMF and the World Bank. At the High-Level Meeting, WTO Members were invited to announce steps they would be taking on an autonomous basis to enhance market access for imports from least-developed countries and a number of countries, both developed and developing, announced such steps. In his Report to Ministers on the outcome and follow-up to the High-Level Meeting, the Director-General stated that "the response received at the High-Level Meeting was not discouraging, but I continue to feel that much more can be done in this area". He proposed that "... it would be appropriate to consider, in the preparation of the third Ministerial Conference, including the objective of eliminating all tariff barriers in favour of the least-developed countries as a matter for implementing on a priority basis in the negotiations which will start in the year 2000. It would be important not just for all the advanced economies, but also for the most dynamic developing countries, to subscribe to this objective and to the principle of binding the liberalization under the WTO."

The High-Level Meeting endorsed the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries. The framework aims at making such assistance in least-developed countries more effective and efficient by laying down a mechanism for closer coordination of trade-related technical assistance activities. The mechanism applies to the trade-related assistance activities of the IMF, ITC, UNCTAD, UNDP, the World Bank and WTO and it is based on least-developed countries' (LDCs') requests for such assistance and on their full ownership of the process. To this end, the Integrated Framework envisages as a first step that the least-developed countries make an assessment of their needs for trade-related technical assistance. Taking this assessment as a basis, the six agencies then formulate a coordinated response of trade-related technical assistance activities which each organization individually, but in coordination with the other five, is in a position to provide in line with its own expertise, comparative advantage and available resources. So far 39 least-developed countries have submitted their needs assessments to which the six agencies have drawn up their "Integrated Responses" of assistance activities. The needs assessments typically cover areas ranging from compliance with WTO rules and obligations to supply side constraints, such as infrastructure, issues of human and institutional capacity building, needs of the private sector. The next stage is to broaden the exercise so that least-developed countries can seek support that goes beyond what the six agencies can make available to meet their needs for trade-related technical assistance. It involves each least-developed country, along with its multilateral, regional and bilateral development partners, reviewing its assessment and preparing a concrete programme – a portfolio of projects – of technical assistance to meet those needs. To this end, the LDC will call a "roundtable" to which it will invite the development partners of its choice and which will provide the opportunity to endorse such a multi-year programme. So far, 16 LDCs have expressed an interest in organizing such "roundtables" and they are in various stages of preparation. The Integrated Framework has resulted in a smooth-running inter-agency mechanism between the six agencies involved, to which WTO not only contributes its particular technical expertise to the endeavour but also the commitment and leadership that it has demonstrated in the process so far. To handle the day-to-day work of and to service meetings of the inter-agency coordination mechanism, an Administrative Unit has been established at ITC, which ensures its day-to-day management. An Integrated Framework website on the Internet is being developed.

The High-Level Meeting also focussed on the application of new information technology to bring the least-developed countries into the mainstream of the global trading system. WTO is helping to realize the objective of offering the LDCs greatly improved access to the global information structures by installing basic equipment and the link to the Internet in the Ministries responsible for international trade in all WTO LDC Members and observers.



Two recommendations emanating from the two Thematic Roundtable discussion at the High-Level Meeting relate directly to the work of the WTO: develop efforts to assist least-developed countries in the process of accession; and accommodate on a priority basis requests from least-developed countries for Trade Policy Reviews and assist least-developed countries in preparing for their reviews. Since the meeting, Laos and Samoa have requested accession to the WTO, bringing to six the number of least-developed countries currently in the process of accession (Cambodia, Nepal, Sudan, Vanuatu). In addition the General Council has granted observer status to Ethiopia, Cape Verde and Bhutan. The Secretariat has been taking initiatives, with the cooperation of WTO Members, to streamline the accession process of these countries to the extent possible. To achieve this, it has been necessary to ensure that the documentation required is up to standard to enable agreement on terms of entry as soon as possible. Special attention has been given to expediting the bilateral market access negotiations through an early submission and negotiation of offers from these governments. On both these fronts, the Secretariat has been providing focussed technical assistance to these countries from the earliest stages of their accession process. Going beyond the specific needs of the accession process, the Secretariat is increasingly assisting these countries in areas such as helping draft WTO-related legislation and helping establish the trade policy infrastructure necessary to pursue their trade interests in the WTO after accession. Under the Agreement in the Trade Policy Review Mechanism, least-developed countries are subject to review at intervals of six years or more. Trade policy reviews have been completed, or are underway in the 1998 review programme for 10 of the 29 least-developed countries that are WTO Members. During 1998, the reviews of Burkina Faso, Mali, Guinea and Togo will be grouped together in the meetings of the Trade Policy Review Body; the review of Lesotho was conducted in April 1998 together with other members of the Southern African Customs Union.

Ministers, at the Ministerial Conference in May 1998, welcomed the report of the Director-General on the follow-up of this initiative, to which Ministers attached great importance. Ministers committed themselves to continue to improve market access conditions for products exported by the LDCs on as broad and liberal basis as possible. They urged Members to implement the market-access commitments that they had undertaken at the High-Level Meeting.

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### III. Working groups set up by the Singapore Conference

The 1996 Singapore Ministerial Conference decided to undertake work on trade and investment, transparency in government procurement, and the interaction between trade and competition policy. The ministers set up three working groups to look at these issues. They report to the General Council.

#### Working Group on the Relationship between Trade and Investment

At the Singapore Ministerial Conference held in December 1996, a Working Group was established to examine the relationship between trade and investment, on the understanding that the work undertaken shall not prejudice whether negotiations on multilateral disciplines in this area will be initiated in the future. The Working Group, which is chaired by Ambassador Krirk-Krai Jirapaet of Thailand, has held meetings on 2-3 June, 6-7 October and 8 December 1997 and on 30-31 March and 16-17 June 1998.

The substantive subjects studied by the Working Group are listed in a Checklist of Issues Suggested for Study which was developed at the first meeting of the Group in June 1997 on the basis of specific proposals made by Members. This Checklist comprises four categories of issues: (1) the implications of the relationship between trade and investment for development and economic growth; (2) the economic relationship between trade and investment; (3) stocktaking and analysis of existing international instruments and activities regarding trade and investment; and (4) certain questions of a more prospective nature relevant to assessing the desirability of possible future initiatives in this area. At the meetings held in October and December 1997, the Working Group discussed the first three clusters of issues; at the meetings held in March and June 1998 it also considered the fourth item of the Checklist.

In regard to the first subject covered by the Checklist, the implications of the relationship between trade and investment for development and economic growth, the Working Group received contributions from Members on their individual experiences with the role of foreign investment in their economies and contributions from several international organizations (IMF, OECD, UNCTAD, UNIDO, World Bank) summarizing the results of analytical work done in these organizations. The information presented and the debate in the Working Group on this subject have highlighted various aspects of the role of foreign investment in economic development, including with respect to capital formation, development of technology and human skills and export performance. Some Members, while agreeing that on the whole the contribution of foreign investment is beneficial, have pointed to the need to take into account problems that can sometimes be associated with foreign investment.

In regard to the second item of the Checklist, the Working Group has considered a Secretariat note on the relationship between trade and foreign direct investment which provides a survey of the relevant literature. A major theme in this study and in the ensuing discussions in the Working Group is the complementarity between foreign direct investment and trade, in both home and host countries. The discussion of this item has also covered the role of investment incentives and performance requirements and the relationship between the mobility of capital and the mobility of labour.

The work on the third item of the Checklist, which provides for stocktaking and analysis of existing agreements and initiatives on trade and investment, has involved an examination of investment-related provisions of WTO agreements and of bilateral, plurilateral and multilateral investment agreements concluded outside the WTO framework. For its consideration of these issues, the Working Group has received various Secretariat notes and a number of contributions from Members on their experiences with investment agreements, notably bilateral investment treaties. The Working Group has also received information on various ongoing initiatives on investment, such as the negotiations on a Multilateral Agreement on Investment, negotiations on investment in the context of the Free-Trade Area of the Americas and ongoing work in the framework of UNCTAD.

With respect to the last item of the Checklist, contributions have been made by some Members regarding differences and commonalities between existing investment agreements and the advantages and disadvantages of bilateral, regional and multilateral approaches to investment rule-making. The Working Group has discussed a number of specific issues under this item, including the various approaches to the admission of investment in existing investment agreements, the definition of investment in international investment agreements, criteria for evaluating investment agreements from a development perspective, and the experience with the OECD Guidelines for Multinational Enterprises.

The Singapore Ministerial Declaration provides that the General Council will keep the work of the Working Group under review and decide after two years how the work of the Group should proceed. At the meeting in June 1998 the Working Group agreed to take up at its meetings in October and November the issue of the report to be submitted to the General Council so as to enable the Council to take the decision called for in the Singapore Ministerial Declaration.

## Working Group on Transparency in Government Procurement

The Working Group on Transparency in Government Procurement was established by a decision at the WTO Ministerial Conference held in December 1996, "to conduct a study on transparency in government procurement practices, taking into account national policies, and, based on this study, to develop elements for inclusion in an appropriate agreement". Over the covered period the Working Group held three meetings on 3 and 4 November 1997, 19-20 February 1998 and 22 June 1998. Reports on these meetings have been circulated in documents WT/WGTGP/M/3-5.

At its meeting of 3 and 4 November, the Working Group had before it a Secretariat note on transparency-related provisions in existing international instruments on government procurement and national procedures and practices, synthesizing the information available in the responses to the questionnaire on government procurement of services in the Working Party on GATS Rules, the surveys of government procurement systems of APEC economies, the sections on government procurement in the various Trade Policy Review Reports and the contributions submitted by delegations together with the information in the earlier note by the Secretariat on the transparency-related provisions in existing international instruments (WT/WGTGP/M/6). The Group discussed the issues before it by taking up in turn the subjects of the sections of the note by the Secretariat, together with the topic of special and differential treatment for developing countries and technical assistance.

At its meetings of 19-20 February and 22 June 1998 the Working Group continued its detailed discussion of the issues before it, taking up in turn the subject of each section of the informal note by the Chair entitled "List of Issues Raised and Points Made", listing the issues that had been raised, together with the points made on these issues, under each of the items that were discussed by the Group since its meeting in November 1997.

Over the period covered written submission have been received containing factual information on national procedures and practices in: Korea; Tunisia and Hungary; Hong Kong, China; the Czech Republic; Uruguay; Australia; Morocco and Slovenia (WT/WGTGP/W/7-10, 12-14, 19). Moreover, Norway, Switzerland, Japan, Australia, APEC Government Procurement Expert Group through its Chair, the United States, the European Community, Norway, Switzerland and Venezuela (WGTGP/W/11 and 15-18) have also made contributions relating to elements of transparency in government procurement.

The IMF, the World Bank, the United Nations represented by UNCITRAL and UNCTAD have observer status in the Working Group.

## Working Group on the Interaction between Trade and Competition Policy

The mandate of this Working Group, which was established pursuant to the Singapore Ministerial Declaration of December 1996, is to "study issues raised by Members regarding the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework". During the past year, the Group's work proceeded under the chairmanship of Professor Frédéric Jenny of France. The Group's meetings have been organized around various elements of a "Checklist of Issues Suggested for Study" which was developed at its first meeting, in July 1997 (the Checklist is reprinted in the WTO Annual Report, 1997, Box V.2).

The Group has now held a total of five meetings. At its second meeting, held on 16-17 September 1997, the Working Group started its substantive discussion on the first two areas identified in the Checklist of Issues Suggested for Study: (I) the relationship between the objectives, principles, concepts, scope and instruments of trade and competition policy, and their relationship to development and economic growth; and (II) stocktaking and analysis of existing instruments, standards and activities regarding trade and competition policy, including of experience with their application. The latter item was taken up with reference to three sub-elements, namely national competition policies, laws and instruments as they relate to trade, existing WTO provisions, and bilateral, regional, plurilateral and multilateral agreements and initiatives.

At its third meeting, held on 27-28 November 1997, the Working Group continued its work on items I and II of the Checklist. It divided its discussion of item I into two components: the relationship between the objectives, principles, scope and instruments of trade and competition policy; and the relationship of trade and competition policy to development and economic growth.

At its fourth meeting, which took place on 11-13 March 1998, the main substantive focus of the Group switched to item III of the Checklist, dealing with specific areas of the interaction between trade and competition policy. In particular, the discussion focused on the interaction between trade and competition policy in general (the chapeau to item III of the Checklist) and the impact of anti-competitive practices of enterprises and associations on international trade (the first tiret under item III of the Checklist). At the same time, the Group continued to review contributions from Members relating to the stocktaking and analysis of existing instruments, standards and activities regarding trade and competition policy, including of experience with their application (item II of the Checklist).

The Group's fifth meeting, on 27-28 July, had two main substantive agenda items: (i) the impact of state monopolies, exclusive rights and regulatory policies on competition and international trade (the second tiret under item III of the Checklist); and (ii) the impact of trade policy on competition (the fifth tiret under item III). In addition, the Group continued to review contributions from Members relating to the stocktaking and analysis of existing instruments, standards and activities regarding trade and competition policy, including of experience with their application (item II of the Checklist), with reference to both national competition laws and policies, and to existing WTO provisions.

The work of the Working Group on the Interaction between Trade and Competition Policy has consistently been characterized by a high level of written contributions from Members. As of 31 July 1998, there had already been 98 formal contributions to the Working Group. A number of these are available on the WTO website ([www.wto.org](http://www.wto.org)).

The Singapore Ministerial Declaration calls for the General Council to keep the work of the Working Group under review, and to determine after two years how its work should proceed. For this purpose, at the end of 1998, the Group will submit a report to the General Council describing its activities over the past year and a half, and any recommendations upon which the Group can agree.

As informal inputs to the work of the Group during the past year, the WTO Secretariat, in cooperation with UNCTAD and the World Bank, organized two symposia on relevant issues. The first Symposium, held on 29 November 1997, dealt primarily with the role of competition policy as an instrument of economic development. The second such event, which took place on 25 July 1998, examined the subject of Competition Policy and the Multilateral Trading System: Issues for Consideration in the International Community. In addition, a Secretariat study on Trade and Competition Policy was published as Chapter Four of the WTO Annual Report, 1997.

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## IV. Trade in goods

During the period under review, the Council for Trade in Goods has convened 15 times. Six of those meetings were dedicated wholly or to a large extent to the major review of the first stage of the integration process pursuant to paragraph 11 of Article 8 of the Agreement on Textiles and Clothing (ATC). A comprehensive report prepared by the Textiles Monitoring Body was used to assist the Council in its review. The review which began on 6 October 1997 concluded on 16 February 1998, with the adoption by the Council of a text containing a detailed summary of the discussions and conclusions of its review. During the course of the discussions, views were exchanged on inter alia the process of integration of products into GATT 1994 rules and disciplines, the application of the safeguard mechanism in the first phase of the ATC and trade policy measures such as anti-dumping actions and/or administrative formalities and their effect on market access.

The subject of trade facilitation was also dealt with extensively by the Council during the period under review. In 1996, Ministers in Singapore had directed the Council "to undertake exploratory and analytical work drawing on the work of other relevant international organizations on the simplification of trade procedures in order to assess the scope for WTO rules in this area". Following several discussions during the early part of 1997, the Council agreed that a symposium on trade facilitation should be held to further contribute to Members' understanding of the subject and to assist them to move to the phase of analytical work. As a result, on 9 and 10 March 1998, such a symposium was held where 27 speakers from private enterprises and industry groups gave an overview of a number of key issues in this respect. Speakers from intergovernmental organizations also reported on the experiences in their work on trade facilitation. The main concerns voiced by traders during the symposium can be summarized under five headings: (1) excessive documentation requirements; (2) lack of automation and insignificant use of information-technology; (3) lack of transparency, unclear and unspecified import and export requirements; (4) inadequate procedures, especially a lack of audit-based controls and risk-assessment techniques; (5) lack of modernization of, and cooperation among customs and other government agencies which thwarted efforts to deal effectively with increased trade flows. Following the symposium and additional discussions, the Council on 8 July 1998 agreed on a work programme during which it will hold regular informal meetings to continue the work on trade facilitation. In these meetings, the Council will examine a series of subjects including import and export procedures and requirements, physical movement of consignments, and technical cooperation.

Additional matters addressed during the relevant time-period include waiver requests, status of notifications and a new questionnaire on state trading. The Council examined and approved requests for waivers and waiver extensions made by Members in connection with the transposition of their Schedules into the Harmonized System, with the renegotiation of their Schedules, and with the introduction of the Harmonized System 1996 changes into their Schedules. A waiver sought by Hungary from its obligations under certain provisions of the Agreement on Agriculture, and a waiver requested by the European Communities concerning France's trading arrangements with Morocco were approved by the Council. The Council also approved the recommendation by the Committee on Rules of Origin to extend the deadline for the completion of the Harmonization Work Programme of non-preferential rules of origin. It adopted terms of reference under which a number of regional agreements are to be examined by the Committee on Regional Trade Agreements, and approved the revised questionnaire on state trading forwarded by the Working Party on State Trading Enterprises. It also took note of the situation with respect to the compliance of notification obligations under the provisions of the Agreements in Annex 1A of the WTO Agreement, and of a report provided by the Chairman on the current status of his consultations on the rectifications and modifications to schedules of tariff concessions and their certification. A communication from the United States concerning a notification made by Colombia under Section XVIII:C of the GATT 1994 was also an item on the Council's agenda. Additionally, the Council's attention was drawn to concerns of certain Members regarding the trading practices of their trading partners. Issues raised included the US government's decision to identify Korea's "barriers" to imported automobiles as a Priority Foreign Country Practice under the so-called "super 301" procedures, MERCOSUR's reported intention to increase its common external tariff, and Canada's implementation of new national tariffs prior to the completion of consultations.

### Market access

The activities of the Committee on Market Access cover market access issues related to tariffs and non-tariff measures not covered by any other WTO body, as well as matters related to the Integrated Data Base.

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## Tariffs

The implementation of Uruguay Round tariff cuts has proceeded according to schedule. To date, no complaint has been received by the Market Access Committee regarding the failure of any Member to fulfil its tariff-reduction commitments.

The Market Access Committee oversaw the introduction of the Harmonized System changes (HS96), implemented by Members on 1 January 1996, and examined the consequences of those changes to Members' schedules of tariff concessions. Over 40 Members were granted waivers in order to implement those changes, to submit the required documentation and then, as necessary, to renegotiate the affected bound items in the schedules, under the provisions of Article XXVIII. These waivers were extended until 31 October 1998.

The Ministerial Declaration on Trade in Information Technology Products (ITA) which was agreed to in Singapore in 1996 has been accepted by 44 WTO Members and states or separate customs territories. According to the provisions set forth in the Declaration, implementation has proceeded as planned with the first tariff reduction occurring on 1 July 1997 and the second on 1 January 1998. Ultimately, the tariffs on computers, telecommunications equipment, semiconductors, semiconductor manufacturing equipment, software, and scientific instruments will be reduced to zero; the details of which are contained in each schedule of commitments.

Since the second half of 1997, the ITA has focused on the review of product coverage. Fourteen participants submitted lists of products for possible additional tariff concessions which were examined by the 44 participants. As of July 1998, the participants did not add any additional products to the ITA, but agreed to extend the time period for negotiations and examine the situation in September 1998.

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## Non-tariff measures

The Market Access Division continues to receive notifications from Members with regard to their use of quantitative restrictions. However, the Chairman of the Market Access Committee has urged those Members who have not yet notified in accordance with the obligations under Decision G/L/59 to do so.

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## Integrated Data Base

As a result of the General Council Decision of 16 July 1997, the IDB has been moved from the mainframe environment to a PC-based system. The Committee examined the status of the IDB submissions, in any PC format, on tariffs and trade for 1996, 1997 and 1998, and endorsed a programme for IDB Technical Assistance. Several consultations on the dissemination of the IDB information took place during 1998, and preliminary conclusions cover the establishment of the modalities of access to a password-protected Internet site. A Pilot Project to evaluate the feasibility of establishing a working database of consolidated tariff schedules was also supported by the Members.

## Textiles and clothing

The Agreement on Textiles and Clothing (ATC), which entered into force on 1 January 1995, is within the WTO legal structure, a 10-year transitional agreement with a four-stage programme to gradually integrate textile and clothing products into GATT rules and disciplines by 2005. It replaced the Multifibre Arrangement (MFA) which began in 1974 and provided the basis on which certain industrial countries, through bilateral agreements or unilateral actions, established quotas on imports of textiles and clothing from several developing countries. The MFA expired when the ATC entered into force and its quotas were carried over into the ATC.

The Agreement on Textiles and Clothing is built on the following main elements:

- (i) the product coverage, which comprises an extensive list of man-made fibres, yarns, fabrics, made-up textile products and clothing;
- (ii) the procedures for the four-stage integration of these products into GATT 1994 rules on 1 January 1995, 1998, 2002 and 2005. When products are integrated by a Member, they are removed from the Agreement with respect to that Member's imports and are freed of any quotas to which they may have been subjected; any new protection for these integrated products must be based on the relevant provisions of the GATT 1994;
- (iii) a quota liberalization process during the 10-year transition period which automatically increases at each stage the annual growth rates in the quotas inherited from the MFA;
- (iv) a transitional safeguard mechanism to deal with cases of serious damage, or actual threat of serious damage, to domestic industries which may arise during the transition period. It permits quotas to be either bilaterally agreed or unilaterally imposed under strict criteria for a limited time period, subject to subsequent

- examination including the determination of the existence of serious damage or actual threat thereof by the Textiles Monitoring Body;
- (v) other provisions, which include, among others, clauses on circumvention of restrictions, quota administration, quantitative restrictions other than those inherited from the MFA, actions as may be necessary to abide by GATT 1994 rules and disciplines, and special treatment for certain categories of exporters; and
  - (vi) the Textiles Monitoring Body (TMB), which is mandated to supervise the implementation of the ATC, to examine all measures taken under the ATC and their conformity therewith, and to report periodically to the WTO Council for Trade in Goods (CTG).

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### **The major review of the implementation of the Agreement on Textiles and Clothing in the first stage of the integration process**

The WTO Council for Trade in Goods (CTG) is responsible for overseeing the implementation of the ATC and for this purpose is required to conduct a major review before the end of each stage of the integration process. The ATC also provides that, in the light of its review, the CTG shall by consensus take such decisions as it deems appropriate to ensure that the balance of rights and obligations embodied in this Agreement is not being impaired. As the first stage covered the period 1995-97, the CTG conducted its first review of the implementation of the ATC in the last quarter of 1997.

To assist in this review, a comprehensive report, as required by the ATC, was prepared by the TMB and transmitted to the CTG on 31 July 1997. This report, which, Members said, provided a valuable contribution to the review, addressed all of the operational provisions of the ATC. It placed particular emphasis on matters relating to the integration process, the application of the transitional safeguard mechanism, and the application of GATT 1994 rules and disciplines as defined in Articles 2, 3, 6 and 7 of the ATC. Furthermore, as the notification of integration programmes for the second stage of integration had been required by 31 December 1996, the TMB report also covered the fulfilment of that obligation.

The major review process was carried out by the CTG through a series of meetings held from October to December 1997. In the absence of an agreement on the text of the report by the end of 1997, the discussions on this aspect continued in January and February 1998, leading to agreement on a detailed report which summarized the discussions held according to the subject areas and included observations and conclusions by the Council. The CTG considered and took note of the report of the major review at its meeting in February 1998 and the CTG Chairman reported the outcome to the General Council also in February 1998.

As to the substance of the review, a number of developing countries expressed their deep concern that the programmes of the major importing Members for the integration of textiles and clothing products into GATT rules were not commercially meaningful for these exporters as the integrated products were concentrated in less value-added goods, with very few products subject to restraints being included. It was considered that this "backloading" or delay in the integration of products of export interest to developing countries to the last stages of the transition would not meet the objectives of trade liberalization. For their part, the Members maintaining restrictions considered that they had met all of the obligations set out in the ATC for stages 1 and 2 of the integration process and they reconfirmed their commitment to achieve full integration by the year 2005.

As regards the application of growth-rate factors (percentage uplifts to existing growth rates at each stage) some Members considered that these increases, as set out in the ATC, would provide no significant improvement in market access; others, however, noted that these increases were cumulative and considered that they would be a valuable contribution to the integration process.

In the review of the application of the transitional safeguard mechanism, a number of developing country Members said that the introduction of a large number of safeguard measures in the first year of the ATC could not be considered as the "sparing" use of this provision as required by the Agreement. Safeguard measures had serious adverse implications for the domestic industry in the exporting country as well as trade distortive effects. Some others stressed that it was the right of Members to apply safeguards in accordance with the ATC and noted that only two Members had done so. They also pointed to a noticeable declining trend in the use of these measures.

Under the topic of the application of GATT rules, as defined in Articles 2, 3, 6 and 7 of the ATC, the Council held an extensive exchange of views on other measures affecting trade in textiles and clothing, including the changes made in rules of origin by one Member; the same Member's proposal to maintain export visa requirements for products after the products had been integrated and, consequently, quotas had been removed; the application of anti-dumping measures on textile and clothing products by another Member; as well as issues related to circumvention of the restraints, customs formalities and market access.

A number of other subjects were also addressed in the review including the implementation of Article 2.18 of the ATC which extends special treatment to certain small suppliers by advancing their quota growth rates by one stage; the treatment of least-developed country Members, specifically in terms of the application of Article 2.18 as well as in the overall implementation of the Agreement; the treatment of cotton-producing Members in terms of ATC Article 1.4; and the importance of Members meeting their notification obligations in a complete and timely manner.

## The Textiles Monitoring Body

The TMB consists of a Chairman and 10 members who act in their personal capacity. It is a standing body and meets as necessary to carry out its functions, relying essentially on notifications and information supplied by Members under the relevant provisions of the ATC.

On 10 December 1997 the General Council decided on the TMB's composition for the second stage of the ATC (1998-2001). The decision included the allocation of the 10 seats to WTO Members or to groupings of Members (i.e. constituencies). Each of these selects a WTO Member, which, in turn, appoints an individual person to be the TMB member and to act on an ad personam basis on the TMB. The General Council further decided to reappoint Ambassador András Szepesi, TMB's Chairman for the first three years of the ATC, for a further period of three years beginning 1 January 1998.

In 1998 the following constituencies were in place: the ASEAN Member countries; Canada and Norway; Pakistan and Macau; the European Community; Hong Kong, China and Korea; India and Egypt/Morocco/Tunisia; Japan; Latin American and Caribbean Members; Switzerland, Turkey and Bulgaria/Czech Republic/Hungary/Poland/Romania/Slovak Republic/Slovenia; and the United States. Most of the constituencies operate on the basis of rotation. The TMB members may appoint their alternate from within the same constituency. The TMB composition also provides for two "second alternates" and two "non-participating observers".

The TMB takes all of its decisions by consensus. However, according to the ATC, consensus within the TMB does not require the assent or the concurrence of those members appointed by WTO Members who are involved in an unresolved issue under review by the TMB. The TMB also has its own working procedures, adopted in mid-July 1995, which include precise terms on how members discharge their functions.

In the year ending 31 July 1998, the TMB spent 31 days in 12 formal sessions carrying out its functions. It examined a large number of notifications in respect of actions taken under the provisions of the ATC, including the first and second integration programmes, administrative arrangements, actions taken under the transitional safeguard, and a number of issues among Members in respect of these obligations.

More specifically, during the period covered by this report, the TMB, inter alia, finalised its examination of some of the lists of products notified by Members as their integration programmes in the first stage of the transition. The TMB also examined most of the product lists notified by 47 WTO Members as their second integration stage (1998-2001). In many cases, additional information in respect of the integration programmes in both phases was sought from the Members concerned to ensure that full information on these programmes was made available to WTO Members.

In its assessment of the second stage integration programmes submitted by WTO Members, the TMB noted, inter alia, that Canada, the European Community and the United States had included in their integration programmes for the second stage some products or categories or parts of categories with respect to which they maintained under the ATC restrictions affecting a number of WTO Members. As a result of the implementation of their integration, these restrictions would be – and were – eliminated as from 1 January 1998. In the case of Canada the restrictions applied to two product categories, affecting 22 WTO Members, were eliminated. Subsequently, effective 1 January 1998, Canada accorded "ex-quota treatment" to imports from all sources, thereby eliminating the restrictions it applied to several products vis-à-vis some Members under Article 2.1 of the ATC. The European Community eliminated the restrictions applied to 12 EC product categories, affecting overall five WTO Members. The United States' integration programme, for its part, resulted in the elimination of the specific limits affecting three US product categories or combined categories, and altogether six WTO Members (in addition, several products integrated, although not subject to a specific limit, were, prior to their integration, subject to a group or aggregate limit with respect to certain WTO Members). Norway did not include in its integration programme for Stage 2 any product subject to restriction; however, it notified the elimination in two steps (i.e. on 31 December 1997 and on 31 December 1998) of most of the restrictions it continued to apply to WTO Members on the products covered by the ATC. In its comprehensive report the TMB noted, however, that up to 67 per cent of the total volume of imports may remain to be integrated during a period of 36 months

(1 January 2002 to 1 January 2005), and the large majority of products subject to restrictions under Article 2.1 will have to be integrated during the same period. The Body observed that the final objective of the integration of the sector into GATT 1994 would be facilitated if Members would, whenever possible, have recourse to the provisions of Articles 2.10 (advanced integration) and 2.15 (early elimination of restrictions).

The TMB took note of a communication received from the European Community in response to the recommendation made by the TMB in May 1997 that, in view of certain discrepancies in its first stage integration programme, the EC re-examine this programme and report on its findings. As a result of this examination, both EC's first and second stage integration programmes had been revised.

The TMB also took note of the communications received from several WTO Members in response to questions it had put with respect to the HS lines contained in their notifications of the first and second stages of integration, already reviewed by the TMB, with a view to checking whether all the products integrated fell within the coverage of the ATC.

With reference to the transitional safeguard mechanism, the TMB examined the notification by the United States of a restraint measure agreed with Thailand on imports of artificial staple fibre yarn for sale from Thailand. The TMB concluded that this restraint measure was justified in accordance with the provisions of Article 6 of the ATC. The TMB examined the notification by Colombia of restraint measures it introduced pursuant to Article 6 of the ATC on imports of denim from Brazil and India. The TMB concluded that the restraint measures Colombia had introduced were not justified in accordance with Article 6. It, therefore, recommended that Colombia rescind these measures.

The TMB examined two communications by Honduras with respect to the maintenance by the United States of the restraint measure previously agreed between Honduras and the United States in respect of exports of cotton and man-made fibre underwear from Honduras. As a result of its examination of the first communication by Honduras, the TMB invited the United States to reconsider the necessity to maintain the restraint in force until its scheduled expiration date. It noted that until the expiration of the measure positive consideration could be given by the United States to any possible concern that would be brought to its attention by Honduras, so as to avoid future exports of this product to the United States from Honduras being adversely affected. During its examination of the second communication by Honduras, the TMB was informed by the United States that while it would maintain the restraint in place until its scheduled expiration date, it had decided to implement this measure in such a way that exports from Honduras would not, in practical terms, be embargoed. The TMB considered, *inter alia*, that the United States had taken steps to ensure that the practical concerns raised by Honduras, in particular during the January 1998 meeting, had been responded to positively.

The TMB decided to request from the relevant Members information on their implementation of the provisions of Article 2.18 during the second stage of the Agreement. Article 2.18 states that, with respect to certain Members corresponding to specific criteria, meaningful improvement in access shall be provided, through advancement by one stage of the growth rates set out in Articles 2.13 and 2.14, or through at least equivalent changes as may be mutually agreed with respect to a different mix of base levels, growth and flexibility provisions. The TMB considered the responses received from those relevant Members, *i.e.* Canada, the European Community and the United States.

The TMB considered communications from Pakistan and the United States regarding the mutually satisfactory solution reached between them with respect to the transshipment charges for cotton bedsheets made by the United States to Pakistan's quota for these products on account of alleged circumvention by Pakistani companies. The TMB recommended that Pakistan and the United States re-examine the measures in question, in the light of the Body's comments and considerations. With a view to exercising proper surveillance of the implementation of its recommendation, the Body expected that the two parties would report back to it on the outcome of this re-examination, in a way that would enable the TMB to pronounce itself definitively on the justification and conformity of the actions with the relevant provisions of the ATC. The mutually acceptable solution also resolved matters concerning changes to US rules of origin with respect to imports of bedsheets and pillowcases from Pakistan into the United States. The TMB took note of this element of the communications. It also took note, *inter alia*, of the adjustment to the quota level for cotton bedsheets resulting from a reduction of the transshipment charges made by the United States to that quota.

The TMB considered a communication from Hong Kong, China; India; and Pakistan, jointly requesting the TMB to review the implementation of the Stage 2 integration programme of the United States with respect to the continuation of visa requirements for imports of products included in this programme. The TMB was subsequently informed by the United States that without conceding its right to maintain such measures, it would eliminate visa requirements with respect to products integrated in Stage 2, without condition and as soon



as practicable, but in any event no later than 31 December 1998. Hong Kong, China; India; and Pakistan, while remaining of the view that the maintenance of visa requirement for integrated products is not consistent with obligations under Article 2.8(a) of the ATC agreed, in the circumstances, that it was not necessary for the TMB to continue with the review under Article 2.21 of the ATC. This was without prejudice to their right to submit a further request for a similar review should this become necessary. The TMB took note of these communications, with the understanding that such elimination of visa requirements shall be effected on a MFN basis, and agreed to keep in view this matter under the provisions of Article 2.21 of the ATC.

## Committee on Agriculture

Progress in the implementation of commitments under the Uruguay Round agricultural reform programme, or resulting from WTO accession negotiations, is subject to regular multilateral review in the WTO Committee on Agriculture. To date, the Committee has held 15 formal meetings as well as numerous informal meetings and consultations.

The review of implementation of commitments is undertaken on the basis of notifications submitted by Members in the areas of market access, domestic support and export subsidies, as well as under the provisions of the Agreement relating to export prohibitions and restrictions. In 1997 the Committee reviewed 242 notifications in these areas compared with 193 in 1996, with domestic support and export subsidy notifications accounting for most of the increase. In total, the Committee has reviewed more than 600 notifications since 1995.

In the area of market access, the Committee's review process continues to focus on the implementation of low-rate tariff-quota commitments. Currently there are 36 Members with a total of 1,370 tariff or other quota commitments in their Schedules. In 1995, the detailed arrangements for administering each of these tariff quotas had to be notified to the Committee, with any changes in these arrangements being notified as and when they were introduced. Imports under these tariff and other quota commitments have to be notified annually. Given the substantial value of these concessions, the examination of these notifications has been conducted rigorously and in considerable technical detail. In cases where tariff quotas were not fully utilised, the importing countries were routinely invited to justify such under-utilisation of market access opportunities. It may be noted that in many cases, tariff-quota products are being imported without limitation at the in-quota or lower applied tariff rates. The Committee also continued to review market access notifications relating to the use of the special agricultural safeguard.

In the area of domestic support, particular attention has been given to the measures which have been claimed by Members as being exempt from reduction commitments, particularly to their conformity with the relevant non-trade distortion and other exemption criteria, such as those relating to the "Green Box" and the special and differential treatment exemptions. In the case of domestic-support measures subject to reduction commitments (generally, market-price support and non-exempt payments), the review has focused on issues of methodology relating to the calculation of current levels of trade-distorting support (Current Total AMS), which Members are required to provide annually to demonstrate that current non-exempt support is below the relevant commitment levels specified in their respective WTO Schedules (Total AMS). There are 28 Members with Total AMS reduction commitments in their Schedules. Other Members are required to keep any non-exempt trade-distorting domestic support below certain *de minimis* levels stipulated in the Agreement on Agriculture and to notify the Committee that this was in fact the case. In a number of cases, additional supporting information has been sought in order to verify such *de minimis* claims.

The 25 Members of the WTO with export subsidy reduction commitments in their Schedules are required annually to provide "full picture" export subsidy notifications covering not only subsidized quantities and related budgetary outlays but also food aid transactions and total exports. These notifications continued to receive close attention and systematic scrutiny in the Committee.

The Committee also addressed a wide range of general and specific matters relevant to the implementation of commitments that were raised under Article 18.6 of the Agreement which entitles Members to raise, in the Committee's review process, any matter relevant to the implementation of commitments under the reform programme. A number of Members have expressed serious concerns over the practice by some other Members of utilising "unused" export-subsidy commitments that have been carried forward from one implementation year to a subsequent implementation year. Relatively high world market prices for certain commodities in 1995 and 1996, such as grains, has in some cases meant that only a fraction of export-subsidy entitlements in those years was exhausted. However, the scope for rolling over such unused export subsidies expires after the penultimate year of the six-year implementation period. For many other products which are subject to export-subsidy reduction commitments the scope for such rollover flexibility is negligible.

Another matter having received attention was the status, from an export-subsidy anti-circumvention point of view, of newly introduced or modified arrangements affecting exports of certain agricultural products, especially dairy products. A number of the matters thus raised have been or continue to be the subject of informal consultations or formal dispute settlement procedures.

At the December 1996 WTO Ministerial Conference in Singapore, Ministers agreed to a process of analysis and information exchange on the built-in agenda issues ("AIE process") to allow Members to better understand the issues involved and identify their interests before undertaking the agreed further negotiations on agriculture towards the end of 1999 (Article 20 of the Agreement on Agriculture). Under arrangements adopted by the Committee on Agriculture, the AIE process is undertaken in informal open-ended meetings on the basis of papers submitted by Members. Since 1997 seven sessions have been held within the framework of the AIE process, with the active participation of a large number of developed and developing country Members. Issues of interest to developing countries and special and differential treatment are regularly discussed at the meetings of the AIE process. Other topics covered include: administration of tariff quotas; circumvention of export subsidies; non trade-distorting or "Green Box" measures; direct payments under production-limiting programmes ("Blue Box"); state trading enterprises (single desk buyers and single desk sellers); domestic support policy reform; the special agricultural safeguard; non-trade concerns in agriculture; and sectoral trade liberalization. In addition, a range of Secretariat background papers have been provided to facilitate the work of the AIE process. These background papers, which have been developed and updated on the basis of information and data notified by Members, cover such topics as: tariff-quota administration methods and tariff-quota fill; domestic support; export subsidies; ad valorem, specific and other tariffs; special-and-differential-treatment provisions relating to the Agreement on Agriculture; studies on the implementation and impact of the Agreement on Agriculture on developing countries; agricultural trade performance by developing countries; Uruguay Round agricultural tariff reductions according to stage of processing; and actions taken within the framework of the Marrakesh Ministerial Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing.

In the Marrakesh Ministerial Decision, which is contained in the Final Act signed at Marrakesh in April 1994, it is recognized that the progressive implementation of the results of the Uruguay Round as a whole will generate increasing opportunities for trade expansion and economic growth to the benefit of all participants. Ministers also recognized that during the reform programme leading to greater liberalization of trade in agriculture, least-developed and net food-importing developing countries may experience negative effects in terms of the availability of adequate supplies of basic foodstuffs from external sources on reasonable terms and conditions, including short-term difficulties in financing normal levels of commercial imports of basic foodstuffs.<sup>1</sup> The Decision accordingly establishes mechanisms which provide for: (i) the review of the level of food aid and the initiation of negotiations in the appropriate forum to establish a level of food aid commitments sufficient to meet the legitimate needs of developing countries during the reform programme; (ii) the adoption of guidelines on concessionality; (iii) financial and technical assistance under aid programmes to improve agricultural productivity and infrastructure; and (iv) differential treatment in the context of an agreement to be negotiated on agricultural export credits. The Decision also takes into account the question of access to the resources of international financial institutions under existing facilities, or such facilities as may be established, in order to address short-term difficulties in financing normal levels of commercial imports.

The follow-up to the Marrakesh Ministerial Decision is monitored annually by the Committee on Agriculture at its November meetings. The monitoring exercise is conducted on the basis of contributions by Members, including notifications concerning actions taken by developed country Members within the framework of the Decision. At its November 1997 meeting, 15 such notifications were reviewed by the Committee on Agriculture. Observer representatives of the FAO, the IMF, the International Grains Council, the UN World Food Programme and the World Bank also contribute actively to this annual monitoring exercise.

At each of its meetings, the Committee on Agriculture also has reviewed the follow-up to the recommendations adopted by the Singapore WTO Ministerial Conference on the implementation of the Marrakesh Ministerial Decision as it relates to food-aid matters. In line with these recommendations, the renegotiation of the Food Aid Convention 1995 is currently underway under the auspices of the London-based Food Aid Committee/International Grains Council with the aim of concluding the substantive negotiations on a new Food Aid Convention by the end of 1998. In these negotiations provision has been made for account to be taken, inter alia, of the recommendations of the Singapore Ministerial Conference regarding food-aid levels and concessionality guidelines, as well as of the 1996 FAO World Food Summit recommendations with respect to least-developed and net food-importing developing countries.

<sup>1</sup>In 1996 the Committee on Agriculture had established a WTO list of Net Food-Importing Developing Countries. This list, which was last revised in March 1997, includes the least-developed countries and 18 developing country Members of the WTO (Barbados, Botswana, Côte d'Ivoire, Dominican Republic, Egypt, Honduras, Jamaica, Kenya, Mauritius, Morocco, Pakistan, Peru, Saint Lucia, Senegal, Sri Lanka, Trinidad and Tobago, Tunisia and Venezuela).

## Committee on Sanitary and Phytosanitary Measures

The Agreement on the Application of Sanitary and Phytosanitary Measures (the "SPS Agreement") sets out the rights and obligations of Members when taking measures to ensure food safety, to protect human health from plant- or animal-spread diseases, or to protect plant and animal health from pests and diseases. Among others, governments must ensure that their food safety and animal or plant health measures are necessary for health protection, are based on scientific principles, are transparent, and are not applied in a manner which would constitute a disguised restriction on international trade. The measures must be justifiable through an assessment of the health risks involved. The use of internationally-developed standards is encouraged. Advance notice must be given of proposed new regulations or modifications to requirements whenever these differ from the relevant international standards.

As of mid-1998, almost 900 notifications had been received with regard to the provisions of the SPS Agreement. Ninety-eight Members have established and identified National Enquiry Points to respond to requests for information regarding sanitary and phytosanitary measures, whereas 90 have identified their national authority responsible for notifications. The SPS Agreement provides a delay until 2000 for the least-developed-country Members to implement and adhere to all provisions of the Agreement, including those with respect to notifications, Enquiry Points and National Notification Authorities.

The Committee on Sanitary and Phytosanitary Measures oversees the implementation of the SPS Agreement. It holds three or four regular meetings each year, supplemented by informal meetings as needed. At each of its regular meetings, the SPS Committee reviews the implementation of the SPS Agreement, considering information provided by Members on changes in their national sanitary or phytosanitary regulatory frameworks and on their disease status. In addition, Members raise specific issues of concern to them, including those related to notifications. In 1997/98, for example, the issues brought before the Committee included measures related to the shelf life of UHT milk; measures on grains, oilseeds, rice, fruits, vegetables and poultry; requirements for wines; plant quarantine regulations; levels of aflatoxins in certain foods; trade restrictions related to cholera; and measures to address citrus canker. In addition, many Members raised specific trade concerns related to measures imposed in response to bovine spongiform encephalopathy (BSE).

In October 1997, the Committee adopted a provisional procedure to monitor the use of international standards, guidelines and recommendations. The Committee has continued to work on the development of practical guidelines to help Members achieve consistency in their decisions regarding acceptable levels of health protection.

The effective implementation of this Agreement requires cooperation from several international standard-setting organizations, and in particular the Office International des épizooties (OIE), the FAO/WHO Joint Codex Alimentarius Commission (Codex), and the FAO's Secretariat for the International Plant Protection Convention (IPPC). Close working relationships have been established with these bodies. They are frequently involved with the work of the Committee. In July 1997, the Committee adopted the text of an agreement between the WTO and OIE, which was signed in May 1998 by the Directors-General of both organizations. In response to a request from Codex, the Committee provided some clarification regarding the applicability of regional Codex standards as well as the status of Codex guidelines and codes of practice in relation to the SPS Agreement. The Committee also closely followed the revision of the text of the IPPC, and held informal discussions with the World Health Organization regarding the revision of the International Health Regulations. The Committee also decided to hold informal discussions regarding the Protocol on Biosafety with the Secretariat of the Convention on Biological Diversity.

At each meeting of the Committee, Members, the Secretariat and the observer international organizations report on their technical assistance activities. Members are provided the opportunity to identify specific needs for technical assistance. The Committee has stressed the need for close cooperation among those providing assistance, and also that particular emphasis should be put on assisting with the implementation of the transparency provisions of the SPS Agreement. Since the entry into force of the SPS Agreement, the WTO Secretariat has organized a series of regional seminars in Africa, Asia, Central and Eastern Europe and Latin America focusing on the implementation of the SPS Agreement. This programme is ongoing.

Over the past three years, a number of trade disputes alleging violations of the SPS Agreement have been brought to the Dispute Settlement Body. These include: a complaint by the United States against Korean shelf-life requirements and a separate US complaint against Korean inspection procedures; complaints by Canada and the United States against Australian restrictions related to fish diseases; a Canadian complaint against Korean regulations on bottled water; complaints by the United States and Canada against the

European Community's ban on imports of hormone-treated meats; a US complaint against Japanese quarantine restrictions on varieties of fruits and nuts, a Swiss complaint against Slovak restrictions on imports of dairy products and the transit of cattle, and a Canadian complaint against European Community restrictions on conifer wood. Several other requests for consultations have also made reference to alleged violations of the SPS Agreement. Dispute settlement panels were established to consider the two complaints on hormone-treated meats, and the reports of the panels and of the Appellate Body were adopted on 13 February 1998. A dispute settlement panel established to consider the Canadian complaint against Australian restrictions on salmon issued its report in June 1998. Another panel is currently considering the US complaint against Japanese quarantine restrictions on certain fruits and nuts.

## Safeguards

WTO Members may take "safeguard" actions with respect to a product if increased imports of that product are causing, or threatening to cause, serious injury to the domestic industry that produces like or directly competitive products. Safeguard measures were available under Article XIX of GATT 1947, but were infrequently used, because some governments preferred to secure protection for their domestic industries by using "grey area" measures. These measures usually took the form of voluntary export restraint agreements between exporting and importing countries.

The WTO Agreement on Safeguards, which entered into force on 1 January 1995, broke new ground in establishing a prohibition against "grey area" measures, and in setting a "sunset clause" on all safeguard actions. The Agreement stipulates that Members shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures. Such measures have to conform with the Agreement, or be phased out by the end of 1998.

During the period under review, the Committee established under the Agreement completed its review of national safeguards legislation which had been notified to the Committee as of mid-March 1998. To date, 78 Members have notified the Committee of their domestic safeguard legislations or made communications in this respect. Thirty-nine Members have not, as yet, made notifications as required by Article 12.6 of the Agreement.<sup>2</sup>

The Agreement requires Members maintaining "grey area" measures to have notified such measures, as well as timetables for their phase-out, to the Committee during 1995. The notifications of timetables received from Cyprus, the European Community, the Republic of Korea, Slovenia and South Africa were reviewed by the Committee, in the context of its monitoring activities and annual reporting to the Council for Trade in Goods required under the Agreement. During the period under review, Slovenia notified the Committee that as of 1 January 1998 it had no pre-existing measures remaining in effect. The Agreement also requires notification and termination of any pre-existing measures imposed under Article XIX of GATT 1947. The notifications of such measures received by the 2 March 1995 deadline for such notifications, from the European Community and the Republic of Korea, and a notification from Nigeria received during the period under review, were reviewed by the Committee during this period.

Members are required to notify the Committee immediately upon taking any action related to safeguard measures. Notifications of the initiation of investigations regarding serious injury or threat thereof and the reasons for it were received from Argentina (including as President pro tempore of MERCOSUR on behalf of Argentina), Australia, India and the United States during the period covered by this report. Notifications of findings of serious injury due to increased imports were received from Argentina and the United States.

Notifications related to decisions to apply safeguard measures, and related to the exclusion from application of safeguard measures of those developing countries whose shares of imports are below the thresholds set forth in Article 9.1 of the Agreement, were received from Argentina (and Uruguay as President pro tempore of MERCOSUR on behalf of Argentina), Brazil and the United States. In addition, notifications regarding the results of consultations held pursuant to Article 12 of the Agreement (related to definitive measures proposed or provisional measures applied) were received from Argentina (and Uruguay as President pro tempore of MERCOSUR on behalf of Argentina). All of these notifications were reviewed by the Committee.

One notification of proposed suspension of concessions and other obligations referred to in paragraph 2 of Article 8 of the Agreement was received during the period under review, from the European Community.

The Committee granted regular observer status to UNCTAD, and invited the OECD and the ACP Group to attend its meetings on an ad hoc basis, during the period of review.

<sup>2</sup>The total of 117 Members used here reflects the fact that for this obligation, the EC submits a single notification that covers all 15 member States. The official total membership of the WTO (132) includes the EC Commission and the 15 individual member States.

## Subsidies and countervailing measures

The Agreement on Subsidies and Countervailing Measures, which entered into force on 1 January 1995, regulates the provision of subsidies and the imposition of countervailing measures by Members. The Agreement applies to subsidies that are specific to an enterprise or industry or group of enterprises or industries within the territory of a Member. Specific subsidies are divided into three categories: prohibited subsidies under Part II of the Agreement, actionable subsidies under Part III of the Agreement, and non-actionable subsidies under Part IV of the Agreement. Part V of the Agreement contains detailed rules regarding the conduct of countervailing duty investigations and the application of countervailing measures by Members. Parts VIII and IX of the Agreement provide special and differential treatment, respectively, for developing country Members and for Members in transformation to a market economy.

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### Notification and review of subsidies

Transparency is essential for the effective operation of the Agreement. To this end, Article 25 of the Agreement requires that Members make a new and full notification of specific subsidies every third year, with the first such notification due on 30 June 1995, and that on 30 June of the intervening years Members submit an updating notification. As of 31 July 1998, 68 Members (counting the EC as a single Member) had submitted a 1995 new and full notification regarding specific subsidies, of which 24 notified that they provided no specific subsidies; 47 Members had submitted 1996 updating notifications; and 33 Members had submitted 1997 updating notifications. In addition, 10 Members had submitted a 1998 new and full notification, of which four notified that they provided no specific subsidies. The Committee on Subsidies and Countervailing Measures ("the Committee") continued its review of 1995 new and full notifications and 1996 updating notifications at its meetings in October 1997 and in April 1998. The Committee also began its review of 1997 updating notifications; however, the late submission or non-submission of these notifications by numerous Members has delayed the review process.

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### Notification and review of countervailing legislation

Pursuant to Article 32.6 of the Agreement and a decision of the Committee, Members were required to notify their countervailing duty legislation and/or regulations (or the lack thereof) to the Committee by 15 March 1995. As of 31 July 1998, 76 Members (counting the EC as a single Member) had submitted such a notification. Of these, 19 Members notified new legislation designed to implement the Marrakesh Agreements, 33 Members notified pre-existing legislation, and 24 Members notified that they had no countervailing duty legislation. Forty-one Members had not submitted a notification. During the period 1 August 1997 through 31 July 1998, the Committee continued the task of reviewing notifications of legislation, which had been begun in four special meetings held jointly with the Committee on Anti-Dumping Practices, during the course of its regular meetings. Both new notifications of legislation and notifications that had previously been the subject of review, were reviewed in detail at the Committee's regular meetings in October 1997 and April 1998.

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### Non-actionable subsidies

Article 8 of the Agreement provides that subsidy programmes for which non-actionable status is invoked shall be notified to the Committee in advance of implementation. The notified programmes shall be reviewed by the Committee upon the request of a Member with a view to determining whether the criteria for non-actionability have not been met. Thereafter, upon request of a Member, the determination of the Committee, or lack thereof, shall be submitted to binding arbitration. At its regular meeting in October 1997, the Committee approved a format developed by the Working Party on Subsidy Notifications for updating notifications of non-actionable subsidies. Further, the informal group on procedures for binding arbitration pursuant to Article 8 continued its work in 1997 and early 1998, and the Committee adopted arbitration procedures in June 1998. To date, no notifications of non-actionable subsidies pursuant to Article 8 have been received by the Committee.

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### Permanent Group of Experts

The Agreement provides for the establishment of a Permanent Group of Experts (PGE), composed of five independent persons highly qualified in the fields of subsidies and trade relations. The role of the PGE involves the provision of assistance to panels with respect to whether a subsidy is prohibited, as well as the provision of advisory opinions at the request of the Committee or a Member. On 8 May 1998, the Committee elected Mr. Renato Galvao Flores Junior to replace Mr. Seung-Wha Chang as a member of the PGE.<sup>3</sup> Although the PGE has drafted Rules of Procedure and submitted them to the Committee for its approval, the draft Rules have not yet been approved by the Committee.

<sup>3</sup>The new membership of the PGE is as follows: Mr. Renato Galvao Flores Junior, Professor of Law at Universidade Federal do Rio de Janeiro; Mr. A.V. Ganesan, former Commerce Secretary and chief Uruguay Round negotiator for India; Mr. Gary Horlick, private attorney in the trade law area; Mr. Akio Kotera, Professor of International Relations at Tokyo University; and Mr. Robert Martin, former Secretary of the Canadian International Trade Tribunal and former Canadian GATT negotiator.

## Informal Group of Experts

Under Article 6.1(a) of the Agreement, ad valorem subsidization of a product in excess of 5 per cent gives rise to a presumption of serious prejudice to the interests of another Member. Annex IV to the Agreement sets forth certain methodological approaches for determining whether the 5 per cent level has been met, but states that an understanding among Members should be developed as necessary on matters regarding this calculation which are not specified in the Annex or require clarification. In 1995, the Committee created an Informal Group of Experts whose terms of reference are to examine any such matters and to report to the Committee such recommendations as could assist the Committee in the development of such an understanding. The Group has met repeatedly since 1995, and circulated a report to Members in late July 1997. This report was taken note of by the Committee at its regular meeting in April 1998.

## Countervailing actions

Countervailing actions taken during the period 1 January-31 December 1997 are summarized in Tables V.2 and V.3. The tables are incomplete because certain Members have not submitted one or both of their semi-annual reports on countervailing actions or have not provided all of the information required by the format adopted by the Committee. The data available indicate that 16 new countervailing duty investigations were initiated in 1997. As of 31 December 1997, Members reported 87 countervailing measures (including price undertakings) in force.

Table V.2

### Summary of countervailing duty actions, 1997<sup>1</sup>

Reporting party	Initiations	Provisional measures	Definitive duties	Price undertakings	Measures in force on 31 Dec. 1997 <sup>2</sup>
Argentina	1	1	0	0	1
Australia	1	0	0	0	7
Brazil	0	0	0	0	6
Canada	0	0	0	0	5
European Community	4	0	1	1	3
Mexico	1	1	0	0	8
New Zealand	1	0	2	2	2
Peru	1	0	0	0	0
South Africa	1	0	0	0	0
United States	6	5	0	0	52
Venezuela	0	0	0	0	3
<b>TOTAL</b>	<b>16</b>	<b>7</b>	<b>3</b>	<b>3</b>	<b>87</b>

1. The reporting period covers 1 January-31 December 1997. The table is based on information from Members that have submitted semi-annual reports and is incomplete due to a significant number of missing notifications.

2. Includes definitive duties and price undertakings.

Table V.3

### Exporters subject to initiations of countervailing investigations, 1997<sup>1</sup>

	Initiations		Initiations
Brazil	1	India	3
Canada	1	Italy	1
Chile	1	Peru	1
Chinese Taipei	1	South Africa	1
European Community <sup>2</sup>	1	Spain	1
Germany	1	Trinidad and Tobago	1
Greece	1	Venezuela	1
		<b>TOTAL</b>	<b>16</b>

1. The reporting period covers 1 January-31 December 1997. The table is based on information from Members that have submitted semi-annual reports and is incomplete due to a significant number of missing notifications.

2. Initiations concerning exporters of the European Community and its member States.

## Anti-dumping practices

The Agreement on Implementation of Article VI of GATT 1994 ("the Agreement"), which entered into force on 1 January 1995, builds on the Tokyo Round Agreement on Implementation of Article VI ("Tokyo Round Agreement"). Article VI of GATT 1994 allows Members to apply anti-dumping measures on imports of a product with an export price below its "normal value" (usually, the comparable price of the product in the domestic market of the exporting country) if such imports cause or threaten to cause material injury to a domestic industry. Detailed rules governing the application of such measures – which take the form of either duties or undertakings on pricing by the exporter – were negotiated during the Tokyo Round. That Agreement was substantially revised during the Uruguay Round.

The WTO Agreement provides for greater clarity and more detailed rules in relation to the method of determining whether a product is dumped, including the calculation of a "constructed"

normal value where no direct comparison with prices on the domestic market of the exporting country is possible. It sets out procedures to be followed in initiating and conducting anti-dumping investigations, as well as additional criteria to be taken into account in determining whether dumped imports cause material injury to a domestic industry. It also clarifies the role of dispute-settlement panels in disputes concerning anti-dumping actions taken by WTO Members.

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### **Notification and review of anti-dumping legislation**

Pursuant to Article 18.5 of the Agreement and a decision of the Committee on Anti-Dumping Practices ("the Committee"), Members were required to notify their anti-dumping legislation and/or regulations (or the lack thereof) to the Committee by 15 March 1995. The obligation to notify legislation is a continuing one, and Members who enact new legislation or amend existing legislation are required to notify the new text or amendment. As of 31 July 1998, 81 Members (counting the EC as a single Member) had submitted notifications regarding anti-dumping legislation or regulations. Of these, 23 Members notified new legislation designed to implement the WTO Agreement, 34 Members notified pre-existing legislation, and 24 Members notified that they had no anti-dumping legislation or regulations. Thirty-six Members have not yet submitted a notification. During the period 1 July 1997 through 31 July 1998, the Committee continued the task of reviewing notifications of legislation during its regular meetings. Both new notifications regarding legislation, as well as notifications that had previously been the subject of review, were the subject of written questions and answers and discussion, at the Committee's regular meetings in October 1997 and April 1998.

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### **Other actions**

At its regular meeting in October 1996, the Committee had referred a series of 10 topics, largely technical issues concerning implementation of the Agreement, to the Ad Hoc Group on Implementation for discussion and the development of recommendations on acceptable practice, the latter to be considered by the Committee for adoption. The Ad Hoc Group held two meetings to discuss those topics during the period, in October 1997 and April 1998. Attendance by capital-based government officials charged with administering anti-dumping regimes was encouraged, and numerous such officials took part in the discussions. The discussions were conducted based on papers submitted by Members, information submitted by Members concerning their own practice in administering anti-dumping laws, and draft recommendations prepared by the Secretariat. No recommendations have yet been adopted by the Group for consideration by the Committee. However, the exchange of information on Members' individual practice has been welcomed by the Committee, and several draft recommendations will be considered by the Group at its next meetings. The Group will continue to meet twice a year, in conjunction with the semi-annual meetings of the Committee, and discuss the topics before it on the basis of papers and information submitted by Members.

The Informal Group on Anti-Circumvention continued the discussions concerning the Committee's response to the Ministerial Decision on Anti-Circumvention, pursuant to the framework agreed to in April 1997. The Informal Group met twice during the period, in October 1997 and April 1998. Discussions proceeded on the basis of papers prepared by Members on the first topic under the framework, "what constitutes circumvention". The Informal Group has agreed to continue to meet twice a year, in conjunction with the semi-annual meetings of the Committee.

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### **Anti-dumping actions**

Anti-dumping actions taken during the period 1 January-31 December 1997 are summarized in Tables V.4 and V.5. The tables are incomplete because certain Members have not submitted one or both of the required semi-annual reports of anti-dumping actions or have not provided all the information required by the format adopted by the Committee. The data available indicate that 240 investigations were initiated in 1997. The most active Members during the year, in terms of initiations of anti-dumping investigations, were Australia (42), the European Community (41), South Africa (23), the United States (16), Argentina and Korea (15 each), Canada (14), India (13) and Brazil (11). As of 31 December 1997, 19 Members reported anti-dumping measures (including undertakings) in force. Of the 880 measures in force reported, 34 per cent were maintained by the United States, 16 per cent by the European Community, 10 per cent by Canada, and 9 per cent by Mexico. Other Members reporting measures in force accounted for 5 per cent or less of the total number of measures in force each. Products exported from the EC or its member States were the subject of the most anti-dumping investigations initiated during the year (59), followed by products exported from China (31), Chinese Taipei and Korea (16 each), the United States (15) and Japan (12).

Table V.4

**Summary of anti-dumping actions, 1997<sup>1</sup>**

	Initiations	Provisional measures	Definitive duties	Price undertakings	Measures in force on 31 Dec. 1997 <sup>2</sup>
Argentina	15	11	10	1	31
Australia	42	17	1	0	45
Brazil	11	0	2	0	23
Canada	14	7	7	0	91
Chile	0	0	2	0	n.a. <sup>3</sup>
Colombia	1	1	1	0	n.a. <sup>3</sup>
Costa Rica	1	0	0	0	0
Egypt	7	0	0	0	n.a. <sup>3</sup>
EC	41	33	23	9	137
Guatemala	0	0	1	0	1
India	13	16	6	0	24
Indonesia	4	6	4	0	n.a. <sup>3</sup>
Israel	3	5	0	0	n.a. <sup>3</sup>
Japan	0	0	0	0	2
Korea	15	5	6	7	20
Malaysia	8	7	2	0	4
Mexico	6	6	7	0	81
New Zealand	5	0	0	0	26
Peru	2	1	3	0	6
Philippines	2	2	1	0	n.a. <sup>3</sup>
Poland	1	0	0	0	0
Singapore	0	0	0	0	2
South Africa	23	17	18	0	43
Thailand	2	2	1	0	2
Trinidad and Tobago	0	1	0	0	n.a. <sup>3</sup>
Turkey	4	0	0	0	35
US	16	16	19	4	302
Venezuela	4	0	2	0	5
TOTAL	240	153	116	21	880

1. The reporting period covers 1 January 1997-31 December 1997. The table is based on information from Members that have submitted semi-annual reports for that period and is incomplete due to missing reports.

2. Includes definitive price undertakings.

3. Did not submit a separate list of measures in force.

Table V.5

**Exporters subject to two<sup>1</sup> or more initiations of anti-dumping investigations, 1997<sup>2</sup>**

	Total		Total
EC or its member States	59	Singapore	4
China	31	South Africa	4
Chinese Taipei	16	Ukraine	4
Korea	16	Canada	3
United States	15	Chile	2
Japan	12	Hong Kong	2
Indonesia	9	Hungary	2
India	7	Iran	2
Russia	6	Israel	2
Brazil	5	Kazakstan	2
Malaysia	5	Latvia	2
Thailand	5	Mexico	2
Poland	4	Trinidad and Tobago	2
		TOTAL	223 <sup>3</sup>

1. Countries subject to only one initiation of an anti-dumping investigation were: Australia, Bulgaria, Egypt, Estonia, Latvia, Liechtenstein, Lithuania, Mozambique, Pakistan, Paraguay, Slovak Republic, Switzerland, Turkey, United Arab Emirates, Venezuela and Viet Nam.

2. The reporting period covers 1 January 1997-31 December 1997. The table is based on information from Members that have submitted semi-annual reports for that period and is incomplete due to missing reports.

3. Does not include exporters subject to only one initiation (see note 1 above). The total number of initiations was 240.



## Technical barriers to trade

The Agreement on Technical Barriers to Trade is aimed at ensuring that activities relating to mandatory technical regulations, voluntary standards and their conformity assessment procedures do not create unnecessary obstacles to trade. For the purpose of transparency, WTO Members are required to fulfil notification obligations and establish national enquiry points.

During the period from 1 August 1997 to 31 July 1998, the Committee held five meetings where statements were made on the implementation and administration of the Agreement. A number of Members informed the Committee of measures taken to ensure the implementation and administration of the Agreement. Several Measures were brought to the attention of the Committee by Members who raised concerns about the potential adverse trade effects or inconsistency with the Agreement of those measures. The Committee granted observer status to ACP, EFTA, ALADI and IOLM on an ad hoc basis.

At its eighth, ninth and 10<sup>th</sup> meetings, the Committee prepared for the First Triennial Review of the Operation and Implementation of the Agreement under Article 15.4. The Triennial Review was carried out at its 11<sup>th</sup> meeting held on 13 and 18 November 1997. The Committee examined the status of implementation by Members and assessed the extent to which the operation of the Agreement facilitated trade in all Members. The overall view was that the operation of the Agreement during the first three years of its existence revealed the capacity and potential of the Agreement to advance the objectives of GATT 1994, by ensuring that technical regulations, standards and procedures for assessment of conformity do not create unnecessary obstacles to international trade. The Committee considered that adjustment of the rights and obligations of the Agreement and amendments to its text were not necessary. The Committee noted however, that certain difficulties or problems existed in a number of areas regarding the operation and implementation of the Agreement. Accordingly, the Committee adopted a number of decisions, recommendations and arrangements aimed at better operation and implementation of the Agreement. The elements considered under the Review included issues concerning: Implementation and administration of the Agreement by Members under Article 15.2; Operation and implementation of notification procedures under Articles 2, 3, 5 and 7; Acceptance, implementation and operation of the Code of Good Practice for the Preparation, Adoption and Application of Standards by standardizing bodies; International standards, guides and recommendations; Preparation, adoption and application of technical regulations; Conformity assessment procedures; Technical assistance under Article 11; Special and differential treatment under Article 12; and Other elements.

The Committee initiated discussions on the programme of work arising from the Triennial Review at its 12<sup>th</sup> meeting, and continued its work programme at its 13<sup>th</sup> meeting. Papers were submitted by a number of Members, and discussions were held based on the submissions made.

At its 12<sup>th</sup> meeting held on 27 March 1998, the Committee carried out its third Annual Review of the Implementation and Operation of the Agreement under Article 15.3, and its third Annual Review of the Code of Good Practice for the Preparation, Adoption and Application of Standard under the Ministerial decision.

## State trading enterprises

The Working Party on State Trading Enterprises was established in accordance with paragraph 5 of the Understanding on the Interpretation of Article XVII of the GATT 1994 and held its first meeting in April 1995. Since the 1997 Annual Report, the Working Party has held two formal meetings: in November 1997 and in April 1998. The Working Party's main task is to review the notifications and counter-notifications submitted by Members on their state trading activities. The Working Party also is charged with two other tasks: (i) to examine, with a view to revising, the questionnaire on state trading adopted in November 1960 and in use since then; and (ii) to develop an illustrative list of the kinds of relationships between governments and state trading enterprises and the kinds of activities engaged in by these enterprises. The Working Party held numerous informal meetings on these two issues, open to any Member wishing to participate.

Reviews of the notifications submitted are conducted in formal meetings of the Working Party. New and full notifications on state trading enterprises were required of all Members by a deadline of 30 June 1995 and will be required in every subsequent third year. An updating notification must be submitted in each of the intervening two years; thus, two separate updating notifications were due by 30 June 1996 and by 30 June 1997. However, exceptionally for 1998, the deadline for the new and full notification will be 30 September. All such notifications must be made, regardless of whether the Member maintains any state trading enterprises and irrespective of whether an existing state trading enterprise has conducted any trade during the period under review.

Concerning the main task of the Working Party, at its meeting in November 1997 it conducted a review of the 14 notifications it had received. The notifications of the following countries were discussed: New Zealand, Romania, South Africa and Turkey. There was no discussion of the remaining 10 notifications. The Working Party also adopted its 1997 Report to the Council for Trade in Goods. At its April 1998 meeting, the Working Party reviewed 11 new notifications. The notifications of the following countries were discussed: Haiti, Nigeria, Brazil, Uruguay and Venezuela. There was no discussion of the remaining six notifications.

Concerning the other tasks of the Working Party, a significant development at its April 1998 meeting was the Working Party's adoption of a revised questionnaire (contained in document G/STR/3). In addition, the Working Party agreed to continue its work, in a way consistent with its mandate, on possible further information needed to enhance transparency, and agreed to reconvene as early as possible to this end. It also agreed that the deadline for submission of the 1998 new and full notifications be moved to 30 September from 30 June, to take account of the date of adoption of the revised questionnaire. The revised questionnaire was approved by the Council for Trade in Goods at its meeting later in April and will be the basis for all state trading notifications starting with those due in 1998. With respect to the illustrative list, work has advanced well and appears to be close to completion. At the most recent informal meeting a draft text was approved ad referendum and will be considered for adoption at the Working Party's formal meeting in September.

## Agreement on Import Licensing Procedures

The Agreement on Import Licensing Procedures recognizes that import licensing procedures can have acceptable uses, but also that their inappropriate use may impede the flow of international trade. It establishes disciplines on the users of import licensing systems with the principal objective of ensuring that the procedures applied for granting both "automatic" and "non-automatic" import licences do not in themselves restrict trade. It contains provisions to ensure that automatic import licensing procedures are not used in such a manner as to restrict trade; and that non-automatic import licensing procedures (licensing for the purposes of implementation of quantitative or other restrictions) do not act as additional restrictions on imports over and above those which the licensing system administers, and are not more administratively burdensome than absolutely necessary to administer the relevant measures. By becoming Members of the WTO, governments commit themselves to simplifying and bringing transparency to their import licensing procedures and to administering them in a neutral and non-discriminatory manner.

The obligations contained in the Agreement include publication of import licensing procedures, notification, fair and equitable application and administration, simplification of procedures and the provision of foreign exchange to pay for licensed imports. The Agreement sets up time limits for the processing of licence applications, the publication of information concerning licensing procedures and notification to the Committee.

Developing-country Members which were not signatories to the Tokyo Round Agreement on Import Licensing Procedures have the possibility of delaying the application of certain provisions linked to automatic import licensing for a period of up to two years from the date of WTO membership.

The Committee on Import Licensing affords Members the opportunity of consulting on matters relating to the operation of the Agreement or the furtherance of its objectives, and reviews periodically the implementation and operation of the Agreement. It holds two regular meetings each year.

During the period from 1 August 1997 to 31 July 1998, 18 Members (counting the EC as a single Member) have notified to the Committee on Import Licensing their laws and regulations pursuant to Articles 1.4(a) and 8.2(b) of the Agreement; 24 have submitted replies to the Questionnaire on Import Licensing Procedures pursuant to Article 7.3; and seven have submitted notifications relating to the institution of import licensing procedures or changes in those procedures pursuant to Article 5.

The Committee held two meetings during the period under review, and reviewed notifications submitted by the following Members under various provisions of the Agreement: Argentina, Australia, Bahrain, Bolivia, Canada, Chile, European Communities, Fiji, Gambia, Haiti, Hong Kong (China), Hungary, India, Japan, Kenya, Korea, Liechtenstein, Madagascar, Mali, Malaysia, Morocco, New Zealand, Niger, Nigeria, Norway, Papua New Guinea, Poland, Qatar, Singapore, Slovenia, South Africa, Switzerland and Uganda.

## Rules of origin

The aim of the Agreement on Rules of Origin is to harmonize non-preferential rules of origin and to ensure that such rules do not themselves create unnecessary obstacles to

trade. The Agreement sets out a three-year work programme (HWP or Harmonization Work Programme) for the harmonization of non-preferential rules of origin to be accomplished by the Committee on Rules of Origin (CRO) in conjunction with the World Customs Organization's Technical Committee on Rules of Origin (TCRO).

Until the completion of the HWP, Members are expected to ensure that their rules of origin are transparent; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard, i.e. that they are based on what does confer origin rather than what does not confer origin.

Members were required to notify, within 90 days after joining the WTO, their rules of origin, and all judicial decisions and administrative rulings of general application which relate to rules of origin and which were in effect at that time.

The Agreement on Rules of Origin contains an Annex II (Common Declaration with regard to preferential rules of origin) by which the general principles and requirements applied to non-preferential rules of origin as contained in the Agreement apply also to preferential rules of origin. These requirements include notification procedures. There is no work programme for the harmonization of preferential rules of origin.

The Harmonization Work Programme was launched in July 1995 by the Committee on Rules of Origin and was scheduled for completion by July 1998. The HWP is divided into four phases:

- (i) Definitions of Goods Wholly Obtained, and Minimal Operations or Processes;
- (ii) Substantial Transformation – Change in Tariff Classification;
- (iii) Substantial Transformation – Supplementary Criteria (ad valorem percentage and/or manufacturing or processing operations); and
- (iv) Final fine-tuning of the results of the work in terms of their overall coherence.

Much work was done in the CRO and the TCRO and substantial progress has been achieved with regard to the various phases of the HWP in the three years foreseen in the Agreement for the completion of the work. However, in May 1998, the CRO concluded that in light of the complexity of the issues and the remaining heavy workload, the HWP could not be finalized within the foreseen deadline. The CRO also decided to make a report to the Council for Trade in Goods (CTG) giving an overview of the status of work in the HWP and making recommendations for the continuation of work. The recommendations and proposals, contained in the report of the CRO (G/RO/25), included a commitment by Members to make their best endeavours to complete the HWP by November 1999, a definite deadline (May 1999) for the completion of the technical work by the TCRO in Brussels, and provision for a review of the status of work by the CRO in June 1999 with a view to setting a final deadline for the completion of the HWP as a whole. In July 1998, the recommendations and proposals of the CRO were approved by the CTG and thereafter adopted by the General Council.

## Customs valuation

The WTO Agreement on Implementation of Article VII of the GATT 1994, known as the Customs Valuation Agreement, entered into force on 1 January 1995. Originally, the Customs Valuation Agreement was one of the Tokyo Round Codes which resulted from the Tokyo Round negotiations. The Tokyo Round Code sought to replace the many different national valuation systems in existence at the time with a set of straightforward rules which provide a fair, uniform and neutral system and preclude the use of arbitrary or fictitious values. The Agreement gave greater precision to the provisions on customs valuation already found in Article VII of the GATT and has led to the harmonization of valuation systems and greater predictability in duties payable by traders.

The WTO Customs Valuation Agreement and the Tokyo Round Customs Valuation Agreement do not differ in a substantive manner.

Members are to ensure that their laws, regulations and administrative procedures conform with the provisions of the Agreement, and are required to inform the Committee on Customs Valuation of any changes in this regard. Such notifications are subject to examination in the Committee. Developing-country Members are allowed to delay the application of the provisions of the Agreement for five years from the date of their accession to the WTO.

During 1997, the Committee held two meetings. At its meeting in April 1997, the Committee concluded its examination of the modifications to national legislations of Fiji, Bulgaria and Liechtenstein. The Committee continued examination of the legislations of Mexico and of India and was informed that one Member, Argentina, had submitted a communication indicating that its legislation notified under the Tokyo Round Customs Valuation Agreement remained valid under the WTO Customs Valuation Agreement.

At its meeting in October 1997, the Committee continued examination of the legislations of Mexico and India and initiated examination of the legislation of Singapore. The Committee

noted that 51 developing countries had evoked the five-year delay period provided in Article 20.1, and that 28 of these countries would have to apply the Agreement by 1 January 2000 and another 20 by the end of the year 2000. It was noted that the transition period, during which developing countries should prepare for implementation, was half over, and these countries were urged to begin transitional procedures to implement the Agreement. The Committee also adopted its report to the Council for Trade in Goods and its Third Annual Review of the Implementation and Operation of the Customs Valuation Agreement.

During 1997, the subject of technical assistance aimed at helping countries in their preparations for the application of the Agreement has continued to be a matter of high priority to Members, to the Committee on Customs Valuation and to the Technical Committee. A proposal by the United States on an increased role for the Committee in such activities prompted three informal meetings of the Committee in 1997. It was agreed at the October meeting that the Committee would discuss, in a systematic and formal manner, technical assistance with a view to contributing towards streamlining and tailoring technical assistance to the particular needs of each developing country. Such discussions would ensue in the formal meetings of the Committee as well as in informal meetings held as and when appropriate in the interim. A Chairman's request for information concerning the implementation of the Agreement was circulated to Members.

Article 18 of the Agreement established a WTO Technical Committee, under the auspices of the World Customs Organization (WCO), to promote at the technical level uniformity in interpretation and application of the Agreement. The Technical Committee presented reports on its Fourth (3-7 March 1997) and Fifth (6-10 October 1997) Sessions.

## Preshipment inspection

This Agreement concerns the practice of employing specialized private companies to check shipment details – essentially price, quantity and quality – of goods, ordered overseas. The Agreement on Preshipment Inspection came into force in January 1995 for all WTO Members. The Agreement applies to all pre-shipment inspection activities carried out on the territory of WTO Members, whether such activities are contracted or mandated by the government, or any government body, of a Member. Approximately 40 governments employ PSI companies, which are contracted to examine and report on the quantity, quality and unit prices of export goods prior to shipment. Of these, 35 are Members of the WTO. Generally the inspection activities are carried out in the country of export by company officials hired by the country of import. Contracts vary as to product coverage and emphasis but are generally intended to control, or aid in the control of, any or all of the following practices: i) over-invoicing of imports; ii) under-invoicing of imports; iii) misclassification of imports; iv) under-collection of taxes due on imports; and v) misappropriation of donor funds provided for import support. Additional services may include verification of origin, monitoring of compliance with national regulations, monitoring and control of tariff exemptions, assistance in the establishment of customs valuation data, trade facilitation, and some consumer protection.

Most provisions of the Agreement contain obligations for user Members, who are expected to ensure fulfilment of the obligations through their contractual arrangements with the inspection agencies. These obligations include non-discrimination, transparency, protection of confidential business information, avoidance of unreasonable delay, the use of specific guidelines for conducting price verification and the avoidance of conflicts of interest by PSI agencies. The obligations of exporting Members towards PSI users include non-discrimination in the application of domestic laws and regulations and the provision of technical assistance where requested. Article 5 of the Agreement provides for notification of laws and regulations by which Members put the Agreement into force as well as of any other laws and regulations relating to PSI. From July 1996 through June 1997, 19 Members notified their current laws and/or regulations, 27 Members reported that they had no laws and/or regulations relating to PSI, and one Member notified changes to its legislation.

In December 1995, the General Council adopted the Agreement Establishing the Independent Entity (IE) as foreseen in Article 4 of the Agreement, which calls for an independent review procedure to resolve disputes between an exporter and a preshipment inspection (PSI) agency. The IE is jointly constituted by the International Chamber of Commerce (ICC), the International Federation of Inspection Agencies (IFIA), and the WTO, and is to be administered by the WTO. At its meeting of December 1995, the General Council also adopted the rules of procedures for the IE and agreed that a moratorium on the acceptance of review applications would be put in place until the ICC and the IFIA confirmed that all administrative and procedural requirements necessary to make the IE operational were completed. In April confirmation was received and the IE became operational on 1 May 1996. A List of Experts to serve as panelists for the reviews was also circulated to Members, affiliates and contacts around the world. As of July 1998, no application for a case had been received.

The WTO's General Council, at its meeting of 7, 8 and 13 November 1996 agreed to the establishment of a Working Party on Preshipment Inspection with a mandate to conduct the review of the Agreement provided for under Article 6 of the Agreement. It is to report to the General Council through the Council for Trade in Goods in December 1997. The Working Party held four formal meetings during 1997. It presented its report to the General Council in December 1997 where it was adopted. The report, *GL/214*, explains the process of work and contains 9 of the Working Party's recommendations designed to enhance implementation of the Agreement. Of particular interest, one recommendation extended the life of the Working Party for one year to exchange views on a Code of Conduct/Practice for PSI entities; a standard inspection format; selective examination of shipments; auditing of PSI entities; the promotion of competition among PSI entities; fee structures for PSI entities; and the use, to user Members, of building price data bases. The Working Party has held two formal meetings and two informal meeting through July 1998. At the second informal meeting, the Working Party heard presentations from the IFIA, the ICC and the World Customs Organization on their experience with PSI.

## Trade-related investment measures

Article 2 of the Agreement on Trade-Related Investment Measures prohibits the use of any trade-related investment measure (TRIM) that is inconsistent with Article III (national treatment on international taxation and regulation) or Article XI (general elimination of quantitative restrictions) of GATT 1994. An annex to the Agreement lists example measures inconsistent with Articles III.4 and XI.1 of GATT 1994. This prohibition is subject to the exceptions permitted under GATT 1994, including safeguard clauses allowing developing countries to take measures to deal with balance-of-payments problems.

Article 5.1 of the Agreement requires that Members notify any measure that is incompatible with the Agreement not later than 90 days after the entry into force of the WTO Agreement. Article 5.2 gives the benefit of a transition period for the elimination of measures notified under Article 5.1 – within two years after the date of entry into force of the WTO Agreement in the case of developed-country Members, five years in the case of developing country Members and seven years in the case of the least-developed-country Members (provided however that the measures had been introduced not less than 180 days before the entry into force of the WTO Agreement). A decision adopted by the WTO General Council in April 1995 on the application of Article 5.1 to governments that joined the WTO after 1 January 1995 provides that they shall have a period of 90 days after the date of their acceptance of the WTO Agreement to make the notifications foreseen in Article 5.1. The period for the elimination of measures notified under Article 5.1 continues to be governed by reference to the date of entry into force of the WTO Agreement itself.

As of 31 July 1998, notifications of measures under Article 5.1 had been received from Argentina, Barbados, Bolivia, Chile, Colombia, Costa Rica, Cuba, Cyprus, the Dominican Republic, Ecuador, Egypt, Indonesia, India, Mexico, Malaysia, Nigeria, Pakistan, Peru, Philippines, Poland, Romania, Thailand, Uganda, Uruguay, Venezuela and South Africa. At the meetings of the Committee on Trade-Related Investment Measures held in September 1997 and March 1998, questions were raised and comments made on some of these notifications. Several measures that have recently been adopted or announced by some Members in the automotive sector have attracted particular attention. Some Members have expressed interest in receiving information on steps taken by Members which have made notifications under Article 5.1 to ensure the elimination of the notified measures by the end of the transition period provided for in Article 5.2.

Article 5.5 of the Agreement deals with the conditions under which, during the transition periods of Article 5.2, a TRIM notified under Article 5.1 may be applied to new investments. A standard format for notifications of measures under this provision had been adopted by the Committee in 1995. So far, no Member has notified such measures to the Committee.

Article 6.2 of the Agreement requires notification of publications in which TRIMs may be found. In September 1996, the Committee adopted a procedure for the implementation of this provision. As of 31 July 1998, information under this procedure had been provided by: Argentina; Australia; Brunei Darussalam; Bulgaria; Chile; Costa Rica; Cuba; the European Community; Fiji; Hong Kong, China; Iceland; India; Indonesia; Israel; Jamaica; Japan; Liechtenstein; Mauritius; Nicaragua; Norway; Paraguay; Peru; Philippines; Romania; Singapore; Switzerland; Thailand; Tunisia; Uganda; United States; Uruguay and Venezuela.

## Working Group on Notification Obligations and Procedures

Under the Ministerial Decision on Notification Procedures, which was adopted by the General Council on 31 January 1995, the Council for Trade in Goods (CTG) established a Working Group on Notification Obligations and Procedures on 20 February 1995 to arrive at

recommendations to the CTG on means to simplify and standardize these notifications and to improve compliance and transparency.

Through the examination of notification processes in 1995 and 1996, the Group was able to identify certain potential problem areas which were developed into recommendations for consideration by the CTG. In addition, to assist developing countries in meeting their notification obligations, the Group developed a practical handbook providing detailed guidance on requirements and preparation of notifications. A number of ideas were also brought forward concerning the question of compliance with notification obligations. The Group submitted its report and recommendations to the CTG in October 1996.

In early 1997, the CTG considered two of the Working Group's recommendations and decided: (a) to maintain in force the notification obligations relating to the GATT CONTRACTING PARTIES Resolution on Liquidation of Strategic Stocks in view of the potentially useful consultative provisions it contains; and (b) to keep under consideration the recommendation that general guidelines be prepared for the regular review of questionnaires and formats for the bodies under the Council's purview and to consider at the appropriate time as to how to proceed further.

In February 1998, the General Council considered two recommendations of the Working Party sent to it by the CTG. The General Council: (a) adopted a decision to eliminate the notification obligation in a Decision of the CONTRACTING PARTIES relating to import licensing; and (b) decided to keep under review the recommendation to establish a body with a mandate to review the notification obligations and procedures throughout the WTO Agreement and to revert to it at an appropriate time.

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## V. Trade in services

The Council for Trade in Services held nine formal meetings during the period 1 August 1997-31 July 1998. Reports of the meetings are contained in documents S/C/M/21-29.

### Conclusion of the negotiations on financial services

At a meeting held on 12 December 1997 the Council took note of the results of the negotiations on financial services which were annexed to the Fifth Protocol to the General Agreement on Trade in Services. Those results consisted of 57 Schedules of improved commitments representing 70 WTO Members as well as 16 Lists of MFN Exemptions. At its meeting on 26 February 1998, the Council concluded the technical verification of these Schedules and Lists of Exemptions and announced the Fifth Protocol open for acceptance as of 27 February 1998.

### Entry into force of the Fourth Protocol

The Fourth Protocol to the General Agreement on Trade in Services relating to Basic Telecommunications stipulated that it would enter into force upon acceptance by all Members concerned (i.e. those who have annexed commitments to the Protocol). The Protocol had been open for acceptance by Members concerned until 30 November 1997. By that date only 50 out of 70 Members had accepted the Protocol. In this case, according to the terms of the Protocol, it was up to those Members who had accepted to decide on its entry into force. In accordance with their decision, the Protocol entered into force on 5 February 1998. Those Members concerned had also requested the Council to extend the deadline for accepting the Protocol. In response to that request the Council adopted a Decision on 19 December 1997 to extend the deadline until 31 July 1998. Until that date there are still 9 Members that have not yet completed their acceptance procedures.

### Extension of the deadline for negotiations on emergency safeguard measures

Upon a recommendation from the Chairperson of the Working Party on GATS Rules, the Council adopted a Decision on 26 November to extend the negotiations on the question of emergency safeguard measures until 30 June 1999.

### Notifications to the council pursuant to Article III:3

At its meeting on 26 February 1998, the Council has received and taken note of the following notifications pursuant to paragraph 3 of Article III of the GATS concerning

modifications to laws and regulations in services sectors where specific commitments had been undertaken.

- Communication from Uruguay (S/C/N/54);
- Communication from Poland (S/C/N/56);
- Communication from Poland (S/C/N/57);
- Communication from Japan (S/C/N/58);
- Communication from Japan (S/C/N/59);
- Communication from Japan (S/C/N/60);
- Communication from Japan (S/C/N/61);
- Communication from Japan (S/C/N/62);
- Communication from Norway (S/C/N/63);
- Communication from Norway (S/C/N/64).

## Notifications to the Council pursuant to Article V:7

At its meeting on 26 November 1997, the Council has received and taken note of the following notifications pursuant to paragraph 7 of Article V of the GATS concerning economic integration agreements.

- Communication from the European Communities and their member States and Bulgaria concerning the Europe Agreement (S/C/N/55);
- Communication from Canada and Chile concerning a Free-trade area Agreement (S/C/N/65);
- Communication from Australia and New Zealand concerning recognition measures under the Protocol on Trade in Services to the ANZCERTA Agreement (S/C/N/66).

## Notifications to the Council Pursuant to Article VII:4

At its meeting on 26 February 1998, the Council has received and taken note of the following notifications pursuant to paragraph 4 of Article VII of the GATS concerning recognition measures and arrangements.

- Communication from the European Communities and their member States (S/C/N/43);
- Communication from Venezuela (S/C/N/44);
- Communication from Venezuela (S/C/N/45);
- Communication from Venezuela (S/C/N/46);
- Communication from Venezuela (S/C/N/47).

## Cooperation between the International Telecommunication Union and WTO

At its meeting on 26 November 1997 the Council received a request from the International Telecommunications Union (ITU) to conclude a cooperation agreement with the WTO. It was noted that, according to WTO rules, a decision on such an agreement could only be taken by Members at the level of the General Council. The initial reaction of Members of the Council was in favour of concluding a cooperation agreement in some form. On the basis of subsequent discussions in the Council, the WTO Secretariat was mandated to engage in consultations with the ITU Secretariat on a possible cooperation agreement. By way of guidance, Members of the Council indicated that such an agreement should cover primarily matters relating to technical cooperation and exchange of information between the two organizations. The WTO Secretariat will be reporting to the Council on its consultations with the ITU Secretariat.

## Submissions of schedules of commitments in basic telecommunications

The Decision on Commitments in Basic Telecommunications (S/L/19) stipulates in paragraph 6 that Members which have not annexed to the Fourth Protocol Schedules of Commitments or Lists of Exemptions from Article II in Basic Telecommunications could submit them for approval by the Council prior to 1 January 1998. In accordance with this provision, the Council received and approved Schedules of commitments in basic telecommunications from Suriname (S/C/W/29), Cyprus (S/C/W/34) and Barbados (S/C/W/35).

## The exchange of information programme

As part of the work programme of the Council which had been endorsed by the Ministerial Conference in Singapore, Members of the Council have engaged in an

information-exchange exercise. As part of this exercise the Council started a series of sectoral discussions focusing on the manner in which different services are traded and regulated. The purpose of such discussions is to enable Members to identify negotiating issues and priorities. It was agreed that, in principle, sectors will be taken up in the order in which they appear in the services Sectoral Classification List (MTN.GNS/W/120). However, it was agreed that certain sectors which were the subject of recent negotiations such as financial services, basic telecommunications, maritime transport and accountancy would be deferred until later in the process. It was also agreed that the Secretariat would provide background papers on each of the sectors to be discussed. So far, the exercise has covered Postal and Courier Services, Audiovisual Services, Construction and Engineering Services, Distribution Services, Legal Services, Architecture and Engineering Services, Computer and Related Services, Environmental Services and Advertising Services.

## Financial services

At the end of the Uruguay Round negotiations in December 1993, negotiations on financial services, along with those on basic telecommunications and maritime transport, remained unfinished. Specific commitments to provide market access and national treatment were made in the sector, but they were not considered enough to conclude the negotiations. Broad MFN exemptions (exemptions to the principle of MFN (most-favoured-nation) treatment) based on reciprocity remained. The Second Annex on Financial Services to the General Agreement on Trade in Services (GATS) and the Ministerial Decision on Financial Services adopted at the end of the Round provided for extended negotiations in this sector. The negotiations were to be held during a six-month period following the entry into force of the GATS; i.e. until the end of June 1995. At the conclusion of this period, Members of the WTO would have the possibility to improve, modify or withdraw all or part of their commitments and to introduce additional MFN exemptions. Negotiations on this basis started shortly after the Marrakesh meeting.

The negotiations in 1995 were concluded on 28 July 1995. The agreement was called the "interim" agreement, since negotiators again decided that the results of the negotiations were not satisfactory and envisaged further negotiations in two-years' time; i.e. in 1997. As a result of the 1995 negotiations, 29 WTO Members (counting the EU as one) improved their schedules of specific commitments and/or removed, suspended or reduced the scope of their MFN exemption in financial services. Those improved commitments were annexed to the Second Protocol to the GATS. Three other countries – Colombia, Mauritius and the United States – decided not to improve their commitments, and took broad MFN exemptions based on reciprocity. As a result, the United States took no commitments on new establishment or new activities of foreign financial services suppliers, in insurance as well as in banking, securities and other financial services. With the conclusion of those negotiations, and with new accessions to the WTO, 97 Members of the WTO (counting EU member States individually) had commitments in financial services by mid-1997 in the area of financial services, compared to 76 at the end of the Round. The Second Protocol and the commitments annexed to it entered into force on 1 September 1996 except for a small number of countries which were unable to complete their internal ratification procedures and formally accept the Protocol before 1 July 1996. For those remaining countries, the commitments entered into force 30 days after acceptance.

In accordance with the decision made in 1995, negotiations on financial services were reopened in April 1997. Members again had an opportunity to improve, modify or withdraw their commitments in financial services and to take MFN exemptions in the sector from 1 November until 12 December 1997. As a result of those negotiations, a new and improved set of commitments in financial services under the GATS was agreed on 12 December 1997. A total of 56 schedules of commitments representing 70 WTO Members and 16 lists of MFN exemptions<sup>4</sup> were annexed to the Fifth Protocol to the GATS, which is open for ratification and acceptance by Members until 29 January 1999. The Protocol, along with the new commitments annexed to it, will enter into force on the 30<sup>th</sup> day following the date of its acceptance by all Members concerned.<sup>5</sup> With five countries making commitments in financial services for the first time, the total number of WTO Members with commitments in financial services will increase to 102 upon the entry into force of the Protocol.

As a result of the most recent negotiations, the United States, India and Thailand decided to withdraw their broad MFN exemptions based on reciprocity; only a small number of countries submitted limited MFN exemptions or maintained existing broad MFN exemptions. Several countries, including Hungary, Mauritius, the Philippines and Venezuela reduced the scope of their MFN exemptions. The United States submitted a limited MFN exemption in insurance, applicable in a circumstance of forced divestiture of US ownership in insurance service providers operating in WTO Member countries. The new commitments contain inter alia significant improvements allowing commercial presence of foreign financial service

<sup>4</sup>The 70 WTO Members with new schedules are: Australia; Bahrain; Bolivia; Brazil; Bulgaria; Canada; Chile; Colombia; Costa Rica; Cyprus; Czech Republic; the Dominican Republic; Ecuador; Egypt; El Salvador; the European Communities (15 Member States); Ghana; Honduras; Hong Kong, China; Hungary; Iceland; India; Indonesia; Israel; Jamaica; Japan; Kenya; Korea; Kuwait; Macau; Malaysia; Malta; Mauritius; Mexico; New Zealand; Nicaragua; Nigeria; Norway; Pakistan; Peru; Philippines; Poland; Romania; Senegal; Singapore; Slovak Republic; Slovenia; South Africa; Sri Lanka; Switzerland; Thailand; Tunisia; Turkey; the United States; Uruguay; and Venezuela. The 16 MFN exemption lists were submitted by Australia, Canada, Honduras, Hungary, India, Mauritius, Nicaragua, Pakistan, Peru, Philippines, Senegal, Switzerland, Thailand, Turkey, the United States, and Venezuela.

<sup>5</sup>As of 20 July 1998, seven Members (Bahrain; Chile; Hong Kong, China; Israel; Japan; Peru; and Singapore) have accepted the Protocol. Brazil has accepted subject to ratification.



suppliers by eliminating or relaxing limitations on foreign ownership of local financial institutions, limitations on the juridical form of commercial presence (branches, subsidiaries, agencies, representative offices, etc.) and limitations on the expansion of existing operations. Important progress was also made in "grandfathering" existing branches and subsidiaries of foreign financial institutions which are wholly – or majority-owned by foreigners. Improvements were made in all of the three major financial service sectors – banking, securities and insurance, as well as in other services such as asset management and provision and transfer of financial information.

In a decision taken at the end of the negotiations in December 1997 (Decision Adopting the Fifth Protocol to the General Agreement on Trade in Services), Members concerned have undertaken not to take measures which would be inconsistent with their commitments resulting from those negotiations. The Committee on Trade in Financial Services will monitor the acceptance of the Protocol by Members concerned and examine any concerns raised by Members regarding the application of this undertaking.

## GATS rules

The Working Party on GATS Rules held five formal meetings between August 1997 and July 1998. In each meeting, the Working Party considered all three negotiating mandates: emergency safeguard measures under Article X, government procurement under Article XIII and subsidies under Article XV.

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### **Negotiations on emergency safeguard measures under Article X of the GATS**

Differing views have been expressed by Members with regard to the desirability of developing an emergency safeguard mechanism under the GATS. Substantive discussions are continuing on the subject without prejudging the position of any delegation in respect of the desirability, feasibility or form of any possible emergency safeguard mechanism.

In recent meetings, the Working Party has focused on four key questions identified by the Chairperson in an informal note (dated 3 June 1997): (i) On whose behalf would emergency safeguard action be taken? (ii) In what circumstances would emergency safeguard action be taken and what would be the purpose of such action? (iii) What approach should be adopted in respect of injury/adverse effects, and the relevant causal link between injury/adverse effects and commitments under the GATS? (iv) What measures would be taken under the emergency safeguard mechanism? Are some measures deemed more suitable than others? Some Members made written submissions stating their positions on these questions (circulated as documents S/WPGR/W/22 and 23). At the request of Members, the Secretariat prepared a note which focused on the second question, and contained hypothetical examples of situations in which emergency safeguard action may be taken (circulated as S/WPGR/W/24). One Member made a submission suggesting some broad principles that might be included as part of any safeguard mechanism (circulated as S/WPGR/W/26).

Since Members recognized that there still remained many points to be considered in order to conclude this negotiation, they decided to propose to the Council for Trade in Services to extend the deadline for conclusion of negotiations until the end of June 1999.

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### **Negotiations on government procurement under Article XIII of GATS**

Progress was made in the information gathering exercise on national procurement regimes. The 21 responses received so far to the questionnaire on national procurement regimes were circulated as addenda to document S/WPGR/W/11. The Secretariat prepared a synthesis of the first 19 responses to the questionnaire (issued as document S/WPGR/W/20). The information gathering exercise has provided a basis for negotiations on disciplines. An indicative tabulation relating questionnaire responses to possible elements of multilateral disciplines was presented in a Chair's note (dated 21 February 1997) and has formed the basis for the commencement of a structured consideration of these elements. In recent meetings, discussion has focused on the scope and coverage of any disciplines on government procurement. The need to coordinate work with the Working Group on Transparency in Government Procurement has been emphasized by several delegations.

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### **Negotiations on subsidies under Article XV of GATS**

Only two responses have been received so far to the questionnaire approved by the Working Party to facilitate the information exchange on subsidies related to trade in services mandated by Article XV (circulated as documents S/WPGR/W/16/Add.1 and Add.2). Some delegations also expressed the need to continue the technical analysis of subsidies related to trade in services. To this end the Secretariat prepared a note presenting information on the subject contained in WTO Trade Policy Reviews (circulated as S/WPGR/W/25). Discussion on

the conceptual and legal issues is continuing even as efforts are being made to advance the information exchange.

## Professional services

The Working Party on Professional Services (WPPS) met regularly between August 1997 and July 1998. The work focused almost exclusively on the development of disciplines on domestic regulation for the Accountancy sector, as mandated by Article VI:4 of the GATS and by the Decision on Professional Services of 1 March 1995. The text of the disciplines was finalized at the end of July 1998, after more than one year of work by the WPPS. By the end of July Members also reached consensus on the legal nature of the disciplines, which shall constitute binding rules and not voluntary guidelines. The only outstanding issue, to be taken up in the after the summer break, concerned the legal form the disciplines should take. Members discussed the following three options: (1) an Annex to the GATS; (2) a reference paper to be incorporated by Members in their Schedule as additional commitments under Article XVIII of the GATS; (3) a Decision by the Council for Trade in Services, adopting the text of the disciplines (but not requiring immediate entry into force) and containing a political standstill not to take measures inconsistent with the disciplines, until entry into force takes place together with other disciplines applicable to other sectors to be developed at a later stage.

The discussion in the WPPS on the Accountancy Disciplines touched upon several issues affecting the legal structure of the GATS. The Working Party discussed at length the relationship between measures falling on the one hand within the scope of Articles XVI (Market Access) and XVII (National Treatment) and on the other hand within the scope of Article VI:4 (Domestic Regulation). A consensus emerged that the Disciplines should apply only to non-discriminatory measures falling out of the scope of Articles XVI and XVII. All remaining Market Access and National Treatment barriers should be dealt with in specific commitments negotiations.

At its next meeting in the fall the WPPS is expected to conclude its work on the Accountancy disciplines and to agree on its future activities. Options on future activities include: (1) the development of disciplines specific to another professional services sector; (2) the development of horizontal disciplines applicable to all professional services sector.

## Committee on Specific Commitments

The Committee on Specific Commitments has held two formal meetings during the period under review. Informal consultations on the finalization of the procedures for the implementation of GATS Article XXI (Modification of Schedules) have also been conducted by the Chairman of the Committee, with a view to their completion before the end of 1998. The formal discussions of the Committee focused on three items: classification issues, the institution of a system of electronically consolidated and updated schedules and the possible revision of the scheduling guidelines.

As far as classification issues are concerned the activities of the Committee were threefold. First the Committee examined the structure of the ongoing revision of the Central Products Classification, which is the nomenclature established by the UN Statistical Commission, in order to appreciate its possible relevance for the Committee's future work. The Secretariat produced detailed structural and qualitative studies of the changes brought about by the revised CPC in a number of service sectors. On this basis the Committee concluded that a global conversion to this new classification would be inappropriate but that the new classification could help to resolve the individual problems of classification which may be identified by delegations in the future. Secondly the Committee considered examples of sectors in which ad hoc systems of classification created specially by the Members of the GATS have been used, as in maritime services and basic telecommunications. Thirdly the Committee began discussion of the question of the definition and treatment of new services.

The Committee approved in principle the establishment of a system of electronically consolidated and updated schedules of commitments. It was agreed that these electronic schedules would not have legal status, since their format would differ from the treaty copies, though their substantive content would be the same. The Committee also considered the calendar, budget, format, circulation, prices and verification procedure applicable to this project.

The Committee also considered the possible need to review the scheduling guidelines and examined several contributions by Members on this topic. The Chairman invited delegations to come forward with issues and questions they might wish to raise in this regard.

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## VI. Trade-related aspects of intellectual property rights (TRIPS)

The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights, the so-called TRIPS Agreement, is based on a recognition that increasingly the value of goods and services entering into international trade resides in the know-how and creativity incorporated into them. The TRIPS Agreement provides for minimum international standards of protection for such know-how and creativity in the areas of copyright and related rights, trademarks, geographical indications, industrial designs, patents, layout-designs of integrated circuits and undisclosed information. It also contains provisions aimed at the effective enforcement of such intellectual property rights, and provides for multilateral dispute settlement. It gives all WTO Members transitional periods so that they can meet their obligations under it. Developed country Members have had to comply with all of the provisions of the Agreement since 1 January 1996. For developing countries, the general transitional period is five years (i.e. until 1 January 2000), and for least-developed countries, the transitional period is 11 years (i.e. until 1 January 2006).

Developed country Members were obliged to notify their implementing legislation to the Council for TRIPS in the beginning of 1996. Given the difficulty of examining legislation relevant to many of the enforcement obligations in the Agreement, Members have undertaken, in addition to notifying legislative texts, to provide information on how they are meeting these obligations by responding to a checklist of questions. This information is being used as the basis for reviews of implementing legislation carried out by the Council. It started the reviews in July 1996 with an examination of the legislation of developed country Members in the area of copyright and related rights. It continued in November 1996 with the legislation in the areas of trademarks, geographical indications and industrial designs; in May 1997 with the legislation in the areas of patents, layout-designs of integrated circuits, undisclosed information and the control of anti-competitive practices in contractual licences; and in November 1997 with the legislation in the area of enforcement. It continued these reviews at its meetings in 1998 with regard to Members that had joined the review exercise late or whose review had otherwise not yet been completed. As for 1998 and 1999, the Chair is consulting with other individual Members about the possibility of taking up for advance review their legislation without prejudice to their entitlement to transition periods so as to avoid a "bunching" of countries to be reviewed in the year 2000, when the Agreement will become fully applicable to developing countries.

The national and MFN treatment obligations of the TRIPS Agreement became applicable to all Members from 1 January 1996, including those Members that avail themselves of the transitional periods provided in the Agreement. The Council for TRIPS, recognizing that Members have a number of options for meeting their obligation to notify the corresponding laws and regulations, made arrangements to facilitate the notification of the implementation of these obligations. During the period covered by the report, the Council has continued its consideration of the notifications concerning the implementation of the so-called "mail-box" and exclusive marketing rights provisions of Articles 70.8 and 70.9, which came into effect on 1 January 1995 for countries which do not yet provide product patent protection for pharmaceuticals and/or agricultural chemicals.

Other notifications in the TRIPS area include those to invoke exceptions to the MFN treatment obligation based on advantages deriving from pre-existing agreements, those of contact points established in administrations for the purposes of cooperating with each other with a view to eliminating international trade in infringing goods, and those under provisions of intellectual property conventions incorporated by reference into the TRIPS Agreement. The Council has considered the criteria that might be relevant to deciding whether a notification invoking an exception to the MFN obligation should be made, and, in this respect, took note of the existence of an informal Secretariat note, the last paragraph of which was intended as an informal guideline to assist individual Member States in making or reviewing such notifications, and had a further exchange of views on the matter at its meeting in September 1997. Having received the first notifications under the Appendix to the Berne Convention as incorporated by reference into the TRIPS Agreement, the Council considered, at its meeting in July 1998, how the renewable periods of 10 years for which such notifications remain valid should be calculated.

As noted elsewhere in this report, four new issues of alleged non-compliance with the TRIPS obligations were the subject of an invocation of the dispute settlement procedure. Of the 14 disputes that have been initiated in the TRIPS area, four have been settled through a mutually agreed solution. They concerned the protection of existing patents, the protection of past performances and existing sound recordings, and the implementation of the "mail-box" and exclusive marketing rights provisions on pharmaceutical and agricultural chemical products. Three panels have been established to date to deal with TRIPS disputes. The first TRIPS panel was established in November 1996 to examine another dispute concerning the

implementation of the "mailbox" and exclusive marketing rights provisions. The report of this panel, which was issued in September 1997, was appealed and, together with the Appellate Body report, which modified the panel report to some extent, adopted by the DSB in January 1998. The measures that were at issue in this dispute are also the subject of a second panel, established in October 1997, the report of which is expected to be issued in August 1998. Another panel was established in September 1997 to examine the consistency of certain trademark measures with the national treatment provisions of and the transitional arrangements under the TRIPS Agreement. The report of this panel was issued, and adopted by the DSB, in July 1998. The pending consultations concern certain measures affecting the grant of copyright and related rights, measures affecting the enforcement of intellectual property rights, and certain provisions concerning patent protection of pharmaceutical products.

The Council has afforded Members the opportunity of consulting on a number of other matters related to TRIPS, including revocation of patents, priority rights and the protection of geographical indications.

Technical cooperation has been a prominent issue in the TRIPS Council. Article 67 of the Agreement obliges each developed-country Member to provide, on request and on mutually agreed terms, technical and financial cooperation in favour of developing and least-developed Member countries. In order to ensure that information on available assistance is readily accessible and to facilitate the monitoring of compliance with the obligation of Article 67, developed-country Members have agreed to present descriptions of their relevant technical and financial cooperation programmes and to update this annually. For the sake of transparency, inter-governmental organization observers to the TRIPS Council have also presented, on the invitation of the Council, information on their activities. In addition, the WTO Secretariat has provided information on its technical cooperation in the TRIPS area. In 1997, the information was updated in time for the Council's meeting in September, which had a special focus on technical cooperation. The Council agreed at its meeting in May 1998 that in 1998 the information should be updated in time for its meeting in September 1998. The regular discussion in the Council on the basis of this material provides an opportunity for developing-countries to identify their needs, in particular any gaps in the assistance available. Developed-country Members have also notified contact points in their administrations which can be addressed by developing countries seeking technical cooperation on TRIPS. In addition, the Secretariat organized, jointly with the International Bureau of the World Intellectual Property Organization (WIPO), three workshops on specific aspects of technical cooperation, which enabled an exchange of views on technical cooperation needs and experiences related to the implementation of the TRIPS Agreement.

The Secretariat has cooperated with a number of other intergovernmental organizations, notably with WIPO. The arrangements for the cooperation with WIPO are established in the Agreement between WIPO and the WTO, which entered into force on 1 January 1996. It provides for cooperation in three areas: first, the notification and translation of, and access to, laws and regulations; second, the implementation of the provisions of Article 6ter of the Paris Convention (relating to the protection of national emblems) for the purposes of the TRIPS Agreement; and, third, the provision of legal technical assistance and technical cooperation by the two secretariats. In July 1998, the Council was informed that the WTO Secretariat had been working with its colleagues in WIPO on how to enhance their existing cooperation in the field of technical cooperation based on the Agreement entered into between the two organizations on 1 January 1996. This was being done particularly in the light of the imminence of the end of the general transitional period for developing countries on 1 January 2000 and the need to be as efficient as possible in making available technical cooperation in the intervening period so as to maximize the assistance that they were in a position to provide. Under a joint initiative that the WTO Secretariat had agreed with WIPO to this effect, the directors-general of the two organizations have sent letters to Ministers of each of the countries concerned, underscoring the commitment of the two organizations to do all within their capacity to provide, on request, technical assistance, drawing attention to the key requirements of the TRIPS Agreement and containing a non-exhaustive list of the forms of technical cooperation that could be provided. This initiative builds on a substantial track record of cooperation between the two organizations since 1996 and earlier in the field of technical cooperation, and is aimed at carrying it forward to a new level.

During the period covered by the report, the Council has held further discussions on various aspects of the TRIPS Agreement's built-in agenda that concern geographical indications. In November 1996, the Council agreed to initiate in 1997 preliminary work on issues relevant to the negotiations specified in Article 23.4 of the Agreement concerning the establishment of a multilateral system of notification and registration of geographical indications for wines, and that issues relevant to a notification and registration system for spirits would be part of this preliminary work. At its meeting in February 1997, the Council initiated this work by agreeing on an information-gathering activity. Information was

received from 12 Members on systems for the registration of geographical indications which they operate. At its meeting in September 1997, the Council considered this information and agreed to request the Secretariat to prepare a background note on international notification and registration systems for the Council's work under Article 23.4. This note was considered at the Council's meeting in February 1998. Since then, further discussions have been held on what the next step should be for carrying forward this work. In July 1998, a proposal on the matter was received from a delegation, which the Council agreed to discuss further at its meeting in September 1998.

The Council has also considered the review of the application of the Agreement's provisions on geographical indications, in particular the arrangements for carrying out this review (Article 24.2). In the autumn of 1996, the Council took up this review after, and taking into account, the review of national implementing legislation in the area of geographical indications, and agreed to first consider the questions involved in informal consultations. In February 1998, the Council was informed that delegations supported the approach of developing a checklist of questions about national regimes for the protection and enforcement of geographical indications. In May and July 1998, the Council took note of questions to be included in such a checklist and invited those Members already under an obligation to apply the provisions of the Agreement's Section on geographical indications to provide their responses by 16 November 1998, it being understood that other Members could also furnish replies on a voluntary basis.

Since February 1997, the following organizations have had a regular observer status in the TRIPS Council: the Food and Agriculture Organization (FAO), the International Monetary Fund (IMF), the International Union for the Protection of New Varieties of Plants (UPOV), the Organization for Economic Cooperation and Development (OECD), the United Nations (UN), the United Nations Conference on Trade and Development (UNCTAD), the World Bank, the World Customs Organization (WCO) and the World Intellectual Property Organization (WIPO). Requests from the African Regional Industrial Property Organization (ARIPO), the Cooperation Council for the Arab States of the Gulf, the European Free Trade Association (EFTA), the Latin American Economic System (SELA), the Office International de la Vigne et du Vin (OIV), the Organization of American States (OAS), the Organization of the Islamic Conference, and the Secretariat of the General Treaty on Central American Economic Integration (SIECA) are pending.

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## VII. Resolution of trade conflicts under the WTO's Dispute Settlement Understanding

### Overview

The General Council convenes as the Dispute Settlement Body (DSB) to deal with disputes arising from any Agreement contained in the Final Act of the Uruguay Round. The DSB has the sole authority to establish dispute settlement panels, adopt panel and appellate reports, maintain surveillance of implementation of rulings and recommendations and authorise suspension of concessions in the event of non-implementation of recommendations.

In its report to the 1998 Ministerial Conference, the Chairman of the DSB stated that the role of the DSB in managing the settlement of disputes within the WTO had continued to be positive. The DSB's work reflected the fact that Members had continued to show confidence in the new dispute settlement mechanism whose proper functioning clearly contributed to the strengthening and consolidation of the WTO and the multilateral trading system.

### Dispute settlement activity for the period 1 August 1997 to 31 July 1998

In the 12 months from 1 August 1997 to 31 July 1998, the DSB received 43 notifications of formal requests for consultations under the DSU. During this period, the DSB established panels to deal with 15 new matters, and received requests to establish a panel in two other cases. It adopted Appellate Body and/or panel reports in eight cases. The DSB also received 11 notifications of mutually agreed solutions (settlements). This section briefly describes the procedural history of these cases. It also considers the implementation status of previously adopted reports, those cases for which panel reports have been issued but not yet adopted, those appeals which have not yet been considered by the Appellate Body, and those panels which have suspended their work during the past year.

### **(1) European Communities – Measures affecting meat and meat products (hormones) (WT/DS26) (WT/DS48)**

On 20 May 1996, a panel was established to consider a complaint by the United States (WT/DS26) regarding the EC's import prohibition on meat and meat products from livestock that are treated with certain hormones for growth promotion purposes. Similar concerns were expressed in a separate complaint by Canada, and on 16 October 1996 a panel was established in respect thereof. It was later agreed that the Panel would be composed of the same panelists as the Panel in the US-EC dispute. Australia, New Zealand and Norway participated as third parties in each of the Panels. The United States was a third party in the Panel requested by Canada. Canada was a third party in the Panel requested by the United States.

In their reports of 18 August 1997, the Panels found that the EC ban on imports of meat and meat products from cattle treated with any of six specific hormones for growth promotion purposes was inconsistent with Articles 3.1, 5.1 and 5.5 of the Agreement on Sanitary and Phytosanitary Standards (the "SPS Agreement"). The Panels found that the EC violated Article 5.1 because its import ban was not based on a "risk assessment", that is, an evaluation of the potential for adverse effects on human health arising from the presence of certain hormones in meat. The Panels further found that the import ban was not based on existing international standards, and was imposed without scientific justification within the meaning of SPS Article 3.3. On that ground, the EC was found to have violated Article 3.1. The Panels also found that the EC violated Article 5.5 by adopting arbitrary or unjustifiable distinctions in its levels of sanitary protection in different situations, distinctions which according to the Panels resulted in discrimination or a disguised restriction on international trade.

In September 1997, the EC appealed the Panels' findings on the interpretation of the SPS Agreement. The EC also maintained the Panels erred in a number of procedural areas, including their allocation of the burden of proof. In its report of 16 January 1998, the Appellate Body upheld the Panels' finding that the EC import prohibition was inconsistent with Article 5.1 of the SPS Agreement. In so doing, the Appellate Body clarified that for an SPS measure to be "based on" a risk assessment within the meaning of Article 5.1, there had to be a "rational" or "objective" relationship between the measure and the risk assessment. The Appellate Body further clarified that the risk that is to be evaluated in a risk assessment under Article 5.1 is not only risk ascertainable in a science laboratory operating under strict controlled conditions, but also risk in human societies as they actually exist. Therefore, risks resulting from the abusive use of hormones and the difficulty of controlling the use of hormones were also relevant to a risk assessment under Article 5.1. The Appellate Body reversed the Panels' finding that the EC had violated Article 3.1 by maintaining, without justification under Article 3.3, SPS measures which are not based on existing international standards. The Appellate Body objected to the Panels' view of a supposed "general rule-exception" relationship between Articles 3.1 and 3.3. The Appellate Body insisted that pursuant to Article 3.3, WTO Members have the autonomous right to establish a higher level of protection than the prevailing international standards in matters relating to human health, in the event there is scientific justification to do so.

The Appellate Body also reversed the Panels' finding that the EC import prohibition was inconsistent with Article 5.5 of the SPS Agreement. In particular, the Appellate Body found that in all but one situation the differences in the levels of protection were not arbitrary or unjustifiable. In that one situation, the difference in the level of protection did not result in discrimination or a disguised restriction on international trade. On the general and procedural issues, the Appellate Body upheld most of the findings and conclusions of the Panels, but it concluded the Panels had erred in making a general ruling that the SPS Agreement allocates the "evidentiary burden" to the Member imposing an SPS measure. Rather, it was first up to the complainants to establish a prima facie case of the inconsistency of an SPS measure with the SPS Agreement, which the Appellate Body ruled the United States and Canada had done in this case.

The EC also claimed that the Panels had failed to make an objective assessment of the facts as required by Article 11 of the DSU. According to the EC, the Panels had disregarded, distorted or misrepresented the evidence the EC had submitted and the opinions expressed by the Panels' scientific experts. The Appellate Body stated that a panel's deliberate disregard of evidence submitted, its refusal to consider such evidence, or its wilful distortion or misrepresentation of such evidence, is incompatible with the panel's duty to make an objective assessment of the facts. The Appellate Body noted, however, that "disregard", "distortion" and "misrepresentation" of the evidence, in their ordinary signification in judicial and quasi-judicial processes, imply not simply an error of judgment in the

appreciation of evidence but rather an egregious error that calls into question the good faith of the panel. With regard to the instant case, the Appellate Body concluded that the Panels' treatment of the evidence did in no instance amount to such error.

On 13 February 1998, the DSB adopted the Appellate Body report and the Panel reports, as modified by the Appellate Body report. In May 1998, an arbitrator appointed under Article 21.3(c) of the DSU determined the "reasonable period of time" for implementation to be 15 months from the date of adoption (i.e. 15 months from 13 February 1998).

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## **(2) European Communities – Regime for the importation, sale and distribution of bananas (WT/DS27)**

On 8 May 1996, a panel was established to consider complaints by Ecuador, Guatemala, Honduras, Mexico and the United States regarding the EC's regime for the importation, sale and distribution of bananas.<sup>6</sup> The essence of the claims was that the EC's banana regime granted preferential treatment to EC and African, Caribbean and Pacific (ACP) bananas at the expense of non-EC, non-ACP bananas. In particular, the complainants alleged that the regime's allocation of import quotas and its import licensing procedures were inconsistent with (a) Articles I, II, III, X, XI and XIII of GATT 1994, (b) Articles II, XVI and XVII of GATS, (c) Articles 1 and 3 of the Agreement on Import Licensing Procedures (the "Import Licensing Agreement"), (d) Article 4.2 of the Agreement on Agriculture and (e) Article 2 of the Agreement on Trade-Related Investment Measures (the "TRIMs Agreement"). Belize, Cameroon, Canada, Colombia, Costa Rica, Dominica, Dominican Republic, Ghana, Grenada, India, Ivory Coast, Jamaica, Japan, Nicaragua, the Philippines, Saint Lucia, Saint Vincent and the Grenadines, Senegal, Suriname, and Venezuela participated in the proceedings as third parties.

The EC's common market organization for bananas, instituted in 1993, allocates import quotas based on the origin of the bananas and allocates import licenses – which are linked to specific quotas – according to the importing practices of licensees. There are four supplier categories: imports from "traditional" ACP countries; "non-traditional" imports from ACP countries<sup>7</sup>; imports from non-ACP countries, and domestic production from EC countries. Bananas from traditional ACP suppliers enter duty-free up to a maximum quota allocated for each country. Imports of non-traditional ACP bananas enter the EC market duty-free within the limits of their tariff-rate quota ("TRQ"), and beyond that subject to a preference of ECU 100 on the out-of-quota tariff. Imports from third countries are subject to an in-quota duty of ECU 75 per tonne, and were assessed an out-of-quota tariff rate of ECU 793 per tonne in 1997. Import licenses for non-traditional ACP and third-country bananas are allocated on the basis of so-called "operator categories" and "activity functions". Three operator categories (A, B and C) allocate the available TRQ licenses to importers according to which types of bananas they had marketed during the previous three years: 66½ per cent to operators who marketed non-traditional ACP and/or third-country bananas, 30 per cent to those who marketed EC and/or traditional ACP bananas, and 3½ per cent to "newcomers". Activity functions further subdivide the category A and B operators according to the stage of the banana importation process in which they operate. In particular, primary importers (i.e. initial purchasers), secondary importers (i.e. customs clearers) and ripeners. In addition, the scheme provides for the issuance of ad hoc "hurricane" licenses to operators who "include or directly represent" EC or ACP suppliers who are unable to supply the EC market because of a tropical storm.

Two other elements related to the EC's banana import regime are relevant to the instant dispute. First, the Framework Agreement on Bananas (BFA) – under which the EC allocated specific shares of the bound TRQ to Costa Rica, Colombia, Nicaragua and Venezuela<sup>8</sup> – permits supplying countries to issue export certificates for up to 70 per cent of their allocations. Presentation of these certificates is required for the issuance of EC import licenses to Category A and C operators, while Category B operators are exempt. Second, and more generally, the banana regime is subject to a GATT waiver – the Lomé waiver – because it involves preferential trade with ACP countries which are signatories of the Fourth Lomé Convention (1989). In effect until 29 February 2000, the waiver allows derogations from MFN treatment under Article I:1 of GATT in order to accommodate the preferential treatment required to be given by the EC to the ACP states under the Convention.

In its reports of 22 May 1997, the Panel found that the EC's banana import regime was inconsistent with the EC's obligations under GATT and GATS. The Panel made four principal findings. First, the Panel found that the EC's tariff quota allocations violated Article XIII:1 of GATT, because import quotas were allocated to certain countries not having a substantial interest in supplying bananas to the EC (e.g., Nicaragua and certain ACP countries), but not to other similarly situated countries (e.g., Guatemala). Concurrently, the Panel found that the quota reallocation rules under the BFA were inconsistent with Article XIII:1. The Panel further noted that neither the negotiation of the BFA and its inclusion in the EC's Schedule, nor the Agreement on Agriculture, permits the EC to act inconsistently with Article XIII's

<sup>6</sup>The same concerns were raised in a previous complaint (WT/DS16), but Ecuador was not a party and the legal basis did not include either the Agriculture or TRIMs Agreements. Furthermore, Panama has made a separate request for consultations regarding the EC's banana import regime (WT/DS105).

<sup>7</sup>Non-traditional ACP bananas include (a) those bananas above "traditional" quantities supplied by ACP countries and (b) those quantities supplied by ACP countries that are not "traditional" suppliers.

<sup>8</sup>The BFA was incorporated into the EC's Uruguay Round Schedule in March 1994.

requirements. However, the Panel found that the Lomé waiver permitted the inconsistency with Article XIII to the extent necessary for the EC to allocate shares of its banana tariff quota to traditional ACP banana countries at their highest import levels before 1991.

Second, the Panel rejected the challenge under Article I:1 of GATT to the EC's tariff preferences granted to traditional as well as non-traditional ACP banana imports. Rather, it accepted the EC's argument that the Lomé waiver permitted such an inconsistency with its MFN obligations.

Third, the Panel found that the EC's import licensing procedures were inconsistent with MFN and national treatment obligations under both GATT (Articles I:1 and III:4) and GATS (Articles II and XVII). In making these determinations, the Panel rejected the EC's argument that its licensing procedures for traditional ACP bananas and those for non-traditional and third-country bananas constituted two separate regimes. On operator categories, the Panel found violations of all four articles with respect to the allocation of 30 per cent of the licenses for non-traditional and third-country imports to Category B operators. In addition, the Panel considered the activity function rules to be inconsistent with Article I of GATT. It also found a violation of Article XVII of GATS with respect to the allocation of a substantial percentage of Category A and B licenses – 28 per cent – to ripeners. Finally, the Panel found that the operator category rules violated Article X:3(a) of GATT, because they were not administered in a "uniform, impartial and reasonable" manner. Because the operator category rules violated Article III:4, the Panel did not consider it necessary to rule on their consistency with Article 2 of the TRIMs Agreement, given that steps taken to bring the licensing procedures into conformity with Article III:4 would also eliminate any non-conformity with the TRIMs provisions.

The Panel also found violations of the four MFN and national treatment provisions with respect to the granting of hurricane licenses. Specifically, the Panel found that the allocation of such licenses exclusively to operators who include or represent EC producers constituted a violation of both Article III:4 of GATT and Article XVII of GATS. At the same time, the allocation of such licenses exclusively to operators who include or represent ACP producers constituted a violation of both Article I:1 of GATT and Article II of GATS. In addition, the Panel found a violation of Article I:1 of GATT with respect to the requirement to match EC import licenses with BFA export certificates. In related findings, the Panel concluded that the exemption of Category B operators of EC origin from the export certificate requirement constituted a violation of Article XVII of GATS, and the exemption of Category B operators of ACP origin from the requirement violated Article II of GATS.

Finally, the Panel found that the Lomé waiver did not cure those inconsistencies arising from the licensing procedures, except those arising from the issuance of hurricane licenses to ACP producers.

In its report of 9 September 1997, the Appellate Body upheld the Panel's principal findings on violations of Articles I, III and XIII of GATT, and Articles II and XVII of GATS. However, the Appellate Body reversed the Panel's decision that the inconsistency with Article XIII was permitted by the Lomé waiver, which waives inconsistency with Article I to the extent necessary under the Lomé Convention. The Appellate Body modified the Panel's finding on the BFA quota reallocation rules by concluding that the rules were also inconsistent with the chapeau of Article XIII:2 of GATT 1994. Finally, the Appellate Body reversed the Panel's finding that Article X:3(a) of GATT and Article 1.3 of the Import Licensing Agreement preclude the imposition of different import licensing systems on like products when imported from different Members. In its view, these articles applied only to the application and administration of licensing rules, and not to the rules as such.

At its meeting of 25 September 1997, the DSB adopted the Appellate Body report and the Panel report, as modified by the Appellate Body report. In January 1998, an arbitrator appointed pursuant to Article 21.3(c) of the DSU determined the "reasonable period of time" for implementation to be 15 months from the date of adoption (i.e. from 25 September 1997 to 1 January 1999).

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### **(3) Japan – Measures affecting consumer photographic film and paper (WT/DS44)**

On 16 October 1996, a panel was established to consider the complaint of the United States regarding Japan's laws governing the distribution and sale of imported consumer photographic film and paper. The claims raised by the United States concerned three broad categories of measures: (a) distribution measures, which allegedly encouraged and facilitated the creation of market structures for film and paper that excluded imports from traditional distribution channels; (b) the Large Stores Law, which allegedly restricted the establishment of an alternative distribution channel for film; and (c) promotion measures, involving restrictions on premiums and misleading representations under the Premiums Law, which allegedly disadvantaged imports by restricting sales promotions. The United States claimed that all three categories of measures, individually and acting in combination, while not in



violation of WTO rules, nullified or impaired its benefits under the GATT within the meaning of Article XXIII:1(b).

The United States argued that as a result of Japanese tariff concessions in the Kennedy, Tokyo and Uruguay Rounds, US photographic film products should have been granted access to the Japanese market on equal terms to Japanese like products, and the cited measures had nullified or impaired the realization of these legitimate expectations. The United States also alleged nullification and impairment with regard to each type of measure, and a violation of Article III:4 of GATT 1994 with regard to the distribution measures. Further, the United States alleged that Japan violated Article X:1 of GATT 1994 by failing to publish enforcement actions of the Japan Fair Trade Commission (JFTC) and fair trade councils, as well as guidance by Japanese governmental authorities related to the challenged measures, which established or modified criteria applicable to future cases.

In response, Japan argued that US claims against the three categories of measures were factually and logically flawed. According to Japan, the United States did not submit credible evidence that the measures were intended to or in fact acted to exclude imports of US products. Rather, the distribution policies, the Large Stores Law and the promotion measures pursued very different policy objectives, and were not intended to work in combination. Japan also rejected US claims with respect to the individual allegations on the grounds that none of the alleged measures adversely affected imported products. The EC and Mexico participated as third parties.

After examining nearly 20,000 pages of evidence, the Panel presented its report on 31 March 1998. On the non-violation claims, it found that the United States had not demonstrated that the Japanese measures nullified or impaired, either individually or collectively, benefits accruing to the United States within the meaning of Article XXIII:1(b) of GATT. The Panel developed a broad interpretation of "measures" that were attributable to the Japanese Government for purposes of Article XXIII:1(b). However, the Panel found that US legitimate expectations were limited because it could have "reasonably anticipated" most of the measures, since they were in place at the time the relevant tariff concessions were made. The Panel also found that none of the cited measures, either individually or collectively, had "upset the competitive relationship" between imported and domestic products, because they could not have caused the formation of a largely pre-existing market structure.

Regarding the violation claims, the Panel found that the United States had not demonstrated that the Japanese distribution measures accorded, *de jure* or *de facto*, less favourable treatment to imported photographic film and paper within the meaning of Article III:4 of GATT. In particular, the Panel was not persuaded that there was a meaningful nexus between the distribution measures and Japan's longstanding system of single-brand distribution. The Panel also found that the United States had not demonstrated that Japan failed to publish administrative rulings in violation of Article X:1 of GATT. In particular, the United States failed to show how certain individual decisions established or modified criteria that would be applicable to future distribution or promotion measures aimed at Japan's photographic film industry.

The Panel report was adopted by the DSB at its meeting on 22 April 1998.

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#### **(4) India – Patent protection for pharmaceutical and agricultural chemical products (WT/DS50)**

On 20 November 1996, the DSB established a panel at the request of the United States to consider the alleged failure of India to meet its obligations under the Agreement on Trade-Related Aspects of Intellectual Property Rights (the "TRIPS Agreement") regarding patent protection for pharmaceutical and agricultural chemical products. Under the transitional provisions of the TRIPS Agreement, India is entitled as a developing country to delay providing patent protection for these products until 1 January 2005. However, the Panel found that India did not comply with the transitional provisions of the TRIPS Agreement. The EC participated in the dispute as a third party.

The Panel's report of 5 September 1997 echoed US concerns on three main issues. First, the Panel found that India had failed to implement its obligation under Article 70.8(a) of the TRIPS Agreement to establish a mechanism (a so-called "mailbox system") that preserves the novelty and priority of the patent applications for pharmaceutical and agricultural products. Principally, the Panel found that the lack of legal security in India's operation of an *ad hoc* "mailbox system" (based on uncodified administrative practices) could not adequately achieve the purposes of Article 70.8 and preserve the legitimate expectations of protection by inventors, particularly after the expiry of the transitional period. Second, the Panel found that, even if India had a valid mailbox system, it had not complied with its obligations under Article 63.1 and 63.2 of the TRIPS Agreement, which respectively require Members to make the specific terms and provisions of that system available to governments and rights holders, and to notify the Council for TRIPS of the legal basis for their mailbox

systems. Finally, the Panel found that India had failed to establish a system for the grant of exclusive marketing rights, as required under Article 70.9, rejecting India's argument that such a system was not necessary because there had not yet been a request for such rights in India.

India appealed the Panel's findings in October 1997. On 19 December 1997, the Appellate Body upheld the Panel's conclusion that India had not complied with its obligations under Article 70.8 and 70.9 of the TRIPS Agreement, but disagreed with certain elements of the Panel's reasoning leading to that conclusion. In particular, the Appellate Body found fault with the Panel's invocation of a general interpretative principle that the legitimate expectations of WTO Members must be taken into account in interpreting the TRIPS Agreement. The Panel had stated that protection of legitimate expectations of Members regarding the conditions of competition is a well-established GATT principle, and argued that it was merely applying this principle in the context of the TRIPS Agreement. The Appellate Body concluded, however, that the Panel's reasoning did not accurately reflect GATT/WTO practice, and that the Panel's invocation of the "legitimate expectations" of Members relating to the conditions of competition melds the legally-distinct bases for "violation" and "non-violation" complaints under Article XXIII of GATT 1994 into one uniform cause of action. This, the Appellate Body stated, is not consistent with Article XXIII of GATT 1994 or Article 64 of the TRIPS Agreement. The Appellate Body stressed that, in interpreting the TRIPS Agreement, the Panel should not have gone beyond the general principles of treaty interpretation set out in the Vienna Convention on the Law of Treaties.

In addition, the Appellate Body reversed the Panel's findings on Article 63 on the grounds that the claim was not within the Panel's terms of reference. Specifically, this claim was excluded from the Panel's "jurisdiction" because the United States had submitted it during the Panel's first substantive meeting with the parties – rather than in its original panel request. At the DSB meeting on 16 January 1998, the Appellate Body report and the Panel report, as modified by the Appellate Body report, were adopted. At the DSB meeting on 22 April 1998, India and the United States jointly announced that they had agreed on an implementation period of 15 months, whereby India would introduce the necessary legislation to ensure that the new procedure would be in place and operational no later than 19 April 1999.

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#### **(5) Indonesia – Certain measures affecting the automobile industry (WT/DS54) (WT/DS55) (WT/DS59) (WT/DS64)**

On 12 June 1997, the DSB established a single panel to deal with challenges to Indonesia's National Car Programme by the European Communities (WT/DS54) and Japan (WT/DS55 and WT/DS64). On 30 June 1997, the DSB established a panel to consider US allegations concerning the same measures, and decided that the dispute would be heard along with the other three challenges (WT/DS59).<sup>9</sup> The dispute concerned three sets of measures: (a) the 1993 Incentive System, which provided import duty relief for parts and components of cars and sales tax reductions on certain categories of motor vehicles, based on the satisfaction of local content requirements; (b) the 1996 National Car Programme's "Pioneer" (or National Car) company status, also based on local content requirements, which triggers exemptions from import duties on parts and components and sales tax exemptions on all sales; and (c) the 1996 National Car Programme's provision of "Pioneer" benefits for cars manufactured in a foreign country by Indonesian nationals that meet certain local content requirements. The complainants raised challenges to these measures under Articles I, III and X of GATT 1994, Article 2 of the TRIMs Agreement, Articles 3, 6 and 28 of the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement") and Articles 3, 20 and 65 of the TRIPS Agreement. Canada and Korea participated as third parties.

In response, Indonesia denied the allegations under the SCM Agreement, Article X of GATT and the TRIPS Agreement. As to the allegations under GATT Article III and TRIMs, Indonesia argued that the aspects of its car programme challenged under those provisions were subsidies and therefore should be governed exclusively by the SCM Agreement. It perceived a conflict between GATT Article III and the SCM Agreement such that the former prohibits what the latter permits, and argued that the conflict should be settled by giving priority to the more specific rules on subsidies. Moreover, it argued that the TRIMs Agreement should be disregarded here, because it is only an interpretation of GATT Article III.

In its report of 2 July 1998, the Panel first rejected Indonesia's arguments of conflict between Article III, the TRIMs Agreement and the SCM Agreement. It then accepted the claims of Japan, the EC and the United States that the local content requirements used as a condition for benefits under the National Car Programme violate the provisions of Article 2 of the TRIMs Agreement. The Panel also accepted the claims of all three countries that the exemption and reduction of sales tax under the programme violated Article III:2 of GATT, because they discriminated against like imported products lacking the required local content. It found that the customs duty and sales tax benefits favouring certain imported cars and

<sup>9</sup>See WTO Annual Report, 1997, pp.132-33.

imported parts and components violated Article I of GATT, because they discriminated against like imported products. The Panel declined to consider complainants' arguments under Article X of GATT since it had already found a violation of Articles I and III.

In addition, the Panel accepted the EC's claim that Indonesia violated Article 5(c) of the SCM Agreement through the use of specific subsidies that caused "serious prejudice" to the interests of the EC arising from price undercutting in the Indonesian market. However, since there were no US automobile exports to Indonesia (only exports from US companies outside the United States), the Panel concluded that there was no serious prejudice to the interests of the United States. The Panel rejected the US claim that the 1996 Programme represented an extension of the scope of an existing subsidy in violation of Article 28.2 of the SCM Agreement. The Panel also rejected US claims that Indonesia had breached its obligations under Article 3 of the TRIPS Agreement in respect of the acquisition and maintenance of trademark rights, or the obligations under Article 3 in respect of the use of trademarks addressed in Article 20 of the TRIPS Agreement. Finally, the Panel rejected US arguments that provisions of the National Car Programme introduced by Indonesia during its transition period under the TRIPS Agreement violated Article 65.5 of the Agreement by imposing special requirements on the use of trademarks inconsistently with Article 20 of the Agreement and amounted to a change in laws, regulations and practice during the transitional period which resulted in a lesser degree of consistency with the provisions of the Agreement.

The Panel report was adopted at the meeting of the DSB on 23 July 1998.

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#### **(6) Argentina – Certain measures affecting imports of footwear, textiles, apparel and other items (WT/DS56)**

On 25 February 1997, a panel was established to consider Argentina's imposition of specific duties on certain imports of footwear, textile and apparel products in excess of the bound rate of 35 per cent ad valorem, as well as its 3 per cent statistical tax on imports designed to finance the collection and processing of import-export statistics by Argentine customs services. The Argentine specific duty regime requires Argentine customs officials to collect the greater of the ad valorem or the specific duties applicable, with no upper limit on the level of the ad valorem equivalent of the specific duty that may be imposed. Likewise, the statistical tax is a blanket tax imposed on all imports, with no provision for a ceiling. The United States contended that the specific duty regime violated Article II of GATT 1994 and that the statistical tax violated Article VIII of GATT 1994. It also claimed that those violations gave rise to a violation of Article 7 of the Agreement on Textiles and Clothing (ATC). The EC and India participated as third parties.

In its report of 25 November 1997, the Panel found that the minimum specific duties imposed by Argentina on textiles and apparel were inconsistent with the requirements of Article II of GATT, and that the statistical tax was inconsistent with the requirements of Article VIII of GATT. The Panel exercised judicial economy and did not rule on the US claim regarding the violation of Article 7 of the ATC. It also accepted Argentina's preliminary request to refrain from ruling on the application of the duties to footwear imports, as Argentina had revoked these duties prior to the establishment of the Panel.

The Panel based its Article II finding on the contrast between Argentina's GATT schedule of commitments – which specified a duty of 35 per cent ad valorem – and its applied specific duties. It noted that past GATT practice is clear: a situation whereby a contracting party applies one type of duty while its Schedule refers to bindings of another type of duty constitutes a violation of Article II of GATT, without any obligation for the complaining party to submit further evidence that such variance leads to an effective breach of bindings. At the same time, it found that evidence submitted by the United States – based both on duty collections averages and individual transactions – demonstrated that duties above the 35 per cent threshold had been imposed. The Panel rejected Argentina's argument that there was no violation of GATT rules, because a domestic challenge procedure to examine foreign exporters' claims under the specific duty regime would ensure that Argentina complied with its international law obligations, including its 35 per cent tariff binding. The Panel found that such a scheme would introduce inevitable delays and uncertainties. The Panel also found that the statistical tax violated Article VIII, because it was not directly linked to the cost of services rendered to individual importers and exporters, and resulted in the levying of charges in excess of the approximate costs of those services. In considering this claim, the Panel rejected Argentina's argument that it was obliged to collect its statistical tax under an agreement with the International Monetary Fund (IMF).

In January 1998, Argentina appealed the Panel's findings on Article II and Article VIII. In its report of 27 March 1998, the Appellate Body upheld the Panel's finding on Article VIII, and modified the finding on Article II. With regard to Article II, the Appellate Body found that the application of a duty different from the type provided for in a Member's schedule is not automatically inconsistent with this provision; rather, it is inconsistent if it may lead to the imposition of duties in excess of the bound rates. The Appellate Body found in this case that

Argentina's specific duties may be higher than 35 per cent in certain circumstances, and that Argentina's specific duty regime therefore violated the country's obligations under Article II. The Appellate Body also agreed with the Panel's implicit finding that Argentina failed to demonstrate that it had a legally binding commitment to the IMF that superseded its commitments under Article VIII.

At its meeting on 22 April 1998, the DSB adopted the Appellate Body report and the Panel report, as modified by the Appellate Body report. On 5 June 1998, Argentina reached an agreement on implementation with the US, whereby Argentina would reduce the statistical tax to 0.5 per cent by 1 January 1999, and would cap specific duties on textiles and apparel at 35 per cent by 19 October 1998.

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#### **(7) European Communities – Customs classification of certain computer equipment (WT/DS62) (WT/DS67) (WT/DS68)**

On 25 February 1997, the DSB established a panel to consider the EC's tariff reclassification of certain Local Area Network (LAN) equipment and personal computers (PCs) with multimedia capability. The United States claimed that after the conclusion of the Uruguay Round, the EC changed the tariff classification of LAN equipment from "automatic data processing (ADP) machines" to "telecommunications equipment", which resulted in higher duties imposed on US exports. The EC also began to classify all PCs as ADP machines, but applied higher duties to those with multimedia capability. The United States alleged that these reclassifications resulted in tariff treatment less favourable than that provided for in the EC's Uruguay Round Schedule, which constituted a violation of Article II of GATT 1994 (WT/DS62). On 20 March 1997, two additional US challenges to the classification of the LAN equipment in the United Kingdom (WT/DS67) and Ireland (WT/DS68) were placed under the auspices of the same Panel. India, Japan, Korea and Singapore participated as third parties.

Specifically rejecting the above claims on LAN equipment, the EC argued that there was no such reclassification, since the tariff treatment of LAN equipment was not uniform throughout the EC during the Uruguay Round. It claimed that the United States had the burden to clarify the scope of the EC's tariff concessions, particularly because the United States had itself classified LAN equipment as telecommunications equipment until 1992.

In its report of 5 February 1998, the Panel found that the EC failed to accord imports of US LAN equipment treatment "no less favourable" than that provided for in the EC Schedule, which rendered the EC's measures inconsistent with Article II:1 of GATT. The Panel found that the United States was entitled to "legitimate expectations" that the EC would continue to treat LAN equipment as "ADP machines" (as it had during the Uruguay Round) and that the United States was not required to clarify the scope of the EC's concessions. Moreover, the US' own reclassification of LAN equipment in 1992 was not relevant to the formation of its legitimate expectations of the EC's system. The Panel also found that the EC's tariff treatment of multimedia PCs did not violate Article II. The Panel found it unnecessary to rule on US claims concerning the United Kingdom and Ireland.

The EC appealed the Panel's findings on LAN equipment. In its report of 5 June 1998, the Appellate Body reversed the Panel's findings on the EC's tariff treatment of LAN equipment, because it found the Panel's reasoning to be erroneous. In particular, the Appellate Body disagreed with the Panel's reasoning that the meaning of a tariff concession in a Member's schedule could be based on the "legitimate expectations" of an exporting Member. Rather, the meaning of concessions should be determined pursuant to principles of treaty interpretation set out in Article 31 of the Vienna Convention on the Law of Treaties. This determination should be made in accordance with the ordinary meaning of the terms in the Member's schedule, in their context and in light of the object and purpose of GATT 1994. On this point, the Appellate Body considered that the classification practice of the EC during the Uruguay Round is part of the "circumstances of [the] conclusion" of the WTO Agreement and may be used as a supplementary means of interpretation within the meaning of Article 32 of the Vienna Convention. However, the Appellate Body found that the factual findings of the Panel lead to the conclusion that the classification of LAN equipment in the EC during the Uruguay Round had not been consistent and asserted that such inconsistent past practice could not be relevant to the interpretation of a tariff concession. The Appellate Body also reversed the Panel's ancillary finding that the onus of clarifying the scope of a tariff concession does not lie with the exporting Member. Rather, the Appellate Body stated that such clarification is the responsibility of both parties.

Both the Appellate Body report and the Panel report, as modified by the Appellate Body report, were adopted by the DSB on 22 June 1998.

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#### **(8) European Communities – Measures affecting importation of certain poultry products (WT/DS69)**

At its meeting on 30 July 1997, the DSB established a panel to consider the EC regime for the importation of certain poultry products and the EC's implementation of a tariff-rate

quota ("TRQ") for these products. The EC's Uruguay Round schedule of commitments contains a duty-free TRQ for 15,500 tonnes of frozen poultry meat. According to Brazil, this TRQ resulted from a bilateral agreement between Brazil and the EC under Article XXVIII of GATT 1994, as part of the settlement of the dispute in EEC – Oilseeds.<sup>10</sup> Certain licensing requirements also apply to imports under this duty-free quota. For out-of-quota imports – which are not subject to licensing requirements – the schedule permitted the EC to introduce an additional duty (a "special safeguard") on imports of such meat according to the conditions set forth in the Article 5 of the Agreement on Agriculture.

Brazil contended that the EC had failed to adequately implement the TRQ within the context of the bilateral agreement, and therefore violated Article XXVIII. Brazil also claimed that the EC failed to implement the TRQ in accordance with the allocation procedures of Article XIII of GATT 1994.<sup>11</sup> In particular, Brazil claimed that the quota was intended to be allocated exclusively to Brazil. Brazil also claimed that the EC's administration of import licenses was inconsistent with the transparency provisions of Article X of GATT 1994 and Articles 1 and 3 of the Import Licensing Agreement, and that the EC's licensing system did not comply with the specific provisions of Articles II and III of GATT 1994. With respect to out-of-quota trade, Brazil alleged that the EC was not complying with the special safeguard provisions of Article 5 of the Agreement on Agriculture. The United States and Thailand participated as third parties.

In its report of 12 March 1998, the Panel concluded that Brazil had not demonstrated that the EC had failed to implement and administer the TRQ for poultry in line with its obligations under the cited agreements (with the exception of the failure to notify certain information regarding the licensing requirements associated with the TRQ to the WTO Committee on Import Licensing). However, the Panel found that the EC had failed to comply with the provisions of Article 5.1(b) of the Agreement on Agriculture by excluding customs duties from the calculation of the relevant import price for triggering the special safeguard.

Brazil appealed in April 1998, challenging the Panel's conclusions relating to Articles X, XIII and XXVIII of GATT, and Articles 1 and 3 of the Import Licensing Agreement. The EC appealed the Panel's conclusion on its employment of the special safeguard under the Agreement on Agriculture. On 13 July 1998, the Appellate Body upheld the Panel's findings on the EC's compliance with GATT and the Import Licensing Agreement. The Appellate Body reversed the Panel's finding regarding the EC's non-compliance with the Agreement on Agriculture, finding that the relevant import price that triggers the safeguard mechanism is the c.i.f. import price, excluding customs duties. However, the Appellate Body found that the EC violated Article 5.5 of the Agreement on Agriculture in its use of a "representative price" – as opposed to the actual price of the import shipment – in determining the amount of additional duties payable.

Both the Appellate Body report and the Panel report, as modified by the Appellate Body report, were adopted by the DSB on 23 July 1998.

## Implementation – Status of previously adopted reports

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### **(1) United States – Standards for reformulated and conventional gasoline (WT/DS2) (WT/DS4)**

Brazil and Venezuela alleged that US gasoline regulations discriminated against their gasoline in violation of Articles I and III of GATT 1994, and Article 2 of the Agreement on Technical Barriers to Trade (the "TBT Agreement"). On 29 January 1996, the Panel examining the US regulations found that they were not consistent with Article III:4 of GATT and could not be justified under paragraphs (b), (d) or (g) of Article XX of GATT 1994. The decision regarding Article XX(g) was affirmed – on alternate grounds – by the Appellate Body on 29 April 1996, and both reports were adopted by the DSB on 20 May 1996.<sup>12</sup>

The United States subsequently agreed with Venezuela to bring its measures into conformity with its obligations within 15 months. In August 1997, the Administrator of the United States Environmental Protection Agency (EPA) signed a new regulation amending the provisions at issue in this dispute. The United States notified the DSB at its 25 September 1997 meeting that it had completed the implementation process within the allotted time period. At the same meeting, Brazil and Venezuela stated that their authorities were still considering the new US regulation and that they reserved their rights to revert to this matter.

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### **(2) Japan – Taxes on alcoholic beverages (WT/DS8) (WT/DS10) (WT/DS11)**

The European Communities, United States and Canada each alleged that the provisions of the Liquor Tax Law of Japan discriminated against their liquor exports in violation of Article III:2 of GATT 1994.<sup>13</sup> On 11 July 1996, the Panel found (i) that shochu and vodka were like products and that Japan violated Article III:2, first sentence, by taxing vodka in

<sup>10</sup>Panel Report, European Economic Community – Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins, adopted 25 January 1990, BISD 37S/86, and DS28/R, 31 March 1992.

<sup>11</sup>Brazil had argued that Article XIII did not apply to TRQs given in compensation as part of a bilateral arrangement, which it said was the case here. In the alternative, however, it claimed that if the Panel was to consider that Article XIII did apply to the EC's poultry TRQ, the EC had not complied with its obligations under this article.

<sup>12</sup>See WTO Annual Report, 1996, pp.132-33; WTO Annual Report, 1997, p.127.

<sup>13</sup>A GATT panel had ruled in 1987 that the Japanese liquor tax system violated Article III. The complainants in the 1995 case were dissatisfied with Japan's amendments.

excess of shochu<sup>14</sup> and (ii) that shochu and certain other such liquors at issue were “directly competitive or substitutable products” and Japan violated Article III:2, second sentence, by not taxing them similarly. The Appellate Body affirmed with modifications on 4 October 1996, and both reports were adopted by the DSB on 1 November 1996. An arbitrator later determined that the reasonable period for implementation of the recommendations was 15 months.

At the DSB meeting of 22 January 1998, Japan informed Members that it had reached mutually satisfactory solutions with all three complainants regarding implementation.

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### **(3) Canada – Certain measures concerning periodicals (WT/DS31)**

The United States claimed that Canadian measures prohibiting or restricting the importation into Canada of certain periodicals were in contravention of Article XI of GATT 1994. The United States also claimed that the tax treatment of so-called “split-run” periodicals and the application of favourable postage rates to certain Canadian periodicals were inconsistent with Article III of GATT 1994. The Panel found violations of Article XI:1 (Canadian Tariff Code 9958), Article III:2, first sentence (Part V.1 of Canada’s Excise Tax Act), and Article III:4 (postage rates for periodicals). However, the Panel found that Canada’s “funded” postage rate system was a subsidy permitted under Article III:8 of GATT.<sup>15</sup>

The Appellate Body reversed the Panel’s decision on Article III:2. However, it found a violation of the second sentence of Article III:2 instead. It also reversed the Panel’s decision on Article III:8. Both the Appellate Body report and the Panel report, as modified, were adopted by the DSB on 30 July 1997. The parties agreed on a 15-month implementation period, and Canada has undertaken to comply with the DSB recommendations. The period for implementation expires on 30 October 1998.

## Panel Reports appealed

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### **(1) Australia – Measures affecting importation of salmon (WT/DS18)**

On 10 April 1997, a panel was established to consider Canada’s complaint regarding Australia’s prohibition of certain salmon imports. Canada alleged that the prohibition, which was based on a quarantine regulation which dates back to 1975, was inconsistent with Articles XI and XIII of GATT 1994 and Articles 2 and 5 of the SPS Agreement. According to the Panel’s report of 12 June 1998, the issue was whether Australia could justify its ban on the basis of the available scientific evidence, as required by the SPS Agreement. The Panel ruled in the negative, finding that Australia’s measures were inconsistent with Articles 2.2, 2.3, 5.1, 5.5 and 5.6 of the SPS Agreement, and nullified and impaired benefits accruing to Canada under the SPS Agreement. Given that it had found several violations of the SPS Agreement, the Panel did not consider it necessary to examine Canada’s claims under GATT 1994. The European Communities, the United States, India and Norway participated in the proceedings as third parties. On 22 July 1998, Australia notified the DSB of its intention to appeal the Panel’s findings. A decision is expected by October 1998.

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### **(2) United States – Import prohibition of certain shrimp and shrimp products (WT/DS58)**

On 25 February 1997, the DSB established a panel to consider complaints by Malaysia, Pakistan and Thailand regarding a US ban on the importation of shrimp and shrimp products from these countries. Under Section 609 of US Public Law 101-62, imports of shrimp are prohibited unless they were harvested in a “certified” country or under conditions that did not adversely affect sea turtles. Certification depends on the presence of a regulatory program governing the incidental taking of sea turtles that is “comparable” to that of the United States, and findings that show that average rate of takings by a country’s vessels is “comparable” to that of US vessels. The complainants alleged violations of Articles I, XI and XIII of GATT 1994. On 10 April 1997, the DSB established a panel at the request of India to examine the same law, and agreed that India’s complaint would be examined by the Panel already established. In its report of 6 April 1998, the Panel found Section 609 to be a prohibited quantitative restriction under Article XI of GATT, and hence did not consider the complainants’ allegations regarding Articles I and XIII. The Panel further found that the measures could not be justified under Article XX of GATT, because they constituted “unjustifiable discrimination between countries where the same conditions prevailed”. Australia, Colombia, the EC, Guatemala, Hong Kong, India, Japan, Mexico, Nigeria, the Philippines, Singapore, Sri Lanka and Venezuela participated as third parties. On 13 July 1998, the United States appealed the Panel’s findings on Article XX. A decision is expected by October 1998.

<sup>14</sup>See WTO Annual Report, 1996, p.134.

<sup>15</sup>See WTO Annual Report, 1997, pp.129-30.

## Panel report issued

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### **Guatemala – Anti-dumping investigation regarding imports of Portland cement from Mexico (WT/DS60)**

At its meeting on 20 March 1997, the DSB established a panel to consider an anti-dumping investigation by Guatemala with regard to imports of Portland cement from Mexico. That investigation led to the imposition of a definitive anti-dumping duty of 89½ per cent on 17 January 1997. Mexico alleged that the investigation violated Guatemala's obligations under Article VI of GATT 1994 and Articles 2-7 of the Agreement on Implementation of Article VI of GATT 1994 (the "Anti-Dumping Agreement"). Canada, El Salvador, Honduras and the United States participated as third parties. In its report of 19 June 1998, the Panel found that Guatemala had initiated its investigation on the basis of insufficient evidence of dumping, injury and causation, in violation of Article 5.3 of the Anti-Dumping Agreement. The Panel also found that Guatemala violated Article 5.5 of the Anti-Dumping Agreement by failing to notify the Government of Mexico before commencing its investigation. The Panel recommended that the DSB request Guatemala to bring its actions into conformity with its obligations under Articles 5.3 and 5.5, and suggested that Guatemala revoke the existing anti-dumping duties on imports of Mexican cement.

## Panels established

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### **(1) Turkey – Restrictions on imports of textile and clothing products (WT/DS34)**

Complaint by India. This dispute concerns Turkey's imposition of quantitative restrictions on imports of a broad range of textile and clothing products. India alleges that these measures violate Articles XI, XIII and XXIV of GATT 1994, as well as Article 2 of the ATC. The DSB established a panel on 13 March 1998. Thailand, Hong Kong, the Philippines and the United States reserved their third-party rights.<sup>16</sup>

### **(2) Brazil – Export financing programme for aircraft (WT/DS46)**

Complaint by Canada. This dispute concerns export subsidies granted under the Brazilian Programa de Financiamento às Exportações (PROEX) to foreign purchasers of Brazil's Embraer aircraft under Article 4 of the SCM Agreement. Canada alleges that these subsidies constitute violations of Article 3 of the SCM Agreement. Canada withdrew an initial request for a panel pending further consultations, but reserved the right to make an additional request if discussions failed. The DSB established a panel in response to Canada's request at its meeting on 23 July 1998, and the United States and the EC reserved third-party rights.

### **(3) Canada – Measures affecting the export of civilian aircraft (WT/DS70)**

Complaint by Brazil. This dispute concerns certain subsidies granted by the Government of Canada or its provinces which, according to Brazil, support the export of civilian aircraft produced by Montreal-based Bombardier Aerospace and its affiliates. Specifically, Brazil alleges that certain equity infusions and loan guarantees are "prohibited subsidies" inconsistent with Article 3 of the SCM Agreement.<sup>17</sup> The DSB established a panel on 23 July 1998, and the United States and the EC reserved third-party rights.

### **(4) European Communities – Measures affecting butter products (WT/DS72)**

Complaint by New Zealand. This dispute concerns certain decisions by the European Commission and the United Kingdom's Customs & Excise Department regarding imports of New Zealand's butter products. New Zealand alleged that butter manufactured by two processes – the ANMIX process and the spreadable butter-making process – were classified so as to be excluded from New Zealand's country-specific tariff quota for butter established by the EC's GATT schedule. These decisions, New Zealand claimed, were taken inconsistently with Articles II, X, and XI of GATT 1994, Article 2 of the TBT Agreement, and Article 3 of the Import Licensing Agreement. The DSB established a panel on 18 November 1997, and the United States reserved its third-party rights.

### **(5) India – Patent protection for pharmaceutical and agricultural chemical products (WT/DS79)**

On 16 October 1997, a panel was established to consider allegations by the European Communities concerning India's obligation under the TRIPS Agreement regarding patent protection for pharmaceutical and agricultural chemical products. Under the transitional provisions of the TRIPS Agreement, India is entitled as a developing country to delay providing patent protection for such products until 1 January 2005. However, the EC alleged that India's efforts during the transition period to secure protection for inventors fell short of its obligations under Articles 27, 65 and 70 of the TRIPS Agreement. The United States

<sup>16</sup>Hong Kong and Thailand have raised similar concerns in separate requests for consultations (WT/DS29 and WT/DS47).

<sup>17</sup>In a parallel request for consultations (WT/DS71), Brazil has alleged that the same measures constitute "actionable subsidies" and cause adverse effects within the meaning of Article 5 of the SCM Agreement.

reserved third-party rights. A parallel complaint by the United States was considered previously by a panel and the Appellate Body, which found India in violation of its obligations under Articles 70.8(a) and 70.9 of the TRIPS Agreement.<sup>18</sup> The United States reserved its third-party rights.

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**(6) Korea – Taxes on alcoholic beverages (WT/DS75) (WT/DS84)**

Separate complaints by the European Communities (WT/DS75) and the United States (WT/DS84). This dispute concerns allegedly preferential internal taxes imposed by Korea on certain alcoholic beverages pursuant to its Liquor Tax Law and Education Law. The complaints in this case are similar to those in Japan – Taxes on Alcoholic Beverages, discussed supra. Because they impose lower taxes on the Korean spirit soju than imported like products, the complainants allege, the laws are incompatible with Article III:2 of GATT 1994. On 16 October 1997, the DSB established a single panel to consider both complaints. Canada and Mexico reserved their third-party rights.

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**(7) Japan – Measures affecting agricultural products (WT/DS76)**

Complaint by the United States. This dispute concerns the prohibition by Japan on imports of certain agricultural products. The United States alleges that Japan prohibits the importation of each variety of each product requiring quarantine treatment until the treatment has been completed for that variety, even if the treatment has proven effective with respect to other varieties of the same product. The United States contends that these measures are inconsistent with Japan's obligations under Articles 2, 4, 5, 7 and 8 of the SPS Agreement, Article XI of GATT 1994 and Article 4 of the Agreement on Agriculture. A panel was established at the meeting of the DSB on 18 November 1997. The European Communities, Hungary and Brazil reserved their third-party rights.

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**(8) Chile – Taxes on alcoholic beverages (WT/DS87) (WT/DS110)**

Complaint by the European Communities. This dispute concerns Chile's internal taxes on certain alcoholic beverages as contained in the Additional Tax on Alcoholic Beverages ("Impuesto Adicional a las Bebidas Alcoholicas").<sup>19</sup> The EC alleges that the law imposes a lower tax on the Chilean spirit Pisco than on other like spirits imported from the EC, and that this differential treatment violates Article III:2 of GATT 1994. The DSB established a panel on 18 November 1997, with Canada, Mexico, Peru and the United States reserving their third-party rights. Chile also modified its law in November 1997. Dissatisfied with the revision, the EC requested a new series of consultations in December 1997. After these talks failed, Chile agreed to the EC's first-time request for a panel and to the proposal that this matter be handled by the same panel established to deal with the EC's original complaint. The panel was established on 25 March 1998. Canada, Peru and the United States reserved their third-party rights.

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**(9) India – Quantitative restrictions on imports of agricultural, textile and industrial products (WT/DS90)**

Complaint by the United States. This dispute concerns quantitative restrictions maintained by India on the importation of more than 2,700 agricultural, textile and industrial products. The United States contends that these restrictions are inconsistent with India's obligations under Articles XI:1 and XVIII:11 of GATT 1994 and Article 4.2 of the Agreement on Agriculture. Moreover, the United States alleges that India's import licensing procedures and practices are inconsistent with Article XIII of GATT 1994 and Article 3 of the Import Licensing Agreement. The DSB established a panel on 18 November 1997.

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**(10) Korea – Definitive safeguard measure on imports of certain dairy products (WT/DS98)**

Complaint by the European Communities. This dispute concerns Korea's restrictions on imports of certain dairy products. In particular, the EC contends that Korea imposed a definitive safeguard measure in the form of an import quota on powdered milk, in violation of its obligations under Articles 2, 4, 5, and 12 of the Agreement on Safeguards and Article XIX of GATT 1994. The DSB established a panel on 23 July 1998.

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**(11) United States – Anti-dumping duty on dynamic random access memory semiconductors (DRAM) of one megabit or above originating from Korea (WT/DS99)**

Complaint by Korea. This dispute concerns the decision of the US Department of Commerce (DoC) not to revoke the anti-dumping duty on dynamic random access memory semiconductors (DRAM) of one megabit or above originating from Korea. Korea contends that the DoC decision, taken in July 1997, disregarded findings that Korean DRAM producers have not dumped their products for more than three and one-half consecutive years and evidence that the producers will not engage in future dumping. According to Korea, the

<sup>18</sup>See India – Patent protection for pharmaceutical and agricultural products (WT/DS50), supra.

<sup>19</sup>The United States raised similar concerns in a more recent request for consultations (WT/DS109).



standard of (non-)revocation adopted by the United States is impermissible under Article VI of GATT 1994 and Article 11 of the Anti-Dumping Agreement. Korea argues that United States violated Article X of GATT 1994 by failing to publish information regarding its decision-making criteria promptly and in such a manner as to enable governments and traders to become acquainted with them. It also contends that the refusal by the United States to revoke the anti-dumping duty without adequate consideration of information submitted by the Korean respondents is inconsistent with Articles I and VI of GATT 1994 and Articles 2, 3, 6, 11 and 17.6(i) of the Anti-Dumping Agreement. Finally, Korea alleges that the margin of dumping considered by the United States to be de minimis in administrative review proceedings is inconsistent with Article 5.8 of the Anti-Dumping Agreement. The DSB established a panel on 16 January 1998.

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**(12) Canada – Measures affecting the importation of milk and the exportation of dairy products (WT/DS103) (WT/DS113)**

Complaints by the United States and New Zealand. This dispute concerns Canada's provision of export subsidies through national and provincial pricing arrangements for milk and other dairy products. The United States alleges that these grants have been proffered in disregard of Canada's export subsidy reduction commitments, and have distorted markets for dairy products and adversely affected sales of the US domestic dairy industry. It alleges that these measures violate Articles II, X, XI and XIII of GATT 1994, Articles 3, 4, 8, 9 and 10 of the Agreement on Agriculture, Article 3 of the SCM Agreement, and Articles 1, 2 and 3 of the Import Licensing Agreement. Focusing more narrowly on the agricultural impact of Canada's export subsidy programme, New Zealand contends that the so-called "special milk classes" scheme is inconsistent with Articles 3, 8, 9 and 10 of the Agreement on Agriculture and Article X of GATT 1994. At its meeting on 25 March 1998, the DSB established a single panel to deal with both complaints. Australia and Japan reserved their third-party rights.

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**(13) Australia – Subsidies provided to producers and exporters of automotive leather (WT/DS106)**

Complaint by the United States. This dispute involved subsidies provided to Australian producers and exporters of automotive leather. The United States alleged that these subsidies included the provision of grants worth as much as A\$30 million and a A\$25 million loan on preferential and non-commercial terms. The United States contended that these measures were inconsistent with Australia's obligations under Article 3 of the SCM Agreement. The DSB established a panel on 22 January 1998. On 11 June 1998, however, the United States withdrew its request.<sup>20</sup>

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**(14) Argentina – Safeguard measures on imports of footwear (WT/DS121)**

Complaint by the European Communities. This dispute concerns safeguard measures imposed by Argentina on imports of footwear. The EC alleges that Argentina imposed a provisional safeguard measure in the form of minimum specific duties on footwear imports in February 1997, and a definitive safeguard measure on these imports in September 1997. The EC contends that the above measures violate Articles 2, 4, 5, 6 and 12 of the Agreement on Safeguards and Article XIX of GATT 1994.<sup>21</sup> The DSB established a panel on 23 July 1998.

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**(15) Australia – Subsidies provided to producers and exporters of automotive leather (WT/DS126)**

Complaint by the United States. This dispute involves subsidies provided to an Australian producer and exporter of automotive leather, Howe and Company Proprietary Ltd., either directly or through its affiliated or parent companies. The United States alleges that these subsidies included the provision of grants worth as much as A\$30 million and a A\$25 million loan on preferential and non-commercial terms. The United States contends that these measures are inconsistent with Australia's obligations under Article 3 of the SCM Agreement. The DSB established a panel on 22 June 1998.

## Panels requested but not established

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**(1a) Ireland – Measures affecting the grant of copyright and neighbouring rights (WT/DS82)**

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**(1b) European Communities – Measures affecting the grant of copyright and neighbouring rights (WT/DS115)**

On 14 May 1997, the United States requested consultations with Ireland regarding Ireland's failure to grant copyright and neighbouring rights under Irish law, alleging that this omission violated Ireland's obligations under Articles 9, 13, 14, 41-48, 61, 65 and 70 of the TRIPS Agreement. On 7 January 1998, the United States made a request for consultations

<sup>20</sup>The United States raised similar concerns in a more recent request for consultations (WT/DS126), *infra*.

<sup>21</sup>Indonesia has raised similar concerns in a separate request for consultations (WT/DS123).

with the European Communities on exactly the same grounds, namely the absence of copyright and neighbouring rights under Irish law.

On 9 January 1998, the United States requested the establishment of a panel. This request was denied at the DSB meeting on 22 January 1998, because of EC opposition and had not been renewed as of 31 July 1998.

## (2) United States – Tax treatment for “Foreign Sales Corporations” (WT/DS108)

On 18 November 1997, the European Communities requested consultations with the United States with respect to Sections 921-927 of the US Internal Revenue Code and related measures establishing special tax treatment for “Foreign Sales Corporations” (FSCs). The FSC regime exempts export-related portions of the income of FSCs from direct taxes. The EC contends that the FSC regime constitutes an export subsidy, and thus violates Articles 3.1(a) and 3.1(b) of the SCM Agreement, and Articles 3, 8, 9 and 10 of the Agreement on Agriculture.

Consultations were unsuccessful; the EC thereafter requested a panel on 1 July 1998. This request was denied at the DSB meeting on 23 July 1998, because of US opposition.

Table V.6

### Requests for consultations<sup>1</sup>

Dispute	Complainant	Date of request
India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products (WT/DS94)	Switzerland	18 July 1997
India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products (WT/DS96)	European Communities	18 July 1997
United States – Measures Affecting Government Procurement (WT/DS95)	Japan	18 July 1997
United States – Countervailing Duty Investigation of Imports of Salmon from Chile (WT/DS97)	Chile	5 August 1997
United States – Measures Affecting Imports of Poultry Products (WT/DS100)	European Communities	18 August 1997
Mexico – Anti-Dumping Investigation of High-Fructose Corn Syrup from the United States (WT/DS101)	United States	4 September 1997
Mexico – Anti-Dumping Investigation of High-Fructose Corn Syrup from the United States (WT/DS132)	United States	8 May 1998
Philippines – Measures Affecting Pork and Poultry (WT/DS102)	United States	7 October 1997
European Communities – Measures Affecting the Exportation of Processed Cheese (WT/DS104)	United States	8 October 1997
European Communities – Regime for the Importation, Sale and Distribution of Bananas (WT/DS105)	Panama	24 October 1997
Pakistan – Export Measures Affecting Hides and Skins (WT/DS107)	European Communities	7 November 1997
Chile – Taxes on Alcoholic Beverages (WT/DS109)	United States	11 December 1997
United States – Tariff Rate Quota for Imports of Groundnuts (WT/DS111)	Argentina	19 December 1997
Canada – Patent Protection for Pharmaceutical Products (WT/DS114)	European Communities	19 December 1997
Peru – Countervailing Duty Investigation Against Imports of Buses from Brazil (WT/DS112)	Brazil	23 December 1997
Brazil – Measures Affecting Payment Terms for Imports (WT/DS116)	European Communities	8 January 1998
Canada – Measures Affecting Film Distribution Services (WT/DS117)	European Communities	20 January 1998
United States – Harbour Maintenance Tax (WT/DS118)	European Communities	6 February 1998
Australia – Anti-Dumping Measures on Imports of Coated Woodfree Paper Sheets (WT/DS119)	Switzerland	20 February 1998
India – Measures Affecting Export of Certain Commodities (WT/DS120)	European Communities	16 March 1998
Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland (WT/DS122)	Poland	7 April 1998
Argentina – Safeguard Measures on Imports of Footwear (WT/DS123)	Indonesia	23 April 1998
European Communities – Enforcement of Intellectual Property Rights for Motion Pictures and TV Programmes (WT/DS124)	United States	30 April 1998
Greece – Enforcement of Intellectual Property Rights for Motion Pictures and TV Programmes (WT/DS125)	United States	30 April 1998
Belgium – Certain Income Tax Measures Constituting Subsidies (WT/DS127)	United States	5 May 1998
Netherlands – Certain Income Tax Measures Constituting Subsidies (WT/DS128)	United States	5 May 1998
Ireland – Certain Income Tax Measures Constituting Subsidies (WT/DS129)	United States	5 May 1998
Greece – Certain Income Tax Measures Constituting Subsidies (WT/DS130)	United States	5 May 1998
France – Certain Income Tax Measures Constituting Subsidies (WT/DS131)	United States	5 May 1998
Slovak Republic – Measures Concerning the Importation of Dairy Products and the Transit of Cattle (WT/DS133)	Switzerland	11 May 1998
European Communities – Measures Affecting Import Duties on Rice (WT/DS134)	India	28 May 1998
European Communities – Measures Affecting Asbestos and Products Containing Asbestos (WT/DS135)	Canada	28 May 1998
United States – Anti-Dumping Act of 1916 (WT/DS136)	European Communities	10 June 1998
European Communities – Measures Affecting Imports of Wood of Conifers from Canada (WT/DS137)	Canada	17 June 1998
United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating from the United Kingdom (WT/DS138)	European Communities	30 June 1998
Canada – Certain Measures Affecting the Automotive Industry (WT/DS139)	Japan	3 July 1998

1. These cases appear in order of date requested, except that related cases are grouped together. It includes three requests made at the end of July 1997 that were not listed in the *WTO Annual Report, 1997*. The list does not include those disputes where a panel was either requested or established.

## Panels suspended

### (1) United States – The Cuban Liberty and Democratic Solidarity Act (WT/DS38)

On 20 November 1996, a panel was established to consider the complaint by the European Communities concerning the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996 and other legislation enacted by the United States Congress to implement trade sanctions against Cuba. Canada, Japan, Malaysia, Mexico and Thailand reserved third-party rights. The EC claimed that US trade restrictions on goods of Cuban origin and associated restrictions against those who do business with Cuba (including the refusal of visas and the exclusion of non-US nationals from US territory), are inconsistent with US obligations under Articles V, XI and XIII of GATT 1994 and Articles II, III, VI, XI, XVI and XVII of GATS. Even if such measures were not in violation of specific provisions of GATT or GATS, the EC argued, they nevertheless nullified or impaired its expected benefits under these agreements. At the request of the EC, the Panel suspended its work on 21 April 1997. The Panel's authority lapsed on 22 April 1998, pursuant to Article 12.12 of the DSU.

### (2) Argentina – Measures affecting textiles, clothing and footwear (WT/DS77)

On 16 October 1997, a panel was established to consider certain measures governing Argentina's textiles, clothing and footwear sectors, in particular the imposition of specific duties on certain products in excess of the bound rate of 35 per cent ad valorem.<sup>22</sup> The EC contends that these measures are inconsistent with Argentina's commitments under Article II of GATT 1994 and Article 7 of the ATC. The United States reserved its third-party rights. At the request of the EC, the Panel suspended its work on 29 July 1998.

Table V.7

#### Notifications of mutually agreed solutions

Dispute	Complainant	Date settlement notified
Korea – Laws, Regulations, and Practices in the Telecommunications Sector (WT/DS40)	European Communities	22 October 1997
Japan – Measures Concerning Sound Recordings (WT/DS42)	European Communities	7 November 1997
United States – Measures Affecting Textiles and Apparel Products (WT/DS85)	European Communities	11 February 1998
Japan – Procurement of a Navigation Satellite (WT/DS73)	European Communities	19 February 1998
Philippines – Measures Affecting Pork and Poultry (WT/DS74)	United States	12 March 1998
Philippines – Measures Affecting Pork and Poultry (WT/DS102)	United States	12 March 1998
India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products (WT/DS94)	Switzerland	23 February 1998
India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products (WT/DS91)	Australia	23 March 1998
India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products (WT/DS92)	Canada	25 March 1998
India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products (WT/DS96)	European Communities	7 April 1998
Australia – Anti-Dumping Measures on Imports of Coated Woodfree Paper Sheets (WT/DS119)	Switzerland	13 May 1998

## VIII. Trade Policy Review Mechanism

The Trade Policy Review Mechanism (TPRM) was established in 1989, on a provisional basis, following the Mid-term Review of the Uruguay Round. It was confirmed as an integral element of the WTO in Annex 3 of the Marrakesh Agreement.

The aims of the Mechanism are to contribute to improved adherence by all Members of the WTO to its rules, disciplines and commitments, and thus to the smoother functioning of the multilateral trading system. The reviews aim to achieve greater transparency in and understanding of the trade policies and practices of Members. The mechanism enables the regular collective appreciation and evaluation by the Members of the full range of individual Members' trade policies and practices in all areas covered by the WTO Agreements, and their impact on the functioning of the multilateral trading system. Reviews take place against the background of the wider economic development needs, policies and objectives of the Members concerned, as well as the external-trading environment.

Reviews are conducted in the Trade Policy Review Body (TPRB), a full-membership body of equal ranking to the General Council and the Dispute Settlement Body. During 1997, the TPRB was chaired by Ambassador Munir Akram (Pakistan); the Chairman for 1998 was Ambassador Ali Said Mchumo (Tanzania).

<sup>22</sup>The United States raised similar concerns in a separate dispute, in which the Panel and Appellate Body found Argentina's specific duty regime to be in violation of its obligations under GATT. See Argentina – Certain measures affecting imports of footwear, textiles, apparel and other items (WT/DS56), supra.

Under the TPRM, the four largest entities in world trade (the European Union (EU), the United States, Japan and Canada – the “Quad”) are to be reviewed every two years; the next sixteen every four years; and remaining Members of the WTO every six years, with a longer interval envisaged for least-developed countries. It has been agreed that these intervals may, if necessary, be applied with a flexibility of six months’ extension; and that every second review of the “Quad” should be an interim review, while remaining comprehensive in scope. The 1997 review of the EU, the review of Canada in 1998 and of the United States in 1999 are the first such “interim” reviews.

By mid-1998, a total of 91 reviews had been conducted, covering 65 WTO Members (including the EU as one), with the “Quad” each having been reviewed four times; one Member (Australia) three times and 18 Members twice. During 1997, the TPRB reviewed eight Members: Fiji, Cyprus, Paraguay, Benin (first reviews), Chile, Mexico, Malaysia (second reviews) and the European Union (fourth review). In January-July 1998, the TPRB carried out six reviews, covering 10 Members: Japan (fourth review), the members of the Southern African Customs Union (Botswana, Lesotho, Namibia, South Africa and Swaziland), India, Hungary, Nigeria (second reviews) and Australia (third review). The review of the SACU members was the TPRB’s first grouped review of a number of Members jointly. The Chairperson’s concluding remarks for the reviews carried out from mid-1997 onwards can be found in Annex II, page 139.

In the period September-December 1998, the TPRB was scheduled to carry out first reviews of Jamaica, the Solomon Islands, and Trinidad and Tobago; a grouped review of Burkina Faso, Guinea, Mali and Togo; second reviews of Argentina, Turkey and Uruguay; third reviews of Indonesia and Hong Kong, China; and a fourth review of Canada.

In the past two years, greater focus has been placed on reviews of least-developed countries (LDCs), as encouraged by the November 1997 High-Level Meeting on Integrated Initiatives for Least-Developed Countries’ Trade Development. By end-1998, reviews had covered 9 of the 28 LDCs that are WTO Members: Bangladesh, Benin, Burkina Faso, Guinea, Lesotho, Mali, Uganda, Solomon Islands, Togo and Zambia. A second review of Bangladesh and a first review of Tanzania are scheduled for 1999. The reviews of Burkina Faso, Guinea, Mali and Togo in 1998 were closely linked with their participation in the technical assistance programme agreed under the Integrated Framework for Least-Developed Countries.

The TPRB is also responsible for carrying out the Annual Overview of developments in trade policy and the international trading system, on the basis of an Annual Report by the Director-General.

The TPRB is required to undertake an appraisal of the operation of the TPRM not more than five years after the entry into force of the WTO Agreement. This appraisal will be carried out in 1999.

Substantial progress has been made in enhancing awareness of the TPRM outside the Geneva circle. Documents distributed for reviews are now more readily available to all delegations of WTO Members in electronic format through the Secretariat’s Document Management System. Press briefings are regularly held by the Chair and in some cases by the Members under review. The Summary Observations by the Secretariat, the WTO press release, and the Closing Remarks by the Chair are available immediately on the WTO Internet home page. Since November 1997, reviews have been made available on-line under the Financial Times Information Service network, and from the second half of 1998, TPR reports are being published on behalf of the WTO by Bernan Associates. These new commercial arrangements aim to ensure a wider and more efficient distribution of the reports than was possible for the WTO Secretariat acting alone. A CD-ROM of all Trade Policy Reviews to date is also being prepared by Bernan Associates. There is, moreover, a substantial bibliography of academic and journal publications concerning the TPRM, which shows that access to and awareness of the mechanism is growing.

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## IX. Committee on Balance-of-Payments Restrictions

Under GATT Articles XII and XVIII:B, Members whose balance-of-payments difficulties have led them to restrict imports in order to conserve foreign exchange are required to consult regularly in the Committee on Balance-of-Payments Restrictions, during the period when the restrictions are in place. Members applying the provisions of Article XII of the General Agreement on Trade in Services are also expected to consult with the Committee.

The “Understanding on the Balance-of-Payments Provisions of the GATT 1994” draws upon and clarifies the provisions of Article XII, XVIII: B and the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes. In order to avoid incidental

protective effects, measures taken for balance-of-payments purposes should be temporary, price-based, control the general level of imports and be administered in a transparent manner. Members are required to notify to the General Council the introduction of, or any changes to, restrictive import measures introduced for balance-of-payments purposes, no later than 30 days after their announcement; consultations are expected to follow within four months of the notification. As long as restrictions for balance-of-payments purposes are maintained, developing countries consult every two years under Article XVIII:B; other countries are reviewed annually under Article XII. In the course of consultations, the Committee assesses the nature of the balance-of-payments difficulties, alternative corrective measures and the possible effect of restrictions on other economies. Members are expected to announce time-schedules for the removal of restrictions which may be modified in accordance with the balance-of-payments situation. In accordance with Article XV of the GATT, the IMF is invited to participate in the consultations and Members are expected to accept the determination of the Fund, *inter alia*, as to what constitutes a serious decline in the level of monetary reserves.

## 1997-1998

On 30 and 31 July 1997, the Committee resumed consultations with Nigeria. Members welcomed the submission of a time schedule for the phasing out of Nigeria's remaining import prohibitions. Most Members, recalling that the Committee had already concluded that these measures could no longer be justified under Article XVIII:B and the Understanding, called for their elimination immediately or over a much shorter time-frame than the eight years proposed by Nigeria. As the delegation was not in a position to propose a shorter timetable, the consultations were suspended until February 1998.

On 10 November 1997, the Committee resumed its consultations with Pakistan, suspended in April. Committee members welcomed the clear identification of items restricted for balance-of-payments reasons and the fact that the number of items had been considerably reduced. The Committee agreed that the consultation would be deemed to be concluded provided Pakistan publicly announced, within twelve months, a schedule, taking account of macroeconomic developments and the interests of trading partners, for the removal of measures within a reasonable period of time.

The Slovak Republic introduced a 7 per cent import surcharge on 21 July 1997, replacing an import deposit scheme in place since 30 May 1997. The Committee consulted with the Slovak Republic on 9 October and 17 December 1997. Members recognized that the Slovak Republic was facing balance-of-payments difficulties and welcomed that the measure was price-based and generally applied. Some members suggested that structural reform and macroeconomic adjustment were more likely to bring lasting relief. The Slovak Republic presented a timetable for the phasing out of the import surcharge, reducing it to 5 per cent on 1 January 1998, to 3 per cent on 1 April 1998 and eliminating the surcharge on 1 October 1998. The Committee agreed to recommend that the Slovak Republic be deemed in compliance with its obligations under GATT 1994 provided it adhered to its time schedule.

On 11 and 12 February 1998, the Committee met again with Nigeria. In the 1998 Budget, four products had been eliminated from the import prohibition list; a five-year timetable for the remaining items was presented to the Committee. Members considered this still too long, given that the measures were inconsistent with the balance-of-payments provisions. The consultations terminated without agreed conclusions.<sup>23</sup>

On 15 May 1998, the Government of Sri Lanka informed the WTO that it had disinvoked Article XVIII:B of the GATT 1994.

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## X. Committee on Regional Trade Agreements

The Committee on Regional Trade Agreements (CRTA) held six sessions in the period under review. In 1998 it decided to reduce the frequency of its meetings while increasing their length in order to afford more preparation time between sessions and allow for more in-depth discussion.

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### Main activities of the CRTA

The Committee has continued to devote much time to the examination of individual RTAs and has used a number of informal meetings to discuss examination reports. Since July 1997, 22 newly notified RTAs have been referred to the Committee for examination. Currently 60 examinations are in process, with 35 of these nearing completion (see Table V.8).

<sup>23</sup>During its Trade Policy Review, held in June 1998, the Government of Nigeria stated that it was considering a three-year phase out plan for the four items that remained on its import prohibition list.

Given the volume of the Committee's work, the streamlined procedures to facilitate and improve the examination process have proved essential in helping structure and speed up the examination of individual RTAs.

The Understanding on the Interpretation of Article XXIV of GATT 1994 includes a reaffirmation by Members of their commitment to report biennially on customs unions or free-trade areas to which they are party. In several meetings the Committee debated key questions, including what purpose the reports should serve (i.e. pure transparency or a basis for monitoring consistency with WTO rules), what agreements should be subject to the reporting requirement, and what information should be supplied in the reports, and in what form. In early 1998, the Committee adopted in principle procedural recommendations as to how the required reporting on the operation of RTAs should be carried out; these will be transmitted to the Council for Trade in Goods, the Council for Trade in Services and the Committee on Trade and Development for appropriate action.

The Committee continued its analysis of the systemic implications of RTAs for the multilateral trading system, based on systemic issues identified in the course of RTA examinations, systemic discussions or written submissions, adding to its evolving "checklist". In an effort to expand its understanding of systemic issues, the Committee agreed to follow a "three-pronged approach", entailing legal analyses of relevant WTO provisions, horizontal comparisons of RTAs, and debate on the context and economic aspects of RTAs.

Its discussions in the period under review covered legal analyses of the Article XXIV requirement that an RTA cover "substantially all the trade" and of the scope of the terms "other regulations of commerce" and "other restrictive regulations of commerce" as used in Article XXIV, and it began a horizontal consideration of issues, on the basis of a Secretariat compilation of non-tariff provisions of RTAs governing trade in goods. The information was

Table V.8

#### GATT/WTO-notified RTAs currently undergoing examination

European Union (services)	Faroe Islands-Norway FTA (goods)
EC Enlargement (goods)	Faroe Islands-Switzerland FTA (goods)
EC Enlargement (services)	Croatia-Slovenia FTA (goods)
EC-Bulgaria IA (goods)	Former Yugoslav Republic of Macedonia (F.Y.R.O.M.)-Slovenia FTA (goods)
EC-Czech Rep. IA (goods)	Romania-Moldova FTA (goods)
EC-Estonia FTA (goods)	CEFTA (goods)
EC-Faroe Islands FTA (goods)	Bulgaria-Slovenia FTA (goods)
EC-Hungary Europe Agreement (services)	Czech Republic-Bulgaria FTA (goods)
EC-Hungary IA (goods)	Slovak Republic-Bulgaria FTA (goods)
EC-Latvia FTA (goods)	Czech Republic-Latvia FTA (goods)
EC-Lithuania FTA (goods)	Czech Republic-Lithuania FTA (goods)
EC-Palestine Liberation Organization for the benefit of the Palestinian Authority of the West Bank and the Gaza Strip (goods)	Estonia-Slovenia FTA (goods)
EC-Poland Europe Agreement (services)	Latvia-Slovenia FTA (goods)
EC-Poland IA (goods)	Lithuania-Slovenia FTA (goods)
EC-Principality of Andorra CU (goods)	Poland-Lithuania FTA (goods)
EC-Romania IA (goods)	Slovak Republic-Latvia FTA (goods)
EC-Slovak Rep. Europe Agreement (services)	Slovak Republic-Lithuania FTA (goods)
EC-Slovak Rep. IA (goods)	Czech Republic-Israel FTA (goods)
EC-Slovenia IA (goods)	Hungary-Israel FTA (goods)
EC-Turkey CU (goods)	Slovak Republic-Israel FTA (goods)
EFTA-Bulgaria FTA (goods)	Turkey-Hungary FTA (goods)
EFTA-Estonia FTA (goods)	Turkey-Israel FTA (goods)
EFTA-Hungary FTA (goods)	Turkey-Lithuania FTA (goods)
EFTA-Israel FTA (goods)	Turkey-Romania FTA (goods)
EFTA-Latvia FTA (goods)	Canada-Chile FTA (goods)
EFTA-Lithuania FTA (goods)	Canada-Israel FTA (goods)
EFTA-Poland FTA (goods)	NAFTA (goods)
EFTA-Romania FTA (goods)	NAFTA (services)
EFTA-Slovenia FTA (goods)	MERCOSUR (goods)
Faroe Islands-Iceland FTA (goods)	ANZCERTA (services)

IA = interim agreement

FTA = free trade agreement

CU = customs union

presented in aggregate form, i.e. without identification of individual agreements, though the RTAs were grouped according to a number of descriptive parameters so as to highlight trends, recurrent features or patterns. These parameters referred to whether an agreement concerned a customs union or a free-trade area (irrespective of the existence of a transition period); whether the agreements were signed before or after 1990 (as a rough indication of whether they were contemporary to the GATT or the WTO); whether the agreements pertained to a particular geographical region; and whether the agreements had two or more parties. The Secretariat has been requested to conduct further analysis of some non-tariff provisions (rules of origin, contingency instruments and standards).

To enhance factual information on RTAs, the Secretariat periodically has updated a list of RTAs notified to the GATT/WTO which are currently in force. Delegations have suggested that this list be expanded to take into account both non-notified RTAs and regional initiatives which are under negotiation in order to give a more accurate picture of preferential agreements in existence today and to project what the system might look like five or 10 years down the road.

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## XI. Committee on Trade and Development

In the period under review, the Committee on Trade and Development held five meetings: on 26 September and 17 November 1997, 6 March, 23 April, and 19 June 1998. As in 1997, Members maintained an active and high level of interest in trade and development issues in the WTO. The Committee's work covered improvements to WTO technical assistance and training activities in favour of developing countries, ways of enhancing the participation of developing countries in the multilateral trading system, a review of the application of special provisions for differential and more favourable treatment of developing countries under the WTO Agreements, follow-up to the High-Level Meeting on Least-Developed Countries, and the development dimension of electronic commerce.

Following on from its adoption of Guidelines for Technical Cooperation in October 1996, the Committee reviewed and took note of the WTO's Three-Year Plans for Technical Cooperation for 1997-1999 and for 1998-2000, and it adopted a new WTO Manual on Technical Cooperation and Training. It discussed proposals made by delegations to broaden the scope of WTO technical assistance and training activities in favour of developing countries, and to establish an effective mechanism for monitoring and evaluating these activities. It also focused on implementation modalities for the provision of technical assistance.

The Committee reviewed trends in and factors underlying the participation of developing countries in world trade, on the basis of background documentation prepared by the Secretariat. Among the points made in the Committee's discussions were that it appeared developing countries' trade performance in aggregate had improved in the past few years, when measured for example by their combined share of world imports and exports, but that performance had not been uniform between regions or between different groups of developing countries; the very low and still declining share of least-developed countries in world trade was brought out as an area of particular concern in this context. Suggestions were made on the need for more disaggregated analysis, dealing for example with sectors such as textiles and clothing, and for renewed efforts to measure and analyse developing countries' performance in services trade.

The Committee continued its review of the application of special provisions for differential and more favourable treatment of developing countries, which it had begun in 1996. A background document prepared by the Secretariat was used as a basis for discussion. Some Members proposed that the Committee should embark on a more analytic stage of work, to examine the difficulties encountered by WTO Members in implementing the special provisions, analysis of the impact and effects of the special provisions on the trade and economies of developing countries, and the continued relevance of the current concept of special and differential treatment in the light of rapid changes in the international trading system. Consultations are underway in the Committee on how work in this area is to be taken forward.

Taking up the new subject of electronic commerce, the Committee recognized its growing importance in international trade and felt that its development dimensions required careful consideration in the WTO. At the end of the period under review, a request was pending to the Secretariat to produce background documentation on the subject, in particular on the development implications for developing countries with a view to enhancing their participation, to serve as a basis for further Committee discussion.

## Sub-Committee on Least-Developed Countries

The Sub-Committee on Least-Developed Countries met four times during the period under review: 16 September, 14 October and 1 December 1997, and 18 April 1998.

During most of the period it focused its work on preparations for and follow-up to the High-Level Meeting on Integrated Initiatives for Least-Developed Countries' Trade Development (see Box V.3 on page 75 for details). It also kept itself informed about the issue of accumulated arrears and the specific problems this might entail for the participation of least-developed countries in WTO technical assistance and training activities.<sup>24</sup>

The importance attached by Members to the work of the Committee and the Sub-Committee and the priority accorded to the issues under discussion there were reflected in the Ministerial Declaration of May 1998. Ministers renewed their commitment to ensuring that the benefits of the multilateral trading system are extended as widely as possible, and recognized the need for the system to make its own contribution in response to the particular trade interests and development needs of developing country Members. They welcomed the work underway to review the application of special provisions in the Multilateral Trade Agreements and related Ministerial Decisions in favour of developing country Members, in particular the least-developed among them, and agreed on the need for effective implementation of these provisions. Ministers reiterated their deep concern over the marginalization of LDCs and certain small economies, and recognized the urgent need to address this issue. To that end, the initiatives taken by the WTO in cooperation with other agencies to implement the WTO Plan of Action for the least-developed countries, especially through the High-Level Meeting, were welcomed.

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## XII. Committee on Trade and Environment

The WTO Committee on Trade and Environment's mandate and terms of reference are set out in the Marrakesh Ministerial Decision on Trade and Environment of April 1994. The CTE has a two-fold mandate, "to identify the relationship between trade measures and environmental measures in order to promote sustainable development" and "to make appropriate recommendations on whether any modifications of the provisions of the multilateral trading system are required, compatible with the open, equitable and non-discriminatory nature of the system".

This broad-based mandate covers goods, services, and intellectual property rights and builds on progress already achieved in the GATT Group on Environmental Measures and International Trade. With the aim of making international trade and environmental policies mutually supportive, the CTE's work programme was initially set out in the following 10 items:

- the relationship between the provisions of the multilateral trading system and trade measures for environmental purposes, including those pursuant to multilateral environmental agreements;
- the relationship between environmental policies relevant to trade and environmental measures with significant trade effects and the provisions of the multilateral trading system;
- the relationship between the provisions of the multilateral trading system and:
  - (a) charges and taxes for environmental purposes; and (b) requirements for environmental purposes relating to products, including standards and technical regulations, packaging, labelling and recycling;
  - the provisions of the multilateral trading system with respect to the transparency of trade measures used for environmental purposes and environmental measures and requirements which have significant trade effects;
  - the relationship between the dispute settlement mechanisms in the multilateral trading system and those found in multilateral environmental agreements;
  - the effect of environmental measures on market access, especially in relation to developing countries, in particular to the least developed among them, and environmental benefits of removing trade restrictions and distortions;
  - the issue of exports of domestically prohibited goods;
  - the relevant provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights;
  - the work programme envisaged in the Decision on Trade in Services and the Environment;
  - input to the relevant bodies in respect of appropriate arrangements for relations with intergovernmental and non-governmental organizations referred to in Article V of the WTO.

A start on the work programme was made soon after the Marrakesh Ministerial meeting, under the authority of the WTO Preparatory Committee, and from 1 January 1995, with the

<sup>24</sup>Pursuant to discussions in the Committee on Budget, Finance and Administration, the General Council decided at its meeting on 22 October 1997 that those least-developed countries which are WTO Members should be exempted from application of the administrative measures which states that "inactive Members" would be denied access to training or technical assistance.



coming into force of the WTO Agreement, the CTE was formally established to continue work in this area.

In the Report of the CTE to the Singapore Ministerial Conference in December 1996 (WT/CTE/1), Ministers agreed that the CTE would continue to work, reporting to the General Council, with the mandate and terms of reference contained in the Ministerial Decision on Trade and Environment. The WTO is interested in building a constructive relationship between trade and environmental concerns. Trade and environment are both important areas of policymaking and they should be mutually supportive in order to promote sustainable development. The multilateral trading system has the capacity to further integrate environmental considerations and enhance its contribution to the promotion of sustainable development without undermining its open, equitable and non-discriminatory character.

As set out in the Report to the General Council in December 1997 (WT/CTE/2), the CTE has continued to broaden and deepen the analysis of all items of the work programme set out in the Marrakesh Ministerial Decision on Trade and Environment. In 1997 and 1998, the CTE has based its analysis on the "cluster approach" under the themes of market access and the linkages between the multilateral environment agenda and the multilateral trade agenda.

In 1998, CTE meetings addressed all items of its work programme. The 19-20 March meeting addressed those items relevant to the theme of market access (Items 2, 3, 4 and 6) and included a substantive, sector specific discussion of the following sectors: agriculture, energy fisheries, forestry, non-ferrous metals, textiles and clothing, leather and environmental services. The willingness of delegations to engage in focused sector-by-sector discussions based on national experiences was felt to move forward the process of identifying situations where removing trade restrictions has the potential to be of economic and environmental benefit.

In fulfilment of the recommendation in the 1996 Report of the CTE, at the March meeting, the CTE established a WTO Environmental Database on trade-related environmental measures according to which the Secretariat will: (a) on an annual basis, undertake a comprehensive review of all environment-related measures which have been notified by WTO Members to continuously up-date the Environmental Database, which will be available to Members electronically through the Document Dissemination Facility; and (b) on an annual basis, conduct an interim review of the glossary of search words used in the compilation of the Environmental Database, which will be modified as necessary. The development of this Environmental Database represents an important step towards increasing the transparency of trade-related environmental measures which are notified by WTO Members.

The items related to the linkages between the multilateral environment and trade agendas were taken up at the CTE's meeting held on 23-24 July (Items 1, 5, 7 and 8). In order to continue to broaden the participation in support of the CTE's analysis, as part of the July meeting the CTE held an Information Session with representatives of eight secretariats of Multilateral Environmental Agreements (MEAs) relevant to the work of the CTE to inform Members on trade-related developments in their respective agreements. The following secretariats prepared background papers (available on the WTO website) and made presentations: the UN Framework Convention on Climate Change; UNEP Chemicals on the Prior Informed Consent (PIC) Convention; the UN/Economic Commission for Europe on the ECE Protocol on Persistent Organic Pollutants (POPs) and the Basel Convention on the Transboundary Movements of Hazardous Wastes and Their Disposal; the Convention on Biological Diversity, the International Tropical Timber Organization, the Intergovernmental Forum on Forests and the International Commission on the Conservation of Atlantic Tunas.

At a meeting to be held from 26-28 October 1998, the CTE will discuss the items under both thematic clusters; Items 9 and 10, and adopt the 1998 report of the CTE to the General Council.

With respect to the issue of broader participation in support of the analysis in the CTE, the Secretariat organized, under its own responsibility, an NGO Symposium on Trade, Environment and Sustainable Development on 17-18 March 1998. The Symposium included the participation of approximately 150 NGOs, the Director-General of the WTO, the Secretary General of UNTAD, the Executive Secretary of UNEP, the Deputy Administrator of UNDP, and a large number of WTO Member government representatives.

Further information on CTE meetings is contained in the WTO Trade and Environment Bulletin. A comprehensive discussion of the work programme and the conclusions and recommendations to Ministers are contained in the CTE's 1996 Report to the Ministerial Conference (WT/CTE/1). Reports of the CTE and the Trade and Environment Bulletins are available from the WTO Secretariat and can be accessed at: <http://www.wto.org/wto/environ/bulletin.htm>.

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## XIII. Plurilateral agreements

### Agreement on Government Procurement

The Agreement on Government Procurement entered into force on 1 January 1996. The following WTO Members are Parties to the Agreement: Canada; the European Communities and 15 member States; Hong Kong, China; Israel; Japan; Korea; Liechtenstein; the Kingdom of the Netherlands with respect to Aruba; Norway; Singapore; Switzerland; and the United States. Ten WTO Members have observer status: Argentina; Australia; Bulgaria; Chile; Colombia; Iceland; Panama; Poland; Slovenia; and Turkey. Three non-WTO members, Chinese Taipei, Latvia and Lithuania, and two intergovernmental organizations, IMF and the OECD, also have observer status.

Over the period under review, Liechtenstein and Singapore acceded to the Agreement on 18 September 1997 and on 20 October 1997 respectively. Iceland applied for accession on 25 June 1998. Chinese Taipei and Panama are currently conducting bilateral consultations with Parties with a view to their accession to the Agreement.

National implementing legislation was notified by Canada, Korea, Norway, Switzerland, the European Community and the United States. At its autumn 1998 meeting the Committee will initiate the review of national implementing legislation by taking up the legislation of the European Community and Korea.

Article XXIV:7(b) and (c) of the Agreement calls on the Parties, not later than the end of the third year from the date of its entry into force, to undertake further negotiations, with a view to improving the Agreement and achieving the greatest possible extension of its coverage among all Parties and eliminating any remaining discriminatory measures and practices. As stated in its 1996 Report to the General Council, the Committee initiated in February 1997 a review of the Agreement, in particular, covering the following elements: simplification and improvement of the Agreement, including, where appropriate, adaptation to advances in the area of information technology; expansion of the coverage of the Agreement; and elimination of discriminatory measures and practices which distort open procurement (GPA/8 and Add.1). This work is being pursued in informal consultations and on the basis of proposals by various Parties. At its meeting on 25 June 1998 the Committee agreed that Parties would seek to complete negotiations, at least on the simplification and improvement of the Agreement, by the time of the third WTO Ministerial Meeting. It adopted a work programme which calls for the tabling of proposals no later than the end of April 1999, the preparation of a basic negotiating document by the summer of 1999 and intensive negotiations during the autumn of that year. The Committee also agreed that Parties would, in parallel, continue work on two other elements of the negotiations, namely the elimination of discriminatory measures and practices which distort open procurement and the expansion of the coverage of the Agreement. The negotiations are aimed at facilitating the expansion of membership of the Agreement by making it more accessible to non-parties. WTO Members, not parties to the GPA, and other observer governments to the GPA have been invited to participate fully in the work.

Other matters considered by the Committee during the period under consideration have been: relationship of the Tokyo Round Agreement on Government Procurement to the 1994 Agreement on Government Procurement, modifications to the Appendices to the Agreement, loose-leaf system for Appendices, statistical reporting and notification of threshold figures in national currencies.

As regards dispute-settlement procedures, in the period under review, consultations were held by the delegations of the European Community and Japan, respectively, with the delegation of the United States regarding the legislation enacted by the State of Massachusetts regulating State contracts with companies doing business with or in Myanmar (WT/DS88/1-GPA/D2/1 and WT/DS95/1-GPA/D3/1).

### Agreement on Trade in Civil Aircraft

This Agreement entered into force on 1 January 1980. It has 24 Signatories: Bulgaria, Canada, the European Communities, Austria, Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, the United Kingdom, Egypt, Japan, Macau, Norway, Romania, Switzerland and the United States. The Agreement has 27 observers: Argentina, Australia, Bangladesh, Brazil, Cameroon, China, Chinese Taipei, the Czech Republic, Finland, Gabon, Ghana, the IMF, India, Indonesia, Israel, Malta, Mauritius, Nigeria, Poland, the Russian Federation, Singapore, the Slovak Republic, Sri Lanka, Trinidad and Tobago, Tunisia, Turkey and UNCTAD.

The Agreement eliminates all customs duties and other charges on imports of civil aircraft products and repairs, binds them at zero level, and requires the adoption or adaptation of

end-use customs administration. The Agreement prohibits signatories from requiring purchasers or exerting pressure on purchasers to procure civil aircraft from a particular source, and provides that purchasers of civil aircraft products should be free to select suppliers on the basis of commercial and technical factors only. The Agreement regulates signatories' participation in, or support for, civil aircraft programmes, and prohibits signatories from requiring or encouraging sub-national entities or non-governmental bodies to take actions inconsistent with its provisions.

Although the Agreement is part of the WTO Agreement, it remains outside the WTO framework. As of the meeting of the Committee on Trade in Civil Aircraft on 24 November 1997, attempts to adapt the provisions of the Agreement to the WTO framework remain unsuccessful.

## International Dairy Agreement

At its meeting on 30 September 1997, the International Dairy Council decided to terminate the International Dairy Agreement as of 1 January 1998. The reasons for the termination of the IDA are contained in the text of the decision (Box V.4). The last annual report of the International Dairy Agreement was published in October 1997.<sup>25</sup>

At the time of its termination, the following were parties to the IDA: Argentina, Bulgaria, Chad, the European Communities (15), Japan, New Zealand, Norway, Romania, Switzerland and Uruguay.

The IDA entered into force on 1 January 1995. It replaced the International Dairy Arrangement, which had operated since 1980. The primary objectives of the Agreement were to advance the expansion and liberalization of world trade in dairy products under as stable as possible market conditions, on the basis of mutual benefit to exporting and importing countries, and to further economic and social development in developing countries. In adopting these objectives, the economic importance of milk and dairy products to many countries was recognized, as well as the need to avoid surpluses and shortages and to maintain prices at an equitable level. The Annex of the Agreement established minimum export prices for defined pilot products to be monitored by a Committee on Certain Milk Products taking into account the relevant market factors.

## International Bovine Meat Agreement

In September 1997 the seventeen WTO signatories of the plurilateral International Bovine Meat Agreement decided to terminate this agreement at the end of 1997.<sup>26</sup> The full text of the decision is contained in Box V.5. The last Annual Report of the International Bovine Meat Agreement on the international markets for meat was published by the World Trade Organization in August 1997.<sup>27</sup>

<sup>25</sup>International Dairy Agreement, Third Annual Report, The World Market for Dairy Products, WTO, Geneva, October 1997.

<sup>26</sup>Argentina, Australia Brazil, Bulgaria, Canada, Chad, Colombia, European Communities (15), Japan, New Zealand, Norway, Paraguay, Romania, South Africa, Switzerland, United States and Uruguay.

<sup>27</sup>The report The International Markets for Meat 1996/97 is available for sale from the WTO.

### Box V.4: Termination of the International Dairy Agreement

Decision pursuant to Article VIII:3

The Parties to the International Dairy Agreement (the "Agreement"),

Noting that, according to Article VIII:3 of the Agreement, the duration of the Agreement shall be extended for a second three-year period after 31 December 1997 unless the International Dairy Council (the "IDC"), at least eighty days prior to 31 December 1997, decides otherwise;

Recalling that the limited membership in the Agreement, in particular the non-participation of some major dairy exporting countries, had made the operation of the minimum price provisions of the Agreement untenable, and that these provisions had been suspended by the IDC as of 18 October 1995 until 31 December 1997;

Considering that Parties wishing to discuss dairy trade-related aspects are able to do so within the framework of the WTO Committee on Agriculture or the WTO Committee on Sanitary and Phytosanitary measures;

Recalling that Parties had, in their report to the Singapore Ministerial Conference in December 1996, expressed doubt about the continued usefulness of the Agreement in the light of the Uruguay Round results;

Recognizing the resource constraints faced by governments and the WTO Secretariat;

Taking into account the availability of other sources of information for dairy trade statistics;

Hereby decide as follows:

- (i) the Agreement will not be extended for a further period of three years after 31 December 1997, and will be terminated as of 1 January 1998; and
- (ii) to request, in accordance with Article X:9 of the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), that the WTO Ministerial Conference delete the Agreement from Annex 4 of the WTO Agreement upon termination of the Agreement.

30 September 1997

### **Box V.5: Termination of the International Bovine Meat Agreement**

Decision pursuant to Article VI:3

The International Meat Council (the "Council") representing the Parties to the International Bovine Meat Agreement (the "Agreement"), Having reviewed the functioning of the Agreement in accordance with Article IV:1(b) thereof and as a follow-up to the report of the Council submitted to, and endorsed by, Ministers at the Singapore Ministerial Conference,

Recalling that the Agreement had entered into force on 1 January 1995 for a three-year period ending on 31 December 1997,

Noting that, according to Article VI:3 of the Agreement, its duration shall be extended for a second three-year period, unless the Council, at least eighty days prior to 31 December 1997, decides otherwise,

Recalling that Parties had expressed doubts with respect to the continued usefulness of this Agreement in the post-Uruguay Round trading environment,

Noting that, following the establishment of the WTO, trade policy-related matters affecting meat and meat products as well as other agricultural products were regularly addressed in the Committee on Agriculture and the Committee on Sanitary and Phytosanitary Measures,

Considering that the work of these Committees had clear priority over the work of the Council,

Noting that, as regards market information, Parties may, and increasingly did, rely on other sources of information, including information prepared by other national and intergovernmental bodies regularly evaluating meat market developments,

Considering the resource constraints faced by governments as well as the Secretariat,

Hereby decides:

- (a) to terminate the International Bovine Meat Agreement at the end of 1997; and
- (b) to request, in accordance with Article X:9 of the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), that the WTO Ministerial Conference delete the Agreement from Annex 4 of the WTO Agreement upon termination of the Agreement.

30 September 1997

The International Bovine Meat Agreement had entered into force on 1 January 1995, replacing the Tokyo Round Arrangement Regarding Bovine Meat which had operated since 1980. The agreement represented one of the four plurilateral agreements that were attached to the Marrakesh Agreement Establishing the World Trade Organization (Annex 4 to the WTO Agreement).

The primary objectives of the International Bovine Meat Agreement were to promote the expansion, liberalization and stability of the international meat and livestock market by improving the international framework of world trade to the benefit of consumers and producers, importers and exporters; to encourage greater international co-operation in all aspects affecting trade in bovine meat and live animals; and to secure additional benefits for the international trade of developing countries in bovine meat and live animals.

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## **Part II**

### **I. The WTO budget and Secretariat staffing**

The WTO's budget for 1999 as approved by the General Council, acting on behalf of WTO Members, amounts to 124.8 million Swiss francs (SwF). Overall, the budget covers the costs of holding meetings, maintenance costs for the Secretariat headquarters in Geneva, technical cooperation missions and other official visits overseas. The budget is also used for technical assistance and for trade policy courses as well as for the salaries and related costs of the Secretariat staff of slightly over 500. An amount of 800,000 SwF was also budgeted in 1999 to replenish the Appellate Body operating fund in order to bring it to a level of 2.2 million SwF. The WTO also finances, jointly with UNCTAD, the operations of the International Trade Centre.

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### **II. Technical cooperation and training**

The establishment of the WTO and the new multilateral trading system that emerged from the Uruguay Round negotiations, have certain implications for the technical cooperation that is provided to developing countries and to economies in transition, in terms of both requirements and the way in which assistance is delivered.

The present activities already largely take account of the changing trading environment and emerging new requirements. The WTO exercises flexibility to best tailor the technical cooperation activities to the needs and priorities of individual countries, groups of countries or regions, taking into account their level of development. This flexibility can be exercised through a variety of instruments that the WTO has at its disposal for delivering such assistance, including seminars, workshops, technical missions, briefing sessions, and training through trade policy courses. The intention is to respond specifically to the requirements of Members both on the contents and on the format. Each type of activity differs in nature and in duration, and is determined on a case-by-case basis. While some activities, by their very nature, are carried out in the country or region concerned, others take place at the WTO headquarters. The financial resources involved are directly related to the duration and the geographical location of the activity.

Technical cooperation in the WTO Secretariat is guided by the fundamental objective of assisting recipient countries in their understanding and implementation of agreed international trade rules, achieving their fuller participation in the multilateral trading system and ensuring a lasting, structural impact on the recipient country. The form is on directing all instruments towards human resource development and institutional capacity building. A follow-up of technical cooperation is increasingly part of the programmes so as to ensure long-lasting relations with beneficiary countries.

Concerted efforts are being undertaken to better coordinate WTO activities with other agencies, in particular in mapping out joint technical assistance programmes with ITC and UNCTAD. Contacts are established at the operational level between the agencies, both in Geneva and during missions, to ensure that the best use is made of available expertise and limited human and financial resources. Also, more attention in the technical cooperation activities is given to the role of the private sector in the development process. Efforts are undertaken to increase the number of participants representing the private sector in the seminars and workshops.

The funds provided by the regular WTO budget for technical cooperation and training activities have been supplemented by additional funds provided by some Members for specific activities and programmes, and which have been put in the WTO Trust Fund for Technical Cooperation and Training. Hong Kong, China, has made a non-earmarked contribution to the WTO Trust Fund; Japan has made special contributions to finance a regional seminar in Asia; the Netherlands have made a contribution to the WTO Trust Fund for the benefit of developing countries, including least-developed countries, economies in transition and countries involved in the process of accession to the WTO. Norway's contributions to the Trust Fund are geared towards the least-developed countries and other Sub-Saharan countries; New Zealand has committed funds for activities with the Forum Island Member Countries; Switzerland has provided extra-budgetary resources to facilitate the participation of Central and Eastern European Countries in WTO training activities and in 1998 has also made a contribution to the WTO Trust Fund.

Since the creation and entry into force of the World Trade Organization, over 600 technical cooperation activities have been organized through mid-1998. Major efforts have been directed towards assisting African countries, while activities for countries in other regions have been maintained. Africa continues to be covered in large measure under specific programmes.

The Integrated Technical Assistance Programme in Selected Least-Developed and other African Countries was undertaken initially in eight African countries: four least developed countries, (Benin, Burkina Faso, Tanzania and Uganda) and four developing countries (Côte d'Ivoire, Ghana, Kenya and Tunisia). In the light of experience in the conduct of this programme, its further development and extension to other African and least-developed countries is envisaged for execution in the short- and medium-term. The objective is to enhance the development prospects and competitiveness of African and least-developed countries through increased participation in international trade.

The programme is based on two fundamental themes:

- (1) close coordination at the design stage and particularly in the conduct of the programme among the three participating international organizations, i.e. WTO, UNCTAD and ITC, alongside the strengthening of relationships on these matters with the World Bank and UNDP, as well as other organizations; and
- (2) a combination of technical assistance activities directed towards human development and institutional capacity building, particularly through the use, as collaborators and not only as beneficiaries, of local institutions and local trainers, with a view to reaching a significant, durable impact. Specific country reports have been prepared and the implementation of programmes started.

A Trust Fund was established to receive funding from donors to finance the activities under this Joint Integrated Programme. The contributions received to date have enabled the

three organizations to start implementing different aspects of the programme. The fund is technically administered by the Fund Administrator, based at ITC.

Separately, a High-Level Meeting for Least-Developed Countries' Trade and Development was held 27-28 October 1997 (see Box V.3).

In 1997 and during the first half of 1998, specific technical assistance activities included:

- national, regional and sub-regional seminars/workshops on the WTO multilateral trading system and on specific agreements;
- a series of eight regional seminars on services, focusing more particularly on the financial services negotiations, which were concluded December 1997;
- training courses on dispute-settlement procedures and practice, both in Geneva and in the regions;
- regional seminars on trade and environment;
- short trade policy courses for least-developed countries;
- workshops for Geneva-based delegations on trade and investment;
- briefing sessions on a regular basis for Geneva-based delegations and visiting officials of least-developed countries, developing countries, economies in transition and countries in the process of accession;
- technical missions on notification requirements;
- technical missions to assist countries in the accession process to the WTO and other countries that are contemplating accession;
- technical assistance in the preparation of the trade policy reviews of developing countries and least-developed countries.

## Trade policy courses

In the period under review, the WTO Secretariat organized three regular Trade Policy Courses and one seven-week Special Course on Accession to the WTO for Eastern and Central European and Central Asian Countries.

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### Regular courses

The three regular Courses in English, Spanish and English respectively were held for developing country officials who are involved in the formulation and implementation of trade policy. The course in 1997 lasted for 14 weeks and the courses in 1998 for 12 weeks and took place at the WTO in Geneva. Course participants (24 places on each regular Course) were financed by WTO fellowship awards which cover expenses for the duration of the Course.

The overall objective of these kinds of courses is to widen the participating officials' understanding of trade policy matters, the multilateral trading system, international trade law and the functioning of the WTO. The knowledge acquired is expected to allow participating officials to improve the effectiveness of their work in their own administrations and to promote a more active participation of their countries in the work of the WTO.

There are specific objectives corresponding to the main courses components, e.g. presentations and discussions on WTO Agreements to acquaint participants with their content and legal/trade policy implications; negotiation simulations to help participants understand the psychology, process and substance of trade negotiations; and dispute settlement exercises to facilitate practical understanding of how cases are prepared and disputes resolved.

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### Special course

The Special Course (for 21 participants) was funded by the Swiss Government, the first week being held at the Foundation Monte Verità in Ascona and the remainder at the WTO in Geneva. The programme of the Special Course is similar to that of the regular Trade Policy Course whereby it is designed to familiarize participants with the functioning of the multilateral trading system. Special emphasis is, however, given to issues relating to accession of relevance to economies in transition.

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## III. Cooperation with other international organizations

Since its establishment, the WTO has had extensive contact with other inter-governmental organizations interested in its activities. Relations have been established with relevant organizations in the United Nations system, the Bretton Woods organizations, or various regional bodies to ensure that the resources and expertise of the international community remain focused, coordinated and, most important, relevant to the most pressing global needs.

Many of the organizations have observer status in one or more of the various WTO Committees, Councils or working groups. Some of them are also represented in the negotiating groups for trade in certain services sectors. A list of all organizations with observer status is provided below.

Table V.9

**International intergovernmental organizations**

a. Observer status in the WTO

		GC	TPRB	CTG	CTS	TRIPS	ADP	SCM	SG	AG	SPS	BOPS	CRTA	CTD	CTE	MA	UC	RO	TBT	TRIMS	VAL	GATT/GPS	GATT/CNCL	GATT/CTD
<b>UN bodies and specialized agencies:</b>																								
UN	United Nations	X		X	X	X								X	X					X		X	X	X
Codex	Codex Alimentarius Commission										X									X				
CSD	Commission for Sustainable Development														X									
CBD	Convention on Biological Diversity														X									
CITES	Convention on International Trade in Endangered Species														X									
ECA	Economic Commission for Africa													X								X	X	X
ECE	Economic Commission for Europe				P									X					X			X	X	X
ECLAC	Economic Commission for Latin America & the Caribbean													X								X	X	X
ESCAP	Economic & Social Commission for Asia & the Pacific													X								X	X	X
FAO	Food & Agriculture Organization	X	X	X		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
ITU	International Telecommunication Union	P			X <sup>1</sup>																			
UNCTAD	United Nations Conference on Trade & Development	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
UNDP	United Nations Development Programme	P												X	X									
UNEP	United Nations Environment Programme	P													X									
UNIDO	United Nations Industrial Development Organization	P												X	X							X		
WFC	World Food Council													X										X
WFP	World Food Programme									X														
WHO	World Health Organization	P									X									X				
WIPO	World Intellectual Property Organization	X				X									X							X	X	
<b>Other organizations:</b>																								
ACP	African, Caribbean & Pacific Group of States	P		P	P		<sup>2</sup>	<sup>2</sup>	<sup>2</sup>	P	P	X		X	X	X	P	X	<sup>2</sup>	P	X	X	X	
ARIPO	African Regional Industrial Property Organization					P																		
	ANDEAN Group													X								X	X	X
	Arab Maghreb Union	P		P	P								P	P										
	Arab Monetary Fund	P		P	P																	X	X	
	Arab Trade Financing Programm	P		P	P																			
CARICOM	Caribbean Community Secretariat													X								X	X	X
UDEAC	Central African Customs & Economic Union													X								X		X
	Commonwealth Secretariat													X								X		X

Table V.9 (continued)

## International intergovernmental organizations

## a. Observer status in the WTO

		GC	TPRB	CTG	CTS	TRIPS	ADP	SCM	SG	AG	SPS	BOPS	CRTA	CTD	CTE	MA	LIC	RO	TBT	TRIMS	VAL	GATT CPS	GATT CNCL	GATT CTD
GCC	Cooperation Council for the Arab States of the Gulf	P	P	P	P	P				P				X	P							X	X	X
EBRD	European Bank for Reconstruction & Development	P	X	P	P							X	P									X	X	
ECOWAS	Economic Community of Western African States													P										
EFTA	European Free Trade Association	P	X	P	P	P					P	X	X	X	X			X	<sup>3</sup>			X	X	X
EPPO	European & Mediterranean Plant Protection Organization										P													
IDB	Inter-American Development Bank		P							P		P	X		X	X		X		P	X	X	X	X
IICA	Inter-American Institute for cooperation on Agriculture									P	P													
ICAO	International Civil Aviation Organization					X <sup>4</sup>																		
ICGFI	International Consultative Group on Food Irradiation										P													
IEC	International Electrotechnical Commission																			X				
IGC	International Grains Council			P						X				X										X
ILAC	International Laboratory Accreditation Cooperation																			P				
IOE	International Office of Epizootics										X										X			
ISO	International Organization for Standardization										X				X						X			
IOLM	International Organization of Legal Metrology																				<sup>5</sup>			
ITCB	International Textiles and Clothing Bureau	P		X												X		X						
ITC <sup>6</sup>	International Trade Centre UNCTAD/WTO	X			X						X			X	X						X			
UPOV	International Union for the Protection of New Varieties of Plants					X																		
	Islamic Development Bank													P							P			
SELA	Latin American Economic System	P		P	P	P				P	P	P	X	X	P						P	X	X	X
ALADI	Latin American Integration Association												P	X							<sup>7</sup>	X	X	X
OIV	Office International de la Vigne et du Vin	P				P					P										P			
OAU	Organization of African Unity	P		P									P	P										
OAS	Organization of American States	P		P	P	P							X	X								X	X	X
OECD	Organization for Economic Cooperation & Development	X	X	X	P	X	<sup>8</sup>	<sup>8</sup>	<sup>8</sup>	X	P	X	P	X	X			X	X	X		X	X	X
	Organization of the Islamic Conference	P	P	P	P	P							P	P	P							X		
RIOPPAH	Regional International Organization for Plant Protection and Animal Health										P													
IPPC	Secretariat of the International Plant Protection Convention										X													



Table V.9 (continued)

**International intergovernmental organizations****a. Observer status in the WTO**

		GC	TPRB	CTG	CTS	TRIPS	ADP	SCM	SG	AG	SPS	BOFS	CRIA	CTD	CTE	MA	LIC	RO	TBT	TRIMS	VAL	GATT/CPS	GATT/CNCL	GATT/CTD
SIECA	Secretariat of the General Treaty on Central American Economic Integration	P		P	P	P								X								X	X	X
SADC	Southern African Development Community			P	P								P	X										
WAEMU	Western African Economic & Monetary Union	P											P	P		P								
WCO	World Customs Organization			X		X									X	X		X			X	X		

1. The Committee agreed to grant ad hoc observer status to ITU pending further decisions.
2. The Committee agreed to grant ad hoc observer status to ACP pending further decisions.
3. The Committee agreed to grant ad hoc observer status to EFTA pending further decisions.
4. The Committee agreed to grant ad hoc observer status to ICAO pending further decisions.
5. The Committee agreed to grant ad hoc observer status to IOLM pending further decisions.
6. The ITC is a joint subsidiary organ of the WTO and the UN, the latter acting through the UNCTAD.
7. The Committee agreed to grant ad hoc observer status to ALADI pending further decisions.
8. The Committee has deferred action on the OECD's request, and agreed that in the interim the OECD will be invited to attend on an ad hoc basis.

Table V.9

**International intergovernmental organizations****b. Observer status in certain other bodies (as referred to in Explanatory note 3)**

		Financial services	GATS rules	Professional services	Specific commitments	Working Group on Government Procurement	Working Group on Investment	Working Group on Competition Policy
<b>UN bodies and specialized agencies:</b>								
UN	United Nations	X	X	X	X	<sup>1</sup>		
ESCWA <sup>2</sup>	Economic and Social Commission for Western Asia						P	
UNCITRAL	United Nations Commission on International Trade Law					X		
UNCTAD	United Nations Conference on Trade & Development	X	X	X	X	X	X	X
UNIDO	United Nations Industrial Development Organization						<sup>3</sup>	
<b>Other organizations:</b>								
ACP	African, Caribbean & Specific Group of States	X		X				
ITC <sup>4</sup>	International Trade Center UNCTAD/WTO Energy Charter Secretariat					P	P	
SELA	Latin American Economic System					<sup>5</sup>	P	<sup>5</sup>
OAU	Organization of African Unity						P	
OAS	Organization of American States						P	
OECD	Organization for Economic Cooperation & Development	X	X	X	X	<sup>6</sup>	<sup>7</sup>	X <sup>8</sup>
	Organization of the Islamic Conference					P	P	P

1. The UNCITRAL, listed below, represents the UN.
2. Observer status in GATT CP (see explanatory note 1).
3. The Working Group agreed to invite UNIDO pending further decisions.
4. The ITC is a joint subsidiary organ of the WTO and the UN, the latter acting through the UNCTAD.
5. The Working Group agreed to grant ad hoc observer status to SELA.
6. The Working Group agreed to grant ad hoc observer status to OECD.
7. The Working Group agreed to invite OECD pending further decisions.
8. The Working Group agreed to grant observer status to OECD on the basis that there would be reciprocity.

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Explanatory notes to Table V.9:

1. An "X" indicates observer status; a "P" indicates that consideration of the request for observer status is pending.
  2. The bodies listed in the table are, respectively, the General Council (GC); Trade Policy Review Body (TPRB); Council for Trade in Goods (CTG); Council for Trade in Services (CTS); Council for TRIPS (TRIPS); the Committees on Anti-Dumping Practices (ADP); Subsidies and Countervailing Measures (SCM); Safeguards (SG); Agriculture (AG); Sanitary and Phytosanitary Measures (SPS); Balance-of-Payments Restrictions (BOPS); Regional Trade Agreements (CRTA); Trade and Development (CTD); Trade and Environment (CTE); Market Access (MA); Import Licensing (LIC); Rules of Origin (RO); Technical Barriers to Trade (TBT); Trade-Related Investment Measures (TRIMs); Customs Valuation (VAL). Additional information concerning the observer status of the listed organizations in the GATT CONTRACTING PARTIES (GATT CPS), Council of Representatives (GATT CNCL) and Committee on Trade and Development (GATT CTD) is provided in the last three columns.
  3. Since the guidelines on observer status for international organizations (WT/L/161, Annex 3) provide that requests for observer status from organizations shall not be considered for meetings of the Budget Committee or the Dispute Settlement Body, these bodies are not listed in the table. Also not listed are the Textiles Monitoring Body, which has no observers, the committees and councils under the Plurilateral Trade Agreements and working parties on accession. As for the four bodies under the Council for Trade in Services, namely the Committees on Financial Services and on Specific Commitments, and the working parties on GATS Rules, and Professional Services, as well as the three working groups on Investment, Competition Policy and Government Procurement, information is provided in a separate table on the last page.
  4. The IMF and World Bank have observer status in WTO bodies as provided for in their respective Agreements with the WTO (WT/L/195), and are not listed in this table.
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## International Monetary Fund (IMF)

Collaboration and cooperation between the WTO and the IMF was strengthened when the heads of the two organizations signed an agreement in Singapore in December 1996 during the WTO's Ministerial Conference. Signed by the WTO's Director-General, Mr. Renato Ruggiero, and the IMF's Managing Director, Mr. Michel Camdessus, the Agreement focuses on three main elements. First, it lays the basis for carrying forward the WTO's Ministerial mandate to achieve greater coherence in global economic policy by cooperating with the IMF and the World Bank. Second, reflecting the synergies in the work and responsibilities of the IMF and the WTO, the Agreement provides channels of communication to ensure that the rights and obligations of Members are integral to the thinking of each organization. Third, in keeping with enhanced cooperation, the Agreement accords observer status to the IMF and WTO in certain of each other's decision-making bodies. Thus, it grants the WTO observer status at the Fund's Annual meetings and at the Interim Committee, as well as at the appropriate meetings of the IMF's Executive Board, when it considers trade issues, and in turn grants observer status to the IMF on most WTO bodies. In December 1997 and on various occasions in 1998, representatives of the WTO Secretariat participated at the IMF's Executive Board meetings on, among other matters, the World Economics Outlook, on a possible amendment of the IMF's Articles of Agreement with respect to capital movements, and on an examination of the trade-policy content of IMF-supported adjustment programmes.

The Agreement between the IMF and the WTO has other benefits, including better access for both organizations to each other's information and data. Such access is vital to avoiding unnecessary duplication. The IMF's macroeconomic information is of great use to the WTO Secretariat, especially in the preparation of the in-depth and regular Trade Policy Reviews of each WTO Member. In turn, the IMF has access to a wide range of WTO information, including its Integrated Data Base, which contains trade statistics and information on WTO Members' tariff rates, and to Members' schedules of concessions in goods and services; this helps the Fund in its surveillance and lending activities. In this context there has also been frequent contact between the staffs of the organizations on country and related matters, including on the East-Asian crisis and accession issues.

While the Agreement establishes new mechanisms by which the institutions can address each other, it also reflects and builds on a long-standing successful relationship. Thus, the institutions emphasize the need for their day-to-day dialogue to develop in a natural way, creating a more fruitful, two-way relationship between the organizations. Now that the institutional footing has been put in place by the Agreement, work has started to address issues related to achieving better coherence in global economic policy making, an area where the WTO, the IMF and the World Bank each have distinctive roles.

Collaboration has also advanced in the area of technical cooperation. The IMF was one of the five organizations that cooperated with the WTO in the organization of the High-Level Meeting for Least-Developed Countries, which the WTO convened in October 1997.<sup>28</sup> This meeting was a first critical step in a long-lasting Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries in which the IMF, World Bank and WTO play complementary and mutually supportive roles.

Under the GATT 1948, the formal relationship between the GATT and the IMF derived primarily from the provisions on balance-of-payments restrictions. In this regard, a close and long-standing institutional relationship existed between the two organizations, whereby the IMF provided information on and an assessment of the situation of the balance of payments of the contracting party engaged in consultations under Articles XII or XVIII:B of the GATT. In accordance with Article XV of the GATT, contracting parties who were not at the same time members of the IMF have, in the past, either signed a special exchange agreement with the CONTRACTING PARTIES or have been granted a waiver of indefinite duration. In addition, Article XV also provided for the IMF and the GATT CONTRACTING PARTIES to seek cooperation with regard to exchange questions within the jurisdiction of the IMF and to questions of quantitative restrictions and other trade measures within the jurisdiction of the

<sup>28</sup>The five agencies referred to are the IMF, ITC, UNCTAD, UNDP and World Bank.

CONTRACTING PARTIES, and for the latter to consult fully with the former on problems concerning monetary reserves, balance of payments and foreign exchange arrangements.

In contrast to the previous situation, formal relations between the WTO, the IMF and the World Bank now encompass a larger range of issues. The IMF's role within the WTO system through GATT Article XV now also covers the corresponding Article of the GATS (Article XI). Similarly, the IMF's balance-of-payments role is maintained but now enlarged to cover services (Article XII of the GATS).

## The World Bank

In April 1997 the World Bank and the WTO signed an agreement to strengthen their cooperation and collaboration. Signed by Mr. Renato Ruggiero, Director-General of the WTO, and Mr. James Wolfensohn, President of the World Bank, at the World Bank's headquarters in Washington, D.C., the agreement focuses on three main elements. First, it provides the basis for carrying forward the WTO's Ministerial mandate to achieve greater coherence in global economic policy making by cooperating with the World Bank and the International Monetary Fund (IMF). The WTO Secretariat and the World Bank are expected to consult and exchange views on all matters of common interest. Second, the Agreement calls for improved communication between the two institutions through the exchange and sharing of information, thus ensuring that interests of Members are integral to the thinking of each organization. The WTO and the World Bank will share access to their respective databases, undertake joint research and technical cooperation activities and exchange reports and other documents. Third, the Agreement accords observer status to the World Bank and the WTO to attend meetings of each other's decision-making bodies. Thus, the WTO attends the Annual Meetings of the World Bank's Board of Governors, the Development Committee and sessions of the Bank's Executive Board as appropriate, while the World Bank may attend the WTO's Ministerial Conference, the General Council and other relevant committee meetings. On various occasions in 1997 and 1998, representatives of the WTO Secretariat participated at the Bank's Executive Board discussions, including on the Global Economic Prospects and Developing Countries, the World Development Report, and the Integrated Framework for Trade-related Technical Assistance to Least-Developed Countries.

The Agreement provides the WTO Secretariat with access to World Bank information, including the Bank's Economic and Social Database (BESD) and the World Debt Tables, the World Bank Atlas and World Development Indicators, its Trends in Developing Economies and its African Development Indicators. This information is essential to the work of the WTO's Trade Policy Review Body, the Committee on Trade and Development and the Sub-committee on Least-Developed Countries. In turn, the World Bank has access to the Integrated Database of the WTO and to WTO Members' schedules of market access commitments and concessions in goods and services.

In 1998, the WTO and the World Bank's Economic Development Institute continued collaboration on a project that uses information technologies to help government officials, academics, journalists and business leaders access information related to trade and development. Part of the project includes a joint WTO-World Bank Trade and Development Internet site. Under the project, some 30 developing countries have been provided with the necessary facilities to enable on-line access to WTO information. Funding for the joint collaboration comes in part from a trust fund made possible by financial contributions received from a number of Members.

Collaboration has also advanced in the area of technical cooperation. The WTO and World Bank co-sponsored in 1998 a number of regional seminars on WTO matters. The World Bank was also one of the five organizations that cooperated with the WTO in the organization of the High-Level Meeting for Least-Developed Countries which was convened by the WTO in October 1997, and its Executive Board has formally endorsed the Bank's participation in the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries, in which the World Bank and WTO play complementary and mutually supportive roles.

## United Nations Conference on Trade and Development

The World Trade Organization (WTO) and the United Nations Conference and Trade and Development (UNCTAD) have continued to develop their important relationship, reflecting their shared interest in advancing the cause of global trade liberalization within the framework of the multilateral system. The two executive heads meet regularly. At their meeting on 20 January 1998 they focused on a number of issues, of particular importance being the follow-up to the High-Level Meeting on Integrated Initiatives for Least-Developed Countries' Trade Development (see Box V.3 on page 75). There was further research cooperation between the two organizations, this time on a joint study on market access prepared for the 1998 ECOSOC High level held segment in New York on 6, 7 and 8 July 1998.

On 29 November 1997 and again on 25 July 1998, the WTO Secretariat organized jointly with UNCTAD and the World Bank a symposium on competition policy. The two events were held close to the times of UNCTAD's Expert Meeting on Competition Policy and the WTO's Working Group on the Interaction between Trade and Competition Policy to take advantage of the presence of national experts. The aim of the two symposiums was to enable an exchange of views in a non-official setting on issues relating to the implications of competition policy for economic development and their interaction with international trade.

In February 1998 and again on 8 and 9 June 1998, UNCTAD held joint seminars with the WTO on "Investment, Trade and Economic Development" for officials from permanent missions to the UN and the WTO. A third seminar was planned for late 1998 and 1999.

Within the overall objective of coordination across the board and making better use of collective resources for the benefit of all developing countries, the major focus of WTO-UNCTAD joint efforts has been to assist least-developed countries, and African countries in particular, in integrating more fully and effectively into the world trading system.

The two organizations and the International Trade Centre (see below) have also collaborated in the establishment of an unprecedented Technical Assistance Programme, designed to target specific African countries and help them expand and diversify their trade, and ease their integration into the multilateral trading system. The drive for greater coordination between WTO and UNCTAD underscores the broader need to integrate the developing world – and especially the least-developed countries – more fully into the global economy.

The outcome of the High-Level Meeting is a self-assessment by least-developed countries of their development needs, leading to a number of activities designed to improve their integration. The WTO, UNCTAD and the other agencies involved – including the International Trade Centre, which is the shared responsibility of the WTO and UNCTAD – will continue to work together on this task.

## The International Trade Centre UNCTAD/WTO

Established by GATT in 1964, the International Trade Centre UNCTAD/WTO (ITC) is a joint subsidiary organ of the WTO and the United Nations, the latter acting through the UN Conference on Trade and Development (UNCTAD). The WTO General Council and the UNCTAD Trade and Development Board determine the broad policy guidelines of ITC's programme and the two contribute equally to ITC's regular budget, which in 1997 totalled CHF 29,126,600. ITC has also been designated by the UN Economic and Social Council as the focal point for technical cooperation with developing countries in trade promotion.

Since 1996, cooperation among ITC, WTO and UNCTAD has been given additional impetus through a general framework for the technical cooperation activities of the three organizations, which was agreed upon by the three Executive Heads after UNCTAD IX, and a framework agreement was concluded among ITC, WTO and UNCTAD to promote complementarity and to avoid duplication of technical cooperation activities in Africa. A joint ITC/UNCTAD/WTO "Integrated Technical Assistance Programme in Selected Least-Developed and other African Countries" was launched in 1996.

Following the 1997 High-Level Meeting on Least-Developed Countries (see Box V.3 on page 75), a new Administrative Unit has been set up at ITC to handle the day-to-day coordination of the work that has resulted from the meeting.

ITC continued to undertake technical cooperation activities as a follow-up to the Uruguay Round agreements, in cooperation with WTO and UNCTAD. These activities included dissemination of information through seminars and workshops based on its Business Guide to the Uruguay Round; the identification of priority areas for further action to expand the business community's participation in the new trading environment; and strengthening of local capacities to provide information and advice on the Uruguay Round Agreements.

## Relations with non-governmental organizations/civil society

Although NGOs have been interested in the GATT since its inception in 1947, the period since the creation of the WTO has vividly demonstrated that the multilateral trading system is being scrutinized by public opinion like never before.

When Ministers adopted the Marrakesh Agreement they also decided to include a specific reference to Non-Governmental Organizations (NGOs) in Article V:2. On 18 July 1996 the General Council further clarified the framework for relations with NGOs by adopting a set of guidelines (WT/L/162) which "recognizes the role NGOs can play to increase the awareness of the public in respect of WTO activities". These guidelines are instrumental for both Members and the WTO Secretariat in maintaining an informal and positive dialogue with the various components of civil society. Since 1996 arrangements for NGOs have essentially focused on attendance at Ministerial Conferences, participation in issue-specific symposia,

and the day-to-day contact between the WTO Secretariat and NGOs. More recently, the Director-General has announced a number of new initiatives designed to improve the dialogue with civil society.

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### **Ministerial Conferences**

Immediately after adopting the guidelines for relations with NGOs, WTO Members agreed on procedures for such organizations to attend the Singapore Ministerial Conference. Hence, it was decided that (i) NGOs would be allowed to attend the Plenary Sessions of the Conference and (ii) NGO applications to register would be accepted by the WTO Secretariat on the basis of Article V:2, i.e. NGOs had to demonstrate that their activities were “concerned with matters related to those of the WTO”.

The Singapore Ministerial Conference in December 1996 represented the first experience with NGO attendance at a major WTO meeting. In total 159 NGOs registered to attend the Ministerial Conference bringing together more than 200 representatives from environment, development, consumer, business, trade union and farmer interests. The NGO Centre in Singapore provided the NGOs with a large number of meeting rooms, computer facilities and documentation from the official event.

The Geneva Ministerial Conference and 50<sup>th</sup> Year Celebration of the multilateral trading system in many ways epitomised the evolving relationship with NGOs and underlined the growing interest of civil society in the work of the WTO. A total of 152 NGOs (362 individuals) registered to attend the Plenary Sessions at the Palais des Nations. The NGO Centre, several meeting rooms and a computer facility were also reserved for NGOs in the Palais des Nations. Throughout the three-day-event NGOs were briefed regularly by the WTO Secretariat on the progress of the informal working sessions – a feature which was welcomed by NGOs as a genuine sign of commitment to ensure transparency and the recognition of civil society as an entity which deserves attention in its own right.

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### **Symposia**

Since 1996 a number of symposia have been arranged by the Secretariat for NGOs on specific issues of interest to civil society, i.e. three on trade and the environment, one on trade and development and one on trade facilitation. These symposia have provided, on an informal basis, the opportunity for NGOs to discuss specific issues with representatives of WTO Member countries.

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### **Day-to-day contact**

The WTO Secretariat receives a large number of requests per day from NGOs from all over the world and Secretariat staff meet NGOs on a regular basis – both individually and as a part of NGO organized events.

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### **Recent initiatives**

During the General Council meeting on 15 July 1998 the Director-General informed Members of certain new steps he was taking to enhance the dialogue with civil society. Beginning in the autumn of 1998 the WTO Secretariat will provide regular briefings for NGOs and will establish a special NGO Section on the WTO website with specific information for civil society, e.g. announcements of registration deadlines for ministerial meetings and symposia. In addition, a monthly list of NGO position papers received by the Secretariat will be compiled and circulated for the information of Members.

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## **Annex I – Publications**

The World Trade Organization’s publications are in print and electronic versions, in English, French and Spanish. They cover legal texts and agreements, country and product studies, analytical economic data, special trade-related studies and histories of various trade negotiations and agreements. The electronic version are produced on CD-ROM and on diskettes. The former include electronic search and text management facilities. An increasing number of these publications are produced under co-publishing agreements with commercial publishers. Listed below is a selection of some of our bestselling publications. For details on our other titles, contact WTO Publications or consult the complete listing at our on-line bookshop: <http://www.wto.org/wto/publicat/publicat.htm>.

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### **The multilateral trading system: 50 years of achievement**

Fifty years ago, the world emerged from the ravages of the Second World War. The GATT came into being amid memories of the economic disasters of the late 1920s and early 1930s, with a firm determination not to repeat the costly policy mistakes of that period. This

new book traces the 50 years of the multilateral trading system – from GATT’s establishment in 1948 to the 132-Member WTO of 1998. It shows how the GATT/WTO trading system has contributed to an extraordinary period of economic growth and prosperity and how the system has widened participation in the global marketplace. The book also looks to the future and the challenges facing the WTO – to globalization and the opportunities offered by information technology and electronic commerce. The interface between the trading system and other global issues is also discussed.

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**Study No. 1: Opening Markets in Financial Services and the Role of the GATS**

This first publication in a new series of special studies explores some of the issues surrounding the financial service negotiations, analyzes what is at stake, and assesses what WTO Members have already achieved in previous negotiations. This 50-page study, which is available in English, French and Spanish, contains detailed tables, charts, and boxes to help the reader understand some of the characteristics of the financial services sector and appreciate the full benefits of its trade liberalization.

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**Study No. 2: Electronic Commerce and the Role of the WTO**

The second study in a popular series examines the potential trade gains from the rapidly increasing use of the Internet for commercial purposes. The study was written as a means of providing background information for the 132 WTO Members who are now developing policy responses to this new form of commerce. Written by a team of economists from the WTO Secretariat, it identifies the complexities as well as the potential benefits of trade via the Internet. The book describes the extraordinary expansion of opportunities that electronic commerce offers, including for developing countries.

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**Trilingual glossary**

The immense vocabulary of trade listed in the WTO’s three languages, English, French and Spanish. This book is an invaluable tool for translators looking for equivalent terms in any of the three languages. The entries consist of words and expressions of particular relevance to the work of the WTO and to international trade generally. It includes terminology developed during the Uruguay Round and embodied in the legal instruments adopted in 1994 in Marrakesh. Many entries contain a reference to the relevant sources and include acronyms, definitions, explanatory notes and other useful information.

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**Guide to GATT Law and practices 1947-1994, Analytical Index, on CD-ROM**

The GATT’s own article-by-article handbook on the General Agreement, describing the drafting history, interpretation and application of the rules, based on official documentary records. The 6<sup>th</sup> edition is the most complete and up-to-date presentation of GATT law. It spans from 1945 to the end of 1994, when the World Trade Organization was established. It includes decisions by GATT bodies, the many interpretations of GATT law made by dispute settlement panels and a new chapter on institutional and procedural matters. Thoroughly researched, each chapter analyses precedents and practice, and presents the relevant material in the original text, with full documentary references. This new easy-to-use CD-ROM enables users to carry out full text searches, to export text to word-processing packages and to print.

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**CD-ROM: Complete Results of the Uruguay Round**

This unique CD-ROM contains the complete legal texts and market-opening commitments of the 125 countries who participated in the 1986-94 Uruguay Round. The trilingual CD-ROM includes the capability to organize information for specific countries, or to make comparison across several countries or country groups. The material covers 30,000 pages of legal text covering goods, services, trade-related intellectual property rights, dispute settlement and individual countries’ schedules of commitments in the goods and services areas.

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**The Results of the Uruguay Round of Multilateral Trade Negotiations:  
The Legal Texts**

This handy publication contains the legal texts of the Agreements and Decisions which emerged from the Uruguay Round and constitute the framework for international trade into the 21st century.

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**Fifth GATS Protocol: Schedules of Specific Commitments and Lists of Exemptions from Article II concerning Financial Services**

The results of the negotiations on financial services concluded on 12 December 1997 under the WTO, consisting of 56 schedules of Specific Commitments, embodying commitments undertaken by 70 WTO Member governments, and 16 Lists of Article II (MFN) Exemptions (or amendments thereof) submitted by 16 Members.

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**The WTO Annual Report, 1997**

The 1997 edition includes a special section on Trade and Competition Policy, a report by the Director-General on significant issues, a report on future trade developments and a full volume of trade statistics for 1996/97.

## Co-publishing with Kluwer Law International

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**Reshaping the World Trading System – a history of the Uruguay Round**

(Second edition)

Take 120 government and territories, each bent on vigorously seeking its own self-interest. Give them a mandate to reach agreement on new rules for more open markets – not only for goods but for services and intellectual property as well. And give them a time-limit – four years. It sounds impossible...and it almost was. This is the story, told in frank, lively and non-technical terms, of how and why the Uruguay Round came about, what the participant countries sought, the twists, turns, setbacks and successes encountered in each stage and sector of the negotiations (which took over seven years)...and how, in many instances, the final achievement in many instances surpassed the original goals.

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**Guide to the Uruguay Round Agreements**

A companion volume to Reshaping the World Trading System, this new book takes the non-specialist reader through the legal texts that were the results of the Uruguay Round. It includes an economic analysis of the impact of the agreements and a number of other features such as "how to read GATS schedules".

## Co-publishing with Bernan Associates

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**Trade Policy Reviews series**

The Trade Policy Review Mechanism was launched in 1989 to improve transparency by enabling GATT members collectively to examine the full range of trade policies and practices of individual members. This process has continued under the WTO in much the same format. The evaluation is conducted on the basis of two reports: one presented by the government of the country concerned, and the other prepared by the GATT/WTO Secretariat.

The Secretariat report examines the country's trade-related policies and measures, covering tariffs and a wide range of non-tariff barriers, from an economic perspective. The report reviews the impact of these policies and measures on the country's recent overall economic performance, and on the development of major sectors.

The government report describes the country's trade-related policies and the basic institutional and legal structure affecting the trade policy decision-making process. It examines these policies against the background of the wider economic and development needs of the country concerned.

The series also provides table and graphics of basic economic data on each country. The four largest traders – Canada, Japan, the United States and the EC (as a single entity) – are reviewed every two years. Other countries are reviewed every four or six years, depending on their relative importance in world trade. This new co-publishing will begin with the 1998 report on Japan.

## The WTO website

The WTO website ([www.wto.org](http://www.wto.org)) in English, French and Spanish offers access to over 10,000 pages of information that is updated on a daily basis. In addition, users can use the website to access the WTO Document Dissemination Facility. This contains over 45,000 trilingual WTO working documents. New documents are added daily.

The site also hosts the WTO broadcasting service which enables users to view and hear highlights of key WTO events, some of which are broadcast live on the Internet.

Over the past year the number of users accessing the site had continued increase, reaching a maximum of 47,000 users in a single month. The volume of information that is retrieved by users varies from 15 to 25 gigabytes per month (25 gigabytes is equivalent to about 15 million pages of text).

The WTO also maintains a joint website with the World Bank ([www.itd.org](http://www.itd.org)) focusing on trade and development.

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## Annex II – Trade Policy Review Body – Concluding remarks by the Chair of the Trade Policy Review Body

### Australia – 30 June and 2 July 1998

The third Trade Policy Review of Australia was conducted by the TPR Body on 30 June and 2 July 1998. These remarks, prepared on my own responsibility, are intended to summarize the main points of the discussion; they are not intended as a full report. Details of the discussion will be reflected in the minutes.

Members raised a large number of written questions, which have been answered in writing today. The discussion developed under three main themes: (i) the economic environment; (ii) trade and investment measures; and (iii) sectoral issues.

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#### **Economic environment**

Members welcomed Australia's strong and active participation in the multilateral trading system. They commended the high degree of transparency in the conduct of Australia's trade and investment policies. Members also recognized that Australia's unilateral approach to trade liberalization, which complemented internal structural and regulatory reforms, had greatly improved the country's overall economic performance, leading to high rates of growth in output and productivity together with low inflation since the last Trade Policy Review, and contributing to a substantial fall in unemployment from a peak of 11 per cent in 1992/93 to near 8 per cent at present.

Some Members noted that a slowdown in the process of liberalization had occurred in recent months. They pointed to an increase in export assistance, slower unilateral reduction in tariff peaks, an increasing threat of contingency measures and a more active industrial policy as symptoms of the slowdown. In this connection, they expressed concern about the likely impact of the continuing Asian crisis on Australia's economic growth rate and current account deficit, sought reassurance concerning the Government's policy response, and encouraged Australia to continue to open and deregulate its markets.

In response, the representative of Australia emphasized that economic projections of 3 per cent growth in 1998/99 remained valid, although caution was required in the light of the continuing Asian crisis. The current account deficit did not so much reflect trade imbalances, as payments for previous borrowings, and would therefore be addressed by fiscal consolidation, not by trade measures. Delegates were assured of the Australian Government's commitment to keeping its markets open and continuing to pursue overall economic reform, while taking into account the legitimate needs of individual sectors for assistance in adjusting to the challenges of globalization.

The representative reiterated the Government's determination to push ahead with autonomous, gradual and predictable MFN trade liberalization under its WTO and APEC commitments. In the latter context, it remained committed to the achievement of free trade by 2010, including in textiles, clothing, footwear and motor vehicles.

Delegations expressed concern that Australia might be moving to a more interventionist industry policy. The representative of Australia stressed that the Government was not attempting to pick winners. Instead, policy focused on improving the business environment through a sound macroeconomic stance and the vigorous pursuit of microeconomic reforms, including the pursuit of more labour market flexibility, tax reforms and competition policy in key sectors like telecommunications, energy and transport.

Questions were raised about relations between Commonwealth and State Governments, notably the adherence by State authorities to the Commonwealth Government's trade and investment commitments. In response, Australia stressed that States did have constitutional responsibilities in several areas and outlined the consultation mechanisms in existence to ensure consistency of State and Commonwealth policies.

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#### **Trade and investment measures**

Members raised the following concerns over specific trade and investment measures:

- remaining tariff peaks and escalation, and the tariff "pause" in the textiles, clothing and footwear and passenger motor vehicle sectors, which also retained higher than average tariff protection; new export assistance policies in the PMV sector were also noted in this connection;
- the effects on developing countries of the "pause" combined with a phaseout of GSP preferences;
- recently introduced changes in anti-dumping and safeguard legislation leading to shorter lead times before introduction of such measures;



- the continuing restrictive nature of Australia's SPS system, under which import of many food products was virtually impossible;
- measures seeking to increase "strategic" investment in Australia;
- concerns relating to government procurement including local preference schemes operated at the State level and offset requirements at both State and Commonwealth levels; a number of Members questioned Australia's policy not to participate in the WTO Agreement on Government Procurement;
- the application of intellectual property rights including on software decompilation, protection of test data and parallel importation.

In response, the Australian representative said that the pause in tariff reductions in the TCF and PMV sectors would be followed by a significant autonomous cut in tariffs in 2005, lowering tariffs to the same point as would have been reached under a gradual reduction. He expressed the view that, as most of Australia's tariffs were at or less than 5 per cent, preferences for developing countries became largely meaningless; preferences for the least developed countries would, however, be maintained as tariffs declined. The fall in 2005 in tariffs in the textile sector would be also to the benefit of developing and other textile-exporting countries; moreover, he emphasized that Australia had no quotas in this area.

He stressed that the new Automotive Competitiveness and Investment Scheme was not linked to export performance in any manner and, instead, encouraged competitive investment, research and development and productivity improvements in the sector.

The recently introduced changes in anti-dumping legislation would streamline the process further and reduce the degree of duplication in investigations. Furthermore, an additional appeal mechanism, not available under the previous system, would now be available. It was also stressed that the private sector will not have an enhanced role in the investigation process.

On safeguards, Australia had established, and notified to the WTO, a mechanism by which to undertake actions required under the WTO Agreement. The first investigation was initiated in June 1998 on imports of frozen pork. He emphasized that no actions had yet been taken.

On quarantine, the representative said that Australia took its obligations under the SPS Agreement very seriously, including the need to base SPS measures on sound science, risk assessment and a consistent approach to risk management. Contrary to what was claimed by many delegations, despite quarantine measures, import penetration in Australia's agricultural market was high. He stressed that in all risk analyses, the quarantine authorities consulted with all stakeholders, limiting their consideration to matters of science and not economic or other unrelated matters. However, the entry of imported pests could have devastating and expensive consequences for production and trade.

Australia remained committed to aligning its standards with relevant international standards and in fact there was already a substantial degree of alignment. However, the representative expressed concern at what seemed to be a push for international standards to take on a dominant role in the area of technical regulations. The Australian Government's policy was that regulations should be written for a specific purpose, and must not be more burdensome than is necessary to achieve their objectives.

In reply to questions about recent measures to attract foreign investment, the representative stated that no separate funds had been set aside to provide investment incentives in the new policy. Rather, the Government would consider granting incentives only in limited and special circumstances for projects which met the eligibility criteria. Screening policies through the Foreign Investment Review Board were liberal, limited to proposals in sensitive sectors and for investment above a certain threshold. He stressed that the "national interest" test placed the onus on the authorities to show reason to reject a proposal.

Australia's position on joining the Government Procurement Agreement was that the Agreement, in its present form, did not necessarily encourage open and transparent government procurement practices. The conditional basis for accession to the Agreement had potentially made the markets of several major industrialized countries more restrictive than Australia's. Australia's approach to WTO activities regarding government procurement was being developed by a Consultative Group comprising agencies of Federal, State and territory governments. Australia's federal structure was not relevant to the fact that Australia had not joined the Agreement: all sectors considered that the present Agreement was disadvantageous to Australia.

On intellectual property rights, the representative pointed out that Australia had implemented all its obligations under the TRIPS Agreement: in addition, a number of legislative reforms had been introduced relating to parallel importation, maintaining high standards for protection while avoiding unnecessary restrictions on the market for legitimate copies of protected works. Australia also paid close attention to enforcement, as demonstrated by recent increases in penalties for pirated intellectual property products, and was involved in promoting improved intellectual property protection throughout the region.

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## Sectoral issues

Members raised a number of questions regarding agricultural trade, in particular relating to levels of protection as reflected in AMS and PSE data, and the role of federal and State marketing boards.

Questions were posed concerning the scope and effects of Government bounties in the machine tool and shipbuilding sectors, and the operation of the "factor f" scheme in pharmaceuticals.

Many delegations raised issues relating to trade policies and conditions in services sectors, including banking, telecommunications, coastal shipping, civil aviation, audio-visual services, and the movement of persons, particularly in regard to Federal and State conditions for exercising professional services.

In reply, the representative of Australia emphasized that whatever measure was used, Australian agricultural support was low. In addition, Australia did not use export subsidies and domestic support measured only one third of the level to which Australia was entitled.

The Government had continued the reform agenda to make Australia's state-trading enterprises more commercially focused, more responsive to international markets and more accountable to their stakeholders. He stressed moves to privatize the Wheat Board and bring all government business activities subject to competition policy. Australia also supported greater transparency in the WTO of state trading activities and actively supported the new WTO questionnaire on state trading enterprise operations.

The representative expressed his appreciation of the acknowledgements, made by many delegations, of the liberalization in Australia's services sector. He stressed that progressive liberalization would continue to be a main pillar of Australian trade policy and Australia would press its trading partners to do the same in the next round of trade negotiations.

Australia would continue to deregulate its financial sector. The new financial system structure, when in place, would provide flexible, efficient, coordinated and consistent regulations in a highly competitive and transparent environment. In telecommunications, deregulation would continue, including, subject to Parliamentary approval, further privatization of the largest carrier, Telstra; the Australian telecommunications sector was now fully open to competition. Another service area high on the Government's agenda was electronic commerce, where Australia was pursuing a forward-looking strategy to ensure that it remained at the forefront of developments in the area. Australia would also continue to make changes and push for greater market access as deregulation of the domestic economy continued.

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## Conclusions

Australia's participation in this review has reflected its commitment to the WTO process. The statements made on Tuesday, and again this morning, have indeed been transparent and helpful to Members. I am sure that Members will also be greatly assisted by the very full written answers provided by Australia to questions.

I would agree with Ambassador Krirk-Krai that many WTO Members have much to learn from Australia's process of reform and liberalization. I believe members can be reassured by the Australian Government's replies regarding the status of the "pause" in tariff reductions in a few sectors and the clear liberalization objectives set out up to the year 2010.

I thank Australia for its clear statements and its helpful participation in the Review.

## Benin – 15-16 September 1997

The first trade policy review of Benin was conducted by the Trade Policy Review Body on 15-16 September 1997. These remarks, prepared on my own responsibility, are intended to summarize the discussion and not to be a full report. This report will be contained in the minutes of the meeting. The discussion developed under six main themes:

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### Progress and prospects for economic liberalization

Benin was commended on the institutional reforms and positive macroeconomic performance since 1990. These had been reflected in solid economic growth, improved public finances and a modest rate of inflation. Some Members expressed concern about the high dependency of Benin's trade structure on cotton exports, and its vulnerability to trade policy changes in Nigeria. In this regard, they inquired about plans for diversification of export products and destinations. Members also commented on the large scale of the informal sector; inquiries were made about how it could be brought into the formal economy and whether this might ease the process of liberalization.

In regard to the legal structure for trade and investment, Members noted the ongoing work to enact various new laws and sought information on progress made. Note was taken of the adoption of a new investment code which, however, had not yet resulted in significant

investment flows. In this connection, questions were raised concerning the scope for further simplification of investment procedures, including the adoption of automatic approval and a "single window".

In response, the representative of Benin noted his government's long-standing concern over the country's dependence on a single crop, and continued efforts to diversify the economy, particularly agricultural production. He noted that three-fourths of all economic activity takes place in the informal sector, which the Government considered a key element to support Benin's growth. Thus, a vast programme was in place to provide a proper framework for informal activities, and eventually incorporate them into the formal economy.

The representative of Benin recognized the need to review the Investment Code of 1990. The draft revision contained plans to abolish several sectoral restrictions, and to increase the number of fiscal and other privileges. In order to ensure consistency of approaches within the WAEMU, Benin would change its current investment legislation only after the Union decided on a regional code. It was also noted that to strengthen its investment framework, Benin had signed or was negotiating various bilateral and multilateral investment agreements. The Government was also working on the creation of an Investment Promotion Centre. The representative stressed that the new initiatives made no discrimination between foreign and domestic investors.

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### **Transparency issues**

Members commented favourably upon Benin's clear and simple tariff structure. However, questions were raised on the public availability of the tariff schedule. One Member requested a copy of the tariff schedule. Concern was also expressed over the complexities of customs and pre-shipment inspection procedures, including the mechanism used for establishing import prices. In this regard, questions were asked about Benin's plans to implement the Harmonized System of Classification and the WTO Customs Valuation Agreement. It was noted that Benin had not notified any delay in the application of the Agreement under its Article 20.

Questions were also raised over the procedures for registration of importers, especially regarding the status of "occasional" importers (importateurs occasionnels) with regard to border and internal taxation, the list of goods reserved to approved importers (importateurs agréés), as well as the requirement for membership in the Chamber of Commerce and rules applied to goods in transit. Some Members noted the absence of an effective appeal mechanism against administrative decisions and urged Benin to update its legal structure in this regard.

In response, the representative of Benin outlined the requirements for the registration of importers, goods in transit, and the operation of the pre-shipment inspection mechanism. He said that his country used the Brussels definition of customs value and that the customs tariff was readily available to the public. The Harmonized System had already been adopted, and the new code being printed used that classification. Customs procedures were transparent, and this would be enhanced by the eventual binding of tariffs at the level of the whole WAEMU. Domestic legislation to apply the WTO Customs Valuation Agreement would also be adopted within the framework of the WAEMU. "Occasional" importers without an import card bore a penalty of 1 per cent of the c.i.f. value of goods over and above usual tariffs and taxes, to encourage them to move into the formal sector. Prices established by the PSI inspection company were generally based on those in the exporting country. The Union's treaty for the Harmonization of Business Rights complemented Benin's appeal mechanisms against administrative decisions.

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### **Other specific measures**

Generally, Members appreciated the considerable steps taken by Benin to liberalize its import markets, and to reduce export restrictions. Benin was urged to continue its trade liberalization and to embed it within the rules and principles of the multilateral trading system by increasing its binding commitments.

Concern was expressed over the lack of clear legislative guidelines for government procurement. In this respect, information was sought on the present status of the draft law on Government Procurement.

Questions were raised over the justification for the continuing export ban on food products (produits vivriers), and about plans for the future liberalization of remaining state monopolies. Details were also requested on Benin's use of rules of origin under the WAEMU Agreement. Members sought confirmation that Benin maintained no investment schemes notifiable under the TRIMs Agreement. They also requested information on the legal framework for, and practical application of, Benin's intellectual property legislation.

In response, the representative of Benin noted that Benin did not maintain any local content requirements outside those contained in the rules of origin under the WAEMU and ECOWAS Agreements in order to qualify for preferential treatment. There was no ban on

exports of food products. Teak exports had been regulated to prevent the destruction of protected forests. The Law on Government Procurement had been voted and promulgated in August 1997, and the implementing decree would be submitted to Parliament shortly. Copyright legislation was under review to ensure conformity with the TRIPS Agreement. In this respect, he called for assistance to ensure coordination between Customs, the Copyright Bureau (BUBEDRA) and the Ministry in charge of telecommunications.

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### **Sectoral elements**

Participants sought Benin's views on the role of foreign direct investment in the economy, notably in the food processing sector and in mining. Some suggested that Benin might take advantage of the WTO Decision in favour of least-developed and net food-importing developing countries, which, inter alia, envisages assistance towards improvements in agricultural productivity and infrastructure.

Some sought information on progress in reforming Benin's legal structures so as to liberalize the main services industries, including financial, maritime, air transport and telecommunication services. They noted that, as an essential part of the development of infrastructure, the telecommunications services industry would benefit from foreign investment. While a move away from the current duopoly in air transport could lead to lower freight costs. Benin was asked to consider binding its current, liberalized financial régime, as well as mobile telecommunications, in the ongoing WTO negotiations on financial services and basic telecoms. Confirmation was sought that foreign investment in hotels is allowed, as bound by Benin under the GATS.

In response, the representative of Benin noted that most production and trade activities had been privatized, including banks, non-life insurance, petroleum production and hotels. Port activities had also been demonopolized, and private operators were to be authorized for mobile telephony; further reforms in the telecommunications sector were in planning. Private investment was being sought in the areas of life insurance, petrol distribution, cement and sugar production. Technical assistance was needed to bind Benin's legislation under the WTO Services negotiations currently under way. He confirmed that there was no restriction in foreign investment in the hotel sector; tourism was a priority development sector and certain state-owned hotels had already been privatized.

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### **Regional integration**

Members took note of Benin's recent efforts to increase participation in regional trade agreements, including the customs union planned among WAEMU countries. In this respect, many participants asked about the prospects for the union, its expected timing, and whether it would lead to the abolition of non-tariff measures and the creation of an internal market within the union. Members emphasized the risk that the tariff convergence required by a customs union could lead to MFN tariff increases in Benin. They viewed any such increase as detrimental to Benin's economy, and suggested the use of tariff bindings under the WTO to reduce such risk. Questions were asked regarding the current state of tariff and non-tariff liberalisation under ECOWAS, and whether this agreement had been notified to the WTO.

In response, the representative of Benin declared that WAEMU's fundamental objectives were to ensure rapid convergence towards an economic union, with a common market based on the free circulation of people, goods, services and capital. Important achievements to date included the removal of all non-tariff barriers to internal trade, and a considerable tariff reduction on internal trade in agreed products. The establishment of a common external tariff was planned for 1 January 1998. Harmonization of legislation was also underway in the areas of taxation, accounting procedures and investment. A certain delay had occurred in the implementation of the Union. Meanwhile, Benin intended to maintain its level of tariffs, which was the lowest of WAEMU countries; the National Assembly would have to ratify any change in tariffs resulting from decisions of the Union.

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### **Benin in the multilateral trading system**

Members highlighted Benin's status as a least-developed country, and its concomitant special position within the multilateral trading system. It was suggested that ways should be found of ensuring more regular participation by Benin in the work of the WTO. In this connection, Benin was asked about its expectations from the forthcoming High-Level Meeting on Least-Developed Countries, notably regarding market access. Participants also invited Benin to specify its needs for technical assistance in order to benefit most from WTO Agreements.

In response, the representative of Benin hoped that the High-Level Meeting on Least-Developed Countries would result in commitments to improve access to markets, increase the competitive capacity of LDCs through training and information for private and public sector operators, and create a system to protect and encourage investment in LDCs. He stressed the need to maintain differential treatment for developing countries during the

transition period, and to provide effective assistance to LDCs. In his view, the survival of the multilateral trading system depended on its capacity to reduce inequalities and increase trade on the basis of each member's comparative advantage. He therefore called for a concrete programme of assistance and information to LDCs to implement the WTO Agreements, participate in future negotiations, train producers to satisfy international standards in export markets and prepare strategies for the future development of trade, and provided a list of specific areas in which Benin would require such assistance.

Members welcomed the important steps taken in recent years by Benin towards a more open and liberal economy, through constitutional, legislative and administrative reforms and privatization programmes. They emphasized the importance of diversification of the economy and the need for development to be pursued on a sustainable basis. Members also stressed the importance of further steps to increase predictability, transparency and certainty in Benin's trade practices. The need for improved access in various fields of services was particularly noted. Overall, Members offered strong encouragement to Benin to continue and accelerate the reform process in all economic areas and responded positively to Benin's requests for assistance in the framework of WTO activities.

## Chile – 23-24 September 1997

The second Trade Policy Review of Chile was conducted on 23-24 September 1997. These remarks, prepared on my own responsibility, are intended to summarize the discussion and not to be a full report: this will be contained in the minutes of the meeting.

The discussion developed under four main themes: macroeconomic issues; the balance in Chile's trade policies among multilateral, regional and bilateral approaches; a discussion of specific trade-related measures and policies; and sectoral elements of trade policies.

Some Members noted that the focus of Chile's trade policies had moved towards regionalism in the past six years, while maintaining a strong commitment to the multilateral system. Chile was congratulated on its generally open and liberal system, and on the liberalization which had taken place in services trade; however, some Members noted that there were some areas of goods trade where few changes had occurred since the previous review.

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### Macroeconomic issues

Members commended Chile's remarkable macroeconomic performance since 1990, which had been assisted by progressive liberalization; the high rate of growth combined with growing social equity; and the reduction of unemployment and inflation. One member sought clarification regarding the use of indexation mechanisms in the economy and their relationship to inflation.

Members noted that, since the last review, there had been some diversification in export products and markets, but that Chile remained reliant on a small range of exports, especially copper. In this regard, the effectiveness of the Copper Stabilization Fund as a shock-absorber was highlighted; one member asked about the possibility of creating an offshore fund to reduce possible negative effects on exports from real exchange rate appreciation. It was noted that State involvement had decreased substantially throughout the economy; however, there were no plans to privatize CODELCO.

Members welcomed Chile's generally liberal and non-discriminatory foreign direct investment regime. Questions were raised regarding the use of a compulsory deposit or "encaje" system for investment funds; while some Members felt that this measure may have contributed to monetary stability, others expressed concern about its possible restrictive effects.

In reply, the representative of Chile noted that the authorities had put emphasis on growth with equity, as shown by an increase in per capita incomes and a marked reduction in the number of persons below the poverty line. However, the distribution of income was relatively unchanged; this was a priority concern. High savings and investment had contributed largely to economic growth: the importance of external factors had declined. While trade liberalization had contributed to growth it did not have the same effect across the economy, hence the importance of social programmes to spread the benefits of liberalization. Inflation had been controlled basically through monetary policy, with overall confidence generated by strict observance of inflation targets and by fiscal surpluses; the degree of indexation – based on past inflation – had been reduced. The representative confirmed that the role of the Copper Stabilization Fund was, as covered in the documentation, to be a buffer against world price fluctuations. He explained that the "encaje" system, a central element of monetary policy, was a reserve requirement limited to portfolio capital inflows, and designed to minimize speculative flows; it benefited investors directly by reducing the risk of financial fluctuations.

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### **Multilateralism, regionalism and bilateralism**

Questions were asked regarding the balance in Chile's trade policies between multilateral, regional and bilateral approaches, and the emphasis currently given to the conclusion of agreements with regional entities. In this connection, specific questions were posed about Chile's relations with NAFTA, the recently concluded Free Trade Agreement with Canada, the status of negotiations for a framework agreement with the European Union, the network of agreements with Latin American partners, including the consistency with LAIA provisions of the complementarity agreements with some Members, and the new agreement with MERCOSUR. Members questioned the effects of the wide range of agreements on the transparency and predictability of Chile's trade policies. Chile's membership of APEC was generally commended; in this connection, clarification was sought on Chile's definition of "open regionalism".

A question was asked on the extent to which Chile was facilitating imports from least-developed countries.

In reply, the representative of Chile said that multilateralism was Chile's top priority. However, Chile saw bilateral and regional agreements as essential to advance the opening of its own economy and new export markets. It was also important to recall the political dimension of such agreements in Latin America, in particular South America, and the relationship between open economies and the development of democracy.

He emphasized that most trade would be liberalized within 10 years, although a longer period was allowed for some sensitive items. He noted that the agreements within South America, and that with Mexico, were under LAIA, covered by the Enabling Clause. Tariff quotas covered imports under preferential rates; there were no restrictions on imports under MFN rates. He noted that there were no non-preferential rules of origin and gave details of the operation of preferential rules.

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### **Specific trade-related measures and policies**

In general Members commended Chile's open trade regime, in particular, the uniform tariff. Some Members sought clarification about the proposal to reduce the tariff by 3-4 percentage points. Noting the gap between WTO bound rates and the MFN applied rate, several Members asked if there were any plans to bind closer to the applied rate.

Some Members sought clarification regarding an apparent difference between taxation of domestic and imported spirits. Information was sought on Chile's implementation of the WTO Customs Valuation Agreement. Some Members also inquired why Chile had not signed the Plurilateral Agreement on Government Procurement and encouraged the authorities to do so. Members recognized that Chile's national requirements regarding standards were generally based on international provisions; however, some concerns were raised regarding the potential impact of health and sanitary requirements as a barrier to trade.

Clarification was also sought regarding the status of the Agreement on Implementation of Article VI of the GATT 1994 in Chilean law, progress with new anti-dumping legislation, and the use of anti-dumping measures in light of provisions agreed upon in the Free Trade Agreement with Canada. The absence of safeguard legislation was highlighted by several participants.

Members noted the existence of certain export subsidies and sought clarification as to whether Chile had implemented any measures to eliminate them. In addition, Members sought clarification regarding the export promotion activities of PROCHILE, and the Agricultural Fund established in 1995 to promote agricultural exports.

On intellectual property, some Members sought information regarding progress in amending Chile's legislation to bring it into compliance with the TRIPS Agreement. Members welcomed the authorities' initiative to draft a new competition law.

In reply, the representative of Chile said that the average bound tariff of 25 per cent for industrial products represented a balance reached in the Uruguay Round. A draft law had been prepared to reduce the flat applied rate from 11 to 8 per cent; the Executive believed that this reduction would need to be offset to guarantee the continuity of social programmes. Concerning liquor taxation, a draft law had been sent to Congress which would ensure equal tax treatment, varying only according to the alcoholic content. Chilean customs valuation was in accordance with the relevant WTO Agreement; variations on transaction value were in line with the provisions of the Agreement. He explained the application of minimum customs values; these would disappear with the full application of the WTO Agreement. The WTO provisions were applied in Chile's agreements with Canada and MERCOSUR.

The representative confirmed that the WTO Agreements on anti-dumping and countervailing measures had the force of law in Chile and were the bases of procedures being applied. A draft bill had been brought to Congress to give operational effect to certain rules. Tariff surcharges may be applied for one year maximum within GATT bindings: they did

not apply to FTA partners and were not "safeguards" in the sense of GATT Article XIX. They had not been used since 1993.

The representative gave details of Chilean government procurement procedures, which were based on transparency, non-discrimination, flexibility and decentralization. The same procedures applied across the public sector. State enterprises were required to be self-financing and to operate on a private enterprise basis. Chile regarded the application of the GPA as complex, bureaucratic and costly; moreover, it did not guarantee MFN treatment below federal level. Chile thus hoped that any wider agreement would include not only the principles of transparency and non-discrimination, but also flexibility and decentralization.

The representative provided details of the operation of Chilean standards, sanitary and phytosanitary measures in relation to wine, beef and lamb, chicken and wheat; he gave assurance that national treatment was applied. The only preferential sectoral regime was the automotive programme, which was being phased out. Programmes for distant regions of the country covered taxation, customs facilitation and investment incentives and did not discriminate against foreigners. Exports benefited from a duty drawback system for imported inputs and a simplified system for minor exports. The simplified system was not sector-specific; any subsidy component was being phased out. Deferred tariffs on capital goods only involved a subsidy in those cases where a tariff waiver was granted on condition that the capital good was employed in the manufacture of exports; this would be reduced by the process of liberalization. He also explained the role of PROCHILE in providing governmental services to exports.

The representative of Chile also provided information on Chile's legislation and practices, as well as recent advances, in the area of intellectual property. Any changes required to bring legislation into line with the WTO TRIPS Agreement were being studied and would be completed by 1 January 2000, as required for developing countries. TRIPS cases were handled by the ordinary courts, not by administrative processes. In the area of competition policy, Chile had extensive jurisprudence, but was drafting a new law to modernize the institutional and legal framework in the light of the international environment.

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### **Sectoral elements**

Some Members questioned the price band mechanism on some import-competing agricultural goods; they noted that the system could lead to high protection and affect resource allocation. This policy was contrasted with Chile's generally active support for international liberalization of agricultural trade, through the Cairns Group. Members asked whether consideration was being given to direct income support for poor farmers.

Some delegations asked about policies to promote the automotive industry, namely the export balancing scheme, domestic content requirements, export subsidies and the prohibition on imports of used cars. One member asked for details on the proposal for a royalty tax on mining. Another mentioned concerns regarding permission for the transshipment of fish in Chilean ports.

Several Members noted that Chile's liberalization efforts in the services sector were ahead of its WTO commitments and asked if this would be reflected in an improvement in Chile's GATS bindings. Details were requested on several specific aspects, for example, the elimination of horizontal restrictions regarding commercial presence, the maritime agreement between Chile and Brazil, the further liberalization of the telecommunications sector, Chile's involvement in the ongoing negotiations on financial services, the removal of the additional tax levied on insurance premia when insurance services were contracted abroad, and prudential requirements applied to foreign and domestic re-insurers.

In reply to questions raised regarding the price band mechanism, the representative stated that the mechanism (applying to wheat, wheat flour, edible oils and sugar) was established to buffer domestic prices against international price fluctuations. The representative noted that imports of goods covered under this mechanism were considerable, amounting in the case of edible oils to 92 per cent of domestic consumption. It was unlikely that the bound rate of 31½ per cent could be breached by the mechanism. Regarding dairy products, the representative replied that Chile considered the 31½ per cent bound level (against an applied rate of 11 per cent) appropriate given the sensitivity of this sector for Chilean agriculture. He also clarified policy regarding irrigation programmes and the Plan for the Recovery of Soil Productivity. The purchase price of sugar beet was set by IANSA, a private enterprise, in negotiation with producers and without government intervention.

The representative clarified the operation of the automotive programme, dating from the 1980s. Currently, only three enterprises benefited. He added that the programme would be phased out by the year 2000, in accordance with Chile's commitments under the TRIMs agreement. The prohibition on imports of used vehicles was for environmental reasons and there were no plans to lift this.

Regarding the services sector, the representative mentioned that in the last seven years telecommunications, infrastructure, transport and financial services had gone through an

important process of legal reform. In telecommunications, the privatization of the local and international telephone companies had begun in 1985, and there was free competition in the sector. As a result of the reform, rates had decreased by 50 per cent and the number of lines had increased substantially. The financial sector had also been subject to important reforms, including the recent approval of a new banking law, covering three major areas: internationalization of the Chilean banking system, widening the scope of banking activities, and adoption of the Basle norms. Regarding maritime transportation, the delegate clarified that Chilean legislation was based on the principle of reciprocity. Chile regretted that maritime transport negotiations had not been able to advance.

He added that Chile had participated actively in the WTO services negotiations. In the 1995 financial services negotiation, Chile submitted an improved offer, and in the context of the present negotiation Chile was elaborating a conditional offer, which it hoped to submit in October. Chile had assumed MFN commitments in international telephony and had reflected its open policy in its list of commitments in this area. He emphasized that Chile was willing to participate in any services negotiation to ensure progressive liberalization in this sector on a multilateral, plurilateral and bilateral basis.

To conclude, I should like to emphasize some main elements. First, Chile's focus, since 1990, on growth with equity is an exemplary combination of economic and social policies, going now well beyond the so-called "Washington consensus". I am sure Members will also welcome Chile's continuing emphasis on economic stability and the success that has been achieved. I also welcome the clear statements that have been made by Chile on the relationship between the multilateral and regional aspects of their policies, and the detailed answers given on specific questions, including those on government procurement, sanitary standards, regional and export support, intellectual property, and sectoral policies. Finally, I am sure that the discussion that we have held in the past two days will have contributed to the important transparency obligation that I stressed in my opening statement.

## European Union – 25-26 November 1997

Over the last two days, the Trade Policy Review Body (TPRB) has conducted the fourth review – the second under WTO provisions – of the European Union's (EU) trade policies and practices. The review of the EU is the first to be conducted under the "interim review" framework agreed in 1996 by the TPRB for two-yearly reviews; as such, it has focused on developments in trade policies in the past two years and on selected sectoral issues, rather than being fully comprehensive in coverage.

The discussion developed under five main themes: (i) the interface between the single market and multilateral liberalization; (ii) the EU's enlargement and network of regional or preferential agreements; (iii) systemic trade policy issues; (iv) sectoral questions; and (v) the EU and the future of the multilateral system.

Participants raised a large number of questions in writing. The representative of the European Union provided written replies in the context of the meeting and undertook to supply further details as necessary.

Members welcomed the statements made by the EU representative concerning its participation in, and commitment to, the WTO-based multilateral trading system. However, many questions were raised on specific aspects of the EU's trade policies and practices as they affect other WTO Members. Any actions by the world's largest trading entity were bound to have an important effect on the trading system and this was a major concern of many participants.

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### **The interface between the single market and multilateral liberalization: institutional issues**

Members noted with satisfaction that, in a growing number of areas, the single market and external liberalization had been mutually supportive, resulting in improved market access for external suppliers and increased exposure of the EU economy to competition. For example, aspects of the EU's participation in recent multilateral services negotiations drew on internal reforms.

However, Members noted that significant impediments to trade and efficient allocation of resources remained, with potential adverse effects on external suppliers. Members mentioned the high level of State aid and its concentration on relatively few sectors, and limitations in the opening of public procurement. While recognizing that WTO rules were a growing point of reference in the elaboration of EU policies, Members urged that further efforts to ensure that all EU regulations respected the principles of transparency, non-discrimination and were properly notified to the WTO. Some Members posed questions concerning "Community competence" for trade negotiations. Specific concerns were raised about recent moves to strengthen measures regarding health, safety and environmental protection. Some Members expressed concern that the share of intra-EU trade in



manufactures during the past few years may have increased at the expense of extra-EU trade in manufactures.

In reply, the representative of the European Union emphasised that the internal process of harmonisation could be equated with liberalization. Third country suppliers benefitted fully from measures aimed at eliminating obstacles to intra-Community trade. Increased intra-trade had not been at the expense of non-EU countries; these accounted for a steady 40 per cent of total EU imports and a rising share of domestic demand for manufactures. He provided details of the Action Plan to remove remaining sectoral obstacles to market integration and undertook to supply information on proposals to simplify EU legislation.

The representative stated that the new Article 133 of the Rome Treaty would clarify the question of the Community's competence. He recalled that the Community had exclusive competence in trade in goods, and that there was no "domaine réservé" for member States in services and TRIPS.

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### **EU enlargement and network of preferential agreements**

Members noted the proposals for further enlargement of the EU and the continued expansion of its network of regional and other preferential agreements. They questioned the effects of these arrangements on third countries' trade. Concerns were expressed in relation to potential trade diversion; in this respect, Members mentioned tariff and non-tariff barriers with respect to sectors such as textiles, agriculture and automobiles. Members stressed that regional integration should remain consistent with relevant WTO rules. In this connection, one discussant raised the need to ensure that WTO rules are adequate to deal with the growth and new structure of preferential and regional agreements. Members took note of the recent call by EU Ministers for more careful consideration of the WTO conformity of preferential agreements, as well as clarification of WTO rules on regional trading arrangements. Questions were also posed concerning the harmonization of, and cumulation provisions in, the EU's preferential rules of origin.

While some Members reported that they had satisfactorily concluded Article XXIV:6 negotiations with the EU on compensation following the accession of Austria, Finland and Sweden to the Community, other Members said that negotiations had not yet been completed and called for a rapid conclusion. One Member emphasized that, in future enlargement, negotiations should be undertaken in advance.

A number of participants expressed systemic concerns about certain new aspects of the EU's GSP scheme, in particular eligibility criteria relating benefits to environmental protection or labour conditions, concern about linkage with the fight against drugs was also raised. These aspects went against the fundamental principles of the GSP. Clarification was also sought on the criteria for sector or country graduation.

The representative of the European Union replied that there was no contradiction between the WTO objective of progressive multilateral liberalization, and preferential agreements. He stressed that free trade was only one component of the EU's agreements which covered such aspects as democracy, economic cooperation, political and security relations, approximation of laws, migration, financial assistance for structural reforms, etc. The EU had been careful to ensure the consistency of its agreements with the WTO. He gave details of recent and current negotiations on preferential agreements, as well as partnership and cooperation agreements. He also gave some details of Article XXIV:6 negotiations, and noted that these did not have to be completed prior to enlargement.

The EU recognized that varying rules of origin could create problems for traders and customs authorities. Uniform origin rules, including "diagonal cumulation", had therefore been introduced in the Europe Agreements and the same rules were proposed for the "new generation" of Mediterranean Agreements. The EU's rules of origin were seen as consistent with WTO Agreements.

The EU GSP scheme, although autonomous and not creating absolute rights, was the most comprehensive in the world. It encouraged the introduction of policies for the protection of workers' rights and the environment. The special incentive scheme was a voluntary scheme to support the efforts of countries to combat the drugs trade, or to introduce forward-looking environmental or social policies.

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### **Systemic trade policy issues**

In general, Members acknowledged the EU's steady progress towards a more liberal trade régime in the last two years, in particular through the implementation of WTO tariff commitments and the phasing out of quotas and voluntary export restraints. They recognized that the EU had played a key role in the negotiations on basic telecommunications and information technology products and was a driving force behind current negotiations in financial services.

However, Members noted that import protection, various forms of assistance and the use of contingency measures remained of importance in sensitive sectors, some of particular

interest to developing countries. While average industrial tariffs were now below 5 per cent and should be under 3 per cent in 2000, significant peaks remained in textiles and clothing, automobiles, and certain consumer electronics. In agriculture, very high rates still affected important products such as cereals, meat, dairy products, poultry, sugar and tobacco. In addition, the EU's tariff structure continued to display some degree of escalation. The trade-restricting impact of tariff reclassification was also raised.

A number of participants regretted the high incidence of anti-dumping, the concentration of recent actions on textile products and the use of anti-circumvention provisions; the combination of high tariff protection and quota limitations for textiles with intensive use of anti-dumping actions added further uncertainty in access to an already protected market. Questions were posed as to the compatibility of certain provisions of the EU anti-dumping legislation with the relevant WTO Agreement.

Members stressed the growing impact of "internal" measures, such as State aid, on external trade and stressed the need for stricter subsidy disciplines on the member States. Concerns were expressed about the low level of opening of public procurement markets and compliance with the Government Procurement Agreements. Members also emphasized that EU health, safety and environmental directives should not constitute unnecessary obstacles to trade. In this respect, some participants raised systemic concerns about the "zero risk" approach apparently contained in certain trade prohibitions, affecting both EU and non-EU Members, including those concerning meat and related animal products deemed to carry BSE agents, and new measures on "specified risk materials" to be introduced on 1 January 1998. Other Members sought greater transparency in the management of the EU Eco-Label scheme.

The representative of the European Union provided details on its tariff nomenclature as well as tariff and customs administration and associated national and Community judicial processes. He also gave extensive replies to questions on the EU's anti-dumping rules and procedures. These, he said, were intended to restore fair trade and were in conformity with the WTO; the number of initiations was, moreover, diminishing. He asserted that procedures were open and transparent, and that there was no specific "targeting" of sectors or exporters. While special regard was given to developing countries, the Commission could only accept constructive solutions which remedied injurious dumping. On intra-Community trade, anti-dumping actions were excluded in the integrated market; instead, competition rules were enforced to deal with such issues as predatory pricing. The "anti-absorption" clause allowed the re-assessment of export prices or "normal values" in cases where price movements to remove injury had not taken place. The "lesser duty" rule was used systematically and had often moderated anti-dumping duty levels. The WTO recognized the need to counter deliberate circumvention of anti-dumping measures.

The representative emphasised that the EU had notified its state aids to the WTO. He appreciated the recognition of its efforts to provide transparency at Community, national and sub-national levels, and provided details on the operation of structural funds, including in specific sectors. State aids should be used with restraint and be transparent. Surveys had shown a long-term reduction in their use in the EU, and the EU believed this trend must continue.

The representative also provided information on the operation of EU competition policy, its Market Access Strategy Database, the application of its Trade Barriers Regulation to Brazilian "conhaque", and the EU's export promotion programme. Responses were also given on environmental standards and eco-labelling; the latter scheme was non-discriminatory and steps were being taken to take account of the interests of all producers. Metric-only labelling was in keeping with ISO standards and was intended to simplify procedures. He clarified that the MRA between the EU and the United States contained no rule-of-origin provisions. The intention was to extend the scope of MRAs to other suppliers.

The representative emphasized the EU's reliance on strong and secure intellectual and industrial property rights. He gave examples of legislation in force or under consideration and replied to specific questions in such fields as electronic commerce, protection of data bases and national treatment. The Government Procurement Agreement (GPA) had the full effect of Community law. By July 1996 140 out of 155 national measures implementing EU directives had been notified to the EC. The absence of harmonization did not necessarily imply divergence from EU rules or GPA requirements, for example where they were already compatible. Contracts below EC and GPA thresholds did not need to be published. Further details on GPA implementation were provided; notification to the WTO would be made by 31 December 1997.

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### **Sectoral issues**

In agriculture, the implementation of the CAP reform and of WTO commitments, while largely aided by favourable market trends, was seen as a step in the right direction. Average tariffs had been reduced but high out-of-quota rates continued to protect sensitive products;

producer subsidy equivalents had increased. Import arrangements for meat, dairy products, rice, fruit and vegetables continued to be a matter for concern. Members called for continued policy reforms in the sector, with further shifts towards direct payments and reduced reliance on price support and export subsidies. In this respect, the recent Commission's Agenda 2000 proposal was welcomed, although some Members wondered whether it went far enough in terms of improved resource allocation as well as market access; information was sought about EU member States' initial reactions to the proposal.

Members acknowledged improved market access in manufacturing under the combination of single market provisions, the reduction of tariff and non-tariff measures, and new commitments under the Information Technology Agreement. However, several participants expressed disappointment about the slow liberalization of textiles and clothing imports and backloading of restrictive items to the last stages of integration under the ATC. In addition, Members noted that sectors such as automobiles faced difficulties in adjusting to new market trends and cost conditions, also benefitted from high tariff protection and significant financial assistance. Some participants underlined the EU industry's high specialization in medium-technology products.

Most Members appreciated the EU's efforts to liberalize trade in services both internally and externally, in particular in telecommunications and financial services. Some Members asked the EU whether, as services liberalization generated substantial benefits for developed countries, it would support the linkage of services negotiations with other areas of interest to developing countries in the next phase of WTO negotiations.

The representative of the European Union noted that the textiles and clothing sectors were in the process of re-integration into the GATT. The EU's schedule was wholly consistent with its liberalization obligations. However, the EU would review its Stage 1 integration in line with the recommendations of the TMB. He explained the provisions for access under the Europe Agreements, noted that applied tariffs were not above bound rates and that the highest rates could not be described as "peaks". The EU had not yet drawn up plans for Stage 3 of integration under the ATC.

The representative provided some initial responses to a range of questions on agriculture and fisheries, promising written answers at a later stage. These referred principally to SPS measures, measures taken in response to the BSE crisis, further CAP reform, and the fruit and vegetable regime. In some cases Members were referred to information provided to other WTO Committees, e.g., regarding tariff quota administration. The EU was complying with its WTO obligations, including those of internal support. The EU did not consider its intervention agencies as state trading enterprises. Reform of the wine sector was under consideration.

The representative noted that some questions on the ongoing reform in the services sector went beyond WTO obligations, and internal reforms did not necessarily have an impact on external obligations. The EU was seeking liberalization by its trading partners commensurate with what it was offering, but it also recognized the beneficial effect of international commitments on the internal agenda. Details were provided on aspects of the single market programme and external market opening in financial services and transport, the VAT Directive for non-EU service providers in telecommunications and media ownership and the "Television Without Frontiers" Directive in audio-visual services. The rules on electronic commerce were currently being examined.

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### **The EU and the future of the multilateral trading system**

Members emphasized that the review was taking place in a period of major policy developments in the EU. Much attention was devoted to the possible consequences of the move towards economic and monetary union and of new enlargements on the EU and third countries. Some Members stressed the potentially beneficial effects of the single currency on transparency and on the security and predictability of trade flows into the euro area. However, further analysis was requested from the EU on the consequences of EMU for European countries which were not in the euro area.

Members generally recognized that the deepening of European integration, with single market completion, preparations for the introduction of a single currency and the reform of Community institutions, had not reduced the EU's involvement in the multilateral system. On the contrary, it was recognized that the EU had contributed to the success of post-Uruguay Round negotiations, promoted the use of dispute settlement procedures, including by acceptance of Panel reports going against the EU, and supported the development of new issues on the WTO agenda. Some Members welcomed the statements made by the EU representative concerning the need for comprehensive, rather than sectoral, negotiations in any future WTO round.

The representative of the European Union recalled his opening statement confirming the EU's attachment to the multilateral system. He outlined the programmes that had been or would be established under "Agenda 2000" for domestic reform and the initiation of

accession negotiations with applicant governments. The EU would observe its obligations under the relevant provisions of the GATT 1994 and GATS. Enlargement of the EU would also imply a broader Single Market. As in the past, internal integration and external liberalization would continue in parallel.

It was too soon to judge the precise trade effects of the creation of the euro. The clear aim was to have a stable currency. A large number of technical questions would have to be solved.

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## **Conclusion**

This review has illustrated that the EU's influence on the multilateral trading system and its evolution is clearly recognized by Members. This has two consequences: that Members greatly value the positive effects of such liberalizing activities as the Single Market, and that Members are strongly sensitive to any trade policies or measures of the EU that are seen as potentially trade-distorting. Members have also shown their concerns about the systemic effects of the expansion of the EU, the development of a new generation of trade agreements with neighbouring and other countries, and a wide range of specific and sectoral issues. Certainly the trade policies and actions of the EU do not leave any WTO Member indifferent; this has been clearly seen in the large number of advance questions covering a multitude of issues, and the level of the debate in the meeting.

Although this is an "interim" review, it comes at an important time for the development of EU trade policies. Many new developments are underway, not least the move to economic and monetary union (leading to further integration and liberalization of the single market), the revision of the Lomé Convention, and steps toward further EU enlargement. We hope that the comments made in the past two days will be taken into account by the competent organs of the European Union – the Commission and the member States – in developing their external relations within the multilateral trading system and in formulating the EU's internal policies which have direct or indirect implications for the multilateral trading system.

## **Hungary – 7-8 July 1998**

The second Trade Policy Review of Hungary was conducted by the TPR Body on 7-8 July 1998. These remarks, prepared on my own responsibility, are intended to summarize the main points of the discussion; they are not intended as a full report. Details of the discussion will be reflected in the minutes.

The discussion developed under four main themes: (i) economic background and transition issues; (ii) regional integration issues; (iii) trade and investment measures; and (iv) sectoral issues.

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### **Economic background and transition issues**

Members congratulated Hungary on the remarkable changes that had been achieved, during the short period since the previous TPR in 1991, in its transition to a market-oriented economy. It was recognized that these changes had taken place under difficult economic and social conditions, including the collapse of trade with the CMEA, the bankruptcy of a large number of companies and the consequent temporary loss of jobs. Members welcomed the fact that, despite these circumstances, Hungary had pursued its liberalization process and continued to make an important contribution to the WTO.

With regard to macroeconomic management, Members recognized the Government's achievement in restoring domestic and external balance following the March 1995 stabilization package. However, questions were raised as to whether fiscal consolidation could be maintained in the absence of further large-scale receipts from privatization, now in its final phase, and in view of difficulties in creating an efficient and equitable tax collection system. Questions were also raised whether the impact on the external balance of recent real effective appreciation of the currency might not lead to renewed contractionary measures.

In response, the representative of Hungary said that the improvement in government finances was not the result of a one-time windfall from privatization, but due to cuts in government expenditures. The budgetary situation was expected to strengthen further, due to improved tax collection methods and to the gradual shrinking of the unofficial, grey sector of the economy as tax rates were to be reduced. He added that improvements in the trade and current account balances implied that there would be few risks of negative effects from the real appreciation of the currency. While the crawling-peg devaluation of the forint might have been lower than the difference between the rates of inflation in Hungary and in its major export markets, this gap was offset by productivity improvements in Hungarian exporting sectors.

While welcoming the considerable structural changes to the economy through privatization and the role of the price mechanism in allocating resources, Members sought

clarification of the role of industrial policies, including investment incentives, in influencing the future structure of the economy. In response, the representative of Hungary emphasized that direct investment in Hungary was fully liberalized. Hungary did not apply specific sectoral incentive schemes; investment incentives in general, and tax concessions in particular, were equally available to any sector.

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### **Regional integration issues**

Members recognized that the move toward EU accession had been a major element in Hungary's liberalization process. However, questions were raised on possible trade diversion stemming from preferences, and there was a considerable debate on this issue and its systemic implications. In response, the representative of Hungary stressed that WTO rules and commitments had been, and would be, thoroughly observed during the whole process of integration into the European Union. He rejected allegations that European integration had diverted trade to the disadvantage of third countries; on the one hand, trade flows had moved in favour of western markets, following the collapse of the CMEA, and before the introduction of EU preferences; on the other, imports from non-European trade partners, both in North America and in the Pacific region, had grown faster than those from EU sources.

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### **Trade and investment measures**

Members raised concerns over the scope of unbound tariffs on a number of items, such as some fish products, footwear, precious stones, transportation equipment and agricultural products, and on the average levels of bound and applied tariffs in some areas. In response, the Hungarian representative noted that 95.7 per cent of tariff lines were bound and that the data on bound and applied items in the Secretariat report reflected averaging of bound and unbound items.

While welcoming the phase-out of the global quota on consumer goods, Members raised questions concerning its allocation and the reasons for its under-utilization. Members also sought clarification of the Government's future import and export licensing policies. In response, the Hungarian representative said that details of the operation of the quota had already been notified to the WTO. The reasons for the under-utilization of some subquotas was that the yearly 10 per cent increase of the quota in many cases exceeds the actual demands.

Members also raised questions on:

- the alignment of technical regulations and standards to international norms, as well as inspection procedures;
- investment incentives conditional upon [export] performance and plans to notify existing TRIMs to the WTO;
- Hungary's attitude to joining the Government Procurement Agreement, to which it is not a party;
- state-trading, and plans and priorities to further reduce Government involvement in enterprises through privatization; and
- the enforcement of laws pertaining to the protection of intellectual property.

In response to these issues, the representative of Hungary pointed out that the number of Hungarian national standards was continuously decreasing, the objective being to reach a 70 per cent share of international or European standards by Hungary's accession to the EU. Only 35 industrial products were subject to inspection (on health and environmental grounds), with domestic and imported products treated identically. He emphasized that Hungary had no incentives in the sense of the TRIMs Agreement. On government procurement, the representative of Hungary called attention to the transparency of the new law introduced from 1996. Having weighed the pros and cons of possible accession, Hungary did not intend to join the Plurilateral Agreement at this stage; however, it was participating actively in the Working Group on Transparency in Government Procurement as well as in the Committee on GATS Rules, where future government procurement rules are being negotiated. On state trading and privatization, the representative of Hungary stated that there was no state trading in the sense of GATT Article XVII. In the context of the full market economy, no sectors or industries were excluded from further privatization. On intellectual property rights, the representative stressed that Hungary's present legislation complied fully with the requirements of the TRIPS Agreement. As a result of new legislation and enforcement efforts, the number of infringement cases had been significantly reduced.

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### **Sectoral issues**

On agriculture, food and beverages, Members raised various questions referring in particular to land ownership; tariffs; plant certification; SPS measures; the nature and value of various types of support; and export restrictions and subsidies. The representative of Hungary responded that there were no plans to change land ownership regulations at

present: compensation for former landowners had recently been ended. The Hungarian agricultural tariff regime was, as shown in its WTO Schedule, one of the most liberal among WTO Members. The increase in tariff dispersion was the consequence of tariffication, which reflected the variable effects of previous agricultural NTMs. Only certified plant types could be marketed in Hungary, consistent with OECD provisions: SPS standards were becoming internationalized under the 1995 Food Law. Domestic support, justified under "green box" provisions, involved advisory services and agricultural research programmes together with assistance for structural adjustment, to disadvantaged regions, and for the promotion of soil conservation. Guaranteed prices were set for five products, below the cost of production; intervention had been used only once. Export licensing was maintained only on maize, and was not restrictive in practice. As regards export subsidies, the representative reaffirmed Hungary's strict adherence to the terms and conditions laid down in the WTO waiver.

On motor vehicles, the representative of Hungary rejected allegations by Members that preferential tariffs and quotas related to regional trade agreements adversely affected third parties, citing the success of a Korean company in increasing exports to the Hungarian market during the period 1992-96. He added that the restriction on importation of used cars over four years old was designed to prevent Hungary becoming a "garbage cemetery" for used cars.

Members raised questions on trade measures applying to textiles and clothing, referring in particular to outward processing trade (OPT), and to wholesale activities for pharmaceuticals. The representative acknowledged that the share of OPT was high, reflecting existing patterns of trade. Hungary respected international practices in this regard; i.e., material inputs are imported duty-free on condition that end products are subsequently exported. On pharmaceuticals, legal provisions were in force to maintain health protection; the wholesale sector was open to foreign participation.

On services, Members welcomed Hungary's high level of commitments in the GATS. It was asked whether this level provided sufficient flexibility for Hungary; if establishment of foreign branches in Hungary was allowed for services other than financial; and whether the Government would advance the date for liberalization of national and international telephone services. The representative of Hungary replied that Hungary would not withdraw its GATS commitments; in unforeseen circumstances, GATS rules would be followed. He confirmed that, as of 1 January 1998, all restrictions on foreign branching, including in financial services, had been abolished. As regards advanced liberalization of telecommunication services, the representative replied that the Government had a legal obligation to maintain the exclusive rights granted in business contracts with investors for the agreed periods, however, there was strong competition in the market.

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## Conclusions

Hungary's participation in this review has reflected its strong commitment to the WTO process, as well as the positive effects of its transition to a market economy. The statements made on Tuesday, and again this morning, have indeed been helpful to Members.

I would agree with the view expressed by several delegations that Members have much to learn from Hungary's process of transition to a market economy and the role of trade and investment liberalization in this process. There has also been quite a lively debate, in this connection, on systemic issues related to regionalism and its effects in terms of possible trade creation and diversion; these issues will, no doubt, be followed appropriately in the CRTA.

Finally, I should like to thank the delegation of Hungary, led by Dr. Balás, for their clear statements yesterday and today, and its positive participation in the review; and also thank our two expert discussants, Dr. Raby and Mr. Mukerji, for their very useful opening remarks yesterday and follow-up comments today. The overall success of this review has also largely depended on the full participation of other delegations, to whom I express my gratitude. I wish Hungary success in their endeavours in the further opening up of their economy in line with their WTO obligations.

## India – 16-17 April 1998

The second Trade Policy Review of India was conducted by the TPRB on 16-17 April 1998. These remarks, prepared on my own responsibility, are intended to summarize the main points of the discussion and not to be a full report. Details of the discussion will be reflected in the minutes of the meeting. Participants raised a large number of questions in writing. The representative of India provided written replies in the context of the meeting and undertook to supply further details as necessary.

The discussion developed under three main themes: (i) the economic environment, (ii) import and export policy issues and (iii) sectoral issues.

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### **The economic environment**

Members commended India for the pursuit of its economic reforms initiated in 1991, which had contributed to healthy economic growth. However, in the light of the fiscal imbalance, the sustainability of this economic performance was queried; it was suggested that comprehensive tax reform and a reduction in subsidies would be desirable to reduce the fiscal deficit. On the structural front, infrastructure services were identified as a severe bottleneck to trade and growth; Members encouraged India to promote further investment in these areas. It was also emphasized that trade liberalization would assist further effective agricultural reform.

It was noted that in recent years the overall policy stance appeared to focus on export-orientation, rather than more general outward orientation. Clarification was sought on whether the recently announced Export-Import Policy reflected a continued emphasis on exports or a more neutral policy orientation.

Some Members noted that, in India, liberalization of foreign investment in combination with restrictive import licensing could mean that investment substituted for trade, rather than being a complement to it. Further liberalization of the trade regime was, in their view, essential for attracting the right kind of foreign direct investment. Clarification was sought on the discrepancy between approved and effective foreign investment; increased transparency in the approval mechanism was seen as necessary.

Several Members sought a statement of the new Government's commitment to ongoing reform and the promotion of competitiveness through more open import policies. Some Members questioned the implications of the new Government's National Agenda for Governance for protection of local industry, as well as the policy stance regarding investment in "core" and "non-core" areas. It was stressed that internal deregulation could complement the trade liberalization process.

In reply, the representative of India described the scope and context of India's economic and trade reforms and reiterated the new Government's commitment to the reform process. Trade, investment, tax and exchange reforms were all important elements in the process. The removal of infrastructural bottlenecks was a priority commitment, being addressed by streamlining procedures for foreign investment and decentralizing decision-making. The problem of the fiscal deficit was being addressed, inter alia, by efforts to increase public sector savings and better targeting of domestic subsidies.

The new Government was committed to liberalization within an open, equitable multilateral trading system. The new Export-Import Policy, oriented to enabling India to maximize its international trade, provided for further liberalization, greater transparency, and simplification of import procedures. Domestic deregulation, tax reform and foreign investment reforms complemented the trade reform process.

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### **Import and export policy issues**

Members complimented India for its tariff reform, under which the simple average rate had fallen from 71 per cent in 1993/94 to 35 per cent in 1997/98, with a weighted average of 20 per cent. However, concerns were raised regarding the complex structure of the tariff system; the distinction in treatment between capital goods and inputs, on one hand, and consumer goods on the other; and remaining tariff escalation in several industries. Some Members sought clarification about the time-table for elimination of the special rate of 5 percentage points. Noting significant gaps between WTO bound rates and MFN applied rates in some areas, several Members asked if there were plans to bind closer to applied rates; they also raised concerns about India's proposals to renegotiate some of its bindings. Members noted that import duties constituted a large share of Government revenues and that continued tariff reductions, complemented by tariffication of import licensing, could contribute to raising revenue.

Members noted that, since the previous review, the number of items subject to import licensing had decreased; some restricted items had also been liberalized by permitting their importation through freely transferable Special Import Licences (SILs). However, this liberalization was mainly applied to capital and intermediate goods, while most consumer goods remained subject to import licensing. Some members noted that the SIL, which can be sold at a premium of some 15 per cent, may be perceived as an export subsidy. Details on the phase-out plans for quantitative restrictions negotiated with several WTO Members were sought.

Information was requested on plans to reform India's various export assistance schemes (including exemption from income tax, export finance at below-market interest rates, guaranteed access to a minimum of 10 per cent of commercial-bank net credit, export insurance and guarantees, access to a wide range of export promotion and marketing assistance schemes, and import access to restricted items). The WTO consistency of the income-tax exemption was questioned.

Some Members noted that India had become an active user of anti-dumping procedures, and was even strengthening its capacity to conduct anti-dumping investigations. In addition

while no safeguard measures had been enforced up to the end of 1997, India had recently initiated several such investigations; Members asked if it was the new Government's intention to continue using safeguard measures.

Some Members requested information regarding India's state trading system, including reasons for the increased coverage of products subject to state trading, and concerning plans to modify or remove privileges granted to state trading agencies.

Some delegations noted that India's industries could benefit from more effective intellectual property protection, and asked about the timetable for bringing intellectual property legislation into line with the TRIPS Agreement.

In reply, the representative of India noted that the phasing out of QRs was proceeding according to a six year programme; he gave an explanation of the import licensing system and the use of SILs. Items recently added to the free list included 99 textile items, 49 agricultural items, 26 marine products, with most of the balance in consumer goods. All capital goods, assemblies, etc. were already in the free list. Reduction and rationalization of tariffs was also an integral part of India's trade liberalization. The simple average tariff had fallen to 35 per cent, but the import-weighted average had declined from 87 per cent in 1990-91 to 20 per cent today, even taking into account the temporary duty of 5 per cent. Applied tariffs were maintained well within bound rates. He described the tariff-setting process, including the recent establishment of the Tariff Commission. The new Exim policy facilitated imports of capital goods at zero duty as well as raw materials for export production. The number of exemptions had been substantially reduced and the simplification of tax laws was an ongoing process. Negotiations for revised bindings under Article XXVIII were related to tariffs bound at historically low levels. Liberalization of industrial licensing and administered pricing, decontrol of banking and capital market reforms were important domestic complements to trade policy reforms.

India remained committed to a rule-based multilateral trading system; in this context, India regarded safeguard and anti-dumping measures as an integral part of the WTO system. The Customs Tariff Act had been amended in early 1997 to provide for GATT-consistent safeguard procedures; there had been a surge of safeguard actions following this measure. The Government had also set up an independent Directorate of Anti-Dumping, primarily to provide transparency and independence to the process and expedite cases.

India's investment policy was to encourage FDI in core areas, to overcome significant bottlenecks; such areas included infrastructure, fuel, fertilizers, cement and information technology. Improvement of implementation was a clear priority and India's attraction for FDI was increasing.

He gave details of the standard-setting process in India and the extent of harmonization of Indian with international standards, including in health – and food-related areas.

The representative outlined India's traditions in knowledge-related areas and recalled that, as a developing country, India had until 1 January 2000 to bring its intellectual property laws into conformity with the TRIPS Agreement, and until 1 January 2005 to extend product patents to areas of technology not protected so far. He gave details of licensing procedures under patents, "reasonable price" conditions and protection of well known trademarks.

India had no export subsidies; exports were disadvantaged by the wide range of national, State and local taxes. Policy sought to neutralize these handicaps through permissible means. Minimum export prices for wheat and coarse grains had been abolished on 13 April 1998.

The representative believed that state trading for a few items of mass consumption (such as petroleum products, vegetable oils and cereals) was inevitable in view of the level of production, seasonal variations, the size of the domestic market and social sensitivity. The list of items under canalization was shrinking, not expanding. Canalizing agencies were independent corporate entities with full authority to function as independent commercial organizations; import or export of canalized items could also be effected by private businessmen in consultation with canalizing agencies, and in some cases exceeded those of the agencies.

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### **Sectoral issues**

Some Members stated that the agriculture sector in India had been almost unaffected by the reform process. It was suggested that the public distribution system, with minimum prices, was a disincentive to agricultural development and an ineffective means of poverty alleviation. Some delegations urged India to extend outward-oriented reform policies to agriculture.

While noting that important trade policy reforms had been pursued in manufacturing, some members noted the continued wide application of import licensing in textiles and clothing, which constrained Indian producers in improving productivity and preparing for a more liberal world market, as envisaged in the WTO Agreement on Textiles and Clothing.



Some Members questioned the consistency of India's export bans on leather, hides and skins with WTO provisions; they also noted that certain local-content measures and trade balancing requirements in the motor vehicles sector included in recently concluded Memoranda of Understanding between the Indian Government and car manufacturers, could be inconsistent with India's WTO obligations.

The role of the services sector in supporting many economic activities was noted; however, Members took note of the uneven pattern of liberalization in this area. While banking had been gradually liberalized, insurance was still closed to foreign participation. Members also noted that access for foreign suppliers in basic telecommunications services had been implemented more slowly than planned and that many licenses awarded were being disputed in the courts. Members asked about plans for further liberalization of the services sector and welcomed India's active participation in the recent negotiations.

In reply, the representative of India recalled that more than 70 per cent of the population was directly or indirectly dependent on agriculture for its livelihood. Production had increased thanks, inter alia, to improved use of fertilizers and increased access to credit. The pace of reform had been, and had to be, carefully calibrated; however, the direction was clear and both liberalization and other reforms had been introduced in agriculture, including frontloading of some agricultural products in the proposed phase-out plan for quantitative restrictions, removal of restrictions on agro-processing units, acceleration of infrastructural investment, improving the public distribution system and reforming the support price system to take into account the interests of both producers and consumers. Agriculture had also benefited from other reforms, including the reduction of high tariffs and controls on imports of manufactures. India's domestic support measures continued below the de minimis levels and no export subsidies were being provided at present. India's draft agricultural policy resolution, currently under finalization, sought to accelerate the process of liberalization and reform.

Regarding textiles and clothing, he noted that very few restricted items had yet been integrated into GATT by developed country Members, resulting in lower export earnings than anticipated when India agreed to the ATC. India had included textile and clothing items in its phase-out programme for import restrictions; 99 tariff lines had been liberalized to date.

He stated that the MOU policy for automobile investment has been framed to create a level playing field for all foreign investors; import licensing procedures for CKD/SKD cars by foreign automobile companies had been liberalized to provide the companies unlimited access to such imports in return for certain minimum criteria.

Exports of hides and skins were restricted because of a domestic shortage owing to socio-cultural and religious reasons.

The representative emphasised the importance of services in promoting economic growth. Commitments were in line with the GATS provisions which seek to achieve progressively higher level of liberalization of trade through successive rounds of multilateral negotiations, with flexibility for Members. India's legislation for banking was liberal; for non-banking financial services, foreign investment up to 51 per cent was allowed, and up to 49 per cent for stockbroking. In the field of insurance, reforms proposed by the Malhotra Committee could not be passed by the previous Parliament: the scope and pace of reform were yet to be examined by the new government. The Government was committed to rapid expansion of telecommunications; six licences for basic telecom services had been signed and cellular services were in operation. All such companies could have foreign equity up to 49 per cent. The independent telecommunications statutory regulatory authority (TRAI) was fully operational. To encourage the rapid development of trade in services, the Government had autonomously undertaken greater liberalization of foreign equity participation in sectors such as financial services and telecoms, than was reflected in India's schedule of specific commitments. New guidelines for private participation in ports, highways and civil aviation had been announced and approval given for mass rapid-transit systems in Delhi and other major cities. He gave details of conditions for multi-modal transport and in shipping. India was engaged in discussions with its major trading partners regarding liberalization of professional services; at the same time, India felt that the outcome of the negotiations on movement of natural persons left much to be desired.

Overall, Members commended India for its continued programme of economic reforms, including trade reforms which have constituted an integral part of the programme. Members appreciated the direction of reforms, welcomed the commitment expressed by India to further broad-based trade liberalization, domestic deregulation, and encouragement of private investment and looked forward to further concrete, well-co-ordinated implementation in these areas. Members also welcomed India's continued positive participation in the WTO and the importance attached by the Indian delegation and authorities to a stable, liberal, rules-based multilateral trading system. Members looked forward to receiving written replies to major outstanding questions and clarifications of various areas of interest.

## Japan – 27-28 January 1998

During the last two days, the Trade Policy Review Body (TPRB) has conducted the fourth review – the first under WTO provisions – of Japan's trade policies and practices. These remarks, made under my own responsibility, summarize the salient points raised during the discussion; they are not intended to substitute for the collective evaluation and appreciation of Japan's trade policies and practices.

The discussion, including the introductory statement of Japan and the remarks of the two discussants, developed under three main themes: (i) macroeconomic background and structural reform, (ii) trade policies, and (iii) sectoral issues. Participants also raised a number of questions in writing. The representative of Japan provided a comprehensive reply in the context of the meeting and undertook to provide further details as necessary.

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### **Macroeconomic background and structural reform**

Participants emphasized Japan's important role in the global and regional economy, in the context of the economic crisis experienced by several countries in East Asia. Members welcomed recent measures aimed at increasing domestic demand in Japan. However, some doubts were expressed whether these measures were sufficient and would produce results quickly enough, to address the current economic issues facing Japan. Some Members queried whether official projections for growth should be adjusted downwards in the light of current developments. Participants emphasised the need for Japan to stimulate domestic demand, rather than rely on exports to revive growth. Some participants expressed concern on the recent widening of the current account and trade surpluses.

Participants commended the progress made to date in deregulation and structural reforms and the recent announcement of a new programme to replace the current Deregulation Action Programme. They asked for supplementary information on the new programme. Some Members noted that certain sectors remained highly regulated, including agriculture, food processing, construction, transportation, telecommunications, financial services and distribution, and urged widening of the scope of deregulation and a faster pace of reform. Concerns were also raised that deregulation might result in new types of regulation. While some welcomed the opportunities given by Japan for comment by foreign authorities on deregulation, others raised concerns regarding the membership of the monitoring group for the deregulation process.

Participants raised questions relating to the enforcement of competition policy by the Japan Fair Trade Commission, and urged Japan to strengthen its competition policy regime. Questions were also raised on Japan's perspectives on the balance between outward and inward investment.

In reply, the representative of Japan said that recent tax reductions should add some 0.2 per cent to Japan's growth, together with a positive psychological effect on consumption. Structural reform should add a further 0.9 per cent per annum to growth in the period 1998-2003. Efforts to stimulate domestic demand through deregulation and reduction in prices were bearing fruit. The Asian currency crisis could affect Japanese exports adversely – both directly, and indirectly through changes in competitiveness – while stimulating imports from Asian countries. A possible fall in Japanese investment in East Asian domestic consumption could be balanced by investment for future exports.

Concerning the current account and trade surpluses, the authorities expected export growth to slow and imports to accelerate in FY 1998: the surplus in goods and services could be some 1.2 per cent of GDP and the current account surplus around 2.4 per cent, comparable to previous levels.

Deregulation was having a stimulating economic effect and these efforts would be continued. Concrete examples of structural reform included the liberalization of gasoline imports, elimination of demand/supply requirements in distribution and transportation, and foreign exchange deregulation. Agriculture, construction and international transport had not been excluded from the programme.

The work of the Administrative Reform Committee had been completed. The Government had set up a body to promote new deregulation efforts. A new three-year deregulation programme had been established, covering all administrative areas. Comments on the programme were welcomed.

The representative of Japan stressed that numerous exemptions to the Anti-Monopoly Act had already been abolished, and others would be reviewed by March 1998. The exemptions for anti-recession and rationalization cartels had been abolished in December 1997. The JFTC worked closely with the public prosecutor in enforcing the law through administrative decisions and criminal penalties. Care would be taken that administrative guidance would not replace anti-competitive regulations and that restrictive practices not be introduced by trade associations.

Japan had adopted in 1995 a decision on increased transparency in governmental advisory bodies. Japan attached importance to increasing inward foreign investment, both as a means to increase competition in the domestic market and to encourage restructuring. Potential investors in Japan benefited from a law providing a preferential tax system, and a scheme to make available preferential credit.

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### **Trade policies**

Participants welcomed Japan's emphasis on multilateralism in its trade relations and commended Japan's contribution to the WTO process. It was stressed that Japan conducts its trade almost entirely on an MFN basis, avoiding participation in preferential trade arrangements; assurance was sought that Japan's bilateral trade agreements would consistently be applied on an MFN basis.

Participants noted that average tariffs in agriculture were higher than in manufacturing, and raised concerns on tariff peaks and escalation in agriculture, food manufacturing, textiles, leather and footwear. Some participants raised concerns on tariff quotas, including high out-of-quota rates; the lack of a reallocation mechanism for unused tariff quotas; import quotas on certain products; length of customs clearance times; and Japan's use of origin marking requirements.

Participants welcomed Japan's efforts towards increased international harmonisation of standards, including embodying of performance based criteria, and the adoption of new mutual recognition arrangements, while noting that further progress could be made. Participants welcomed the increase of transparency in quarantine procedures and the revision of some Japan Agricultural Standards. However, concerns were raised on the complexity and cost of sanitary and phytosanitary conditions; variety-specific approval procedures for fruits and vegetables; and restrictive standards for frozen foods. Participants encouraged further revision of Japan's Food Sanitation Law.

Some participants noted that Japan's import and investment promotion scheme did not adequately address obstacles to investment and that tax incentives under the Import Promotion Scheme may favour industrial imports from developed countries. Questions were raised on the advantages of the Foreign Access Zones for foreign exporters.

Participants also raised concerns on the scope of state trading in Japan, as well as issues regarding transparency and the state of liberalization in government procurement procedures.

Participants noted recent reductions in the examination periods for patent approvals, and asked for the scope of further actions. Participants also requested information on the proposed amendment to the Civil Procedures Act concerning trade secrets.

Participants raised concerns on the product coverage of Japan's GSP scheme; and on trade policy towards least developed countries, including in the follow-up to the recent High Level meeting.

The representative of Japan thanked Members for their recognition of Japan's commitment to the MFN principle in the multilateral trading system. He saw no possibility under present conditions of this commitment weakening. Regional trading agreements, while they could contribute to trade liberalization, had the potential danger of undermining the MFN principle. He noted that tariff rates were reviewed every year on the basis of requests from foreign and domestic entities. Customs clearance times were difficult to compare among countries with differing import systems but efforts were constantly being made to reduce delays; for example, an immediate release system had been introduced for air cargo, and cut flower imports from the EU and Australia were cleared in an average of 1.8 hours.

On TBTs, Japan had decided in 1997 on a review of procedures to facilitate imports. Legislation to adopt performance criteria had been sent to the Diet to encourage the adoption of international standards. The representative provided details on standards, both concerning JIS and JAS. Japan was giving consideration to recognizing foreign certification agencies.

The representative also provided information on Japan's SPS measures, including those on frozen products, fruits and vegetables, and plants. Details were given on animal inspection, including disease control.

The representative of Japan noted that the share of manufactured imports in GDP had risen from 3.2 to 4½ per cent between 1994 and 1996: therefore he was confident that the import promotion programme was working. Its central focus was not on incentives; deregulation and recognition of foreign standards were also import promotion measures. The import promotion tax concession system had been extended until 1999: it was applied on an MFN basis to all countries exporting duty-free items, not favouring imports from industrialized countries. Imports into Foreign Access Zones had grown more rapidly than the total: again, the infrastructure of FAZs were available to imports from all sources.

State trading enterprises sought specific policy objectives, and Japan believed their operation was consistent with WTO rules. Information was given on state trading in livestock and tobacco.

Foreign participation in government procurement varied across products, but overall it was higher than in other major trading partners. Moreover, Japan was going beyond its obligations under the GPA.

Regarding IPRs, Japan was making efforts to shorten the period of examination for the granting of patents, trademarks and designs. Administrative procedures were also being streamlined.

Japan's GSP system had a broad coverage and efforts had been made to simplify its use. The system offered particular advantages to least developed countries. The GSP was currently under review to remove countries that had reached higher stages of development; LDCs had more favourable treatment under the GSP scheme.

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### **Sectoral issues**

Some participants raised concerns about the levels of protection and support for agriculture, and likely policy options in the future, including in the next round of liberalization negotiations. Questions were also raised on testing and certification requirements for agricultural products and regulatory obstacles to trade in pigmeat. Others raised concerns about the WTO consistency of the SBS system on rice, the continuation of import quotas on fisheries and the import cartel of laver. A number of participants suggested that the results of Japan's agricultural policies had been inconsistent with the Government's own food security objective. Questions were raised on moves to review Japan's Basic Agricultural Law.

Some participants raised concerns about inadequate reimbursement prices of pharmaceuticals, also noting burdensome and costly testing procedures for medical devices, pharmaceuticals, chemicals, mechanical and electrical appliances. The continuation of regulatory obstacles to trade in leather and leather footwear was also noted.

Participants welcomed Japan's contributions to the WTO financial services and basic telecommunications negotiations. However, they raised concerns about low productivity in some services sectors and openness of certain services areas; complex regulations in certain services sectors; and the low level of competition in some services. Particular attention was paid to construction, financial, legal, accounting and distribution services. Participants sought an assessment of the effects of weakness in the financial sector on the trade policy of Japan. Questions were raised on transparency and disclosure in the financial sector, including criteria for receiving public funds. Members requested an up-to-date assessment of the implementation of the "Big-Bang" programme, especially in the light of recent regional developments.

Some members urged further deregulation in construction materials, including further recognition of international certification procedures, moving towards performance-based standards, revision of fire safety restrictions, and recognition of qualified foreign organizations as Registered Grading Organizations.

In view of the limited time, the representative of Japan in his reply focused on selected sectoral issues.

In respect of agriculture, he said that as regards rice, Japan was faithfully implementing the Uruguay Round agreement, particularly by setting the price for minimum access rice some 20 per cent below that for domestic rice and promoting consumption of minimum access rice in Japan's market. Administration of unfilled tariff rate quotas had been improved in FY 1997 by permitting applications for unused quotas at different periods. He noted that the trigger level for special safeguard provisions was based on imports in the previous three years, which in Japan's view was in conformity with the Agriculture Agreement. The import quota on fisheries was intended to prevent resource exhaustion in surrounding waters and was, in Japan's view, justifiable under GATT Article XI:2(i).

Concerning footwear and leather, the representative described Japan's tariff quota system, and noted the specific difficulties of this sector. He also stated that prior confirmation system for silk aimed to ensure the faithful application of bilateral agreements, not to limit imports; this measure would be phased out by 2004.

Japan had eliminated tariffs on automobiles in 1978, and imports had increased substantially in recent years. There was no government involvement in dealership arrangements. The representative gave information on the reclassification of vitamins, herb and mineral products and noted that Japan's tariff classification would not be affected.

The representative of Japan noted concerns regarding low productivity in services, particularly distribution, and suggested that differences in productivity levels between services and manufacturing were not significantly different from other countries. He said that the Deregulation Action Programme sought to promote transparency in services and to simplify administrative procedures and notification or reporting requirements. He gave

examples of increases in recent years in foreign service providers in telecoms, construction, legal and all areas of financial services. He called attention to liberalization measures in various areas of telecommunications and broadcasting, including the abolition of the KDD Law, the forthcoming abolition of the "100 destination rule", improvements in interconnection liberalization on cable providers, modification of accounting rates, and the liberalization of foreign investment.

We have had a very constructive discussion of Japan's economy and trade policies, which has been held at a difficult time for Japan and the world economy. Many participants have emphasized the importance of market opening and deregulation as well as Japan's role in assisting the resolution of the Asian financial crisis.

Structural reform, deregulation and market stimulation – leading to more open markets – have been common themes running through this TPR discussion. The Japanese economy was, in earlier days, a major engine of world trade and investment and the TPRB has clearly expressed the hope that Japan can again effectively assume this role through its economic recovery and the positive effects of deregulation.

All participants have recognized Japan's strong and active participation in the WTO system and the importance attached by Japan to MFN treatment has been welcomed. We hope that Japan will respond positively, as they have undertaken, to the large number of specific or bilateral concerns raised during this meeting by various Members.

## Malaysia – 4-5 December 1997

The second Trade Policy Review of Malaysia was conducted by the TPRB on 4-5 December 1997. These remarks, prepared on my own responsibility, are intended to summarize the main points of the discussion and not to be a full report. Details of the discussion will be reflected in the minutes of the meeting.

The discussion developed under four main themes: Malaysia's economic performance and reaction to present financial "turbulence"; regional and multilateral issues; specific trade policy issues; and sectoral questions.

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### **Malaysia's economic performance and reactions to the present financial "turbulence"**

Members commended Malaysia on its remarkable macroeconomic performance since 1993. High rates of growth were coupled with low unemployment and inflation, and an improvement in the well-being of the population. This had been assisted by the pursuit of open trade policies. Nevertheless, questions were raised on macroeconomic and structural problems such as the savings-investment gap, the current account deficit, the lack of skilled labour and the recent slowdown in productivity growth. The rapid transformation of the Malaysian economy from one largely dependent upon exports of primary products into one in which exports of manufactures predominate was noted. In this context, comments were made on the scope and impact of incentives in the transformation.

Members generally considered Malaysia's underlying economic fundamentals to be sound. Therefore, a number of Members were concerned about the signals given by restrictive trade measures announced in Malaysia's 1998 Budget to address the current crisis. In this context various views were expressed on the factors underlying market volatility. Clarification was sought on a timetable to review and phase out these measures and the criteria on which these would be based. Noting that trade was central to the Malaysian economy, some expressed the view that currency adjustment could itself be sufficient to correct the external deficit and warned against short-term measures with trade restrictive effects. However, some Members felt that the WTO system should provide the necessary supportive environment to countries like Malaysia when they face difficulties. These Members pointed out that Malaysia has been pursuing a very liberal trade policy for many years. They suggested that Malaysia, and countries in a similar situation, should be given sufficient flexibility in adopting policy options in order to overcome the difficulties, even if these options are perceived to be trade restrictive.

In response, the Malaysian representative said that the current economic difficulties were caused by massive shifts of capital flows. The authorities believed that the risks associated with such flows could be minimized if the country's current account and reserve position was kept in equilibrium. Emphasis was placed on improving the level of national savings and encouraging investment that could generate higher foreign exchange earnings. The growing savings-investment gap had adversely affected the national balance sheet. The level of domestic credit growth should be reduced for prudential reasons. Loans geared towards expanding export capacity or increasing productivity would not be affected. He noted the need, because of over-capacity, to take measures such as increases in tariffs for materials and machinery used in the construction sector, and a reduction of two percentage points in corporate tax.

He emphasized that the fundamentals of the economy remained strong, but in light of the present crisis some measures had to be taken. He stressed that the tariff increases and other measures introduced in the 1998 Budget were consistent with Malaysia's obligations under the WTO, and noted that these measures were temporary. The need for the measures would be reviewed case by case.

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### **Regional and multilateral issues**

It was noted that, as a member of APEC and AFTA, regionalism was a major component of Malaysia's trade policy. Members hoped that these arrangements would promote greater trade liberalization and domestic efficiency. In this regard, specific questions were raised about possible trade diversion as a result of the implementation of AFTA; harmonization of standards within APEC; the justification for granting tariff preferences to Australia and New Zealand; and concrete liberalization measures taken by Malaysia as part of its APEC down-payment.

Members commended Malaysia's commitment to the multilateral trading system through its active role in the WTO, including in the ongoing financial services negotiations. They welcomed the announcement of a revised offer by Malaysia. However, some Members enquired about Malaysia's timetable for compliance with Uruguay Round undertakings, including progress with new anti-dumping legislation, the timetable for amending existing intellectual property legislation, a phase-out programme for prohibited export subsidies, and the elimination of local-content requirements. Some Members encouraged Malaysia to accede to the Government Procurement Agreement, and were pleased to note Malaysia's active participation in the Working Group on Transparency in Government Procurement.

The representative of Malaysia replied that ASEAN members were gradually changing specific duties to ad valorem duties and that these duties would be reduced on an MFN basis. Malaysia did not envisage any trade diversion as a result of AFTA. The Arrangement had been notified to the Committee on Trade and Development. He added details on steps taken or promised by Malaysia in the recent meeting of APEC Ministers, including multilateral tariff reductions and deregulation in services.

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### **Specific trade-related measures and policies**

In general, Members commended Malaysia's open trade regime, particularly the substantial reduction in tariffs since the last review. Several Members voiced concern, however, regarding the tariff increases for some consumer goods, capital goods and building materials announced in the 1998 Budget. Some Members sought reassurance that these increases would be temporary and asked when tariffs would be lowered again. There were also questions regarding the relationship between the new applied rates and bound rates, and the tariff lines which would be affected by the increase.

Some Members sought clarification regarding Malaysia's import licensing procedures, especially regarding automobiles. Concern was expressed about new import restrictions announced in the budget and their consistency with the Agreement on Import Licensing Procedures. In regard to government procurement, questions were raised regarding tendering procedures, criteria used to review procurement regulations, statistics on procurement by country of origin and sector and application of preferences to suppliers from ASEAN countries. Members sought information about Malaysia's intentions to align national standards to international standards and about institutional practices and coordination in this area; questions were posed regarding environmental requirements, accreditation of foreign laboratories and conformity assessment used. Regarding sanitary and phytosanitary (SPS) measures, enquiries were made regarding new legislation to accommodate all the provisions in the SPS Agreement.

Questions were raised about anti-dumping investigations and the timetable for bringing current anti-dumping legislation into full conformity with the relevant Agreement. The practice of not providing foreign exporters with an individual calculation of their dumping margin before final determination of definitive measures was also questioned.

Information was sought regarding the phase-out programme for export subsidies. Concerns were expressed as to whether recently announced tax exemptions were WTO-consistent. Noting the existence of investment and export incentives, Members sought clarification as to whether Malaysia had plans to evaluate their economic efficiency. Members sought information on plans to phase out local content and export balancing requirements attached to incentives and other measures inconsistent with the TRIMS Agreement. The environmental justification for different export taxes was also questioned.

Some Members sought information regarding progress in amending Malaysia's intellectual property legislation to bring it into compliance with the TRIPS Agreement. Questions were posed on Malaysia's schedule for implementing the provisions of the Agreement and the relevant laws to be applied within the Multimedia Super Corridor (MSC).

Regarding competition policy, Members asked about the current status and content of a draft competition law prepared by the Ministry of Domestic Trade and Consumer Affairs. Questions were raised regarding how price controls on basic and strategic goods were applied to imports.

In reply, the representative of Malaysia emphasized that the tariff increases and other measures introduced in the 1997 Budget were consistent with its rights and obligations under the WTO. All the increases in tariffs, for example, were within the bound rates. The temporary nature of these measures was also stressed.

Non-automatic licensing was confined to 17 per cent of national tariff lines, 60 per cent of which related to wood products. This mechanism was designed to facilitate development of infant and strategic industries, and, in the case of wood products, for conservation purposes. The licensing requirement introduced in the 1997 budget for heavy machinery was largely to ensure that existing idle machinery was utilized, thereby optimizing the use of foreign exchange. Since the requirement was put in place, all applications had been approved by MITI.

While participation in the Working Group on Transparency in Government Procurement was viewed as an educational process, Malaysia did not see the need to accede to the GPA. Although government procurement policy was designed to enhance socio-economic development, it was relatively open and provided adequate opportunities to foreign suppliers. There were plans, however, to undertake periodic reviews as regards the economic efficiency of existing policy.

The representative stated that Malaysia's standards would be aligned to international standards. There were no private sector standards bodies. In order to accommodate the provisions of the SPS Agreement, acts to be amended included the Animal Ordinance 1953, the Fisheries Act (Amendment) 1993 and the Fisheries Development Board of Malaysia Act.

He indicated that new anti-dumping and countervailing legislation was being finalized and would be tabled in Parliament at its next sitting. In the meantime, as notified to the WTO, Malaysian anti-dumping authorities were applying measures administratively. Only two actions were taken during the period under review, both in 1995-1996.

Export levies and licensing on timber were designed to ensure sustainable forestry management, encourage downstream activities and finance R & D. These measures were constantly reviewed to ensure that the intended objectives are met. The local content requirement for the automotive sector would be phased out by 2000.

Drafting of new legislation on intellectual property was at an advanced stage. Among the key changes were new laws on "neighbouring rights", "industrial designs", "layout designs of integrated circuits" and "plant varieties". As regards enforcement of existing legislation, in the case of copyrights more than 5,000 cases had been resolved and 32 million ringgit worth of goods confiscated during the past 10 years. In addition, judges and enforcement officers were undergoing training. The Ministry of Domestic Trade and Consumer Affairs was still examining the feasibility of a Competition Act and was discussing the matter with relevant groups. Import licensing applicable to goods subject to price control was intended to ensure their adequate supply.

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### **Sectoral elements**

Some Members questioned the differential treatment applied to services, as compared with manufacturing, regarding limitations on foreign ownership and voting rights in Malaysian companies, and asked whether these limitations would be relaxed. Members also asked whether liberalization measures planned for the MSC would be extended to other sectors. Some Members enquired about restrictions on foreign participation in Malaysian-owned banks, insurance companies and securities trading companies; on the establishment of new bank branches; and on the issuance of new licenses for banks and insurance companies. Questions were raised regarding the timetable to adopt the regulatory reference paper of the Agreement on Telecommunications, future liberalization plans, and limitations on foreign participation in the sector. Details were requested on future liberalization of air transport services, requirements for the establishment of new airlines, limits on commercial presence in maritime transport and limitation on foreign participation in airlines and shipping agencies.

The representative of Malaysia noted that at present there were 13 foreign bank branches locally incorporated. No new licences would be issued under present policy, since the existing banks were sufficient to serve the needs of the country. Malaysia had no intention to raise the 30 per cent limit on foreign equity. In the current round of financial services negotiations, Malaysia had relaxed the limitation on employment of specialists. On insurance companies he noted that Malaysia had relaxed the limit of foreign shareholding from 30 to 49 per cent. This limitation would be further relaxed to 51 per cent. This was, however, subject to the successful outcome of the current ongoing financial negotiations. As

in the banking sector no new direct insurance licences would be issued in the near future, to consolidate the fragmented insurance industry. He added that there were no plans to allow branches of foreign stockbroking companies to become member companies of the Exchange and that the existing regulations were to remain in place.

Regarding Malaysia's intention to further improve their basic telecommunications commitment and the regulatory reference paper, he responded that it was premature to talk of further commitments in this area, given that negotiations had just been completed and that some Members had not even signed the Protocol, while Malaysia had already done so. Malaysia would be guided by the elements contained in the regulatory reference paper.

I should like to thank Members for the participation in the TPR of Malaysia. I am sure all Members present appreciate the answers provided by Malaysia today. We also welcome Malaysia's announcement that its financial services offer has now been submitted. I am also sure all Members will be sympathetic to Malaysia's efforts to withstand the present financial sector turbulence.

## Mexico – 7-8 October 1997

The second Trade Policy Review of Mexico was conducted on 7-8 October 1997. These remarks, prepared on my own responsibility, are intended to summarize the discussion and not to be a full report: this will be contained in the minutes of the meeting.

The discussion developed under four main themes:

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### **Economic and developmental policies**

Members commended Mexico on the positive macroeconomic developments since the deep recession of 1995; economic growth had resumed, inflation fallen, capital inflows risen and public finances improved. They praised the Mexican authorities for their courageous response to the 1994 financial crisis, particularly for having avoided protectionist measures. Members also noted the fall in per capita income following of the 1995 crisis, and the persistence of poverty, especially in rural areas. It was noted that recently some economic indicators, including the current account balance, had again deteriorated. Some Members stressed the need to maintain the exchange rate at a competitive level.

In reply, the representative of Mexico said that the response of his Government to the financial crisis of 1994 had been to deepen the reforms, and accelerate structural change and economic liberalization, committing itself to the disciplines of the market. He gave details of fiscal policy aimed at improving the revenue-expenditure balance and reducing public debt. Pension reforms were expected to increase savings and help finance future investments. Monetary policy, acting through interest rates, had recently been used to prevent real exchange rate appreciation resulting from short-term financial inflows. As a result, exports had grown strongly. The Mexican Government was conscious of the effects of the crisis on the standard of living and was focusing on sustained medium-term growth to create employment as the best means of addressing the problem; increasing public resources were being devoted to social concerns. The prospects for growth in the next few years were positive; not less than 6 per cent this year and 5½ per cent in 1999 and 2000, with exports continuing to play an important role.

He added that the Industrial and Trade Policy Programme (PPICE) recognized the need for sustained development, employment creation and improved standards of living. Policy sought to alleviate market imperfections and improve industrial competitiveness. The representative elaborated on various aspects of the programme aiming at providing better information for business, promoting economies of scale, assisting the grouping of small enterprises and encouraging transfer of technology and development of labour.

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### **Regional/multilateral trade**

Members praised Mexico's active and positive role in the WTO. They also took note of Mexico's growing participation in regional trade agreements, highlighting in particular NAFTA's major role in Mexico's trade policy reforms. Areas of concern included the continued and considerable dependency of Mexico on the U.S. market, the widening gap between preferential and MFN tariff rates, and the impact on third parties of NAFTA rules on customs valuation and rules of origin. Members thus sought Mexico's views on the link between regional and multilateral liberalization and the possibility of trade distortion, as well as the use of reciprocity as a guiding principle of trade policy. They asked under what conditions Mexico would extend the benefits of NAFTA liberalization to all WTO Members. Members were also interested in Mexico's agenda for future regional integration.

Mexico was encouraged to notify to the WTO the G-3 Agreement, and its agreements with Bolivia and Costa Rica. Details were also sought on the WTO justification for the existence in the NAFTA of some phasing out periods exceeding 10 years.



In reply, the representative of Mexico said that participation in the WTO, including the dispute settlement mechanism was fundamental to Mexico's trade policies. It was also a key element in how Mexico had addressed the financial crisis, having a positive effect on the expectation of the business and financial community and increasing confidence in Mexico's future. Mexico's relationship with the United States was intense and complex; NAFTA created a permanent legal basis for North American cooperation, that went beyond Uruguay Round commitments. Given the slow speed of improvements in the multilateral system, Mexico was continuing to explore the regional path as a means to greater liberalization. He mentioned the EU, Israel and APEC as new areas for such cooperation. However, Mexico supported the opening of a new round of multilateral negotiations that would lead to further bindings and liberalization.

The representative pointed out that many of the benefits of NAFTA were available on an MFN basis to other WTO Members, especially in services other than financial services. Mexico had recently also eliminated MFN tariffs on some 1200 tariff lines of inputs and machinery. Since 1995, imports from non FTA partners had shown great dynamism, growing very rapidly in the first half of 1997. In practice, Mexico also considered important the principles of MFN and national treatment in federal government procurement; reservations for national suppliers were clearly specified in Mexico's international treaties. The representative concluded that Mexico's regional agreements complemented the multilateral system. Most, including NAFTA, LAIA and the G-3 agreement, had been notified and others would be notified shortly.

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### **Implementation of commercial policies, including sectoral policies**

Members appreciated Mexico's autonomous tariff reductions and the decline in other restrictions since the 1980s. However, concerns were expressed about the gap between "ceiling" bound tariffs and applied levels; this issue was highlighted by increases in tariffs for textiles, clothing, and footwear in 1995. Some Members asked about the rationale for such increases in view of the earlier strong devaluation of the Mexican currency.

Several Members expressed concern regarding Mexico's application of a f.o.b. customs valuation base for NAFTA and c.i.f. for other partners. Some Members sought information on the operation of registration requirements, including on a sector-specific basis. Information was also requested on restrictions on the entry of various products through specific Mexican ports.

Some Members noted Mexico's intensive use of anti-dumping measures, which they felt was increasing uncertainty for economic operators, while undermining Mexico's reforms. Information was requested on proposed changes to current anti-dumping legislation, and on the independence of its anti-dumping authority; it was also noted that Mexico imposed special origin certification requirements for certain products subject to anti-dumping measures; in the opinion of some Members, these requirements imposed excessive demands on traders from third countries.

Potential problem also included the increased use of technical and labelling requirements that did not seem to conform to international standards, including brand regulations introduced in 1996. Mexico was asked about the scientific justification for measures affecting rice imports.

Members noted that Mexico was not a member of the WTO Government Procurement Agreement, and restricted national public tenders to domestic suppliers. Mexico was asked whether it would consider acceding to a new agreement on government procurement or participate in the ongoing discussions on transparency.

Several Members asked when Mexico would notify CONASUPO as a state trading enterprise.

Members requested information on the current status of policy reforms affecting agriculture, including the use of tariff quotas and direct payments under PROCAMPO. Some Members thought that there was a need for further trade liberalization on an MFN basis.

Members recognized the considerable economic importance of the maquiladora industry, but some stressed the need to encourage its closer integration in the domestic economy. Several Members sought details on the phasing out of the regime by 2001, as provided under the NAFTA, and the regime that would then prevail with respect to third countries.

Mexico's policies to promote the automotive sector were seen as contradicting the country's general thrust towards a more liberal trade regime. Some Members asked how current restrictions would be liberalized for suppliers not currently producing in Mexico. Mexico was requested to open the automotive market after the year 2000, as provided by the WTO TRIMs Agreement.

Members asked about plans for further liberalization of trade and investment conditions in services and welcomed Mexico's active participation in current negotiations. Details were requested on Mexico's policy towards financial services. Information was also requested on how Mexico's development banks obtained funding and set interest rates.

In reply, the representative of Mexico pointed out that Mexico's trade liberalization, including recent tariff eliminations, was largely the result of autonomous actions, benefiting all partners. The gap between applied and bound rates was due to this liberalization as well as to tariffication in agriculture. Mexico stood ready to negotiate on bound levels in a new multilateral round. He noted that recent tariff increases on textiles, clothing and leather goods were within bound levels. The difference between customs valuation on a FOB basis of NAFTA trade and CIF basis for other trade would be insignificant and temporary, given the geographical proximity, and the large share of duty-free trade, which would eventually encompass all NAFTA trade. The representative noted that initiation of anti-dumping procedures depended on requests. The new draft law, still to be approved by Congress, was intended to harmonize domestic texts with the WTO rules, which had the status of Supreme Law in Mexico. Origin certificates were intended to counter circumvention in cases where final anti-dumping duties had been imposed.

The representative said that there was no requirement for domestic standards to be in strict agreement with international standards, although in Mexico the latter often served on the basis for domestic norms and this was considered important for promoting Mexico's economic development and international competitiveness. He gave details of the operation of the National Standardization Commission, procedures for the establishment of Mexican standards and certification, which were open, transparent and equitable, and on the use of ISO 9000 and 14000 procedures. NAFTA provisions in this regard were compatible with WTO rules and its Code of Good Practice. He also gave details of Mexico-EU cooperation. The operation of the Mexican labelling system was explained. The National Commission for Animal and Plant Health, an autonomous body, established, regulated and coordinated sanitary and phytosanitary rules.

He said that, as noted earlier, Mexico had a transparent and non-discriminatory regime for government procurement, and most federal procurement was on an international basis. Reciprocity rules reflected international realities. Mexico had fought for this subject to be included in FTA agreements and supported the work of the WTO working party on transparency in government procurement. At present, however, the GPA was limited in membership and did not guarantee reciprocal treatment.

The representative emphasized that, following the Uruguay Round, CONASUPO was no longer the sole channel for the import of milk powder. Others could import at the in-quota tariff with appropriate certification, or otherwise at the out-of-quota rate. The issue of licences to "traditional" importers (in this event, CONASUPO) for in-quota imports should not be confused with state-trading operations.

The representative also gave details of the operation of various sectoral policies. He said that the in-bond (maquiladora) industry regime would be changed from 1 January 2001 as a result of NAFTA commitments, to equalize tariff treatment on inputs as between goods sold on domestic markets and exports to other NAFTA partners. MFN duties would continue to be paid on imports from non-NAFTA partners.

In agriculture, the role and coverage of PROCAMPO was explained; imports could exceed WTO access commitments if required to ensure supplies; price controls were limited to tortillas and to corn flour. He explained the status of automotive policy, which aimed to expose the sector progressively to external competition; TRIMS provisions had been notified and NAFTA aspects discussed in the WTO Committee on Regional Trade Agreements; he noted that the transitional period allowed under the TRIMS agreement could be extended by the Council on Trade in Goods.

The representative noted that market opening and deregulation had improved the supply in, and competitiveness of, the services sector in recent years. Mexico's commitments in the WTO were extensive and ambitious. The sole exceptions to MFN treatment related to cross-border land transport with the U.S.; Mexico was reviewing its commitments with a view to removing as many barriers as possible on an MFN basis. He provided details on certain limits to foreign investment and the circumstances in which the limits could be exceeded. He also reviewed developments, bindings and conditions for foreign direct investment in telecommunications, maritime and land transport, and financial services.

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### Specific questions

Members sought information on recent foreign investment flows, and on policies and regulations to diversify the sources of new investment. They asked about the elimination of remaining restrictions on private and foreign participation in a number of sectors.

Mexico was asked about its recent experience with the Federal Competition Commission, on plans to strengthen the Commission, and on cooperation programmes with other countries in competition policy.

Several Members expressed appreciation for the introduction of improved legislation on intellectual property, but raised various questions on plant protection, copyright and

enforcement. One Member requested information on a new Health Law affecting generic drugs.

In reply, the representative of Mexico said that the Foreign Investment Law of 1996 had extended on an MFN basis the treatment negotiated under NAFTA. He cited examples of the liberalization and simplification of the investment regime. Other regional trade agreements also included disciplines on investment. Bilateral agreements for the protection of investment had been signed with a number of countries and Mexico was participating actively in the OECD negotiations for a Multilateral Agreement on Investment.

He said that deregulation and privatization complemented economic liberalization, especially in services, fisheries and mining. The Council on Economic Deregulation was working mainly on simplifying administrative procedures and eliminating inefficiencies, and he gave examples of legislative reform in the area. He also provided information on the operations of the Federal Competition Commission, an autonomous body charged with investigating and combatting monopolies, monopolistic practices and anti-competitive mergers, fostering deregulation and promoting a competitive environment. He gave details of international cooperation in this area.

He drew attention to the fact that, while Mexico was using the extended period afforded to developing countries to implement the TRIPS agreement, Mexico now had modern legislation in this area, covering industrial property, authors' rights and plant protection. Work was also being undertaken to draft a law for the protection of integrated semi-conductor circuits. He gave details of penalties for infringement and confirmed that customs could seize infringing goods.

Overall, Members commended Mexico for its continued programme of trade liberalization and economic reform, despite the difficult circumstances faced in recent years. Mexico's open policy had assisted recovery from the 1995 recession. However, concerns about certain areas were expressed in the discussion, including: the balance between regionalism and multilateralism; the use of anti-dumping measures; government procurement policies; application of standards; and sectoral policy aspects in agriculture, manufacturing and services. Members encouraged Mexico to continue its positive participation in the WTO.

## Nigeria – 23-24 June 1998

Over the past two days the TPRB has conducted the second review of Nigeria's trade policies and practices. These remarks, prepared on my own responsibility, are intended to summarize the main points of the discussion, and they do not constitute a full report. Details of the discussion will be reflected in the minutes of the meeting, and you will recall that the Nigerian delegation provided written replies in the context of this meeting.

The discussion developed under three themes: (i) economic performance and institutional framework; (ii) trade measures; and (iii) sectoral issues.

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### **Economic performance and institutional framework**

Members welcomed the progress made since 1995 in restoring macroeconomic stability, under an extensive programme for private sector-led growth, encompassing the liberalization of foreign investment and a reform of the capital market. However, they noted that development remained uneven and social indicators were not improving. Noting that the economy remained dependent on oil export revenues, members asked about future economic prospects in the context of weak oil prices. They emphasized that integration of the informal sector into the economy could increase tax revenue and provide a more stable basis for trade.

Some Members stressed that the Nigerian economy had suffered from persistent political and institutional uncertainty. They emphasized that democracy, good governance and the rule of law were fundamental to economic development and urged the new Government to continue the reform programme, including the transition to democratic civilian rule. Members stressed the need for clarification regarding the new Government's plans to adopt well-defined constitutional arrangements.

Participants asked how the Government intended to address the problem of foreign public debt, which was a serious burden on the economy. It was also noted that the use of a dual exchange rate system distorted public sector accounts and was an obstacle to resumption of multilateral credits and debt rescheduling.

Participants urged Nigeria to pass domestic legislation implementing the WTO Agreements and, where necessary, to seek assistance from the relevant WTO Committees to bring its legislation into conformity. Some Members urged Nigeria to establish a consistent follow-up mechanism which would provide a framework to measure achievements, implement further legislative amendments and define technical assistance needs. Some Members asked how the ECOWAS trade liberalization scheme had reinforced trading links among countries in the region, and what benefits it had brought to Nigeria.

In response, the representative of Nigeria observed that the uneven distribution of growth had resulted from the lagged response of some sectors to the economic reforms undertaken in recent years. The Government was making efforts to address these problems, particularly in manufacturing and services. He recognized that the economy remained dependent on oil revenue, and that weak oil prices would affect the Budget outcome. However, foreign exchange reserves of over US\$8 billion, prudent fiscal policies and budget adjustments would ensure the effective implementation of the 1998 Budget.

The representative also pointed out that the stock of external debt had been reduced to US\$28 billion as of December 1996. The Government intended to achieve sustainability of external debt service and debt stock by the turn of the century. Reconciliation of the various debt estimates continued; Nigeria's total debt to the Paris Club members had fallen to just under US\$19 billion on 31 December 1997. On the dual exchange rate he noted that the use of the official rate was strictly limited to settling public foreign debt payments and transfers to Nigerian missions abroad.

The representative of Nigeria stated that a new constitution would be promulgated on 1 October 1998. All laws that inhibited competition and reduced transparency were being reviewed. An interministerial committee had been established to advise on changes required to bring domestic legislation into conformity with the WTO Agreements. Gaps had already been identified in areas such as intellectual property, government procurement, anti-dumping, safeguards and customs valuation.

The representative noted that Nigeria's bilateral agreements did not include preferential trade arrangements. Nigeria was participating actively in the ECOWAS scheme, which however had been hampered by the volume of informal trade within the region and by the failure of some members to meet their commitments.

Steps were being taken to integrate the informal sector into the mainstream economy, including setting up border markets, which the authorities expected would help reduce smuggling.

The representative of Nigeria indicated that technical assistance was required to study the informal sector and develop the ECOWAS scheme. Assistance was also needed to realign domestic regulations with multilateral rules and develop the institutional capacity to implement the WTO Agreements, notably on customs valuation.

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### **Trade measures**

While welcoming the reduction in tariff levels and dispersion since 1995, participants noted that duties on consumer products remained high and that Nigeria's tariffs were subject to frequent changes; they called for a simplification of the system by removal of annual duty rebates and import surcharges. Predictability would also be enhanced by increasing tariff bindings on industrial products, and closing the gap between applied and bound rates.

Members noted that import procedures were cumbersome and lengthy; reference prices were still in use; the pre-shipment inspection scheme appeared to be expensive, discriminatory and inefficient; and Customs frequently re-evaluated upwards payable duty as assessed by the PSI companies. In this context, some Members asked about the Government's plans to introduce the ASYCUDA scheme for customs data processing and how the Government intended to comply with the provisions of the WTO Customs Valuation Agreement by the end of the transitional period.

Members welcomed proposals submitted to the Nigerian Government to phase out all remaining import prohibitions by the year 2000. Meanwhile, some Members regretted the maintenance of import prohibitions and sought clarification on their WTO justification in the absence of WTO-consistent domestic legislation on safeguard measures.

Members also questioned the coherence of Nigeria's export policies. They noted that several prohibitions continued to restrict potential export diversification while administrative export requirements, designed primarily to ensure repatriation of export proceeds, also acted as a constraint to export. In contrast, a wide array of export-assistance instruments remained in place.

Public sector companies continued to dominate large segments of the economy and trade, accounting for 30-40 per cent of fixed capital investment. Participants deplored the lack of transparency in public procurement. While welcoming the announcement of the privatization of several public entities, including that of the telecommunications operator before the end of 1998, Members emphasized the need for a competition policy to ensure market efficiency.

Some participants noted the need for improved enforcement of intellectual property rights, and asked for the Government's plans to bring its intellectual property legislation into conformity with the provisions of the TRIPS Agreement.

The representative of Nigeria replied that Nigeria's import and export regimes had undergone several reforms since 1991 to establish a more stable framework for trade. The

overall objective of the Nigerian tariff structure was to encourage efficiency by reducing tariffs on consumer goods relative to those on raw materials and intermediate products.

Customs clearance procedures were being reformed to implement fully the Kyoto Convention. Preshipment inspection was being applied across-the-board without discrimination. Documentation requirements had been drastically reduced through the introduction of a Single Goods Declaration, which was a first step towards implementation of the ASYCUDA scheme. The objective was to allow importers to clear goods within 48 hours. Nigeria had also produced a draft Customs code that was already approved by the World Customs Organization; this code, and answers to the WTO customs valuation questionnaire, would be forwarded to the Secretariat for comment.

The representative restated that prohibitions falling under balance-of-payments provisions would be phased out by 1 January 2000: and in this regard, a notification would be submitted very soon. In addition, his Government was studying a proposal to address all remaining items on the Import Prohibition List with a view to their eventual phase out. Licensing had been abolished except for prohibited items allowed as part of foreign investment contracts, on which a 100 per cent duty was imposed.

Anti-dumping duties were not incorporated into the tariff structure. Nigeria did not yet have the capacity to investigate dumping claims, but plans to establish an investigating authority were under consideration.

Nigeria provided export incentives but no subsidies to trade. The Government was reviewing those incentives to ensure their WTO consistency. There were no state-trading companies in Nigeria and no import privileges were granted, except for those awarded to the national oil company as an emergency measure following the breakdown of the country's refineries. There was no express policy giving preference to local goods in government procurement.

The representative noted that a full description of Nigeria's technical regulations was already available in WTO documents, and that Nigeria had complied with all its notification obligations under the TBT and SPS Agreements.

Nigeria was reviewing its laws on intellectual property to make them WTO consistent. Certain legislative gaps and enforcement problems had been identified, and would be addressed in collaboration with WIPO and WTO. The authorities were also aware of the need to ensure that appropriate competition rules were put in place.

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### **Sectoral issues**

Members raised questions on various sectoral issues, including:

- the performance of the agricultural sector, which was inhibited by certain import and export prohibitions, despite recent liberalization of fertilizer imports and cassava exports;
- structural and environmental issues relating to oil and gas production, which represented 95 per cent of export earnings and three-quarters of government revenue, including fuel shortages resulting from a breakdown of refinery capacity;
- the need for a reform of the mining law to encourage development of the solid mineral sector;
- obstacles to industrial development stemming from the complexity of import and export policies and the high level of Government intervention, and the prospects for reform;
- obstacles stemming from infrastructural inadequacies in ports, transport, power and telecommunications, and the prospects for improvements through privatization and other measures to enhance efficiency.

In response, the representative indicated that agricultural trade had been further liberalized. He emphasized that there was no import ban on meat and meat products. Measures to enhance competition in the provision of infrastructure and foreign exchange were expected to improve prospects for industry.

Nigeria had begun a review of the Minerals Act to encourage foreign investment in the solid minerals sector, while the capital gains tax had already been abolished. Nigeria recognized the adverse environmental consequences associated with gas flaring and was providing incentives for producers to decrease such practices.

Recognizing the problems associated with the operation of ports, the representative indicated that the Government had already started a reform programme in that area. The privatization of NITEL would begin before end 1998, while the electricity utility NEPA was being reorganized in view of privatization. Nigeria's shipping policy was also under review with a view to liberalization. A number of other activities were already open to private investment, including banking, air and road transport.

In conclusion, let me say that in this review, most Members have recognized the progress made by Nigeria in macroeconomic and trade policies in recent years. However, at the same time, Members have pinpointed, in a clear and frank manner, a large number of governance, structural and policy-related issues that still inhibit the development of Nigeria's economy and trade.

As Chairman, I welcome the frankness of the discussion and of the replies made by the Nigerian delegation. I hope that Nigeria's transition to a democratic regime – clearly signalled by the Delegation – will resolve many of the serious concerns expressed in this meeting regarding governance, stability and predictability of policies. I welcome Nigeria's identification of technical assistance needs, the indications that have been given as to where such assistance can be found, and hope that the dialogue initiated in the last two days can be continued. I also trust that the questions and points raised by delegations will be taken seriously into consideration by the new administration in Abuja, and translated into a positive programme of ongoing economic reform that can enable Nigeria and all its people in all economic sectors to fulfil their considerable potential as a major economic power in Africa.

## Southern Africa Customs Union (SACU) – 21-23 April 1998

Over the past three days the TPRB has conducted the first group review of the members of the Southern African Customs Union (SACU), Botswana, Lesotho, Namibia, South Africa and Swaziland; this has also been the second review of South Africa. These remarks, prepared on my own responsibility, are intended to summarize the main points of the discussion and not to be a full report. Details of the discussion will be reflected in the minutes of the meeting. The SACU members provided written replies in the context of the meeting and have undertaken to supply further details as necessary.

The discussion developed under three themes: (i) the macroeconomic and structural environment; (ii) trade policies and sectoral issues; and (iii) trade agreements.

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### **Macroeconomic and structural environment**

Members commended the SACU countries for the fundamental economic reform that they were undertaking; they had moved away from import-substitution to more outward-oriented policies and were adjusting to the political transformation of South Africa as well as to the fast changing environment of globalization.

Members welcomed South Africa's pursuit of structural adjustment and its reintegration into the world economy. Members emphasized that the reform and its continued pursuit, including substantial trade liberalization, would contribute to further diversifying South Africa's exports away from their dependence on mineral products, particularly gold, and would help to attract foreign direct investment. Noting in this context the role of the Growth, Employment and Redistribution (GEAR) framework, Members sought clarification on its coherence as a macroeconomic and structural strategy, comprising elements such as wage policy and incentives schemes geared at capital intensive sectors, with the objectives of job creation and an improvement in competitiveness. Some concern was expressed about the perceived slowdown in privatization; and there was a certain worry that, as the region's largest economy, South Africa might divert resources from neighbouring countries and make it difficult for them to compete. Some Members also asked about the effects of the east-Asian crisis on the SACU economies.

Members commended Botswana on its recent economic performance; they asked about the coordination of its monetary and trade policies, with Botswana not a signatory to the Multilateral Monetary Agreement linking the other SACU members. It was emphasized that further liberalization under SACU would help diversify the Botswana economy away from its dependence on diamonds and meat, and create employment.

Members recognized that Lesotho's status as a least developed country posed special challenges. They noted that Lesotho was heavily dependent on SACU revenues and asked about efforts to widen and improve the fiscal base; this question applied equally to Swaziland and, to a certain extent to Namibia. It was further noted that these revenues could decline as SACU further liberalized its trade regime. They added that Lesotho's market-oriented reforms, and trade liberalization under SACU, should help to diversify the economy away from its dependence on remittances from migrant workers.

Participants congratulated Namibia on its efforts since independence in 1990 to restructure and diversify its economy, including its export base, away from mining and agricultural and fisheries production; combined with further trade liberalization under SACU, the reforms should help to create a free-market environment and contribute to meeting objectives such as job creation.

Members asked about Swaziland's development plan. Noting that investment, mainly in the industrial sector, had stagnated since the political transformation in South Africa, some participants stressed that a free-market environment should contribute to attracting foreign capital to Swaziland.

In reply, the representative of South Africa said that coherent macroeconomic policies had resulted in an unprecedented stability in South Africa's national accounts and in improved business confidence; this, and the ongoing restructuring of the productive base, constituted a strong platform from which future targets could be reached. On employment, he indicated

that South Africa had a multifaceted strategy to promote labour-intensive sectors in manufacturing and to increase value-added in capital intensive sectors. He contested the suggestion of any slowdown in privatization; rather an overall strategy was being followed that would lead to improved efficiency and competitiveness. He added that in moving toward a free-trade area in the Southern African Development Community (SADC), South Africa would liberalize more rapidly than its partners, so as to allow them a longer adjustment period; in addition, South Africa was convinced of the need to promote investment in the smaller economies in order to help accelerate their development process.

The Botswana representative noted that her country's currency was fully convertible and that international reserves were the equivalent of 30 months of imports. She added that the Government had established a task force for privatization, which was seen as an important element in liberalizing and diversifying the economy. Both the representatives of Botswana and Namibia indicated that the east-Asian financial crisis would affect their economies, particularly through the slowdown in the sale of gem diamonds.

The representative of Lesotho stated that his country's Structural Adjustment Plan had been implemented since the late 1980s and was improving Lesotho's economic performance, thus helping to reduce reliance on remittances from migrant workers. The new Lesotho Highlands Water Project had also made a significant contribution.

The representative of Namibia said that the planned introduction of a value added tax (VAT) in 1999 should help diversify the revenue base and lessen the impact of any changes in the SACU regime. Namibia believed that the ongoing commercialization of public enterprises would put them in a better position for successful privatization. He added that Namibia had embarked upon a process of industrial development and export diversification supported by a tax-based incentive scheme and an export processing zone regime.

The representative of Swaziland noted that his authorities were also considering the introduction of a VAT, which together with improved tax administration, should improve the revenue base and reduce reliance on SACU customs duties. To promote investment, the Government had recently launched a one-stop shop for investors and an Investment Act had been finalized.

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### **Trade policies**

Members welcomed the recent changes in the trade policy of SACU members and the adoption of more outward-oriented trade practices. However, some Members considered that SACU's existing tariff structure might not be completely appropriate for the smaller economies. Moreover, some import prohibitions and controls were maintained. Overall, the trade regime still appeared to show a certain anti-export bias. Members welcomed the Tariff Rationalization Process, but a rather complex tariff regime remained, which lacked a certain transparency and stability. Some sectors were protected behind high and escalating tariffs. One Member expressed concern about the recent tariff increases on dairy products. Several Members inquired about proposed tariff increases on certain electronic and agricultural products. Members encouraged SACU countries to further simplify the tariff and reduce the rates.

Questions were raised about rules of origin. Some Members questioned South Africa's VAT regime on imports, and raised concern about the implementation of the WTO Customs Valuation Agreement by SACU countries.

Some Members sought information on efforts to restructure South Africa's trade remedy regime, expressing some worry about the application of anti-dumping measures. Questions were also asked about the use of local content requirements in industries such as motor vehicles and telecommunications. Some Members thought that certain technical standards were unnecessarily stringent and cumbersome. Questions were raised on government procurement, including as to whether South Africa intended to join the Government Procurement Agreement.

On intellectual property, concerns were expressed about certain aspects of South Africa's TRIPS legislation, including its application to pharmaceuticals. South Africa was encouraged to modify its TRIPS legislation and thus provide a model on intellectual property protection to other SACU members. Information on the status of the various TRIPS-related bills was requested.

Members welcomed South Africa's removal of the General Export Incentive Scheme, but drew attention to the wide variety of export incentive schemes that still remained.

Speaking on behalf of its SACU partners, South Africa noted that the perceived anti-export bias in its trade policy instruments was not simply related to the tariff structure but to a complex set of factors. In this respect, it was essential to examine specific trade matters as part of the integrated approach South Africa had adopted on trade, industrial, investment and competition policy matters. Industrial and trade policies aimed at accelerating industrial restructuring and raising competitiveness. To achieve such restructuring, legitimate industrial instruments and export promotion measures were being used.

The representative added that the tariff structure was not complex, except perhaps with respect to textiles. The ongoing tariff restructuring, which had incorporated a downward trend in rates, would continue reducing the number of tariff bands. Moreover, South Africa was committed to a structure of ad valorem tariffs and, excluding some agricultural products, this would be achieved by 1999. The still frequent tariff changes were mainly linked to the restructuring process. Strict guidelines were used to consider tariff increases; thus while policy had at times been selective, changes were made in transparent manner. Compound and formula tariffs applied to only a few items. South Africa would allow formula tariffs to lapse by January 1999. Tariff phase-down schedules had also been published for major sectors such as textiles, clothing, and motor vehicles.

Remaining quantitative import restrictions were not a significant trade barrier with almost all such restrictions having been removed. Restrictions on black tea would be tariffed and local content requirements on this product removed within the next few months. Licensing was used on a non-restrictive basis. Import restrictions on used goods would remain in order to protect against disruptive prices. Most export controls were not applied restrictively and were to be removed. The representative of Namibia added that his Government was in the process of reviewing Namibia's import and export licensing regime, to assure full conformity with WTO rules.

The representative of South Africa noted that while it would be a major challenge to streamline the rules of origin in existing and future trade agreements, and in the Lomé Convention, such rules were, by the nature of customs unions, not an issue for SACU itself.

South Africa applied trade defense measures in accordance with WTO rules and legislation was being amended to reflect this. He added that given South Africa's short experience with such measures, further experience and capacity would be required to cope with the growing number and complexity of investigations.

The South African representative noted that South Africa's approach to government procurement was based on the desire to employ it as an instrument to achieve socio-economic objectives without forfeiting good financial management. The representatives of the SACU members provided details on their standards and technical requirements.

On intellectual property, the South African representative said that his country was the only developing country to have assumed full and immediate obligations under the TRIPS Agreement. To bring domestic legislation into line with international rules, several legislative amendments had been enacted over the last five years. The representative of Botswana gave details on the Copyright and Neighbouring Rights Bill that was expected to be tabled in Parliament in July 1998.

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### **Sectoral issues**

Expressing full appreciation for the progress made by South Africa in liberalizing its agricultural sector, Members inquired about plans for the abolition of the remaining control boards; some participants expressed concern about the evolution of tariffs on agricultural products, including for wine and dairy items. Questions were raised about trade policy instruments in manufacturing, including in the motor vehicle sector. Questions were also asked about the gold tax formula, and about further liberalization and privatization in services, particularly in the telecommunications, transport and financial areas. Similar questions on services were addressed to the other SACU members and Lesotho was also asked about self-sufficiency in agriculture and outward processing in clothing.

The representative of South Africa indicated that his Government had been engaged in an agricultural policy reform process that would result in a White Paper for agriculture by end 1998. In line with such reform, all agricultural marketing boards had been phased out in 1997 and export controls on agricultural products had either been removed or were not applied restrictively. Price controls had also been eliminated, except on sugar. Reform of the marketing of wine and sugar was under way.

He added that the industrial subsector was being restructured, with an emphasis on the use of supply-side measures. In addition, reforms were also under consideration in telecommunications and in transport.

The representative of Botswana noted the liberalization already achieved in telecommunications in her country, and the representative of Lesotho indicated that steps were being taken to promote tourism. He added that his Government had removed distortions caused by the agricultural self-sufficiency policy followed in the 1980s; policy was now geared to exploiting Lesotho's comparative advantage in the production of high value crops. In manufacturing, Lesotho was committed to maintaining the momentum achieved in the past decade, including in clothing, with an export-led growth strategy. The representative of Namibia added that Namibia was committed to liberalizing its service sector and that it would participate in the next WTO round of negotiations on trade in services. The representative of Swaziland noted that liberalization of telecommunications in his country was under consideration.



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## Trade agreements

Members took note of the importance attached by SACU countries to their participation in the multilateral trading system and of their determination that their regional agreements would conform with the rules of the multilateral system. Certain SACU countries still faced some challenges in reviewing their domestic legislation to ensure conformity with multilateral rules. Some SACU members might also need to strengthen their institutional capacity to implement their individual WTO rights and obligations; the WTO could provide technical assistance for this.

Several WTO Members highlighted the interlinkage among Southern African countries, which collaborated closely through an elaborate network of regional agreements including SACU, SADC, and COMESA. Details were requested on the status of the renegotiation of the SACU Agreement and the implementation of the SADC Trade Protocol. The matter of a possible free-trade agreement between South Africa and the European Union was raised, and some Members stressed the requirement that it apply to substantially all trade. Members inquired about the notification to the WTO of the regional arrangements.

Members noted that for the countries under review, SACU was the focal point of their trade policy regime. It was recognized that the network of agreements in which these countries participated facilitated economic exchange. However, this network may have complicated trade relations and perhaps created certain conflicts between national and collective interests.

The representative of South Africa, speaking on behalf of the other SACU members, stated that their countries were engaged in efforts to foster economic growth and balanced development through cooperation and integration. Regional integration would help build a competitive regional economy that would provide a basis for more effective integration into the world economy. Given the disparity of economies involved, this process would require strategies to boost supply capacity in the smaller SACU economies. Measures would also be needed to ensure that these countries did not suffer sudden reductions in SACU revenue. The representatives of Botswana and Namibia stressed that their Governments sought to make SACU more democratic.

With regard to the SADC Trade Protocol, the South African representative indicated that SACU partners would make a comprehensive offer at the soon to be held SADC Ministerial meeting. The ratification of the SADC Trade Protocol was progressing and concerns about delays were premature. It would be notified to the WTO following the conclusion of the substantive agreement and its ratification.

Negotiations were still in progress on a comprehensive trade, cooperation and development agreement between South Africa and the European Union. Both parties desired to conclude those negotiations by June 1998.

Overall, Members welcomed the collective participation by Botswana, Lesotho, Namibia, South Africa and Swaziland in the review process. Members appreciated the recent measures taken by them towards economic reform and market opening. Members also emphasized the importance of the continued pursuit of these policies, both to increase market access and to improve the stability and transparency of the SACU trade regime. I wish to emphasize that the thrust of the discussion was supportive of the underlying direction of economic and trade policies in Southern Africa during a period of sharp transition in that region. Members offered strong encouragement to the five countries reviewed to consolidate and build on the achievements of recent years.