

# Supply Chains, Mega-Regionals and Multilateralism

A Road Map for the WTO

by Bernard Hoekman



CEPR Press



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# Foreword

The world trading system is at an historic fork in the road. The small package of measures agreed by WTO Members in Bali last year is a powerful illustration of how multilateral trade liberalisation has to change. Twelve years of talk produced a deal that was only a sliver of the Doha Round's initial ambition of rebalancing the global trade system. What we need now is a way forward.

In Bali, the trade ministers directed their WTO negotiators to develop a road map for liberalising trade on a multilateral basis. Bernard Hoekman has written a masterful book that provides just such a plan. But this is not merely a plan – it marshals the best available evidence and theory to explain the deep fundamentals of what changed and what needs to change in the WTO.

The touchstone of his thinking is that any road map must recognise – and exploit – the radical changes that have occurred in international commerce. One name for this is the Global Value Chain (GVC) 'Revolution' that means that the trading system is increasingly being used to make goods, not just sell goods. The disciplines needed for this 'factories-crossing-borders' world are not those that sufficed for trade in 'made-here-sold-there' goods. Each stage of the supply chain requires efficient logistics and other services to move products across borders. Supply chain production implies that trade negotiations today need to focus on a much broader range of policies that are also more interconnected.

Hoekman's proposals address three broad questions: how to conclude the Doha Round, how to use the WTO as a forum for deliberation on the issues raised by the GVC Revolution, inter alia, and how to rethink how development is addressed in the WTO.

Not everyone will agree with Bernard's conclusions, but his careful and professional marshalling of the evidence and his insightful framing of the issues is something every policymaker and scholar will profit from. As ever, we also gratefully acknowledge the vital contributions of Anil Shamdasani for his characteristic speed and professionalism in producing this book.

Richard Baldwin  
Director, CEPR  
4 April 2014, London



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# Executive Summary

The market access dimension of the WTO Doha Round has been deadlocked since 2008. The US, EU and likeminded countries increasingly have turned their attention towards the negotiation of preferential trade agreements, including so-called 'mega-regional' initiatives such as the Trans-Pacific Partnership. So far there are no regional initiatives to liberalise trade and investment that include all of the major players, and there is a danger of the world economy splitting into separate blocs. The shift towards regional approaches by large trading countries is not in the interest of the majority of nations that are not part of them.

In the 2013 Ministerial Conference in Bali, ministers directed their WTO negotiators to develop a work programme by the end of 2014 that offers a road map for agreements to liberalise trade on a multilateral basis. A premise of this report is that any such road map should internalise and leverage the fact that the structure and organisation of international trade has changed.

Goods and services are increasingly produced in international supply chains, with suppliers in one country producing inputs that are processed in another and then shipped to one or more other countries. Each stage of the supply chain requires efficient logistics and other services to move products across borders. Supply chain production implies that trade negotiations today need to focus on a much broader range of policies.

The changes in the way trade is conducted raise new challenges but also offer new opportunities for international trade policy cooperation. Issues such as differences in domestic regulation of goods and services and investment policies are now of major importance to manufacturers, farmers and service providers around the world, especially those that are integrated into international supply chains. More effectively incorporating and addressing these issues into trade agreements is essential to creating the dynamism that has been missing from the Doha Round.

The WTO, like other trade agreements, tends to take a 'silo' approach, addressing policy areas in isolation. For businesses this policy-specific approach may reduce the relevance of WTO agreements. From the perspective of international supply chains and production networks a variety of policies will matter. The marginal effect of disciplining or changing one policy instrument may be reduced if the cost-raising effects of others are not addressed in parallel.

This insight – and more generally the rise of supply chain trade – motivates a number of proposals that are made in the report. These address three broad subjects: (i) concluding the Doha Development Agenda (DDA) talks on market access and rules; (ii) doing more to use the WTO as a forum for deliberation – identifying the effects of policies on trade and investment and building a common understanding on the policy areas that should be the focus of cooperation looking forward; and (iii) reconsidering the approaches that have been taken in the WTO to address development concerns.

## *2 Supply Chains, Mega-Regionals and Multilateralism: A Road Map for the WTO*

The core market access and rule-making elements of the DDA in the areas of trade in agriculture, industrial goods and services remain very important. The report argues, however, that the approach that has been taken so far by WTO Members should be revisited. Rather than exclusively pursuing negotiations on specific trade policies such as tariffs on imports of goods, subsidies for agriculture, and market access for specific services, an approach that focuses on how various policies impact negatively on the operation of different types of supply chains may offer a complementary mechanism to help move negotiations forward.

The adoption of a supply chain framework can help to better understand how different policies that are the subject of negotiation in separate groups jointly impact on the value chains that are used to trade agricultural products, industrial goods or services. The idea is not that negotiations should focus on specific value chains, but that a supply chain framework can help identify how an overall package can be constructed that spans the different policy areas that are on the table, including not just tariffs but also services policies that affect the operation of supply chains.

A second set of proposals are forward-looking and revolve around greater use of the WTO for deliberation on trade policy matters and for providing greater space for plurilateral agreements among groups of WTO Members on new issues. Figuring out what policies have the greatest impact on trade and investment, and which policy areas are ripe for discussions to agree on a set of disciplines requires substantial preparatory work. There is much that can be learned in this regard from what is being done in regional agreements and the WTO offers a potential forum through which to do so.

The rapid increase in the number and depth of preferential trade agreements (PTAs) suggests that greater focus is needed in the WTO on approaches that allow groups of like-minded nations to agree amongst themselves to address the trade effects of differences in regulatory policies. Numerous subjects may lend themselves to plurilateral cooperation, ranging from investment policies to 'green' industrial policies. The focus of small-group cooperation might also be sector-specific, with countries that are interested in doing so going beyond tariffs to include other policies that are not the subject of WTO disciplines. This need not be limited to manufacturing sectors, but can span agri-business and services as well. Depending on the coverage of the policy commitments, such cooperation could be pursued on a critical mass basis (an agreement that is applied on a nondiscriminatory basis by a subset of WTO Members, without any obligations applying to nonsignatories). The ultimate goal must be that the results of agreements among groups of WTO Members be open to all WTO Members. Ensuring this is important to be consistent with the consensus necessary to conclude meaningful agreements, as well as for fulfilling the goals of the WTO system.

The final section of the report discusses implications of recent economic history and changes in the structure of global trade for the approaches that have been used in the WTO to address development concerns. The new Agreement on Trade Facilitation concluded at the Bali Ministerial is not just a positive development for the trading system. It illustrates that the WTO processes can

generate concrete outcomes and do so in a way that recognises and addresses the resource constraints that affect the ability of many developing countries to implement new agreements. Looking forward, efforts should be devoted to emulating this approach to allow development concerns and resource constraints to be addressed in a more effective and meaningful way than the approach that has historically been pursued by developing countries – an insistence on ‘less than full reciprocity’ and greater freedom to continue to use trade-distorting policies. An important dimension of addressing development concerns is improving the knowledge base to inform international cooperation on trade, including efforts to better identify policies to promote value addition and enhance the development impacts of supply chain participation.





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# 1 From Doha to Bali

The multilateral trading system has provided an important framework for countries to agree to trade policy disciplines and commitments, as well as a mechanism through which these can be enforced. Starting with limited participation by low-income countries in the General Agreement on Tariffs and Trade (GATT) in 1948 – twelve of the original 23 signatories were developing economies – as of early 2014 membership of the World Trade Organization (WTO) stands at 160. Over 30 countries joined the WTO following its establishment in 1995, including China and Russia, and some 20 countries are in the process of negotiating accession. Emerging economies and developing countries have become active participants in the multilateral trading system.

## 1.1 The Doha Development Agenda: Diverging objectives

The first round of multilateral trade negotiations launched under WTO auspices in Doha, Qatar, in 2001 was called the Doha Development Agenda (DDA). The inclusion of the word ‘development’ reflected the rising influence of developing countries in the WTO and a view that more needed to be done to address a perceived ‘development deficit’. After the creation of the WTO in 1995, many developing countries had come to the view that implementation of some WTO agreements might not be a priority from a development perspective and might constrain the ability to use national policies needed to promote growth, and that more needed to be done to recognise and address the capacity constraints that limited the ability of many countries to benefit from existing market access opportunities.

Key objectives of many developing country governments included making special and differential treatment (SDT) provisions more effective and operational; improving preferential (non-reciprocal) access to major markets; applying the principle of less than full reciprocity in negotiations; increasing financial and technical assistance to improve trade capacity; and addressing instances of ‘reverse SDT’ – provisions in the WTO permitting high-income countries to use policies that distort trade. Examples of the latter include tariff escalation – which creates incentives for exports of unprocessed goods as opposed to higher-value, processed products – and the latitude permitted to high-income countries to provide trade-distorting agricultural support (subsidies), including for commodities that are important for developing nations such as cotton.

For developed countries, a key objective was improved access for their exports of goods and services to the rapidly expanding markets of developing and emerging economies. High growth rates in developing countries – especially in large nations such as Brazil, China and India, and in East Asian economies – coupled with barriers to trade that remain significantly higher than the OECD average, explain the focus on achieving substantial reductions in applied tariffs

on manufactured and agricultural goods (as opposed to merely reducing the 'water' between bound and applied rates) and improved access to markets for services.

An important factor impeding agreement to a liberalisation package in the DDA was both the imbalance in the average levels of tariffs prevailing in major trading nations – OECD countries had less to 'give' – and the fact that many emerging economies had pursued unilateral trade liberalisation following the creation of the WTO in 1995. India, for example, had gradually reduced many of its tariffs from 35% to 10% in the decade following the launch of the DDA, and was unwilling to contemplate the demands from some trading partners to go further.

The absence of an ambitious package of trade liberalisation has a significant opportunity cost for the world economy. The post-2001 period saw agricultural prices rise substantially, in principle facilitating agreement to lower agricultural protection. The 2008 financial crisis revealed the need for developed countries to implement structural reforms to improve competitiveness. In the case of the EU for example, the DDA offered an opportunity to undertake liberalisation of services markets that is impeded by national political economy forces. The post-2008 shift in China to rebalance the economy more towards domestic consumption will imply expanding the services sectors. A successful DDA package of services liberalisation would have helped China pursue its internal economic rebalancing, while at the same time creating opportunities for foreign providers. These post-Doha developments suggest that failing to conclude a DDA market access liberalisation package was a significant missed opportunity not just for small countries but also for some of the major players.

Although agreement on a large market access package proved elusive, progress was made post-2001 in achieving results on the 'development' dimensions of the DDA. Milestones include the Enhanced Integrated Framework for Trade-related Assistance for Least Developed Countries (LDCs); the launch of the 'duty-free, quota-free' (DFQF) market access initiative for LDCs; and the Aid for Trade initiative at the 2005 WTO Ministerial meeting in Hong Kong. Many OECD countries have now completely opened their markets for merchandise imports from LDCs (the US being a notable exception in not going beyond the 97% minimum coverage of DFQF access). LDCs also increasingly benefit from DFQF access for many of their exports to large emerging economies.

Another achievement was the initiative to permit WTO Members to provide trade preferences in the area of services to LDCs, following a waiver of the General Agreement on Trade and Services (GATS) most-favoured nation (MFN) rule that was agreed at the 8th WTO Ministerial conference in 2011. The Aid for Trade initiative has been a mechanism to engage development agencies (bilateral and multilateral) more in the trade integration agenda, and to raise the profile of trade issues in the process of determining priorities for investment and policy reform at the country level. These achievements address part of the 'development deficit' in the design of the WTO.<sup>1</sup>

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<sup>1</sup> This is also true with respect to other concerns about the operation of WTO processes, such as internal transparency and access to information and consultations. See Hoekman (2012).

Further progress was made at the WTO ministerial meeting in Bali in December 2013 with the adoption of the Agreement on Trade Facilitation. But to date no progress could be made on redefining the core rules of the WTO, or on agreeing on a set of new reciprocal market access commitments and policy disciplines affecting trade in agricultural products, manufactures or services; let alone initiating discussions on policy areas that are off the table but are of increasing concern in terms of generating negative spillovers for other countries, or where cooperation is needed to address global challenges such as climate change.

## **1.2 Explanations for the deadlock**

There has been much discussion and analysis of the factors that led to the deadlock on market access and agricultural support negotiations in the DDA.<sup>2</sup> Among the more compelling arguments are that the cost of non-agreement is low and that the potential upside from agreeing on a deal spanning the issues that are on the table is limited. Wolfe (2013) among others argues that changes in the structure of the world economy, and in particular the explosive growth of China, was a key factor that made the DDA agenda, as conceived in 2001 and restructured in 2003, increasingly less relevant to major players as time passed. These dynamics are discussed briefly in Chapter 2, as they have important implications for any effort to conclude the DDA.<sup>3</sup>

A fundamental source of the breakdown in the talks was the difference in what OECD countries, in particular the US, wanted to obtain from the large emerging markets, especially Brazil, China, and India, and what these countries were willing to offer and looking for in return. India is a demandeur on services, but seeks to maintain the ability to restrict agricultural imports and expand subsidisation of production. Brazil is a demandeur on further reform of agricultural policies in OECD countries, including bio-fuels, but wants flexibility to maintain the level of protection for national industries. For much of the DDA China took the position that it already had made major commitments as part of its 2001 WTO accession. To some extent this was also true for India in that it had undertaken significant unilateral trade liberalisation and sought to obtain credit for this as part of any deal on non-agricultural market access (NAMA).

Many of the poorest countries were focused on obtaining concessions in areas that are of key export interest to them – often agricultural. Movement on policies distorting agricultural markets that were of most interest to LDCs, most notably cotton in the case of West Africa, proved impossible because of the strength of the relevant domestic lobbies in rich countries. Increasingly, developing countries

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<sup>2</sup> See, for example, Evenett (2014).

<sup>3</sup> Arguments that the inability to conclude the DDA is in (large) part due to the rise of China and a ‘fear of China’ are not particularly compelling given that WTO Members have access to WTO-permitted instruments to address instances where import competition seriously injures domestic industries (i.e. safeguard actions, antidumping and countervailing duty measures). The fact that it will become harder to use such instruments once China is granted market economy status and the transitional arrangements in its protocol of accession expire is not persuasive, as there remains significant scope to impose temporary trade barriers using standard WTO-legal instruments.

are seeking to protect their own agricultural sectors (e.g. the focus by India in Bali to relax the 10% support cap on agricultural production subsidies).

For most large firms – whether from emerging economies or the OECD – agriculture does not matter, while NAMA can only deliver significant benefits if a deal is ambitious, given that average tariffs in major markets are low. Firms appeared to perceive the probability of governments raising tariffs again to be small, as they did not seem to attach much value to the fact that the NAMA formulae would bring down average levels of bound tariffs in emerging economies very substantially, much closer to actually applied levels. The suggestion by G7 countries in the July 2008 mini-Ministerial meeting to augment the NAMA tariff reduction formula (for tariff bindings) with a series of sectoral tariff agreements that would substantially reduce applied tariffs was opposed by the emerging economies as it implied them liberalising more than the OECD countries without enough of a quid pro quo.

There are, of course, areas in which high peak tariffs remain in high-income countries, including agricultural products, textiles, furniture, footwear, apparel and some manufacturing sectors. However, these are sectors of political sensitivity, such that – without the prospect of significant developing and emerging country concessions on NAMA and agricultural market access – substantial offers in these areas are unlikely. Subjects that could have generated greater political support for progress in such areas – such as significant liberalisation of services trade – were never the focus of serious negotiations before the talks were suspended in 2008. Indeed, this is one reason why services negotiations came to be pursued among a subset of countries outside of the Doha Development Agenda.

The foregoing does not imply that the potential economic gains from implementing what was on the table in Doha are trivial – they have conservatively been estimated to be on the order of \$160 billion for the merchandise trade part of the DDA alone (Laborde *et al.*, 2011), not taking into account the benefits of potential tighter disciplines on issues like fishery subsidies, trade facilitation or services. Trade facilitation gains are likely to be substantial over time if the Bali agreement helps to mobilise a broader effort to reduce trade costs.

Perhaps more important than the size of overall economic gains is that the best alternative to a negotiated agreement – the downside of not concluding the DDA – is not perceived to be that bad. Those that care intensively about an issue (e.g. cotton) have nothing to offer in mercantilist terms, while those that can – the major emerging economies – did not see enough of a quid pro quo on offer.

### **1.3 The shift away from the WTO and the 2013 Bali Ministerial**

Efforts to negotiate liberalisation and new rules of the game have increasingly shifted away from the WTO. Major preferential trade agreements are being negotiated among small groups of countries, including the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP) and a Trade in Services Agreement (TISA). These follow on a large number of bilateral trade agreements that have already been negotiated by countries that

are pursuing aggressive trade liberalisation and integration strategies in Europe, Latin America and East Asia. They are complemented by numerous ongoing bilateral negotiations (e.g. China-Korea, Korea-Japan, Canada-EU). Whatever the reasons for the lack of movement in the WTO to further liberalise trade and define new rules of the game, the action has moved to other fora.

Time will tell to what extent efforts to establish 'mega-regional' and other preferential trade and investment agreements will succeed in going significantly beyond what is covered by the WTO. Although with the majors going regional the world's focal point for trade cooperation seems to have changed, it must be recognised that not everything that is being pursued in the PTAs can be done in the WTO. Conversely, some of the important subjects that are on the table in the WTO are not addressed by PTAs – agricultural support policies being a prominent example. While this implies that PTAs are complements and not a substitute for the WTO, the revealed preference for PTAs raises numerous questions. What are the possible consequences for the multilateral trading system? For the countries that are driving efforts to negotiate mega-regionals? For the emerging economies that (so far) are not participating in mega-regionals that include the US? For the majority of developing countries that are not part of the mega-regionals?

There are strong economic forces that are likely to keep markets open (e.g. the increasing role of global value chains and international production networks discussed below), but the rules of origin of PTAs, regulatory convergence and mutual recognition among members of mega-regionals may create incentives for companies to locate in a bloc, or to source from firms located within a bloc. Moreover, although many governments have pursued unilateral trade liberalisation, some large emerging economies are actively pursuing policies to increase the share of locally produced value-added (e.g. local content requirements or subsidies) in ways that may distort trade and inhibit the ability of firms in these countries to benefit from participation in global value chains.

The agreement reached at the December 2013 WTO Ministerial meeting in Bali was important for the multilateral trading system. It did not just show that progress can be made in developing new rules of the game, but also that WTO Members can craft agreements that recognise the differences that exist across the membership in the capacity to implement new rules. The Agreement on Trade Facilitation will help countries around the world improve the operation and governance of national border-management systems and reduce uncertainty and trade costs for traders, although the degree and speed with which such benefits will materialise depends on how long transitional implementation periods will last. It also illustrates that it is possible to move forward on an issue-specific basis in a way that ensures LDCs will also benefit, by linking implementation to the provision of technical and financial assistance. The Agreement on Trade Facilitation offers a model for possible additional agreements in areas such as trade in services.

The big question confronting the WTO now is whether Bali will generate momentum to move forward in constructing a grand multilateral bargain to liberalise trade in agricultural products, manufactured goods and services, and to

begin to address policy areas that so far have been kept off the WTO table, such as investment, competition and industrial policies.

Part III of the Bali Ministerial declaration, entitled 'Post-Bali Work' (WTO, 2013b), reads as follows:

1.9. We reaffirm our commitment to the WTO as the pre-eminent global forum for trade, including negotiating and implementing trade rules, settling disputes and supporting development through the integration of developing countries into the global trading system. In this regard, we reaffirm our commitment to the Doha Development Agenda, as well as to the regular work of the WTO.

1.10. We take note of the progress that has been made towards carrying out the Doha Work Programme, including the decisions we have taken on the Bali Package during this Ministerial Conference. These decisions are an important stepping stone towards the completion of the Doha Round. We reaffirm our commitment to the development objectives set out in the Doha Declaration, as well as to all our subsequent decisions and declarations and the Marrakesh Agreement Establishing the WTO.

1.11. To further demonstrate this commitment, we instruct the Trade Negotiations Committee to prepare within the next 12 months a clearly defined work program on the remaining Doha Development Agenda issues. This will build on the decisions taken at this Ministerial Conference, particularly on agriculture, development and LDC issues, as well as all other issues under the Doha mandate that are central to concluding the Round. Issues in the Bali Package where legally binding outcomes could not be achieved will be prioritised. Work on issues in the package that have not been fully addressed at this Conference will resume in the relevant Committees or Negotiating Groups of the WTO.

1.12. The work program will be developed in a way that is consistent with the guidance we provided at the Eighth Ministerial Conference, including the need to look at ways that may allow Members to overcome the most critical and fundamental stumbling blocks.

The reference to the guidance provided at the 8th WTO Ministerial conference is reflected in the Chairman's concluding statement (WTO, 2011a), which includes the following:

Ministers underline the importance of the work of regular WTO bodies including their role in the oversight of implementing existing Agreements; dispute avoidance; transparency through monitoring and reporting and as a forum for the consideration of trade-related issues raised by Members. Ministers call for strengthening and improving their functioning.

Ministers reaffirm that development is a core element of the WTO's work ...and ... call on WTO Members to fully operationalize the mandate of the Committee on Trade and Development as a focal point for development work.

In order to achieve [a successful multilateral conclusion of the DDA] and to facilitate swifter progress, Ministers recognize that Members need to more fully explore different negotiating approaches while respecting the principles of transparency and inclusiveness.

In this context, Ministers commit to advance negotiations, where progress can be achieved, including focusing on the elements of the Doha Declaration that allow Members to reach provisional or definitive agreements based on consensus earlier than the full conclusion of the single undertaking.

The instruction by ministers to devise a work programme by the end of 2014 to conclude the Doha round recognises that a rethink of what is on the table is needed, as the modalities that have been pursued to date have failed to generate an agreement. Both MC8 and MC9 make clear that ministers are ready to consider new approaches to achieving the objectives that underlie the DDA. The Trade Facilitation Agreement and the launch of plurilateral negotiations on services in 2012 illustrates the willingness to accept that not all subjects need to be agreed as a single package, with all rules applying to all WTO Members. The new agreement on trade facilitation is particularly noteworthy in this regard, both for having been agreed on a stand-alone basis and for the extensive 'variable geometry' that is allowed for in terms of the implementation of the agreement's disciplines by each WTO Member.

## **1.4 Plan of this report**

The goal of this report is to suggest approaches in the WTO that might help to mobilise greater momentum to conclude the DDA and to use the WTO as a forum for multilateral cooperation on trade-related policies. Some or all of the proposals could be adopted as an element of the work programme called for by ministers, although the latter must address many issues that we do not discuss here (e.g. finalising the commitments on trade facilitation by each WTO Member).

The report starts with a bird's eye view of recent trade developments (Chapter 2), and a brief overview of recent trade policy trends (Chapter 3). These two chapters provide some background and context for the proposals that are developed in the remainder of the report to revitalise market access negotiations and to prepare the ground for cooperation in areas that are not (yet) on the multilateral trade agenda.

These proposals are presented in Chapters 4 to 6. Chapter 4 suggests adoption of a supply chain framework to inform and guide market access negotiations given the supply chain nature of most trade today, whether the final product is an agricultural product, manufactured good or a service. Chapter 5 makes a case for greater use of the WTO for deliberation on trade policy matters and for providing greater space for plurilateral agreements among groups of WTO Members on new issues. Chapter 6 discusses implications of recent economic

history and changes in the structure of global trade for the approaches that have been used in the WTO to address development concerns. Chapter 7 concludes.

All the suggestions and proposals made in these three chapters are consistent with – and responsive to – the decisions taken by ministers in the Bali Ministerial meeting. A basic premise is that any suggestions for moving forward in the WTO context must recognise that ministers continue to make the conclusion of the Doha market access and rule-making agenda a key objective. The proposals that are made in this report build on the mandate that has been provided in Bali. Many of the issues that are on the table in the DDA will not and cannot be addressed in PTAs, including the mega-regionals. It is therefore important that attention continue to focus on addressing the policy spillovers that are the focus of the DDA negotiations. But it is also important to recognise that the changing structure of world trade and the revealed preference for PTAs has implications for the WTO as an organisation, and that consideration should be given to facilitating cooperation between subsets of WTO Members in new policy areas.



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## 2 Developments in Global Trade

One of the distinctive features of the post-Second World War period has been the steady and sustained increase in international commerce, which, with the exception of a few episodes when the world went into recession (most notably in 2008), has grown more rapidly than output year in, year out. The extent to which world trade has grown since the 1950s is dramatic, especially when put in historical perspective. The volume of trade increased 27-fold between 1950 and 2008, three times more than the growth in global GDP. The value of global trade in goods and services passed the \$22 trillion mark in 2013 (WTO, 2013a) or 59% of global GDP, up from 39% of GDP in 1990.<sup>4</sup>

The basic drivers were a steep fall in trade costs, the result of technological change and the pursuit of policy changes, especially the adoption of outward-(export-) oriented policies. Technological changes have been both hard and soft and include advances in information and communications that led to a sharp drop in the costs of international telecommunications, and the adoption of containerisation and other improvements in logistics that led to a sharp fall in unit transport costs.

The increase in trade was accompanied by rising real per capita incomes around the globe. Notwithstanding the 2008 global financial crisis (which led to a temporary collapse in global trade), for many developing countries economic growth rates in the period after the launch of the DDA were a multiple of those attained in the 1980s and 1990s (Table 1).

**Table 1** Average annual growth rate of per capita GDP (constant 2005 US\$)

Developing country groups	1982-2012	2001-2012
East Asia & Pacific	7.2%	7.5%
Europe & Central Asia	1.8%	3.8%
High-income countries	1.8%	1.0%
Latin America & Caribbean	1.1%	1.9%
Least Developed Countries	1.5%	3.3%
Middle East & North Africa	1.5%	2.5%
Sub-Saharan Africa	0.4%	1.9%
South Asia	4.0%	4.9%

*Source:* Own calculations based on World Bank, World Development Indicators database.

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<sup>4</sup> Trade openness ratios were calculated from the World Bank Global Economic Prospects database.

## 2.1 Diverging performance: A multipolar world economy

In 2010, abstracting from the EU as a bloc, China became the world's largest exporter in gross value terms, with a 10.4% share of global merchandise exports. The US remains the world's largest importer, but China has the number two slot. If the EU-28 is considered as a bloc (and netting out intra-EU trade), the EU is the largest exporter (15%), followed by China (13%) and the US (11%). These three entities are also the largest importers, accounting for 45% of global merchandise imports. Brazil and India are much smaller players on merchandise trade, ranking 22<sup>nd</sup> and 20<sup>th</sup> respectively. They are outranked by countries such as Mexico on both the export and import side.

Thus, as is often pointed out, China has become a dominant player among the developing countries.<sup>5</sup> Overall, including trade in both goods and services, China exports five times more than India. Much of China's trade growth has occurred in the last decade. In 2000, as it was entering the WTO, China accounted for 3.7% of global trade. This increased by 6.7 percentage points in the following decade.

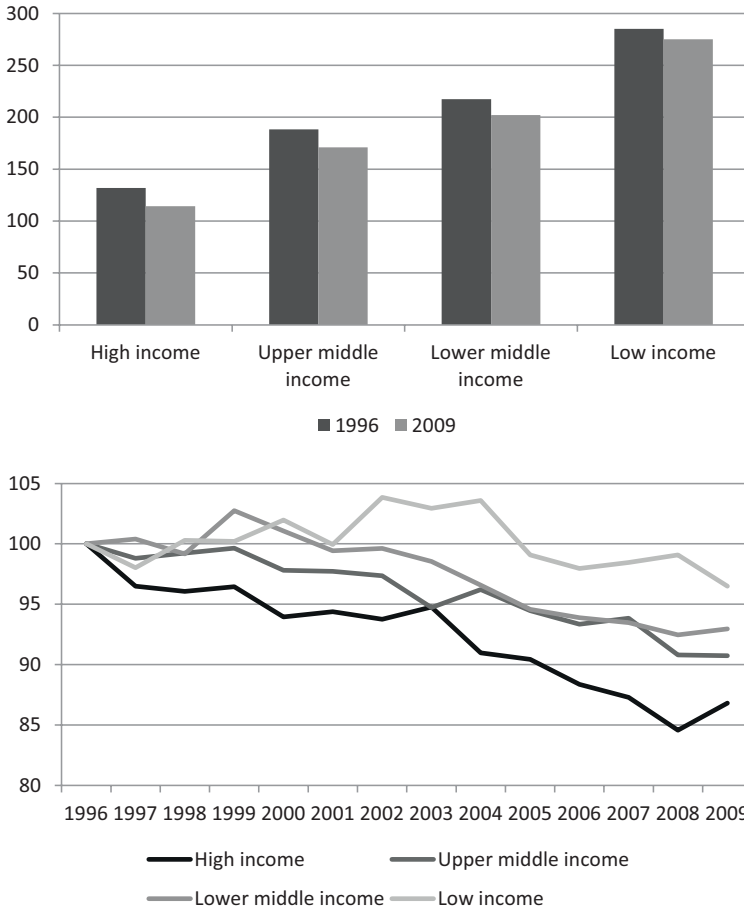
There is substantial variation across countries in trade growth and diversification. Sub-Saharan African countries in particular remain heavily dependent on natural resources and agricultural products. To a somewhat lesser extent, this is also true of the Mercosur countries of South America. To date most African countries and many countries in Latin America, the Middle East and Central Asia have not seen anything like the shift into trade in manufactures that has been achieved in East Asia, Mexico, Turkey, or Central and Eastern Europe.

One reason for the diverging performance is that although barriers to trade have fallen everywhere (see Chapter 3), average trade costs are much higher for low-income countries than richer ones. Indeed, research suggests that in the last 15 years trade costs have fallen much more in richer nations (Figure 1). The poorest countries often tend to have higher barriers and trade costs, in part because a lack of 'connectivity', reflecting weaknesses in infrastructure.

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5 India is a much bigger player in trade in services, ranking 5<sup>th</sup> for both exports and imports (China is 3<sup>rd</sup> after the EU and the US).

**Figure 1** Average trade costs for manufactured exports by income group, 1996-2009



Note: Bars indicate average trade costs as percent ad valorem equivalents for the 10 largest importing partner nations for each country in the sample; trend over time is an index with 1996 = 100.

Source: Arvis et al. (2013).

## 2.2 Growth in ‘vertical specialisation’ and ‘supply chain trade’

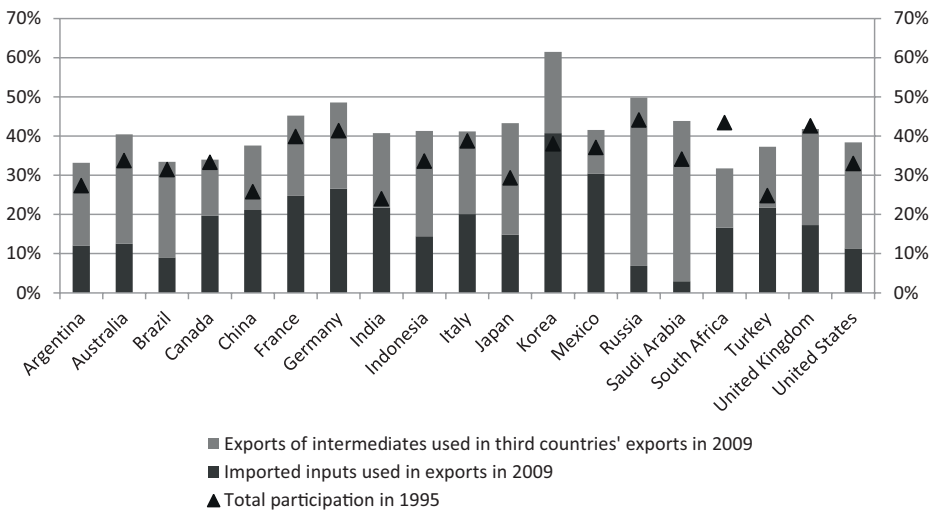
Much of the recent growth in world trade comprises intermediate inputs, components and services of various kinds. Steadily declining costs of trade and information and telecommunications have permitted firms to geographically splinter their ‘production lines,’ designing international supply chains that allocate different parts of the production process to firms in different countries. International supply chains and production networks are the mechanisms through which this process of specialisation is organised, with goods being processed – and value being added – in multiple countries that are part of the chain. By

locating (sourcing) activities and tasks in different countries as a function of their comparative advantages, total costs of production can be reduced.

A consequence of the growth in supply chain trade (SCT) is that the share of manufactures in total merchandise exports of developing countries has increased from just 30% in 1985 to some 70% today. Much of this trade is intra-industry and intra-regional – for example, about half of all East Asian exports of manufactures go to other East Asian economies, often as part of a supply chain (Baldwin, 2012). Since the 1990s, intra-industry trade ratios for high growth developing and transition economies have risen to 50% or higher.

One result of this process of specialisation is that imports make up an increasing share of the total value-added embodied in a given product, ranging from 25% to 40% or more for small open economies that are integrated into supply chains. Figure 2 reports data for the G20 countries, where supply chain trade is broken down into two types: products that are exported and used in further processing in the importing nation and imports that are used in production. As can be seen the relative magnitude of each of these types of trade varies significantly across countries, as does the overall share of SCT in total trade.

**Figure 2** Vertical specialisation (G20), 1995 vs. 2009

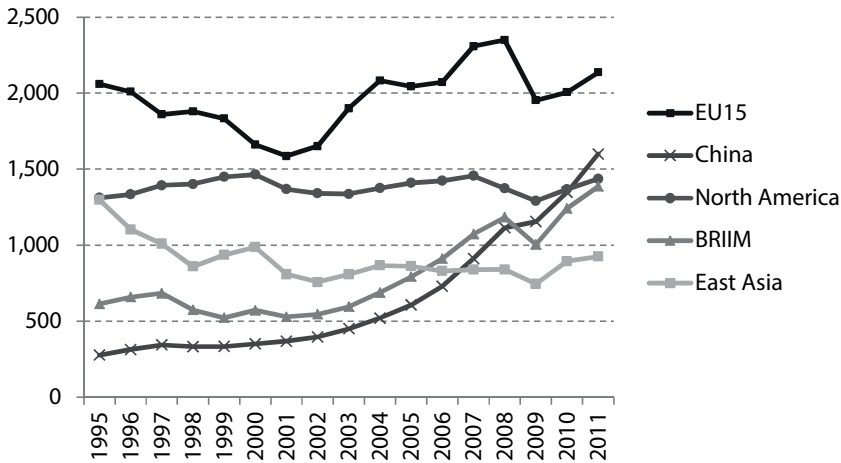


Source: OECD (2013).

An implication of SCT is that much of the value of the goods that is recorded when products cross borders is comprised of the value of imported parts and components. As discussed below, a significant share of that value – as well as the total value-added that is embedded in final products – reflects the many services that are needed to produce them. Although a large share of value-added is generated in OECD economies – in the form of knowhow, technology, R&D, design, branding, distribution networks, etc. – the countries that have been most successful at moving into the production of manufactured goods by integrating

into international supply chains are also increasing the amount of value-added that is generated nationally. In the case of China this increase started in 2001 – the year China joined the WTO and the DDA was launched – but as can be seen from Figure 1 the same is true for other major emerging economies, including Brazil, India, Indonesia, Mexico and Turkey (Figure 3).

**Figure 3** Contributions to global manufacturing value added (1995 US\$ bn)



Note: East Asia includes Japan, South Korea and Taiwan. BRIIM includes Brazil, Russia, India, Indonesia, Mexico and Turkey. EU15 spans the states that joined the EU before 2004.

Source: Timmer, Erumban, Los, Stehrer and de Vries (2013).

SCT has numerous implications for economic policy. One is that it facilitates the entry of low-income countries into manufacturing. Through ‘vertical specialisation’ (focusing on specific tasks that are part of an international supply chain) even very poor countries can engage in manufacturing for the global market. SCT allows firms to locate labour-intensive and relatively unskilled tasks in poor countries. Contrary to what is sometimes argued, supply chains are very relevant to low-income countries, which often are engaged as suppliers of natural resources (minerals etc.) – where there may be potential for economies of scope (e.g. leveraging railways or roads to increase the return on investments in agricultural exportables) – or otherwise benefit from natural endowments (e.g. tourism). There is great potential to benefit from international value chains – whether as a supplier of foodstuffs to large global retail chains following entry into a country or as a supplier of specialised intermediate inputs that exploit specific regional comparative advantages.<sup>6</sup>

<sup>6</sup> There is a large and rapidly expanding literature on global (regional) value chains. See, for example, Baldwin (2014), Bamber *et al.* (2013), Cattaneo *et al.* (2010), Gereffi *et al.* (2013), and Sturgeon *et al.* (2013) for recent examples of value chain analyses. Gereffi and Sturgeon (2013), Gereffi *et al.* (2005) and OECD (2013) discuss some of the policy and governance issues that arise, Park *et al.* (2013) offer a comprehensive survey of much of the extant literature on supply chains.

While the share of the total value of a final product that is added by the processing activities located in a low-income developing country will generally be small, the employment and income that is created as a result of SCT participation may generate significant indirect benefits through greater demand for local goods and services. Over time, as countries increase their experience in SCT, firms may be able to increase the share of total value that is generated locally, as has been done by China and other countries (Figure 3).

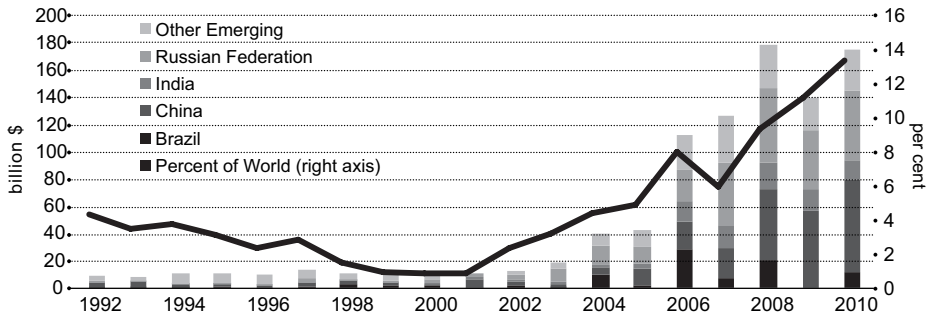
## **2.3 Foreign direct investment as a driver of trade growth**

The expansion in supply chain trade is in part a reflection of the cross-border movement of capital and knowhow. The global value of the stock of foreign direct investment (FDI) rose more than 6-fold between 1990 and 2008, substantially faster than the growth in trade, which increased ‘only’ 3.5 times over the same period. A network of some 3,000 bilateral investment agreements (BITs) helped to provide a framework to support these FDI flows. The value of sales of foreign-owned firms was some \$26 trillion in 2012, as compared to \$18 trillion for world merchandise trade (UNCTAD, 2013).

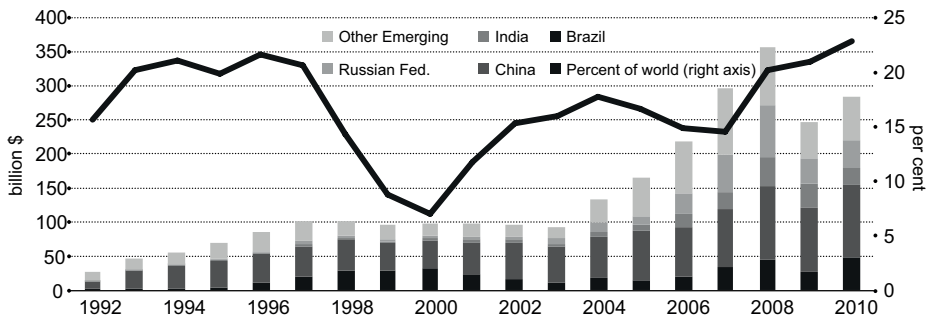
As has recently been documented extensively by UNCTAD (2013), FDI is a key element of SCT. Paprzycki and Ito (2010), for example, document that FDI is a key feature of Factory Asia – foreign companies often manage the regional networks through which the different parts of the value chain are coordinated. FDI and the associated regional SCT (cross-border flows of parts and components) in East Asia mostly reflect supply-side integration. On the demand side, Asian markets are much less integrated. Relative to the EU, for example, the share of final products that are traded within the region is low. Paprzycki and Ito attribute this to remaining trade barriers.

An increasing share of global FDI flows has been going to emerging economies, and these nations have also become sources of outward FDI flows. In the post-2000 period, the share of global outward FDI accounted for by emerging economies rose from some 1% to over 13% in 2010 (Figure 4). Moreover, emerging economies account for a significant share of inflows of FDI into low-income countries that occurs through mergers and acquisitions (M&A) (Figure 5). The total number of M&A deals has risen steadily since the early 2000s, with emerging economies accounting for about one-half of all deals in recent years. IMF data indicate that in recent years China has accounted for over 15% of total FDI into Africa. These developments illustrate that issues related to investment policies are no longer a matter that is of interest solely to multinationals headquartered in OECD nations.

**Figure 4** Emerging markets' flows of foreign direct investment  
a Outward flows

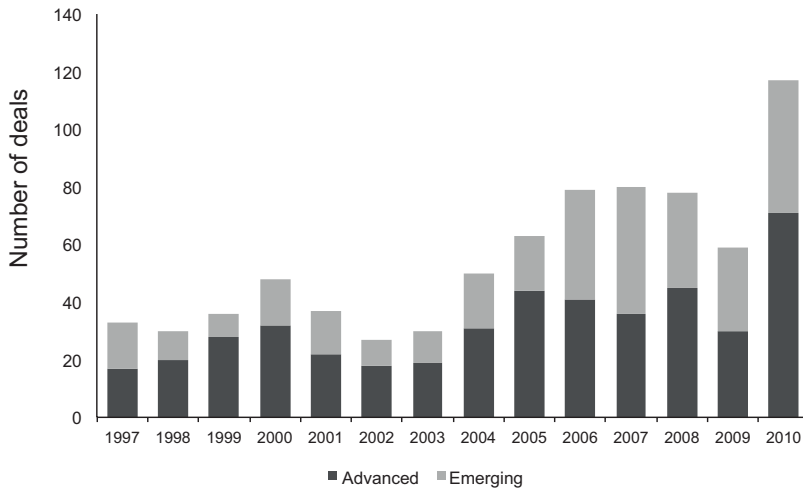


b Inward flows



Source: Noeth and Sengupta (2012).

**Figure 5** M&A investment in low-income economies by source, 1997–2010



Source: World Bank staff estimates based on Thomson-Reuters SDC Platinum.

## 2.4 Services, data flows and digital trade

Services have grown from roughly 55% of global GDP in the mid-1970s to some 70% today. Services are also important by other measures, including employment shares, cost shares for industry, and the share of overall FDI stocks and flows (Francois and Hoekman, 2010). Cross-border trade in services stood at some \$4.3 trillion in 2012, or about 20% of world trade.

Although modern information technologies allow ever more cross-border, 'disembodied' trade in services to occur – call centers and other types of 'business process outsourcing' being well-known examples – the share of services in global trade has been remarkably constant since the 1980s, varying between 20% and 25%. What has changed is the composition of this trade, with private business services growing in importance, and the travel and transport share declining. The value of world trade in services has been expanding rapidly, but so has trade in goods. As a result, the overall ratio has not changed much.

The picture changes if it is recognised that services continue to be much less tradable than goods. Frequently, provider and consumer must be in the same place at the same time. This proximity requirement means that providing services to foreign nationals often requires establishing production facilities abroad – FDI. Over 60% of the stock of global FDI is in services. If the sales of services by the affiliates of foreign companies are included in total services trade, the relative importance of services in global trade increases greatly. Such foreign affiliate trade in services (FATS) is a multiple of cross-border trade in services.<sup>7</sup>

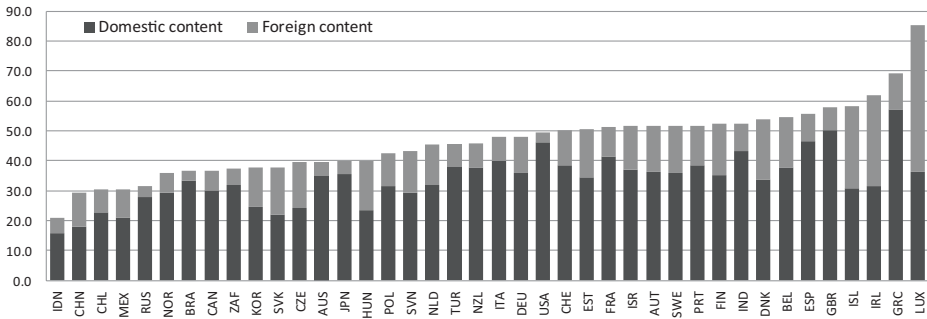
As countries grow richer, the increasing share of services in GDP and employment is accompanied by an increasing share of the value of all products reflecting services inputs. Often the tasks and activities that are part of SCT involve business, intermediation and knowledge services (R&D, design, engineering, etc.), transport and logistics, financial services, and so forth. On average, services account for 40–45% of the value of exported goods (Figure 6).

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<sup>7</sup> The value of all sales by affiliates for the world as a whole has been estimated at US\$ 26 trillion (UNCTAD, 2013). Assuming that at least half of this comprises services (services account for 60% or more of the stock of global FDI), suggests that FATS could be on the order of US\$15 trillion. The share of services in global trade rises further if international transactions are measured in terms of direct and indirect value-added content – that is, if account is taken of the fact that part of the value of a traded good reflected embodied services. Escaith (2008) estimates that this by itself raises the services share of global trade to 50%.



**Figure 6** Services share of total value-added embodied in exports, 2009



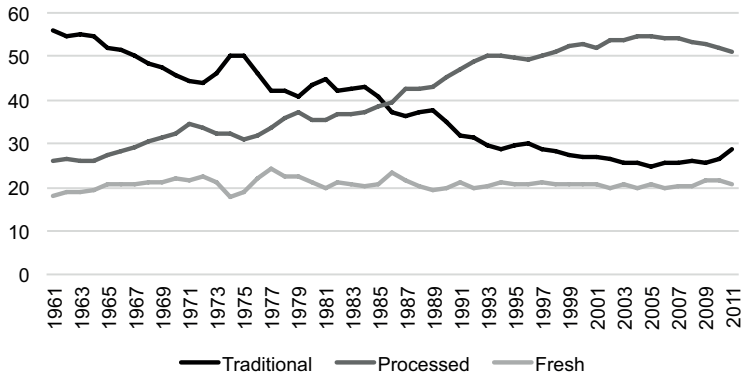
Source: OECD/WTO Statistics on Trade in Value Added (database), April 2013.

## 2.5 Changes in trade in agricultural and natural resource-based products

Unprocessed ('raw') agricultural produce today accounts for less than 2% of global merchandise trade, down from almost 9% in the early 1960s. Food exports, including processed products, declined from 22% of global merchandise trade in the mid-1960s to 8.5% of the total in 2012. For developing countries food and natural resources account for larger shares of exports.

There has been a major shift in the composition of trade in agricultural products, with a substantial rise in the share of higher-value processed products and a decline in the share of traditional commodities (Figure 7). Similarly to what has occurred to trade in manufactures, trade in agricultural products often involves global value or supply chains, with commodities being processed in other countries. This may in part be driven by prevailing trade policies. Thus, countries often have higher tariffs on processed products than on raw materials. Such tariff escalation may distort supply chains and affect the location of value-adding activities. The same is true of other policies – country of origin labelling requirements and traceability regulations are examples. More generally, the efficiency and design of agri-business value chains are a function of the availability and quality of a variety of services, ranging from quality control, logistics and storage facilities to packaging, insurance and distribution. The types of trade costs discussed previously impact particularly strongly on perishables.

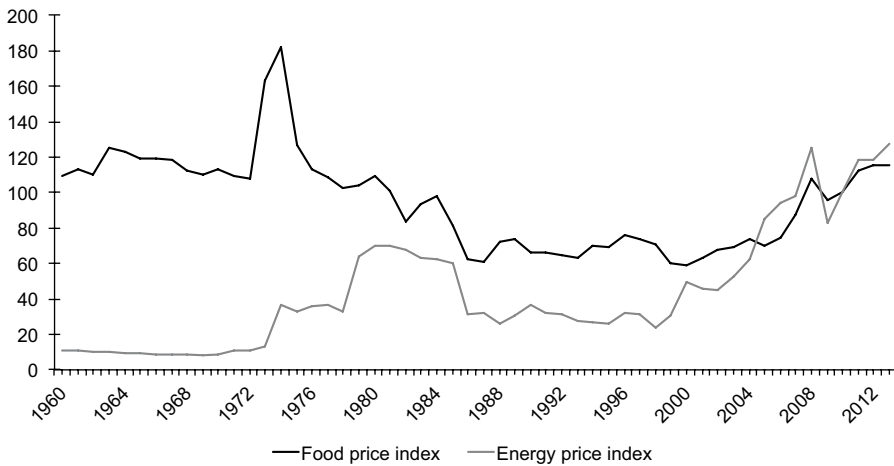
**Figure 7** Composition of global agricultural trade, 1961–2011



Source: FAOSTAT Gateway, available at <http://faostat3.fao.org/faostat-gateway/go/to/download/T/TP/E>.

Exports of agricultural products remain of great importance for many low-income countries. A major post-2001 (post-Doha ministerial) development with respect to agricultural trade was the sharp increase in world prices for food and natural resources (Figure 8) – resulting from increasing per capita incomes and greater demand in developing countries, as well as factors such as climate change and related policies (e.g. to encourage the production of biofuels). Higher prices are beneficial for farmers and rural communities around the world. They also reduce the extent to which farmers in rich countries can claim income support policies, and in principle should facilitate movement towards agreement to reduce trade-distorting agricultural support.

**Figure 8** Food and fossil fuel price index, constant 2005 US\$



Source: World Bank Commodity Price Data (World Bank, 2014).

Supply responses to higher prices will depend in large part on domestic policies and the level of trade costs. Noteworthy here is the increasing use of subsidies for agricultural production in economies such as India and China. An implication for the WTO is that the agricultural negotiating agenda has changed to be a less OECD-centred one – many developing countries are employing instruments that used to be a mainstay of policies in the EU, the US and other OECD nations. Issues such as access to natural resources and food have become more of a concern, including the use of export restrictions by net exporters, which are reflected in both import protection and subsidies aimed at increasing domestic output and thereby ‘food security’.



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## 3 Trends in Trade Policy and Trade Agreements

Unilateral trade liberalisation has been a prominent feature of the trade policy landscape in recent decades. Average tariffs in the early 1950s were in the 20–30% range (WTO, 2007), and were complemented by a plethora of nontariff barriers that were often more binding (including quantitative restrictions, licensing and exchange controls). Today the average uniform tariff equivalent in OECD countries for merchandise trade is only 4%, mostly reflecting protection of agriculture, and the average level of import protection around the world has dropped to the 5–10% range (Kee *et al.*, 2009). Effective (applied) tariffs for firms are often much lower than MFN rates as a result of free trade agreements.

Unilateral trade reforms accelerated in the 1990s and continued in the 2000s. For example, China undertook a massive trade and investment liberalisation programme pre- and post-WTO accession (2001), with applied tariffs declining to less than 7% today. All its tariffs are bound in the WTO at 9.8% on average, and numerous services industries were opened to foreign competition (Sally and Sen, 2011). Similarly, the average applied MFN tariff in India is now around 6%. Many other countries have also lowered their tariffs and other barriers to trade.

### 3.1 Trade policy

#### 3.1.1 Goods: agriculture and manufactures

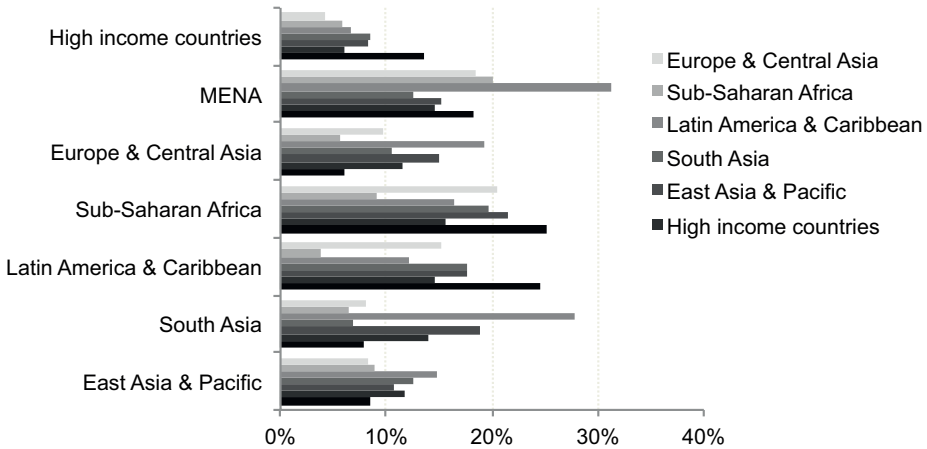
Grossly oversimplifying, developing countries have pursued two different approaches to their trade policies in recent decades. One set of countries has actively pursued a ‘global integration’ strategy, unilaterally liberalising trade, welcoming inward FDI and promoting participation by local firms in international supply networks and SCT. Many of these countries have also pursued deep reciprocal trade agreements with large trading partners, including the EU and the US, as an instrument to anchor domestic policy reforms and market openness and improve the governance of trade policy-related institutions. Examples include the Pacific Alliance countries (Chile, Colombia, Peru and Mexico), other countries participating in the TPP, Costa Rica, Turkey and recently acceded EU member states. Another group of developing countries have put greater stress on continuing to use trade policy as an instrument to promote import substitution and industrialisation, and limiting the extent of commitments in trade agreements to ‘shallow integration’. Countries in this category include a number of large economies such as Brazil, Argentina, and South Africa.<sup>8</sup>

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<sup>8</sup> As noted, this is a generalisation that certainly does not capture the specifics of individual situations. India, for example, demonstrates aspects of both types of group, having pursued significant unilateral trade liberalisation but continuing to maintain restrictive FDI policies.

The level of trade policy restrictions confronting exporters from a country in other markets can be measured by an overall Trade Restrictiveness Index (OTRI) – see Kee *et al.* (2009). This index measures the uniform tariff equivalent confronted by firms in their export markets, taking into account both tariffs and available information, often incomplete, on nontariff measures. OTRI data – reported in Figure 9 – reveal that high-income countries have relatively low barriers to trade, while developing regions have higher barriers. Figure 9 also reveals that protection varies significantly depending on the origin of an exporter. Latin American, East Asian and Middle Eastern countries tend to confront higher barriers than other regions—in part a reflection of preferential market access programmes, both non-reciprocal and free trade agreements.

**Figure 9** Overall Trade Restrictiveness Index by Region, 2008–09



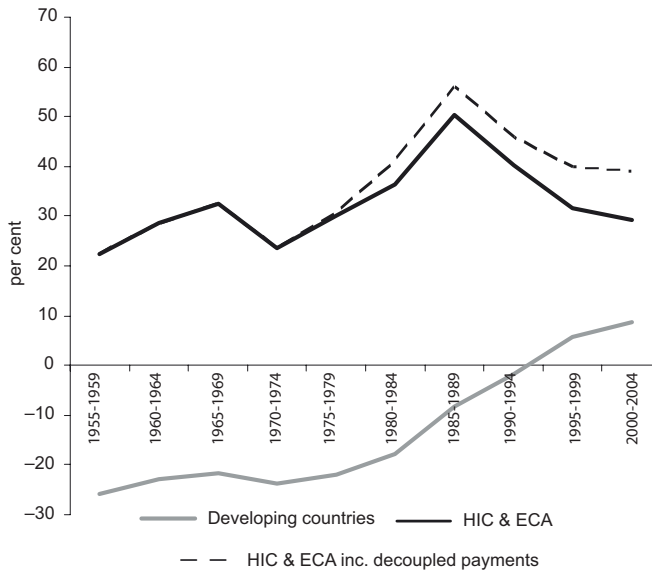
Source: World Bank (<http://siteresources.worldbank.org/INTRES/Resources/469232-1107449512766/OTRI2009.xlsx>)

Many agricultural commodities tend to be protected relatively heavily in the industrial countries, while historically, agricultural products in developing countries have tended to be taxed.<sup>9</sup> Anderson (2009) shows that agricultural distortions began to decline from very high levels in the mid-1980s in high-income countries. Conversely, in developing countries the average rate of taxation of agriculture declined sharply, turning to modestly positive assistance, reflecting a sharp shift away from dependence on exports of commodities towards reliance on exports of manufactures (Figure 10). Sub-Saharan Africa is today the only developing country region where farmers still confront net taxation relative to other sectors. Matters are made worse because of weaknesses in infrastructure,

<sup>9</sup> What follows draws on Hoekman and Martin (2012). Explanations for positive (negative) agricultural support in industrial (poor) countries include: (i) food tends to be a small (large) share of the consumption expenditures of households; and (ii) farmers are a small (large) share of the workforce, facilitating (impeding) organisation into a lobby group. Moreover, in developing countries policy often was aimed at supporting industrialisation and shifting resources out of agriculture.

inefficient logistics, and so on that result in high transport-related costs and reduce the pass-through of world market prices, thus reducing the extent to which higher prices benefit rural communities.

**Figure 10** Average nominal rate of assistance to agriculture, 1955–2004

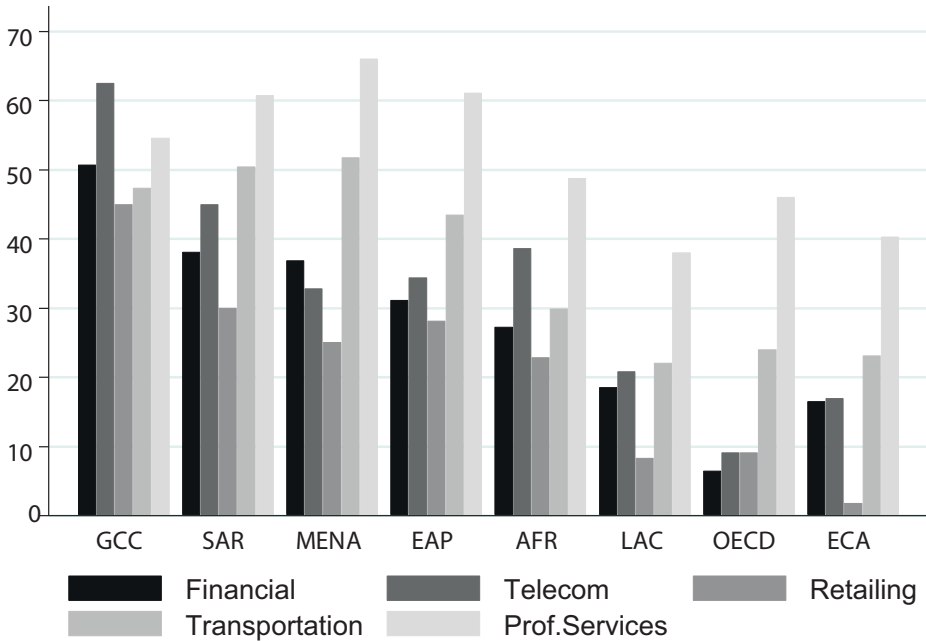


Note: HIC: high-income countries; ECA: Europe and Central Asian countries

Source: Anderson (2009), [www.worldbank.org/agdistortions](http://www.worldbank.org/agdistortions).

### 3.1.2 Services

The rise in services trade discussed above, especially FATS and embodied services trade, has been supported by falling barriers to trade and investment as well as technological advances, both of which have lowered trade costs for services. However, recent World Bank research documents that barriers to trade in services in both high-income and developing countries are significant, and that emerging economies have barriers that are on average substantially higher than OECD countries (Figure 11).

**Figure 11** Services Trade Restrictiveness Index, 2010

Source: Borchert *et al.* (2014).

Although there is significant discrimination against foreign suppliers of services in some services sectors (e.g. professional services providers), the observed explosion of global trade has been possible in part because of liberalisation of services markets in many parts of the world. Examples include the deregulation of air and road transport, the abolition of antitrust exemption for maritime liner transport, the privatisation of ports and port services, and the divesture and breakup of state-owned telecommunications monopolies. The types of services that are increasingly being provided cross-border through the internet (itself the result of a variety of services policy reforms and technological advances in the ICT area) are not subject to restrictive trade policies in most countries. The market access agenda in this area increasingly revolves around regulation, for example, requirements pertaining to privacy and cross-border transfers of data, matters that are not covered by the WTO (Kommerskollegium, 2014).

### 3.1.3 Changing political economy of trade policy

The process of vertical specialisation and fragmentation of production, in conjunction with extensive flows of FDI into developing countries, has attenuated the incentives to use trade policy to protect specific industries as it is more likely to hurt, not help. Being able to compete in a specific niche or activity requires that firms are able to integrate into the relevant value or production chains. Significant levels of import protection would impede their ability to do so.



The 2008 financial crisis and subsequent global recession illustrated the change in the incentives to use traditional import protection instruments. Gawande *et al.* (2014) show that the intensity of vertical specialisation helps explain observed trade policy responses to the crisis as well as the level of trade protection pre-crisis. The major emerging economies did not utilise the ‘policy space’ they have – given tariff bindings that are generally far above applied rates (with the exception of China; see Gao, 2012) – as a result of the incentives created by SCT. These incentive constraints were complemented by disciplines associated with membership in trade agreements. Countries that are members of deep free trade agreements, such as Mexico (NAFTA) and Turkey (a customs union with the EU), or that bound their tariffs at applied levels in the WTO (e.g. China) were much more constrained than other countries.

The increasing vertical specialisation of production and trade helps to understand the increasing use (and relative share of) measures that restrict exports of natural resources that are upstream inputs into global value chains. This acts as a subsidy, making domestic processors and the chains to which they connect more competitive.<sup>10</sup> While the increase in supply chain trade affects the incentives to use alternative trade policy instruments, these continue to provide a basis for the negotiation of international disciplines to internalise the associated spillovers. Governments appear to be making increasing use of subsidy-like policies that aim to reduce costs for firms located in their jurisdictions.<sup>11</sup> An implication is that the focus of rule-making efforts needs to be on a broader set of policies.

## **3.2 Trade agreements**

### **3.2.1 Developing country participation in the WTO**

Developing countries have become very active players in the WTO. As noted in Chapter 1, some 35 developing and transition economies acceded to the WTO since its establishment in 1995 and another 20 or so are in the process of accession. Accession to the WTO is a demanding process, involving not just trade policy reforms to bring a country’s trade regime into compliance with the WTO’s rules and disciplines, but also trade liberalisation commitments and institutional reform and strengthening. On average, the ‘post-1995’ WTO Members have trade policy regimes that are superior to those that prevail in many ‘original’ WTO Members. This reflects the rigorousness of the accession process, which generally takes many years. Countries that were contracting parties to the GATT did not have to go through the level and intensity of scrutiny that new members of the WTO do. One consequence is that new members are well prepared to engage in the WTO and often do so.

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10 A number of major exporters have also imposed measures to restrict the exports of agricultural products, mostly food staples, in an effort to lower domestic prices for consumers.

11 See Hufbauer *et al.* (2013), recent WTO Trade Policy Review reports and the Global Trade Alert database at <http://www.globaltradealert.org/>.

A perusal of the submissions to the various negotiating groups reveals that developing nations have been energetic participants in the DDA. Examples include the G-20 group of developing countries that was created in the run-up to the Cancun ministerial in 2003 and the formation of coalitions such as the Africa Group and the LDC group. They are also active in the day-to-day work of the WTO's regular business and increasingly make use of dispute settlement procedures and instruments of contingent protection that are permitted by the WTO.<sup>12</sup> Brazil, China and India account for over one-third of all cases brought by developing countries, but smaller middle-income states such as Argentina, Chile, Mexico, and Thailand have also been very active.<sup>13</sup>

Developing countries are also increasingly active users of contingent protection, using instruments such as antidumping to target exports from other developing countries. China has become the main target for such actions, but the instrument is also used to check imports originating in other developing economies. In Brazil and China, antidumping covers around 2% of total imports; in India – now the world's most active user – it is 4% (Bown, 2011).

### 3.2.2 Preferential trade agreements (PTAs)

Increasing engagement by developing countries in the WTO has been accompanied by a steep increase in the pursuit of PTAs by high-income countries and developing nations. As noted in Section 1, a sea change here is the pursuit of mega-regionals by the US, as well as the shift by a group of WTO Members to negotiate a Trade in Services Agreement (TISA) among a subset of WTO Members. While there are many factors that help explain the shift towards PTAs, two that arguably are particularly pertinent are (i) the increasing heterogeneity across developing countries, with a number of large economies growing rapidly and attaining middle-income country status; and (ii) an increasingly perceived need to address spillovers created by policies that were not on the table in the DDA but that are important for international business decisions and operations.

So far the extant evidence suggests that PTAs to date have not been a substitute for progress at the multilateral level in the sense that most developing countries are not doing on a bilateral or plurilateral basis what they are unwilling to do at the WTO level. The exceptions are PTAs involving the US, the EU and the Pacific Alliance/TPP countries, and to a lesser extent China and East Asia where many countries are engaged in plurilateral (ASEAN+) or bilateral agreements (Sally and Sen, 2011; Chia, 2010). In part this reflects the intensity of regional

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12 See, e.g. Apepu-Laker (2013) for a comprehensive study of African participation in the WTO.

13 See Horn *et al.* (2011) for statistics on WTO disputes. Noteworthy examples are use of the Dispute Settlement Understanding (DSU) by Brazil and India to attack preference programmes that benefit poorer/smaller developing countries. Examples include a 1998 decision by Brazil to contest the EU Generalised Scheme of Preferences (GSP) as inconsistent with the Enabling Clause (which requires that preferences be 'generalised, non-reciprocal and nondiscriminatory'). This led to a 6-year waiver being negotiated for EU preferences for African, Caribbean and Pacific (ACP) countries in Doha in 2001, and the launch of the negotiations between the EU and the ACP to establish reciprocal Economic Partnership Agreements (EPAs). Other examples are the 2003 cases brought by India against the EU GSP+ programme and by Brazil against EU export subsidies for sugar. Mention can also be made of Brazil's successful cases against the US on cotton supports and against Canada on civil aircraft subsidies.

trade. Regional trade is much more important for China than for Brazil or India, accounting for over 30% of both exports and imports of goods.<sup>14</sup>

Many PTAs negotiated since the mid-1990s go beyond the WTO in terms of coverage of policy areas such as investment and services (e.g. van der Marel and Miroudot, 2014). However, the substantive disciplines (rules) that are included in many PTAs are similar to those in the GATS, i.e. the depth of the associated commitments often does not go much beyond what PTA members committed to under the WTO (Fink and Jansen, 2009). In areas where there are no WTO disciplines, there often tend not to be rules in PTAs either – examples in the area of services are safeguard provisions, rules on subsidies and domestic regulation (Horn *et al.* 2010). Two important exceptions are investment and public procurement – policy areas that are not covered by general WTO disciplines.

This situation may well change as a result of the shift by the US and the EU (and possibly China) towards negotiation of PTAs with each other and other large high-income countries such as Japan. Four major examples at the time of writing are the Regional Comprehensive Economic Partnership (RCEP), the Trans-Pacific Partnership (TPP), the Trade in Services Agreement (TISA) and the Transatlantic Trade and Investment Partnership (TTIP).<sup>15</sup> TTIP is a bilateral EU–US initiative, although in practice it presumably will have to become quadrilateral given that Mexico and Canada are part of the NAFTA and both countries also have bilateral trade agreements with the EU.<sup>16</sup> Developing countries are participating in the RCEP, TPP and the TISA talks, but the first two of these are regional arrangements and thus by design exclude the majority of developing countries. The TISA is limited to a group of ‘really good friends of services’ which again does not include the majority of developing nations, although China has made clear that it wants to be part of those negotiations.

Countries that are participating in the RCEP, TPP and TISA include economies that have actively pursued a ‘global integration’ strategy, liberalising trade, seeking inward FDI and promoting participation by local firms in international supply networks. But many ‘global integrators’ are excluded from the RCEP and TPP negotiations as a result of geography (they are not Pacific countries), because they were not invited, or because they decided not to participate. A large number of developing countries, including the poorest ones (the LDCs), have remained outside these new initiatives and many would not want to be involved even if

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14 Gao (2009) argues that China’s strategy is to connect to countries that are themselves part of a PTA network and are often natural resource exporters and that political objectives are important (e.g. obtaining market economy status).

15 At the time of writing (December 2013), RCEP involves 16 countries: the 10 members of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam) and six countries with which ASEAN has a free trade agreement (Australia, China, India, Japan, Korea, and New Zealand). The TISA includes Australia, Canada, Chile, Chinese Taipei, Colombia, Costa Rica, Hong Kong China, Iceland, Israel, Japan, the Republic of Korea, Mexico, New Zealand, Norway, Panama, Paraguay, Pakistan, Peru, Switzerland, Turkey and the US. The TPP spans Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam.

16 Determining how existing PTA partners will be affected and integrated into new agreements between countries that all already have PTAs with the same set of countries will be a challenge. In the case of the EU–US talks, the EU already has PTAs with both Canada and Mexico, which are of course members of NAFTA.

they were able to (as is the case with TISA, which in principle is open to any country).<sup>17</sup>

There are important potential downside effects of the present proliferation of regional and plurilateral non-MFN initiatives. Most obviously, there is a potential for balkanisation of trade, particularly in the Asia-Pacific region where there is a clear threat of division of the region into a TPP and an RCEP bloc. There is also potential to distort FDI flows. A regional trading group that has superior 'behind the border' rules and/or pursues regulatory cooperation that requires firms to be located in the bloc in order to benefit will increase the incentives for firms to invest in the bloc rather than elsewhere. This could be welfare-enhancing, but if more efficient firms in non-members are excluded it could also result in investment diversion and locking firms from non-signatories out of cross-border production networks.

Another negative consequence is the loss of negotiating leverage for the least developed and other developing countries. In WTO negotiating rounds, especially where consensus and 'single undertaking' requirements exist, small countries can influence the result in ways that are simply not possible in the new patterns of negotiation. This issue is also relevant to potential new plurilateral agreements under the umbrella of the WTO, and is discussed further in Chapter 4.

Will the mega-regionals generate greater incentives to pursue trade cooperation? Classic trade diversion costs generated by preferential removal of tariffs under TPP or the TTIP are likely to be limited because average tariffs in most of the countries participating in these initiatives are low.<sup>18</sup> The same may be true of a TISA given the likelihood that regulatory changes will be applied on a nondiscriminatory basis because in practice it is difficult to apply regulatory policies on a discriminatory basis. Thus the type of dynamics that have been argued to have supported multilateral liberalisation – the creation and expansion of the EEC – may have less force today.<sup>19</sup>

That said, trade diversion will still occur in areas where there are tariff peaks. More generally, there is potential for both *de jure* and *de facto* discrimination following agreement to reduce the market-segmenting effects of differences in regulatory policies. How significant this will be will depend on whether third-country firms will be able to benefit from access to the larger market created by the PTA by demonstrating that their products or services comply with the relevant regulatory standards. In practice it may be difficult to exclude third-country firms from benefiting from initiatives that lower the fixed costs of

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17 In practice the ability to participate is conditional in the sense that countries that did not join the talks early on will find it more difficult to be accepted in the ongoing negotiations on the substance of an agreement – once the talks have advanced and the outlines of an agreement have been agreed among participants, new countries will likely have to wait until the 'original' TISA countries have finalised an agreement and then negotiate their accession. The same is likely to be true of the TPP.

18 In part such additional costs will be low because the US has PTAs with most of the other TPP countries.

19 See Hoekman and Kostecki (2009) for a discussion of the relationship between the periodic expansion of the European Economic Community in the 1960s and 1970s and multilateral trade rounds under GATT auspices.

enforcement of regulation in member countries.<sup>20</sup> But such exclusion can easily occur if third countries do not have access to recognised certification systems and therefore have to continue to incur market-specific conformity assessment and inspection costs.

This may increase incentives to engage in Geneva. Given that for many countries it will not be possible to join TPP, TTIP or RCEP given the regional nature of these PTAs,<sup>21</sup> another potential response is for Brazil, China, India, and other large developing economies such as Indonesia to pursue PTAs in turn. This would generate greater trade with countries that are likely to continue growing more rapidly than the EU and US, and where traditional barriers to trade are substantially higher. If such PTAs result in meaningful preferential liberalisation, the associated trade diversion could become an incentive for a renewed effort to conclude a multilateral deal at the WTO, in part by eroding the power of the interest groups in the large emerging economies that currently resist market opening on an MFN basis. However, as mentioned, to date the PTAs involving emerging markets have tended to be shallow, with substantial exceptions and exclusions to safeguard sensitive products and industries and no disciplines on the use of industrial policy-related instruments and regulatory regimes.

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<sup>20</sup> The literature investigating the effects of regional harmonisation of standards has found that this may benefit excluded countries, but that this is conditional on the capacity to satisfy the norms and mechanisms that are adopted by a PTA. See e.g. Chen and Mattoo (2008) and Shepherd (2007).

<sup>21</sup> TISA is an exception.



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## 4 A Supply Chain-Informed Approach to Market Access

A variety of policies can result in market access barriers or distort competition on third markets. Foreign competition in some sectors may be prohibited altogether. Maritime cabotage is a common example, as is public procurement, with governments giving preference to national firms for public purchases of goods or services. Many of the relevant policies are on the table in the DDA: import tariffs, agricultural export subsidies, tariff quotas, other trade-distorting support for agriculture, restrictions on FDI in specific services activities, and various nontariff policies such as antidumping and licensing requirements.

Small and medium enterprises (SMEs) may suffer disproportionately from policies that generate SCT barriers because the magnitude of the associated costs may be independent of volumes shipped, that is, they entail a fixed cost. Small firms often cannot spend the staff time needed to understand the idiosyncratic policies and procedures that must be satisfied to do business with potential clients in a country, and this helps to explain why many firms do not enter the international market, and, if they do, often focus on just one or only a few countries. Actions to reduce the fixed costs of selling internationally can have big effects if it gets firms over the ‘tipping point’ where these costs taken together no longer make operating internationally prohibitively costly or uncertain (WEF, 2013).

Hoekman and Jackson (2013) argue that one implication of the rise of SCT is that governments should ‘think supply chain’ when pursuing market access negotiations. WTO negotiations generally follow a silo approach in the sense that specific policy areas or instruments are addressed in isolation in distinct negotiating groups that follow their own modalities and approaches.

To be effective in lowering supply chain barriers, the focus of negotiations needs to be on all of the major policy areas that impact SCT opportunities and investment incentives. Simply lowering tariffs or relaxing barriers to FDI in a service sector may not have a significant impact if other policies that limit competition or create excess costs for firms to engage in SCT remain in place. Even if separate negotiations on distinct policy areas jointly address some of the major frictions that impede SCT, it may not be clear to negotiators, to business or to legislators in parliaments that this is the case.

The Agreement on Trade Facilitation, while an important step forward for the WTO, illustrates the point. In the WTO, trade facilitation refers to a rather narrow set of policies that revolve around border-clearance processes and transit regimes. The agreement will not do anything to improve services-related policies that impact on supply chain costs. Services negotiations are conducted independently, and within those negotiations each service sector is considered separately. This continues to be the case in the current negotiations on a TISA. A number of the policy areas that matter for supply chain performance are not on

the table at all – such as competition policy, the existence of dominant suppliers that can foreclose entry by new suppliers, or restrictions on foreign investment in certain activities.

Shifting towards a ‘whole of the supply chain’ approach could help address these weaknesses, and enhance the relevance of market access and rule-making negotiations for businesses. This in turn would help generate the political support needed for trade agreements to be adopted by national legislatures and to be implemented by governments. As has been argued by many observers, one lesson of the failure to conclude the Doha Round negotiations by the WTO is that what is on the table is not seen to make enough of a difference from an operational business perspective. Adopting a supply chain approach may help to address this failure by focusing attention on the *set* of policies that *jointly* impact on SCT, in the process helping to connect the various negotiating areas.

Introducing a supply chain dimension into the market access talks can be done without changing the set of issues that are on the table in the DDA or adding new issues to the WTO. Many of the policies that impede SCT are the subject of negotiation – tariffs on agricultural manufactured products, agricultural subsidies and measures that reduce the ability of foreign firms to supply services – or are covered by existing WTO agreements.

The basic idea is to complement existing approaches towards market access negotiations in the WTO with an explicit focus on how proposals in *different* negotiating groups impact on types of supply chains and international production networks that are important for different countries. Thus, some WTO Members are major agricultural exporters and have a strong interest in agri-business value chains, whereas others are specialised in SCT involving manufactured products. All will rely on and have an interest in lowering the cost and improving the quality and variety of intermediate services that allow the specialisation that underpins SCT to occur.

Different countries will have different interests and stakes in specific supply chains, whether as the hosts of lead firms, suppliers of inputs (intermediate products, services tasks, etc.) or sources of final demand. A narrow focus on agricultural tariffs will benefit exporters of the products concerned, but in practice the effects may be much larger if account is also taken of the various inputs into the production of the products concerned (e.g. seeds, fertilizer, equipment, crop insurance, logistics and distribution). These are the focus of negotiations in other groups. Adding a supply chain focus to the negotiating process may allow such interdependencies to be identified and a *package* of market access and policy commitments to be negotiated that will have both a much greater impact in terms of reducing SCT costs and, perhaps as – if not more – important, increase the number of WTO Members that have a stake in seeing such a package agreed.

Package deals and issue linkages are a staple of trade negotiations. The single undertaking is a technique that ‘formalises’ the notion that at the end of the day the negotiation outcome needs to be balanced in the sense that there is a Pareto improvement for all participants.<sup>22</sup> This is a judgement that is made by

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22 See e.g. Sebenius (1983), Conconi and Perroni (2002), Hoekman and Kostecki (2009) and Evenett (2014).



governments, one that is generally not particularly well informed or influenced by economic considerations or analysis. It is left to business and civil society groups in each WTO Member to lobby for or against the package and to attempt to influence the constituent elements. A supply chain framework offers a potential mechanism to better inform these processes and to increase the transparency of the 'value' of what is ultimately negotiated. In the process this may facilitate issue linkages and agreement across the various negotiating areas.

Governments are not necessarily aware of the impacts of prevailing policies on SCT investment incentives and operations. The same is true of their negotiators in the WTO. Indeed, this is often also true for businesses – supply chain managers generally take policies as a given part of the business environment and may not devote much effort to interacting with those in the company who are responsible for government affairs. The 'silos' in which negotiations are pursued in the DDA and other trade agreements are understandable in that they reflect and replicate the way that governments are organised. But they may be counterproductive – negotiators may lose sight of the forest for the trees. Making tradeoffs across issue areas is a basic task for governments. Greater knowledge of how what is being negotiated impacts on the supply chains that drive much of today's world trade may help in crafting agreements in a way that increases the probability that what is dealt with in each policy silo will have a meaningful impact/make a difference for firms.

Of particular importance in this connection is to integrate services into the negotiating process. To date this has not been done in the DDA. The decision taken by the group of 'really good friends of services' to pursue negotiations on a plurilateral basis is in this respect a new hurdle for concluding the DDA, as it potentially removes the possibility of a larger package deal. However, it does not nullify the basic arguments for 'thinking supply chain'. All the countries presently negotiating a TISA have agricultural and manufacturing sector interests that are directly impacted by what will be agreed in terms of liberalisation of trade and investment in services. A better understanding of how services impact on the supply chains for agri-business and manufactured products will help to identify priority areas for negotiation.

WTO rules and the DDA negotiations on rules are also very relevant from a supply chain perspective. Rules of origin are an obvious example, antidumping another. The former can be a serious impediment to SCT trade if they are too restrictive in the sense of imposing high domestic value-added requirements; the latter can be a source of uncertainty that impacts on investment location and sourcing decisions.

Existing negotiating modalities are not designed with a view to minimise negative SCT spillovers. Nor are they designed to assist governments to put in place a policy environment that will support SCT specialisation and greater use of SCT opportunities, whether for high- or low-income countries. While specific priorities for action will differ, all nations have an important stake in SCT and further exploiting the opportunities that exist for greater specialisation at the firm-level. Complementing market access negotiations and rule-making by

identifying the set of policies that have an important impact on the operation of supply chains may help in achieving an agreement.

#### **4.1 Implementing a supply chain dimension in market access/ rules negotiations**

How might a supply chain approach be designed to complement the DDA market access and rule-making negotiations? A first step would be to select a small number of representative supply chains that are important for specific sectors (a selection of agricultural and manufactured products) and regions (Hoekman, 2013). It will be impossible to consider dozens of supply chains so a first challenge will be to determine which to choose. Given that there will be many commonalities across value chains – all require services of various kinds, are affected by product regulation and standards, etc. – it will be important to select a group of products/value chains that reflect the interests of broad cross-sections of the WTO membership.

One consideration in selecting the supply chains to use as a focal point for identifying and analyzing the impact of different policies is to take into account the role and interests SMEs. SMEs generally will be suppliers to lead firms, contract manufacturers and multinational service companies, but they also can use the internet and business-to-business market platforms to sell their products internationally.

One source of data that can be used to assist in identification of representative supply chains is the recent international effort to calculate trade in value-added. The associated datasets allow the identification of the use of all the inputs that are used by sectors in the production of final goods, including services inputs. Another source of information on global value chains are detailed case studies that have been undertaken for a broad range of sectors, including agricultural and natural resource-based value chains.<sup>23</sup>

Once a set of supply chains/production networks has been selected, the aim would be to seek to identify how the policies that are being negotiated in the DDA jointly and separately generate barriers to SCT and investment. This will require the active involvement of and participation by the business community. The effects of policies may not be direct – for example, they may be reflected in delays and other sources of uncertainty that give rise to a need to hold excess inventory stocks and engage in other forms of costly activity.

Business input – data, qualitative information, perceptions – will need to be combined with the more aggregated data on trade in value-added that has been compiled by the OECD and other organisations, including national institutes such as the US International Trade Commission, the Centre d'Etudes Prospectives et d'Informations Internationales (CEPII) and the Japan External Trade Organization (JETRO), to analyse and assess whether and how what is on the table in the market access talks will have an impact on SCT costs.

<sup>23</sup> See, for example, Kaplinsky and Morris (2002); Trienekens (2011); Bamber *et al.* (2013); Cattaneo *et al.* (2010); Staritz *et al.* (2011).

The analysis of how policies impact on SCT costs and investment incentives will require technical expertise. The WTO Secretariat has some of the requisite analytical capacity but does not have the resources to undertake such an effort. However, other organisations have ongoing work programmes and expertise in the area of international supply chains and the new organisation of global trade. A decision to complement market access negotiations with an assessment of how what is being negotiated impacts on SCT offers an opportunity to build on the partnerships that have already been established by the WTO Secretariat in this area with the OECD and national policy research institutes. It also will provide an opportunity to bring in institutions that have been focusing on the impact of SCT from the perspective of economic development.

To reiterate, the proposal here is not to shift away from the market access and rules negotiations that form the core of the DDA and start to negotiate 'supply chain agreements'. The suggestion is instead to recognise the 'silo problem' and to put in place mechanisms that will help understand the linkages across different negotiating areas and identify where there are opportunities in the different areas – agriculture, NAMA and services – to have a greater positive impact on potential SCT opportunities. At the end of the day the negotiating silos in Geneva reflect the way that governments are organised. Agriculture negotiators, NAMA negotiators and services negotiators come from different government departments, and often the key players at the national level are not part of the ministry of trade or commerce. Services negotiations span many different sectors that are governed by different line ministries and regulatory agencies. As discussed below, the fact that differences in regulatory policies and enforcement are increasingly the source of negative spillovers makes it very difficult if not impossible to create the type of issue linkages that were feasible for traditional trade policies. The increasing complexity and need to establish trust among regulatory agencies in different countries is likely to be a major force behind more plurilateral forms of international cooperation. But making a concerted effort to do more to determine how different policy areas and proposed agreements impact on SCT silos may help in constructing an overall market access package that is beneficial to all participants.



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## 5 Deliberation and Cooperation on New Issues

Currently PTAs appear to be regarded by policymakers as the default option for the pursuit of cooperation on a policy matter if no consensus can be found in the WTO. Pursuing alternative options that already exist or could easily be created in the context of the WTO could help reduce the fragmentation of the trading system over time, and do more to assist all WTO Members to learn and benefit from initiatives and experimentation pursued among smaller groups of members.

What follows discusses a number of options that could be pursued in the WTO without major institutional changes:<sup>24</sup> (1) using WTO mechanisms as ‘deliberation’ devices – enhancing common understanding of the (spillover) impacts of policies that are currently not subject to WTO disciplines; (2) increasing the transparency of what is done in PTAs and identifying ‘good practices’ that could be pursued by non-members as well; (3) making greater use of opportunities for plurilateral agreements and cooperation under the umbrella of the WTO; and (4) building on these processes and approaches to identify a new multilateral negotiating agenda that could be pursued on the basis of either critical mass and/or plurilateral agreements and therefore explicitly allows for and recognises the need to accommodate additional variable geometry within the WTO.<sup>25</sup>

### 5.1 Deliberative mechanisms

The agenda for international trade cooperation increasingly concerns the effects of regulatory policies that generate negative pecuniary spillovers for trade and investment. Frequently, a multiplicity of regulatory norms and related enforcement requirements that are imposed independently by different government agencies generate excess costs for firms, in the sense that costs of compliance are greater than what is necessary to attain the underlying social or economic objectives. Many of these regulatory policies apply equally to local and foreign firms and products, but even if they do they will usually increase trade costs more for foreign than for domestic suppliers simply because regulations

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<sup>24</sup> The proposals discussed in what follows are process-oriented as opposed to substantive in the sense that the focus is not on specific policy areas and issues that arguably should be priorities for WTO Members to address. There are many papers that do the latter – e.g. Baldwin (2014); Mattoo and Subramanian (2009) and the contributions to Narlikar *et al.* (2012), Melendez *et al.* (2012) or Evenett and Jara (2013). Rather than enumerating yet another list of issue areas, the aim of what follows is to focus attention on process and approaches that WTO Members could use to help them identify areas for potential cooperation, opportunities to make existing agreements more effective and to improve the common understanding of preferential trade initiatives.

<sup>25</sup> In what follows a critical mass agreement is defined as an agreement among a subset of WTO Members on new commitments, with the benefits of the agreement being extended to all WTO Members, including those that do not participate and make no commitments. In contrast, a plurilateral agreement involves a subset of WTO Members agreeing to new commitments, without the associated benefits extending to nonsignatories. In both cases, nonparticipants incur no obligations.

differ across countries and/or because foreign firms are subject to a multiplicity of requirements that are redundant (duplicative). More generally, regulatory policies may needlessly raise costs across the board – for domestic and foreign firms – and thus the price of goods and services for firms and households.

Regulatory measures often cannot simply be abolished or their impacts on trade reduced by a certain percentage as can be done for tariffs or taxes. In principle they fulfil a specific social or economic purpose, even if the effect is to restrict trade. Addressing the trade effects of regulation requires first an understanding at the national level of the effects of prevailing policies and the likely impacts of alternative welfare-enhancing reforms. Many reforms will not require actions by other governments (trading partners), but international agreements may help mobilise political attention to an issue and overcome resistance by vested interests. International cooperation may also help governments identify beneficial reforms. But such cooperation may not be very effective if it is pursued through reciprocal exchanges of policy commitments – the standard modality of trade negotiations – because parties will generally be unwilling to change policies if they believe these to be effective. Building a better understanding of the status quo and its impacts, knowledge of the approaches and processes used in different jurisdictions, and potential gains from reforms may be a necessary condition for cooperation on regulatory matters.

The WTO is geared towards the negotiation of enforceable commitments. This is its primary strength – binding disciplines reduce uncertainty for traders who know that the dispute settlement mechanism can be used to ensure that governments live up to what they sign on to. A precondition for agreement on binding international rules is a shared recognition that the negative spillovers associated with a policy or set of policies are significant and that a proposed set of (enforceable) disciplines will benefit all parties. At present there is no such recognition among the WTO membership at large when it comes to policy areas that can generate market segmentation, raise costs, impede innovation, or otherwise give rise to negative spillovers.

Addressing the impacts of differences in regulation across jurisdictions is much more complex than traditional trade liberalisation. In practice, many of the policies that affect supply chain costs and influence the organisation of value chains are regulatory in nature. Many pertain to (impact on) the service sectors that are inputs to production and determine the competitiveness of firms. The relevant policies and procedural requirements are generated by a multiplicity of agencies, with frequently very little in the way of communication and coordination or any consideration of trade impacts. Making progress in removing or reducing the market-segmenting effects of regulation requires coordination across many government agencies as well as engagement with business.

A central element in identifying how international cooperation can address the negative spillovers caused by differences in regulation and policies across countries is to identify such spillover impacts. As was proposed for the ongoing DDA market access and rules negotiations in the previous chapter, doing so in a way that is guided by a value chain perspective can help identify ‘clusters’ of policies that jointly generate supply chain barriers for industries that are

particularly important for a country or set of countries, and that make them a less attractive location for investment and impede movement ‘up the value chain’. A supply chain lens can also help in identifying where economic development agencies can be more effective in the provision of trade-related assistance.

Figuring out how various policy areas matter from a value chain standpoint is something that requires substantial preparatory work. In some areas it simply may not be possible or appropriate to negotiate binding rules and the best that may be feasible is to increase transparency and the information that countries have about the aim and effects of policies. This is the case in particular when it comes to behind-the-border regulatory policies, as cooperation will be required by the regulatory agencies that are charged with their design and implementation.

These considerations suggest that WTO Members could benefit from putting in place platforms for deliberation, dialogue and learning that are focused on improving the transparency of applied policies; supporting independent analysis of the effects of policies; and establishing mechanisms through which governments can consult and exchange information. Hoekman and Mattoo (2013) suggest the formation of ‘knowledge platforms’ that would bring together different government agencies, regulators and stakeholders to assess/analyse the impacts of prevailing policy regimes and act as a focal point for agreement on beneficial reforms. Such platforms would facilitate knowledge exchange and build on existing networks of regulators and industry associations. In the case of low-income countries, they would also provide a vehicle to connect with the donor community and development agencies that can provide support for implementation of reforms. Elsig (2013) suggests leveraging existing committees and the various options that exist within the WTO to create working groups and to engage informally on specific issues of interest.

No deliberative mechanism exists in the WTO that provides a ‘knowledge platform’ function or that is designed to discuss complementary sets of policies and identify how they interact to impact on trade costs and investment location decisions.<sup>26</sup> Given the complexity of today’s organisation of global trade and investment flows, this may explain why business appears to be less engaged in and supportive of the WTO than was the case during the Uruguay Round. Creating platforms that allow (encourage) looking across the various policy silos that all have an impact on supply chain trade, that help identify what policy areas should be prioritised and whether there are important ‘gaps’ in the existing coverage of WTO agreements would at a minimum be informative. But better knowledge may also support unilateral action by governments seeking to improve the competitiveness of firms located in their jurisdictions and, over time, such engagement could prepare the ground for new agreements or the deepening of existing disciplines.<sup>27</sup>

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26 Many of the contributions to Evenett and Jara (2013) call for greater deliberation under the umbrella of the WTO.

27 It is an interesting question why the business community does not take (has not taken) the initiative to put in place such a mechanism on its own. It does not need governments to put in place what is suggested here.

Business arguably needs to be an integral part of any cross-cutting transparency and learning processes in a way that goes beyond ‘consultations’ and ‘dialogue’. One reason is that the business community can provide the data that are needed for objective assessments of the impacts of policies and for measuring the progress over time in reducing the negative trade and investment effects of regulatory policies. A constraint in this connection is that business may be hesitant to make relevant data publicly available for fear of adverse reactions by government agencies or worries about revealing useful information to competitors. Conversely, governments may discount information provided by business because of perceptions that firms will seek to remove any policies that raise their costs even if the underlying measures are implemented efficiently by the administrative bodies responsible for enforcement of policy and enhance social welfare.

The WTO secretariat could play a role in addressing these concerns by acting as an objective intermediary and depository of data provided by business, and assuring WTO Members that these are relevant and appropriate in measuring and assessing the impacts of regulatory policies.

Hoekman (2013) suggests one option to move towards operationalising greater engagement with business on trade and investment-related policies: establishing ‘supply chain councils’ that would focus on a selected number of specific production networks.<sup>28</sup> These could be limited to a purely informational mandate, tasked with identifying the most binding regulatory policy constraints that impact negatively on supply chain trade (SCT), including the effects of policy-induced uncertainty that generate a need to hold excess inventory and engage in other forms of costly ‘self-insurance’. It would be impossible to establish councils for all the major types of international production networks given the enormous heterogeneity that prevails in the market place. But identifying a number of ‘representative’ supply chains/networks for a set of products that are important for a broad cross-section of the WTO membership should be feasible and help to improve policymakers’ understanding of how a broad variety of regulatory policies impact on the operation of the chosen chains and networks.

The process of ‘mapping’ supply chain trade costs and inefficiencies to regulatory policies will require inputs from both business and the research community. Supply chain managers within firms may not understand or be interested in determining the various sources of costs and uncertainty, implying a need for collaboration with analysts. One can imagine various outputs of such a process. One could be a proposed action plan to address the policy-based sources of excessive SCT costs. Another output could be to identify performance indicators and quantitative baselines that would help both to motivate the need to pursue reforms and allow a determination of whether progress is made over time to reduce trade costs. Examples might include the time it takes for consignments to satisfy all border-management processes, or the share of transactions that are physically inspected, or the variance in the average time that is required for regulatory approval to be obtained. One reason why metrics matter is because

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28 If the proposal to complement DDA market access and rules negotiations with a supply chain framework is pursued, what follows could build on the mechanisms that were suggested in the previous chapter.



of the scope for policies to substitute for each other – removing one source of redundant or duplicative regulatory cost may not have an effect if other policies continue to impose excess costs.

An important question for governments in determining whether to go down this track is whether the WTO is the best place to do it. Are WTO Members willing to engage with the business community on trade and trade-related regulatory policies? Would other fora be more appropriate? Clearly the type of exercise that is being suggested can be pursued by other organisations. Indeed, to some extent organisations like the World Bank undertake similar types of activities. Thus, any assessment of national trade competitiveness will do much of what is being proposed here. Analysis of the business environment and investment climate is regularly undertaken by the World Bank for its clients or by the OECD for its members. This suggests a need for bringing these organisations into the envisaged process.

Doing so has value given that the national officials that work with these organisations are often not the ones responsible for trade policy, and even if trade officials are aware of the diagnostics and follow-on activities, the national delegations in Geneva often will not be. Conversely, the teams that undertake the diagnostics and policy analysis for the World Bank, OECD or regional development banks often will not consider the implications of their findings for the design and operation of the WTO. Whether the policies or SCT frictions that are identified are covered by the WTO may not be a matter of interest, even though this would be relevant information for WTO delegations. The same is true as regards the interactions between policy areas that impact on trade costs. A regulatory regime for road trucking that significantly reduces competition and the average quality of services may nullify much of the expected reductions in trade costs from an effort to reduce customs clearance times. There has been much talk about policy coherence – doing more in the WTO to bring in the methodologies and approaches used to assess trade competitiveness could be one way of enhancing coherence.

While there is much that other organisations can bring to the WTO in terms of assessments of policies and regulatory regimes and their impact on investment incentives, the products and activities that they undertake are not a substitute for the proposed supply chain approach. The latter differs in important ways from the modus operandi of institutions such as the World Bank. One difference is that by its nature a supply chain approach to analysis must be multi-country. The competitiveness diagnostics that are done by the World Bank and other development institutions are generally country-specific. Supply chains are by nature multi-country, and the assessments of SCT frictions that will emerge from the proposed process will focus on policies in a number of countries. This characteristic provides one rationale for making this a WTO-centred process.

Another rationale is that one function of the WTO is to address international pecuniary spillovers. Policies of trading partners that affect access to export markets or the availability and cost of imported inputs such as natural resources are generally taken as given in competitiveness diagnostic assessments. Bringing an SCT focus to the WTO would allow the effects of all policies along the supply

chain to be identified and discussed and thereby become a potential focal point for actions aimed at internalising some of the externalities that are identified.

One locus within the WTO for moving in the proposed direction is the Trade Policy Review Mechanism (TPRM), which has two dimensions. The first has the same feature as the World Bank's and other organisations' analyses of policies, in that the focus is country-specific (or customs union-specific in cases where WTO Members have a common trade policy). The second is much broader and focuses on the trading system more broadly. The main example is the annual report on the trading system, which was bolstered following the 2008 financial crisis to permit more frequent and in-depth reporting on and monitoring of trade-related policies (WTO, 2011b). The trading system dimension of the TPRM mandate could provide a platform for the deliberative approaches suggested here. Given that an objective of the proposed exercise is to focus on a broad set of policies that impact on international trade and investment (SCT) – i.e. to cut across the various silos and identify gaps/overlaps – this is best pursued through an inter-agency taskforce with the involvement of WTO Secretariat staff drawn from different divisions, including the economic research division, working with business associations that are willing to contribute to the exercise.

There are many ways in which the WTO can do more to engage with business. The approach advocated above differs from many proposals to emulate what is done in other organisations to provide business with a voice, for example in the OECD, where business is represented by a Business and Industry Advisory Committee (BIAC). This is unlikely to do much in terms of learning and mobilising attention on SCT frictions because by construction such advisory bodies engage on specific policies. It is important that business be able to express a view on policy matters, and an advisory business council would be an improvement over the status quo. But what is envisaged here goes significantly beyond the policy-specific advisory and advocacy inputs that characterise the role of the BIAC in the OECD. The premise of the supply chain-centred process is that WTO Members would benefit from creating mechanisms to engage with business and generate 'real-world' feedback and input that allows them to better understand how regulatory policies interact to affect trade and investment.

## **5.2 Engaging with the PTAs: Transparency and learning**

One area where deliberation can have payoffs relates to the proliferation of PTAs. These offer the WTO membership as a whole an opportunity to learn from the different approaches that are being pursued. PTAs are in some sense laboratories. The experiments that are successful in specific PTAs may be transferable. Over time, WTO Members may come to the view that some of the processes and approaches that have proved successful in a PTA context should be embedded into the WTO. A precondition for such learning is transparency: WTO Members need to have information on what is being done in the PTA context. Rather than seek to determine this individually, this is much better done by an agency such as the WTO secretariat that provides the information to all WTO Members.

Ideally, signatories to the PTAs would agree to provide information and share their experiences with implementation with the broader WTO membership. But independent of whatever PTAs members are willing to provide in this regard, the WTO Secretariat should be mandated to analyse and report on the specific processes or approaches that have been implemented in PTAs and to assess their impacts on economic outcomes.

An important contribution the WTO could make in this regard is to significantly expand what is done today by the Committee on Regional Trade Agreements (CRTA) and the Transparency Review Mechanism. Collecting and analysing information on the implementation of PTA disciplines would allow a much better understanding of what is actually being done in the PTA context, not just in terms of policy but in terms of institutional change and strengthening, specific types of cooperation and interactions between PTA members, and the investments that are undertaken as part of the implementation of PTA provisions. Current monitoring of PTAs by the secretariat focuses primarily on documenting the provisions of PTAs. This is not particularly informative for countries seeking to understand what is entailed in implementing those provisions and the outcomes that are generated. As in the previous proposal, bringing in and using firm and industry level data on variables of interest – such as trade costs and clearance times – would help WTO Members to better understand if and how PTA procedures and disciplines have an impact in improving economic outcomes and performance.

An alternative, less WTO-centred and less ambitious option to increase the transparency of PTAs is to create mechanisms that are open to any WTO Member and that provide a platform for analysts, business, regional secretariats etc. to provide information on specific PTAs. Suominen (2013) and Estevadeordal *et al.* (2013) suggest the formation of an ‘RTA Exchange’ – an annual forum where WTO Members share their experiences in implementing PTAs and cooperate in creating and populating an interactive website where they publish not only their agreements, but also research that has been done on the impacts of their PTAs, case studies of practical experiences in the design, negotiation and implementation of PTAs, including at the sub-central (or Federal) level. Their proposed RTA Exchange and interactive website would bring in independent outside analysts and aim to increase the quality of information and debate on PTAs.

### 5.3 Plurilateral cooperation and Annex IV WTO agreements<sup>29</sup>

Deliberation processes may not go further than mechanisms for greater transparency and for learning. But they may also become the basis of new agreements in the WTO. These may be general in the sense of applying to all WTO Members, or being limited to only a subset of WTO Members that decide to cooperate on an issue.

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<sup>29</sup> This section draws on Hoekman and Mavroidis (2013), which undertakes a comprehensive comparison and assessment of the PA and PTA approaches to cooperation between subsets of WTO Members.

The WTO offers two mechanisms for Members to form ‘clubs’ to move forward on an agenda of common interest without necessarily extending the benefits to other WTO Members: (i) negotiating a PTA that is justified under Art. XXIV GATT and/or Art. V GATS or the Enabling Clause if all members are developing countries, or (ii) conclusion of a Plurilateral Agreement (PA) under Art. II.3 WTO. The latter provision permits sub-sets of the WTO Membership to agree to certain disciplines applying to signatories only. In contrast to a PTA, which must cover substantially all trade in goods (Art. XXIV GATT), and/or have substantial sectoral coverage of services (Art. V GATS), PAs can be issue- or policy-specific. The recently concluded Agreement on Trade Facilitation may offer another approach. It provides for differences in the application of its provisions as a function of how WTO Members schedule commitments – either unconditionally, subject to a transition period, or subject to an open-ended transition period that ends after the country has received the technical and financial assistance needed to allow it to implement the obligation.

Four PAs were incorporated into the WTO in 1995 as ‘Annex 4 agreements’: the International Dairy Agreement, the International Bovine Meat Agreement, the Agreement on Civil Aircraft and the Agreement on Government Procurement (GPA).<sup>30</sup> The first two of these agreements were not incorporated into the WTO for pragmatic reasons, and are no longer in force having been superseded by the Agreement on Agriculture.<sup>31</sup> The GPA is a combination of market access commitments and rules in an area that was explicitly excluded from the coverage of the GATT and that continues to be excluded from the WTO. The Civil Aircraft agreement also has market access and rule-making elements, with the important difference that the liberalisation commitments made by signatories apply on a MFN basis, in contrast to the GPA. Much of the Agreement on Civil Aircraft has been superseded by the WTO Agreement on Subsidies and Countervailing Measures and the GPA (which includes rules on public purchases of civil aircraft).<sup>32</sup>

The case for greater recourse to PAs as a way of allowing subsets of countries to move forward on an issue and permit progress to be made on rule-making under the umbrella of the WTO is not new (e.g. Lawrence, 2006, 2013; Levy, 2006). The argument has not had much traction because there is significant opposition to expanding the number of PAs in the WTO. For example, Brazil and India among others have opposed the idea of adopting new agreements in the WTO on a plurilateral basis. This opposition contrasts with the general acceptance and pursuit of PTAs.

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30 Sometimes the Information Technology Agreement (ITA) is inaccurately depicted as a PA. It is not. It is a critical mass agreement that is implemented on an MFN basis through tariff commitments (bindings) of signatories. The same is true for other sectoral agreements for goods (e.g. so-called zero-for-zero agreements for certain chemicals, agricultural machinery, medical equipment, scientific equipment, and construction equipment) and services (e.g. the agreements on basic telecommunications and on financial services).

31 The dairy and bovine meat agreements were terminated by decisions of the General Council on 31 December 1997 and 17 December 1997 respectively.

32 The genesis of the Civil Aircraft Agreement was an effort by the EU and the US to agree on more specific rules on permissible support for aircraft production and trade than those that applied under the GATT. Signatories to the Civil Aircraft Agreement agreed to eliminate import duties on a specific list of civil aircraft-related products on a MFN basis (because the products involved are covered by the GATT).

PTAs and PAs both permit but do not require discrimination. Both liberalise trade and/or define rules of the game for a subset of the WTO membership that shares similar views and wants to go beyond prevailing WTO disciplines. Recent-vintage PTAs often deal with issues that are not covered by the WTO,<sup>33</sup> while any PA must by definition go beyond existing WTO rules. While PTAs must have substantial coverage of the trade between the partners to be WTO-legal, PAs can be limited to just one policy area. Another major difference is that Art. X.9 of the WTO Agreement stipulates that the Ministerial Conference of the WTO may decide to add an agreement to the existing set of PAs listed in Annex 4 'exclusively by consensus'.

In contrast, with the advent of the Transparency Mechanism in 2006, there is no longer any effort by WTO Members to approve new PTAs (Mavroidis, 2011). Consistency with the WTO is instead left to be determined through dispute settlement – if a WTO Member believes a PTA is inconsistent with the WTO, it can bring a claim to that effect and ask for a Panel to rule on the matter. The fact that there are no provisions or criteria on what is (should be) permitted in terms of sectors or their content/coverage implies that there is great flexibility in principle for those aspiring to establish a PA, but that utilisation of this flexibility is constrained by the need to obtain approval by *all* WTO Members to move forward, even if many or most do not intend to join.

Another difference between the two instruments is that PTAs tend to be closed clubs – most PTAs do not include an accession clause. Those that do often limit this to geographically proximate countries. This helps explain the proliferation of PTAs – a new agreement tends to be negotiated between members of any given PTA and non-members. PAs in contrast are 'open' – in principle no WTO Member can be excluded from a PA once it has been negotiated and accepted as an Annex 4 agreement. Thus, insofar as WTO Members can satisfy whatever conditions apply for membership (i.e. conform to the disciplines that constitute the substantive provisions of the PA) they cannot be excluded. Indeed, a rationale for negotiating a PA in the first place is to encourage wider membership over time – that has certainly been the goal of the signatories of the GPA. Of course, a precondition for expanding participation over time is that WTO Members can (are willing) to pay the entry price. If a large enough set of countries is of the view that it is not, membership will remain limited and the original signatories may need to reconsider the rules of the game they agreed to initially.

Transparency of PAs is ensured through the process of notification to the General Council and the need for the Council to approve any PA that is brought forward. If approved, a PA will result in the establishment of the types of WTO bodies that assist Members in the implementation of agreements, such as a Committee, with regular (annual) reporting on activities to the Council, and documentation that is open to all WTO Members. Moreover, disputes under a PA must be submitted to WTO Panels (and eventually the Appellate Body). This

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33 Horn *et al.* (2010) distinguish between WTO+ and WTO-X obligations in PTAs. The former cover matters that are fall under the current mandate of the WTO but where commitments in the PTA-context are more comprehensive (e.g. deeper than MFN tariff cuts); the latter refer to policy areas currently not addressed by the WTO (e.g. cooperation on macroeconomic policies).

ensures that case law regarding plurilaterals will develop harmoniously with case law regarding the multilateral WTO agreements. These are all arguably features of PAs that make them more attractive than PTAs from a trading system perspective.

Objections raised against PAs include worries that they will focus on controversial issues such as labour standards, that PAs will erode MFN, that the rules that are negotiated will be precedent-setting, that asymmetric negotiating capacity will bias disciplines towards what powerful countries want, and that PAs will reduce the prospects for issue linkages needed to conclude deals policies that are supported by strong vested interests.

The salience of many of these concerns depends on the substance and coverage of a PA. If the PA is WTO-X (that is, deals with a new issue – say an agreement on certain climate change-related policies), it may be precedent-setting but there is no issue of fragmentation or undercutting MFN as this currently does not apply. Countries that stay out may object to the PA precisely because it is precedent-setting and they fear the disciplines eventually being ‘imposed’ on them, as was done in the Uruguay Round as a result of the creation of the WTO and the take-it-or-leave-it choice that this created. However, a repeat of the this scenario seems rather unlikely.

Such a sanguine perspective is much less applicable in the case of so-called WTO+ PAs – i.e. agreements that deepen existing rules. WTO+ agreements that involve discriminatory market access concessions are likely to be problematic from a trading system perspective as they presumably imply targeted, narrow discrimination of the type that the WTO rules on PTAs were intended to prevent. WTO+ PAs that involve regulatory commitments and cooperation may be discriminatory in effect but this is more likely to be a side effect of whatever is jointly implemented – e.g. mutual recognition of regulatory standards and practices.<sup>34</sup> This suggests that if a PA involves a set of common rules and aims at regulatory cooperation/convergence for a policy area that is not covered by the WTO, there is less cause for concern about potential detrimental consequences for the trading system.

Greater willingness to accept PAs might on the margin result in fewer new PTAs and facilitate a process through which specific dimensions of PTAs dealing with regulatory policies could be incorporated in the WTO and gradually be multilateralised over time. While arguably good for the trading system, in part because it would propel reforms in non-parties, such PAs could engender resistance by non-parties because they see such an outcome as discriminatory. Such concerns, if widespread, would make the achievement of ‘explicit consensus’ much more difficult to obtain. Requiring aid for trade for non-parties as a built-in principle for any PA to be accepted could be one channel through which

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<sup>34</sup> An example would be a PA on supply chain trade that involves signatories committing to specific actions that would complement the Agreement on Trade Facilitation and other WTO agreements with commitments in policy areas that have a direct impact on the efficiency of supply chains. This might span logistics-related standards, cabotage, visa liberalisation, etc. This would imply better market access conditions for signatories of the PA, but this is conditional on having put in place an agreed set of procedures, having made the necessary policy reforms and investments, etc. As non-members satisfy the preconditions for establishing the capacity to implement the specific commitments required for club membership they should be able to participate and benefit from the provisions of the PA.

to address such concerns. A ladder approach to commitments, and possibly extension of full benefits by developed countries and large economies to LDCs to allay their concerns could be another.

A constraint in pursuing the plurilateral route is that the incorporation of a PA into the WTO requires unanimity ('exclusively by consensus'). Greater use of PAs arguably will require a relaxation of this rule (Tijmes-Lhl, 2009). While presumably intended to ensure that any PA is consistent with multilateralism, consensus is arguably too strong a constraint. A rationale for the consensus rule may have been concern about countries putting forward subject areas simply because of the DSU or for 'strategic' reasons (e.g. controversial issues like labour standards). However, consensus is not needed to provide assurances that efforts to introduce PAs on controversial matters that are only weakly trade-related can be blocked.

Relaxing the consensus requirement – for example through agreement that 'substantial coverage' of world trade or production is sufficient (Hufbauer and Schott, 2012)<sup>35</sup> or acceptance that a two-thirds majority suffices – would still ensure that controversial issues can be rejected while removing the ability of a limited number of countries to block a PA that the majority of the WTO Membership finds acceptable. The Enhanced Cooperation Agreements that are foreseen in the EU context to permit a subset of EU members to move forward in a policy area only require participation by nine member states in instances where consensus cannot be obtained (Hoekman and Mavroidis, 2013).

Lawrence (2006), WEF (2010) and Draper and Dube (2013) suggest that a necessary condition for moving towards greater use of PAs is to address the concerns that have been expressed by WTO Members. One way of doing this is to focus on negotiating, upfront, a 'code of conduct' for PAs to be negotiated under the umbrella of the WTO. Qualified majorities – as suggested above – could be incorporated as one modality and buttressed by other principles that any PA should embody for it to be acceptable – such as aid for trade.

A code of conduct could include, among other things, the underlying principles that: (i) membership is voluntary; (ii) the subject of the plurilateral is a core trade-related issue; (iii) those participating in plurilateral negotiations should have the means, or be provided with the means as part of the agreement, to implement the outcomes; (iv) the issue under negotiation should enjoy substantial support from the WTO's membership; and (v) the 'subsidiarity' principle should apply in order to minimise the intrusion of 'club rules' on national autonomy.

Flowing from these principles, Draper and Dube (2013) suggest PAs should also be governed by a set of rules that are agreed up front by the WTO membership as a whole. They note that these could include the following:

- Only parties to the agreement could participate in WTO dispute settlement and, consequently, cross-agreement retaliation should not be allowed, since it would reduce the incentives to join the agreement.

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<sup>35</sup> They suggest a minimum coverage of 40% of world trade as opposed to the norm of 90% that empirically has defined the feasibility of critical mass agreements in the GATT/WTO.

- Any WTO Member could participate in the negotiations on a voluntary basis, subject to demonstrating sufficient capacity to implement the outcomes.
- The provision of benefits to non-members should not be required, since that would reduce the incentives to negotiate the plurilateral, but could be allowed.
- Furthermore, transparency mechanisms should be built into plurilateral negotiations so that exclusiveness could be minimised in order to build trust and interest in it.

## 5.4 Defining a new agenda for multilateral cooperation

The proposals made in this Chapter are process-oriented. The choice of policy areas that could be tabled in a deliberation process will need to be determined by WTO Members. There are many candidates, including many of the issue areas that are on the table in the mega-regionals and that are not covered by the WTO. Possible subjects for deliberation that are often mentioned in the literature include the following:

- Global value chains (Nakatomi, 2013)
- Digital trade and data flows (Kommerskollegium, 2014)
- Industrial policy/local content requirements (Hufbauer *et al.* 2013)
- Environmental policies (for goods and services) (ICTSD, 2013)
- Food security (Tangermann, 2013)
- Sustainable energy policies (Hufbauer and Kim, 2012)
- Competition policy (Aggarwal and Evenett, 2013)
- Exchange rate policies/'currency manipulation' (Mattoo/Subramanian, 2009)
- Subsidies (Cosbey and Mavroidis, 2014)
- Product market regulation and private standards (WTO, 2012)
- Business/civil society engagement in the work of the WTO (Braga, 2013)
- Investment policies (Gonzalez, 2013)
- Export restrictions (food, natural resources) (Mitra and Josling, 2009)

The extent of knowledge and information that exists on the various possible subjects varies significantly. Some policy areas such as investment policy have already been the subject of extensive discussion in the WTO, and there are already binding disciplines on investment policies (right of establishment, etc.) in many PTAs. Other policy areas are much less ripe for negotiations to establish rules, and some simply do not lend themselves to agreement to binding disciplines. Similarly, policy areas vary substantially in the extent to which they lend themselves to small-group cooperation that does not extend to other countries



and policies where cooperation can only proceed on the basis of 'critical mass' – i.e. there is a binding free-rider constraint that prevents just a small number of countries from taking an initiative that they perceive as beneficial to them. This is most obviously the case for matters that are already subject to the WTO and where the MFN rule applies.

There may also be interest in the pursuit of sectoral agreements, with countries that are interested in doing so going beyond tariffs to include other policies that are not the subject of WTO disciplines, or going further than is required under the WTO. This need not be limited to manufacturing sectors, but can span agri-business and services as well. Depending on the coverage of the policy commitments, such cooperation might be pursued on a critical mass basis or alternatively as a plurilateral agreement.

What matters is that a group of WTO Members takes the initiative to start a discussion in the WTO on at least some of these subjects that explicitly allows for a range of possible outcomes. Contrary to the approach that was followed with the so-called Singapore issues, the presumption should not be that the aim in all these areas is to negotiate new rules that will (eventually) apply to all WTO Members. Instead, outcomes may range from simply having a discussion forum (exchanging information), to soft law-type cooperation, to the conclusion of an agreement with binding disciplines that extends to only those WTO Members that decide to join. The latter may be pursued on a critical mass basis (with benefits applying to all WTO Members on an MFN basis) or be premised on the understanding that the benefits of the agreement apply only to signatories, consistent with the provisions of a code of conduct along the lines of what was suggested previously for new plurilateral agreements.



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## 6 Rethinking Economic Development in the WTO

Engagement by many developing countries in the trading system has tended to revolve around efforts to defend and improve upon the provisions in the WTO that call for special and differential treatment (SDT) of developing countries. SDT in the WTO takes several forms. One is acceptance by the WTO membership of high(er) trade barriers in developing nations and 'less than full reciprocity' in multilateral trade negotiations. Another is a promise by rich(er) countries to provide preferential access to their markets for exports from least developed countries – through the generalised system of preferences (GSP) or through better than GSP treatment – duty-free, quota-free (DFQF) access for the developing countries. A third dimension involves exceptions and exemptions from certain disciplines and longer transition periods for the implementation of new rules that apply to all WTO Members.

A key objective of many developing countries in the DDA was to make the WTO's many SDT provisions more effective and operational. One way this was pursued was through a concerted push to make preferential market access programmes more meaningful by expanding their product coverage and relaxing the conditionality that applied, especially with respect to rules of origin. This push proved successful in the case of the LDCs – with the Hong Kong Ministerial meeting declaration calling for at least 97% of LDC exports to developed country markets to benefit from 'duty-free, quota-free' (DFQF) access. Many OECD countries (but not the US) have now completely opened their markets for merchandise imports from LDCs, who also increasingly benefit from DFQF access for many of their exports in large emerging economies such as China and India.

The success of the LDCs in improving and defending preferential access to major export markets post-2001 – not just OECD markets but also those of the BRICS – is a significant achievement. However, it also had a downside: it created tensions among developing countries (DFQF only extends to the LDCs and not to other countries that may be very similar in terms of per capita income and other development indicators), and gave rise to incentives to resist the preference erosion that would result if the DDA was to reduce applied MFN tariffs of preference-granting countries. This negative dynamic is illustrated most notably in the resistance by the United States to extend DFQF treatment to Asian LDCs (Bangladesh, Cambodia and Laos), which is driven in part by concern that doing so would erode the value of the preferential market access provided to eligible African countries under the African Growth and Opportunity Act (AGOA).

Another element of the strategy pursued by many developing countries in the Doha Round was to propose a shift from 'best endeavours' SDT language in WTO provisions to more legally binding, i.e. enforceable, texts. Numerous proposals were put forward, including in the area of dispute settlement, aimed for example at addressing the constraint that most countries have in credibly

threatening retaliation in the case of noncompliance by large trading partners with the findings of the Dispute Settlement Body. The dispute settlement-related proposals were part and parcel of the effort to shift from best endeavours language to binding SDT commitments, as a precondition for this to be meaningful is that commitments are enforceable.

Concerns about implementation costs and more generally limited supply capacity (lack of competitiveness) were a major motivation for the launch of the Aid for Trade (AFT) initiative (at the 2005 Hong Kong Ministerial) and the creation of the Enhanced Integrated Framework (EIF) for trade-related technical assistance for the LDCs. The launch of the AFT programme and the creation of the EIF, although not formally tied to the DDA and not formally an element of SDT, signified recognition by the WTO membership that technical and financial assistance was needed to help low-income countries improve supply capacity.

AFT has become a mechanism to engage development agencies (bilateral and multilateral) more in the trade integration agenda and helps to raise the profile of trade issues in the process of determining priorities for investment and policy reform at the country level. AFT and the EIF are qualitatively different from SDT – they are an alternative instrument to support the realisation of the objectives that motivate SDT and are arguably a more appropriate and productive approach if designed appropriately and implemented effectively. The major challenge – and opportunity – looking forward is to do more to ensure that AFT has a greater impact in terms of improving trade capacity and competitiveness.

This very brief summary of developing country objectives and outcomes to date illustrates that progress has been made as regards economic development concerns in the WTO. Some of the issues that were of most concern to the poorest developing countries in the late 1990s/early 2000s and that factored into the launch of the DDA have at least partially been addressed. However, key market access and agricultural support reduction objectives remain to be achieved – a high-profile example being liberalisation of trade in cotton, a key demand for a number of African countries. As noted in Chapter 1, a necessary condition for moving forward on the market access front is that the large players in the WTO agree on a package of commitments that they consider to be balanced. There is little that small developing nations such as the cotton-4 (Benin, Burkina Faso, Chad and Mali) can do in this regard beyond advocacy.

Traditional SDT arguably has resulted in significant opportunity costs in terms of benefits foregone.<sup>36</sup> It has meant less market access in areas of export interest (continued tariff escalation/peaks in major export markets through the 1990s for

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36 The seminal contribution on the approach that has been taken in the GATT/WTO towards defining rights and obligations for developing countries remains Hudec (1987). Recent research suggests that in principle SDT can be consistent with the reciprocity principle that underpins the WTO in the sense of allowing developing countries a period of greater policy freedom and better access to major markets that is conditional upon future full participation in the trade regime once trade performance exceeds a certain threshold level (i.e. reciprocity applies in a dynamic sense) – see Conconi and Peroni (2012). But a precondition for this mechanism to work is that the conditionality is indeed applied, i.e. there are ‘graduation’ criteria. No such criteria prevail in the WTO, in contrast to the bilateral context that prevails when it comes to preferential market access. This suggests a need for greater explicit differentiation and criteria to define eligibility for SDT—an issue that has long been recognised and debated in the GATT/WTO setting but that to date has not proven to be tractable.

example). Some important tariff peaks continue and rules of origin and various non-tariff measures continue to impede trade, although these have become a more prominent feature of the structure of trade policy in developing countries than in OECD nations. SDT has also reduced the benefits associated with applying WTO trade policy disciplines, including limited use of WTO dispute settlement procedures and the WTO's transparency mechanisms. Given that average MFN tariffs are declining steadily (the applied average MFN tariff for manufactures in OECD countries is around 3%), the value of DFQF treatment is inherently limited. It can only partially make up for the high trade costs that confront enterprises in low-income countries and that raise the costs of consumption goods for households.

Core elements of the SDT toolbox – especially seeking to limit the extent of own trade policy concessions – do little to address the key factors that matter for competitiveness and that could therefore help improve trade performance. Four areas stand out in this regard: tariffs, the cost and quality of service inputs, reducing the trade-impeding effects of non-tariff measures (NTMs), and improving trade facilitation/border management. Policy reforms affecting these areas can have a major positive impact in terms of reducing the trade costs confronting firms and farmers. A large and expanding body of research has documented that the potential benefits for developing nations and for the world as a whole of action in these areas are substantial (Hufbauer and Schott, 2013; WEF, 2013).

While average tariffs are low, tariffs can be an important factor precluding investment in developing countries that is dependent on the efficient operation of supply chains. An insistence on not fully participating in tariff reduction commitments implies that developing countries incur a significant opportunity cost, as tariffs can have the result of locking a country out of a production network or supply chain. It is increasingly the case that in order to export, and thus to attract investment in exportables, firms need to be able to import (buy) goods and services at world market prices. Insisting on the policy space to raise tariffs makes little sense in a world economy that is increasingly organised in international production networks that crisscross borders, with firms in different countries specialising in specific activities that are needed to produce a final good. Imports are needed to be able to export.

Tariffs, even at low rates, throw sand into the gears of supply chains. Seeking to do less (or nothing at all) in WTO tariff negotiations implies higher trade costs for firms and perhaps exclusion from participation in production networks. SDT may have the unintended consequence of freezing LDCs out of the major new dynamic for promoting development – FDI related to global supply chains (Draper and Lawrence, 2013; Baldwin, 2014).

Matters are less clear-cut as regards rules and rule-making for NTMs and services, as the specifics of a proposed new discipline may not be beneficial to a low-income country, or, more generally and more likely, give rise to implementation costs that require the use of resources that have a higher social return if allocated elsewhere. This helps explain why developing countries insisted in the Doha negotiations on trade facilitation that any commitments made on their part would only become enforceable if high-income countries provided the assistance necessary

to implement the agreement. This is an approach that could be extended to other areas, and arguably offers better prospects to address development concerns than a mechanical insistence on less than full reciprocity.

Much emphasis has been put by many developing country governments on the need to preserve 'policy space', while many high-income country governments have argued for the need to differentiate more across countries and for 'graduation' by developing countries out of SDT. These debates and the underlying conflicts are increasingly redundant. Less than full reciprocity and limited or much-delayed implementation of WTO rules may not do anything positive for economic development, given that trade policies are generally not effective, let alone efficient, instruments to address market failures or assist firms to move up the value chain and expand export sales.

Rather than continue to fight old battles, it would be more productive to do more to identify where specific WTO rules impede the ability of governments to implement policies that would enhance their economic welfare and target those for re-negotiation or waivers, and to better utilise available financial resources to help implement policies that promote economic development (Hoekman, 2005a,b).

The WTO does not have much in the way of capacity to become engaged in the design and delivery of development projects. From an institutional coherence perspective there is a compelling case that it should not seek do so, even if some donors would be willing to allocate the (significant) resources needed to have an impact. What the WTO can do is to provide more effective support in helping countries to deal with the 'real trade cost' agenda. It can do so through agreements on frameworks that embody good practices – the trade facilitation agreement in Bali is a noteworthy positive development in this regard – and by focusing more on establishment of mechanisms for regular dialogue, peer review and monitoring of domestic policies and progress in the implementation of good economic practices. The latter could be a subject for deliberation along the lines suggested in the previous chapter, and that could be undertaken under the auspices of the Committee on Trade and Development.

The building blocks for a more constructive approach to address development concerns are already largely in place. WTO Members have already been pursuing issue- and agreement-specific approaches to addressing specific development concerns. An important innovation here is the Agreement on Trade Facilitation, with its flexible scheduling approach and the opportunity it offers for developing countries to identify commitments where implementation assistance will be sought – and that are not enforceable until such assistance has been received and the relevant provisions have been fully implemented.

Another important innovation that has occurred is the Aid for Trade (AFT) initiative. AFT can have the greatest positive impact if it is allocated so as to address the sources of trade costs that reduce the competitiveness of firms in developing countries. This is of course a big agenda, and there are numerous agencies, national and multilateral, that provide support to governments with this aim. The value-added of AFT is arguably likely to be highest when it focuses on areas that are covered by the WTO: trade-related policy, broadly defined as

measures that have a direct impact on trade costs. Much of the focus of the AFT initiative is however on infrastructure investment and 'productive capacity'. These are areas that development institutions would engage on in any event.<sup>37</sup> What the relevant agencies are less naturally inclined to focus on in a consistent manner over time are trade-related policies, including non-tariff measures and policies affecting trade and investment in services.

Using AFT to support the types of mechanisms and platforms mentioned above would be relatively low-cost, but could potentially have a high payoff. One such payoff would be to move the WTO to become a global institution where the substance of policy is discussed and debated, whether or not a policy area is subject to binding disciplines, as opposed to being a body that focuses predominantly on the negotiation and enforcement of policy commitments. The WTO is the only *global trade policy* organisation extant. Focusing AFT on *trade-related policies*, on helping to identify and put in place mechanisms and processes to assist members to strengthen and improve implementing institutions could make the WTO more effective in supporting efforts to achieve development objectives.

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<sup>37</sup> Although it must be recognised that these agencies substantially increased the attention and the level of support provided in these areas following the launch of the AFT initiative, which was of course a key objective of the trade community.





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## 7 Concluding Remarks

Two developments have played an important role in the trading system since the creation of the WTO in 1995 and the launch of the DDA: (i) the sustained high growth rates in many developing nations, especially the large ‘emerging economies’ – most notably China; and (ii) the increasing share of world trade that involves supply chains and firms located around the world specialising in very specific activities and tasks that are part of a global value chain. The latter has led to the policy agenda surrounding international production and trade becoming more complex, spanning not just the traditional market access issues that are the primary focus of trade agreements, but also a variety of ‘behind-the-border’ policies that can be a source of negative spillovers.

Many of the relevant policy areas – including investment, certain subsidies, environment, procurement, data protection and privacy policies – are not on the table in the DDA. Many of these policy areas are the subject of negotiation in PTAs, including the TPP and TTIP. Time will tell whether the mega-regional agreements will make substantial progress in crafting disciplines in such areas. Brazil, India and China have yet to conclude a deep PTA with another large economy, developed or developing. The large emerging economies have not been active in negotiating deep PTAs with each other or with the large OECD nations. This suggests that the WTO will remain an important vehicle to engage on and address trade issues, both as regards market access for goods and services, and for potential new policy areas.

The fact that major trading nations regard preferential trade agreements as effective mechanisms to address certain policy spillovers should be seen as a positive feature of the trading system. The challenge is to ‘walk on two legs’ and continue to utilise the WTO to address matters that cannot be dealt with in PTAs, as well as policy areas that are on the table in PTAs but could and should be the focus of deliberation in the WTO as well.

Many of the policies that have an impact on the organisation and design of global value chains are on the table in the DDA – including policies that impede access to markets. Concluding a comprehensive market access deal in the DDA therefore remains important. The proposals sketched out in this report offer one potential avenue to provide an impetus to agreeing to a market access package in the WTO. Whether or not that proves possible, the focus in recent PTAs on policies that are not addressed by the WTO suggests a need to do more in and through the WTO to understand what is being done in the PTAs and where there are opportunities for subsets of WTO Members to cooperate in new areas.

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With the WTO trade talks deadlocked since 2008, the US and the EU are turning towards preferential trade agreements, including so-called 'mega-regionals'. But these leave out the planet's more dynamic traders – including large emerging economies such as China, India and Brazil – so such agreements can only have a relatively small positive impact. From a world welfare perspective, deals to further integrate markets need to be multilateral. The challenge is how to get there.

This book considers the various ways forward and proposes specific solutions for revitalising multilateral trade liberalisation and rule-making. A key premise is that any road map must recognise that trade today involves supply chains and that these are impacted by many policies. The effect of a deal in one area may be minimal if other policies are not dealt with in parallel.

The book recommends adoption of a 'supply chain framework' that helps negotiators identify how an overall package can be constructed that spans the different policy areas that are on the table, including not just tariffs but also services policies that affect the operation of supply chains.

The growth in regional agreements partly reflects supply chain trade dynamics: a need to cooperate on regulatory policies. The WTO offers the flexibility for groups of like-minded nations to do this without implicating all members. The book identifies ways governments can make the WTO a forum for deliberation on new policy areas, learn from regional initiatives, and build on the precedent set by the Bali Agreement on Trade Facilitation to address development concerns in meaningful way.



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