Trade Policy and WTO Newsletter

ICRIER

November 2010

In This Issue

Recent Global Trade Developments

Anwarul Hoda[1]

The third quarter of 2010 saw the major advanced economies moving listlessly forward. Economic recovery in these economies has not been strong enough to make a major dent in the prevailing high levels of unemployment and the Wall Street Journal's forecasting survey in August revealed a pessimistic economic outlook, with slow growth and low job creation. In this environment, there has been a lack of initiative to address the issues that caused a stalemate in the Doha Round. Trade liberalisation has not been on the list of priorities of world leaders and, at Toronto, the G20 dropped altogether the reference to any target year for completion of the protracted trade talks. Now it is going to be "as soon as possible".

There has been occasional good news though on this front emanating from important sources. Late in July, WTO Director General Pascal Lamy stated that after months of impasse in the negotiations, "my own sense is that we are beginning to see signs of a new dynamic emerging". The US trade Representative, Ron Kirk, said early in August that "real progress" could be made in the Doha Round by the end of 2010. US Federal Reserve chairman Ben Bernanke called upon the Congress to go forward with the three bilateral trade deals with Colombia, Panama and South Korea and also support efforts to reform global trade rules. The US chief agricultural negotiator has said early in October that some progress had been made over the last six months. The Group of Five members – the United States, the European Union, Brazil, China, and India – were reported to have agreed to

[1] The author is chair professor of ICRIER's Trade Policy and WTO Research Programme

organise small group discussions on outstanding issues in the hope that enough progress would be made to encourage the G20 Summit at Seoul in November to provide political guidance for the completion of these talks.

Assessment of trade gains from the Doha Round

While the world waits for positive moves to take the negotiations forward detractors of the multilateral process are asking how worthwhile the final Doha package is going to be. How meaningful are the potential gains from liberalisation in agriculture and NAMA that would result from the formula cuts envisaged in the current versions of the negotiating modalities likely to be? Although there is no clarity yet on whether the US initiative for liberalisation of three sectors (chemicals, information technology and environmental goods) would succeed and the extent of liberalisation that would be undertaken in the services negotiations, estimates have been made of the potential gains from these as well. The latest estimate came out in a report by the Washington based Peterson Institute for International Economics in June, assessing increase in world exports by US $ 17.1 billion in agriculture and by US $ 50.6 billion in non-agricultural products. The report assesses that the proposed sector agreements in NAMA would increase world exports by another US $ 70.9 billion. According to the Peterson Institute a 10 per cent reduction in services trade barriers would have the potential to scale up exports by as US $ 55 billion. There is considerable optimism on the trade benefits that could flow from an agreement on trade facilitation and the Peterson Institute puts the trade enhancing value at US $ 86.8 for 22 major trading countries.

These figures in their totality do not look very impressive against the total world trade turnover of US $ 15,450 billion in goods and services in 2009. However, the importance attached to the Doha Round is not linked only to the additional trade opportunities that might be created from the liberalisation that is eventually agreed. Equally important is the assurance that success in the negotiations would ensure that the WTO continues to have the support of the trading nations as a forum for trade negotiations. Regional and bilateral free trade agreements have already been receiving disproportionate attention from the world's important trading nations. However, major trade problems can be tackled successfully only through a global approach in a multilateral forum like the WTO. We shall have to turn to the WTO for addressing emerging problems such as trade imbalances, carbon border measures and competitive subsidisation of clean energy. Besides, unless the existing task before the WTO is concluded satisfactorily, trading nations will not have the confidence to try to resolve the new generation of problems in that forum. And, if these problems are not resolved, trading nations would try to impose unilateral solutions and this could engender trade retaliation, and eventually result in a contraction of international commerce.

Plurilateral Agreements- ACTA

One of the well-known risks of a prolonged impasse in the Doha Round is that FTA Agreements would get a fillip. In fact, that is already happening. Another risk is that there would be plurilateral initiatives for striking agreements limited to small groups of like-minded countries on specific aspects of international trade relations. Plurilateral approaches by themselves are not a bad idea if the eventual aim is to seek agreement in a small group of countries on liberalisation in any area and to invite others to join in later. The Information Technology Agreement was negotiated in this manner in 1996 on the fringes of the first WTO Ministerial Agreement held at Singapore. However, plurilateral approaches to rule making are not desirable as countries, which do not participate in the evolution of the initial draft, do not get the opportunity to propose rules adapted to their particular trade and development situation. Unfortunately, such initiatives have also begun to be taken, to the detriment of the interests of non-participants as well as of the multilateral trading system. One such negotiation is for the Anti-Counterfeiting Trade Agreement (ACTA) in which the participants are Australia, Canada, the European Union, Japan, Mexico, Morocco, New Zealand, New Zealand, Singapore, South Korea, Switzerland and the United States. The objective of these negotiations, which were launched in 2008, is to strengthen enforcement of laws relating to trademarks and copyright, the latter especially in relation to internet piracy. The secretive nature of these talks has led to concern among non-participants that the eventual agreement could possibly shift enforcement from the domestic courts to the customs authorities. There were also fears that draconian provisions would be included such as requiring internet service providers to cut off service to individuals caught downloading illegally three times or authorising customs officials to inspect and seize an iPod containing illegally downloaded music. However, these fears have proved to be unjustified. Regarding the ACTA negotiations, two observations would be in order. First, the deadlock in the Doha Round is the possible reason for the negotiations moving out of the WTO. Second, since the negotiations are taking place in a small group of principally rich countries, there is a likelihood of the Agreement being tilted in favour of rights holders and against the interests of users. Even if the ACTA were conceived of as a plurilateral agreement from the outset it would have been much better if everyone got the right to participate in the negotiations. This would have happened if the negotiating forum of the WTO were to be used. But the recent history of deadlocks and stalemate in that organisation seems to have driven these twelve countries away from the WTO for conducting these negotiations.

Protectionism

No review of global trade developments can be complete without an assessment of the situation on protectionism, especially in the immediate aftermath of the Great Recession. The G20 initiated a special process of monitoring trade restrictive measures at its Summit meeting at Pittsburg on 25 September 2009 by asking the WTO to submit six-monthly reports in collaboration with the OECD and the UNCTAD. The last report, submitted in March, 2010 confirmed the trend reported in the first one that major trading nations had not intensified significantly their trade and investment restrictions in response to the global recession despite a difficult domestic environment created by high levels of unemployment. The framework of WTO rules, supported by an effective dispute settlement machinery, is universally recognised as one of the main factors responsible for preventing the slide into protectionism. But as the March report of the three organisations points out, this is not to say that new trade restrictions have not been put in position or that foreign and non-resident investors have not faced any discrimination. In fact, the Global Trade Alert (GTA), an independent trade policy monitoring initiative, has reported that since November 2008 , as many as 950 measures have been implemented, out of which two-thirds almost certainly discriminate against foreign commercial interests. An interesting fact that has come out in the GTA reports is that many of these measures are in areas in which the WTO rules are weak (such as state subsidies and government procurement) or there are no WTO rules (such as migration and export taxes). All major trading nations, including emerging economies like India, have been affected by the discriminatory trade barriers that have been introduced in other countries. One instance of discriminatory action affecting India, which has been in the news in recent months, has been the border security legislation of the United States under which H-1B and L visa fees that allow US employers to hire skilled foreign workers have been substantially raised (from US $ 320 to $2,000 for H-1B and to $2,250 for L1). Another example, which has also affected India adversely, is the ban on offshore outsourcing by government departments imposed by the State of Ohio in the United States. A feature of both these US measures is that although they are protectionist and affect India's commercial interests adversely, they are prima facie WTO compliant. They can be tackled not by raising disputes in the WTO but through quiet diplomacy.

The concern now is that more protectionist actions are in the making. With the high stake mid-term elections approaching in the US protectionist pressures are in evidence most in that country. Two bills have been passed by the House of Representatives with highly protectionist intent. The first was approved in July 2010, aimed at establishing an Emergency Trade Deficit Commission that would identify the causes and consequences of both the overall and bilateral

US trade deficit and would develop recommendations to reduce the imbalances. The second approved at the end of September 2010 is the Currency Reform for Fair Trade Act, which would enable imposition of punitive tariffs on imports from countries that undervalue their currencies. Both bills seem to be directed against China with whom the US trade deficit has widened to $145 billion in the first seven months of the year. If these legislative initiatives bear fruit and result in actual enactments a currency and trade war between the two economic super powers might ensue. The issue is likely to be discussed at the Seoul Summit of G20 in early November and hopefully a crisis will be averted.

Trade Policy Developments in India: New Foreign Trade Policy

Anwarul Hoda

On August 23, 2010, the Commerce and Industry Minister, Mr. Anand Sharma, released the Annual Supplement for 2010-11 to the Five Year Foreign Trade Policy announced in August 2009 for the period 2009-2014. The supplement addresses primarily programmes and schemes providing assistance for exports of merchandise: all the pre-existing schemes have been extended and in some cases, additional benefits have been granted. A dose of expanded export assistance had been given in August 2009 in the context of steep fall in exports and the resultant increase in joblessness. The downward trend in exports was reversed in October 2009 and Indian exports have grown by 32 per cent as compared to last year. Notwithstanding this improvement, the Government of India has decided to not only extend but also further strengthen these programmes. The rest of the world has started withdrawing the stimulus measures introduced in the wake of the recession. India too has commenced the process of fiscal consolidation and the central excise duties that had been cut earlier have begun to be raised. But an exception has been made for the export sector. The following are the key decisions taken by the government:

- The Foreign Trade Policy 2009-14 had extended the interest subsidy of 2 per cent on pre-shipment credit available to Handloom, Handicraft, Carpet and SMEs until October 2010. The Annual Policy has now extended it March 31, 2011. This facility has also been expanded to cover a number of additional products including engineering items, leather, textiles and jute.
- The Duty Entitlement Passbook (DEPB) had been validated until December 31, 2010. Now, it has been extended for a further period of six months up to June 30, 2011.
- Under the focus product scheme, a benefit of 5 per cent duty free credit scrips is available in the existing scheme for handicraft, silk carpets, toys and sports goods and of 2 per cent for leather products, leather footwear, handloom products and certain engineering items. In all, the benefit is available for 135 products. In the new policy, an additional benefit of 2 per cent bonus has been given to these products. In addition, 256 products have been added to the list for receiving the duty free credit scrip benefit at the rate of 2 per cent.
- Under the existing export promotion capital goods (EPCG) scheme, import of capital goods is allowed at the concessional customs duty of 3 per cent, subject to an export obligation equivalent to eight times the duty saved on capital goods imported under the

scheme. In addition, the Foreign Trade Policy (2009-14) introduced a zero duty EPCG scheme (valid until March 31, 2011), allowing import of capital goods subject to an export obligation equivalent to six times the import duty saved, applicable to certain dynamic areas of Indian exports, such as engineering and electronic products, basic chemicals and pharmaceuticals, apparel and textiles, plastics, handicrafts, chemicals and allied products and leather and leather products. In the Annual Policy, the minister announced extension of the scheme for zero duty for another year and addition of new products within its ambit, such as paper and paperboard, ceramic products, refractories, glass and glassware, rubber articles, plywood, marine products, sports goods, toys and additional engineering products.

- The press release of the Department of Commerce also mentions that nearly 300 products at the eight-digit level from the readymade garment sector have been granted the benefit of the Market-Linked Focus Product Scheme for a further period of six months from October 2010 to March 2011 for exports to 27 EU countries.

An important consideration for India while taking a decision for extending existing schemes of export promotion or for introducing new ones is the WTO framework of rules. The WTO prohibits the use of export subsidies on manufactured products as a general rule, but the least developed countries and a number of low-income developing countries (including India), which have been listed in Annex VII of the WTO Agreement on Subsidies and Countervailing Measures (ASCM), are exempted from the prohibition. The underlying idea behind the exemption was that these countries needed to use such subsidies to neutralise market imperfections and distortions that their economic operators faced. Of course, the exemption does not give Indian exporters relief from countervailing duties, which can be and are being imposed by some countries, in cases where imports from India are causing material injury to domestic industry. However, Indian exporters have been taking the imposition of these duties in their stride as only very few products face such duties and that too, in one or two markets.

However, indications are that WTO obligations on India with respect to export promotion schemes might become more stringent in the not-too-distant future. First, Article 27.5 of the ASCM envisages that export subsidies must be phased out (over eight years) by an Annex VII country, which has reached export competitiveness in one or more products. Article 27.6 stipulates that export competitiveness in a product would be deemed to exist if the developing country concerned has reached share of at least 3.25 per cent in world trade of that product for two consecutive calendar years.

There is some confusion on what constitutes a product. The relevant Article of the ASCM defines a product for the purposes of this obligation 'as a section heading of the Harmonized System Nomenclature'. The Harmonized System Nomenclature (HS) is divided into 21 sections, 98 chapters and much larger numbers of four digit headings and six-digit sub-headings. A section would be a much broader definition of a product than a heading and a country can be expected to reach share of 3.25 per cent world trade in a heading much faster than in a section. To measure export competitiveness, one has, therefore, to use either a section or a heading of the HS, and it does not make sense to use both. Obviously, there is a drafting inaccuracy in the text of the ASCM and the matter has to be resolved in the Committee, or in the course of a WTO dispute. When the matter is taken up for resolution, it would be advantageous for India to take the stand that competitiveness should be deemed to exist only when the country concerned attains the stipulated share in respect of a section in the HS. A broader group of products would be advisable from India's perspective, as it would take a longer time for India to attain the stipulated share in respect of such a group. This would enable it to take advantage of the exemption from the prohibition on export subsidies for a longer period. In practical terms too, the adoption of a broader group of products is more advisable as it would be easier to implement export promotion programmes on an industry-wide basis rather than on a 4-digit basis. At present, the EC's GSP programme envisages graduation on the basis of the share that a beneficiary has in respect of a broad group of products rather than a narrow one and in respect of textiles, the whole section is taken into consideration.

Irrespective of whether the share of a country in world exports has to be taken into consideration on the basis of headings or sections, the fact remains that India's export share in textiles and clothing was calculated by the WTO Secretariat in response to a request made by the United States in February 2010. It has come to light that it crossed 3.25 per cent in 1996 itself and, more recently, it has been in the range of 4 to 4.5 per cent. India's share in the world trade of several textile headings is much higher – at 8.1 per cent for men's shirts and 15.7 for women's blouses, for instance, in 2008. It is not unlikely that the matter will be taken up for discussion at the next meeting of the ASCM Committee, and India will be under pressure to phase out export subsidies. The phase out will have to be for all textiles products if the decision is to go by a section of the HS, but the decision could also be to take individual headings as the basis.

There also is a threat to the continuation of India's status as an Annex VII country, eligible for exemption from the prohibition on export subsidies. Annex VII stipulates that for the countries listed therein, the exemption from the prohibition on use of export subsidies would cease to have effect 'when GNP per capita has reached $1,000 per annum'. At the Doha Ministerial

Meeting, an agreement was reached in principle that the members listed in Annex VII would remain eligible for the exemption until their GNP per capita reached US $ 1,000 in constant 1990 dollars for three consecutive years.

The WTO Secretariat provides regular updates of the position regarding the per capita incomes of Annex VII countries, derived from World Bank data. The World Bank data series, formerly identified as Gross National Product ("GNP"), is now published as Gross National Income ("GNI"). According to the latest figures made available by the Secretariat in June 2010, India's GNI per capita at current dollars in 2008 stood at $1012 and at constant 1990 dollars, at $821. If the Indian economy continues to grow between 8.5 and 9 per cent in the next few years, it would cross $1000 in constant 1990 dollars by 2012. Thus, by 2014 or so India may lose the benefit of an Annex VII country.

India's recent record of economic growth has been truly impressive but it is also likely to bring with it increased international obligations. It is time India reviewed all its export promotion programmes and began the phase out of those schemes that are likely to become inconsistent with such increased obligations. Schemes such as subsidy on export credit, product and market focus assistance, which constitute outright export subsidies, need to be eliminated gradually. Withdrawal of these schemes would also help the process of fiscal consolidation, which is the need of the hour in the country. There are other programmes like the DEPB, which have design faults and need to be restructured to ensure that they really rebate state-level taxes borne by the product. There are also flaws in the WTO rules, such as disallowance of rebate of taxes borne by capital goods used in the production of the exported products, and India had made proposals in this regard early in the Doha Round. These too would need to be followed up.

The European Union considers review of its GSP scheme

Swapna Nair [1]

The current EU Generalised System of Preferences (GSP) regulation expires in 2011. In order to legislate a successor GSP regulation post-2011, the EU has recently undergone public consultations and is in the process of reviewing its regulation.

The GSP is regarded as one of the most important outcomes of North-South co-operation. This system of preferences by which, developing countries are granted non-reciprocal preferential tariffs in the markets of industrialised countries, is a significant departure from the GATT/WTO principle of MFN. The principle of MFN aims to keep the trading system non-discriminatory, stable and predictable. Since the GSP scheme would have violated the MFN, it was given a waiver under an enabling clause. This waiver was given since the objective of the GSP was to (1) increase export earnings (2) promote industrialisation and (3) accelerate the growth rates of developing countries by providing them non-discriminatory, non-reciprocal preferences in the markets of industrialised countries (UNCTAD Resolution 21 (II)). The GSP, though a departure from MFN, was not expected to affect the predictability and stability of the trading system because all developing countries were to be given equal preferences. The only discrimination was between developed and developing countries.

However, many of the current GSP schemes have undergone revisions and have features that cause uncertainty to the beneficiary country exporters. There also seems to be an increasing trend towards complicating the GSP schemes by extending the objectives beyond the traditional goals of increasing economic earnings and promoting industrialisation to social objectives such as environmental and labour standards and good governance. Given this background, this article tries to analyse briefly the EU's GSP programme.

The European Union, being one of the largest trading entities, has one of the most significant GSP schemes. The EU was one of the first developed economies to have introduced the GSP in 1971. The stated objective then was (1) to help developing countries expand sales of their products in the markets of industrialised countries and (2) promote the industrialisation of developing countries through customs duty reductions or exemptions for finished or semi-finished industrial products and certain agricultural products (Article 133 (113) EC). The GSP programme of the EU underwent revisions in 1981, 1986, 1990 and 1995.

The current GSP scheme of the EU in practice is that for the period 2009-2011 and has the objective of "poverty reduction in developing countries by generating revenue through international trade and giving support to sustainable development and good governance"

[1] The author is the coordinator of ICRIER's Trade Policy and WTO Research Programme

(Council Regulation (EC) No 732/2008). This scheme is extended to 176 beneficiaries and territories and covers three separate regimes:

- The general arrangement (the standard GSP) which is granted to all those beneficiary countries, which are not classified by the World Bank as high income countries and which are not sufficiently diversified in their exports. Under this scheme, the EU provides preferences to 176 developing counties and territories on 6200 tariff lines
- The special incentive arrangement for sustainable development and good governance (The GSP+): In order to qualify for these additional tariff preferences countries, have to ratify and implement 27 different conventions (16 conventions related to core political, human and labour rights and 11 conventions related to environment, good governance and fight against drug production and trafficking). Further, countries, along with being a non-high income country and not sufficiently diversified, must also ensure that their GSP-covered imports into the EC is less than 1 per cent of the total GSP imports.
- The "everything but arms" (EBA) arrangement, which provides duty-free, quota-free access for all products for the 49 least developed countries (LDCs).

Products for which preferences are given under the GSP scheme are divided into sensitive and non-sensitive. All non-sensitive products are given duty free treatment. Sensitive products are subject to a fixed rate reduction from MFN rates (in general 3.5 percentage points on ad valorem duties but for products from section XI-textiles by 20 per cent and for all specific duties by 30 per cent)

The EU's current scheme differentiates between advanced developing countries and those less advanced (the criteria being those countries having less than 1 per cent of the total GSP imports into EU). This differentiation is made by having a common, regular GSP scheme covering all beneficiaries and a GSP+ scheme for the less advanced developing countries. Under the GSP+ scheme, as explained above, further preferences are given to those not-so-advanced developing countries that ratify and implement the 27 different conventions related to social objectives.

The important issue is whether preferences should be differentiated under GSP and GSP+ schemes. The differential treatment provided to LDCs under the EBA programme is acceptable since the list of LDCs is finite and has been prepared by international organisations on the basis of objective criteria. In the earlier GSP scheme (2006-2008), India raised a dispute within the Dispute Settlement Board (DSB) on the legality of the differential preferences given by the EU to those developing countries that combat illicit drug trafficking and those who comply with certain labour and environmental standards. (Later on, India restricted its dispute to the preferences given to those combating drug trafficking, leaving the possibility of raising the issue of labour and environmental standards later). Although initially, the WTO panel ruling was in favour of India, the appellate body ruling reversed this by concluding that in granting differential tariff treatment, preference-granting countries are required, by virtue of the term "non-discriminatory", to ensure that identical treatment is available to all similarly-situated GSP beneficiaries. This implied that the treatment be available to all GSP beneficiaries that have the same "development, financial and trade needs" to which the treatment in question is intended to respond. This ruling has opened the door to further possible differential treatment of developing countries, which might not be an ideal situation.

By differentiating among developing countries, the GSP scheme is bringing in a whole gamut of complications. The impact of preferences given to an economy is not restricted to that economy alone. Changing the conditions of competition affects other economies as well. Often preferences have trade creation and trade diversion effects and the ultimate effect might defeat the objective of promoting developing country growth and poverty alleviation.

An even more important aspect of the scheme is the principle of graduation. The system of graduation modulates the economic benefits members receive under the GSP on the basis of their relative economic performance in the EU market. If the share of EU's GSP-covered imports from a particular beneficiary country in a certain section rises above a decided upon benchmark (12.5 per cent for textiles and clothing and 15 per cent for all others) consecutively for three years, then that product would graduate and no longer be eligible for benefits. If the share subsequently dropped below the reference threshold, the preferences would be re-established through a system of de-graduation. The chief concern regarding this system of graduation and de-graduation is the extent of uncertainty it brings along with it. Many of the relatively larger developing countries might have a larger presence in the EU market with respect to one or two products and the possibilities of graduating and de-graduating would be rather high for them, leading to a large element of uncertainty among their domestic exporters and producers. Further, if poverty alleviation is the objective of the GSP programme, a graduation system on the basis of a three-yearly performance does not seem to make much sense. Poverty might persist in a country even if a certain segment of domestic exports performs relatively better. Further, the frequent instances of graduation might adversely affect poverty. The current threshold levels also seem rather low. If graduation is to be continued, perhaps it might make more sense to have higher levels of thresholds for the determination. In the current EU consultations, a question has been raised on whether graduation should be on the basis of a section or at more disaggregated levels of classification such as tariff sub headings. This is definitely not advisable since there would be increased chances of graduation and de-graduation and increased uncertainty. Further, it might make more sense to graduate a country rather than a product section. For instance, if a beneficiary country gains a large share of imports into the EU across product sections, then it might be a good idea to graduate that country from all GSP benefits.

If graduation is the concern for large developing countries, a temporary withdrawal of GSP benefits is a concern for smaller countries. This happens under the GSP + scheme. The GSP scheme was started originally with the objective of reducing poverty by generating revenue through international trade. But, it now seems to be overloading itself by linking itself to non-trade objectives (GSP +). It does not really seem appropriate to use trade policy instruments to influence social policy in partner countries. Further, the GSP + also has a provision by which preferences can be temporarily withdrawn for serious and systematic violations of core human and labour rights conventions and on a number of other potential grounds identified in the regulation. Myanmar and Belarus have been removed from the GSP preferences for the violation of core labour standards and this removal persists, since according to the EU, the reasons for their removal remains. Recently, Sri Lanka has also been temporarily removed from being granted GSP+ benefits on the grounds of violation of human rights. Without addressing the question of whether these countries did or did not violate these rights , the key issue that arises here is whether trade preferences should be linked to non-trade aspects.

Concluding remarks

Any form of preferential treatment in the realm of trade brings in a gamut of complications. The GSP programme of the EU, as it currently is, tries to link social objectives with economic ones. The objectives of sustainable development and good governance are valid by themselves but they should not be conditionalities to the grant of preferences. These objectives should be promoted by means of official development assistance and dialogue rather than trade benefits. Further, for larger developing countries such as India, which face higher possibilities of graduation and de-graduation, the GSP scheme diminishes the benefits by bringing in a large element of uncertainty. Predictability is an essential prerequisite for trade expansion. The EU's GSP programme began with the simple objective of increasing exports and promoting industrialisation in developing countries by giving them tariff preferences. With the many revisions, the programme now seems to have loaded itself with social objectives. The question is whether the EU's GSP scheme is aimed at promoting development in less advanced economies or whether it is a strategic tool for the EU to achieve its trade policy and social objectives. If the aim is the former, as it should be, then it is better to have a simple and uncomplicated system that ensures non-discrimination and predictability. It would be extremely beneficial if the EU, in its ongoing review, would consider these aspects and adapt the scheme accordingly.

Export Restrictions and the WTO Agreement

Anwarul Hoda

In recent months export restrictions have been in the news. First, measures taken by China to limit exports of rare earth have drawn international criticism. Rare earth is the collective name for 17 elements that are critical to high technologies such as hybrid car batteries and wind turbines besides a wide range of military products. China produces 95 per cent of the world supplies and has been progressively reducing its exports of these products over the past three years. In July 2010 it decided to impose a quota on annual exports of rare earth. Second, there has been a howl of protests against the ban on export of wheat imposed by Moscow. Russia has been a long term exporter of wheat but it has been driven to this action by the failure of the current harvest resulting from its hottest summer in recorded weather history. High volatility is a feature of the international commodity markets and export restrictions and prohibitions tend to exacerbate the trend. Volatile food markets impact adversely on international commerce generally but they hit hardest the world's neediest countries such as those in sub-Saharan Africa. Third, there has been disapproval in some quarters also against restrictions on the export of cotton imposed by India, in the wake of high international prices.

WTO rules on quantitative export restrictions

What are the disciplines imposed by the WTO Agreement on the use of trade policy instruments to restrict imports? As a general rule Article XI of the GATT 1994 requires the general elimination of quantitative restrictions, on exports as on imports, whether through quotas, licenses or other measures.

The general pattern of substantive obligations in the WTO Agreement is that for every rule there are one or more exceptions. In the context of export restrictions the most significant exception is any prohibition or restriction applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting member. Thus when confronted with severe shortages a government may not only restrict the level of exports but may also ban exports and it may do so even before the shortage has reached critical proportions. Food stuffs such as wheat are covered but so is cotton, which qualifies as other products essential to the exporting country. The only condition that has to be fulfilled is that the measure must be of short duration.

Article XX of GATT 1994 contains certain general exceptions, under which measures could be taken, which are otherwise inconsistent with the obligations of that agreement, subject to certain requirements being met as provided in the introductory part of that article. These requirements are that the measures should not be applied 'in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade'. There is a substantial body of WTO jurisprudence interpreting various aspects of these requirements but these do not have a bearing on export restrictions.

Article XX clearly allows export restrictions for the protection of public morals, or for the protection of human, animal or plant life, or those imposed on export of bullion. Similarly export restrictions are permissible for the protection of national treasures of artistic, historic or archaeological value or if undertaken pursuant to obligations under an intergovernmental commodity agreement. These aspects are relatively non-controversial. There are three sub-sections of this article which are particularly relevant for export restrictions on raw materials, imposed with the objective of making such materials available for domestic industry. These provisions can be more contentious as such export restrictions have the potential to affect the interests of other WTO members. First, export restrictions are permissible under Article XX (g) for the conservation of exhaustible natural resources, provided they are made effective in conjunction with restrictions on domestic production or consumption. Quantitative export restrictions on iron ore, for instance, would be WTO compliant only if there is an overall limit placed on its extraction in order to make the known reserves last longer. Second, Article XX (i) allows 'restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan'. The provision also stipulates that the export restrictions 'shall not operate to increase the exports of or the protection afforded to such domestic industry'. This provision was introduced in the GATT draft during the preparatory phase has not been tested in a WTO/GATT dispute and it is difficult to surmise how much freedom it gives to members to impose export restrictions. There is a third provision, Article XX (j), which allows measures 'essential to the acquisition or distribution of products in general or local short supply', and which could be used to impose export restrictions. However, an attached condition is that any such measures shall be consistent with the principle that all members are entitled to an equitable share of the international supply of such products.

The WTO rules are less than precise and the jurisprudence is not fully settled on the extent to which the member governments can deviate from the general prohibition on quantitative restrictions and use export restrictions to make domestic natural resources available for the processing industry. There is some amount of clarity with respect to export restrictions imposed in conjunction with restrictions on domestic production for the conservation of exhaustible natural resources and for export restrictions and prohibitions temporarily applied to prevent or relieve critical shortages of foodstuffs or other essential products. It has been held the WTO disciplines come into play with respect to natural resources after these have been extracted or exploited and not when they are in their natural state. In respect of other aspects there are ambiguities and even contradictions in the rules. In 2009 the US, the EC and Mexico have raised a dispute against China on export restrictions imposed on natural resources and have invoked various provisions including Article XI of GATT 1994 as well as the requirements in China's accession protocol in support of their complaint. The findings in this dispute would help to bring greater clarity in the rules.

WTO rules on export duties and charges

While the WTO rules prohibit the use of quantitative restrictions on exports as a general rule they allow the WTO members to regulate exports by means of duties, taxes or other charges. It follows that where a WTO member wishes to regulate exports it may do so through the mechanism of taxes. The freedom to impose export duties is a mirror image of a similar flexibility that exists in respect of import duties. While giving them freedom to impose import or export duties the WTO Agreement encourages members to enter into negotiations from time to time, on a reciprocal and mutually advantageous basis, 'directed to the substantial reduction of the general level of tariffs and other charges on imports and exports'. Once a reduction commitment has been taken export duties cannot be raised beyond the bound level and in any case, whether bound or not, the MFN obligation of the WTO requires the duties levied by a member to be applied non-discriminatorily for all partner countries. The only difference is that since the inception of GATT 1947 the members have not imposed export duties to a significant extent and therefore the question of reducing them during the rounds of negotiations has not been an issue. There have been some cases though even in the past in which export duties have been in vogue on natural resource products such as timber and selected mineral ores. During earlier rounds there were only a few instances in which reduction commitments were obtained from a few members. Recently however, in the context of high commodity prices there has been a greater inclination to use export taxes on natural resource products and this has given rise to greater concern among importing countries and the concern has led to proposals in multilateral as well as regional for a to redress the situation. In the recent past export taxes have figured prominently in the accession negotiations of countries rich in natural resources and these countries have had to make significant commitments. Restraint on the use of export taxes have been a feature of regional trade agreements as well.

Export Restrictions and the Doha Round

Export restrictions have figured in both the NAMA and agricultural negotiations. In NAMA it has figured in the negotiations on non-tariff barriers and the EC made a proposal for a WTO Agreement on Export Taxes, which envisaged elimination of all such measures over a period. The latest Chairman's text contains a substantially toned down version, which proposes that the WTO members should notify the introduction and modification of export taxes and commit to set an upper limit to such taxes on all non-agricultural products on the basis of negotiations. According to the proposal the least developed countries would have the flexibility to keep export taxes fully unbound and other developing countries would maintain a certain number of tariff lines unbound on the basis of negotiations.

In the agricultural negotiations Japan has been prominent in proposing disciplines on the imposition of export prohibitions and restrictions. The WTO Agreement on Agriculture envisages only procedural disciplines on export prohibitions and restrictions, requiring that 'before any Member institutes an export prohibition or restriction, it shall give notice in writing, as far in advance as practicable, to the Committee on Agriculture comprising such information as the nature and the duration of such measure, and shall consult, upon request, with any other Member having a substantial interest as an importer with respect to any matter related to the measure in question'. During the Doha Round also the emphasis is on procedural rather than on changes in substantive disciplines. However, the latest Chairman's text proposes that existing export prohibitions and restrictions in foodstuffs and feeds under Article XI.2 (a) of GATT 1994 shall be eliminated by the end of the first year of implementation and further that any new export prohibitions or restrictions under Article XI.2 (a) of GATT 1994 should not normally be longer than 12 months, and shall only be longer than 18 months with the agreement of the affected importing Members.

Concluding remarks

The WTO rules on export taxes are quite clear and nothing needs to done to make it clearer. The suggestion that the EC has made for bringing about greater predictability is sound and in general the endeavour should be to ensure binding of export duties in all cases. But the binding of export taxes and well as the levels at which they are bound should be matters for negotiations and not for norm setting. In such negotiations there would be a good case for relating the level of export taxes on natural resource products to the level of import duties on downstream products in the principal import markets.

There is, however, an inadequacy in the WTO disciplines on quantitative export restrictions from the point of view of the extent to which members can use such restrictions to make natural resources and essential raw materials available to domestic industry. In 1950 the Report of the Working Party for Protective and other Commercial Purposes had observed that Article XX (i) 'does not permit the imposition of restrictions upon the raw material in order to protect or promote a domestic industry, whether by affording a price advantage to that industry for the purchase of its materials, or by reducing the supply of such materials available to foreign competitors, or by other means'. That was the heyday of colonialism and the observation in the Report of the Working Party reflected the view of the industrialized countries. Times have changed and now any suggestion that the developing countries cannot restrict export of raw material with the objective of developing downstream processing will be met with considerable skepticism. Part IV of the GATT 1994, which was added in 1965, recognizes specifically the need for the developing countries to diversify their economies and develop manufacturing industries. There is a need to update the rules in this respect.

FDI in Multi Brand Retail: Moment of Decision Nears

Tanu M. Goyal[1]

On July 6, 2010, the Government of India had issued a discussion paper inviting public comments on the possible opening up of multi-brand retail for foreign direct investment (FDI). In the comments received, there is predictably both support and opposition and the matter is now under inter-ministerial scrutiny. While the political imperative tends to slow down consideration of policy matters in government generally, there are indications that a decision might be taken soon on this issue.

During the liberalisation programme undertaken after the introduction of economic reforms in 1991-92, there has been a sea change in India's policy allowing foreign direct investment. Such investment is now allowed without a cap in virtually all manufacturing activities. In the services sector, that was once the bastion of government monopolies, there has been substantial liberalisation to allow foreign direct investment. The liberalisation has been extended to the trade sector as well, with 100 per cent FDI being allowed through the wholesale cash and carry route for B-to-B operations and 51 per cent being permitted through the single brand retail route. However, multi-brand retail, which is the face of large-scale retail trade the world over, is still out of bounds for FDI in India. This situation might change in the near future. The debate on FDI in multi-brand retail has led to a dawning realisation in the country that the issue is not one of foreign versus Indian retailers but of large-scale, organised retail versus small, unorganised retail. The advent of modern organised retail in India has brought with it a number of benefits for consumers, producers, employees and for the government. The entry of foreign investors will consolidate and expand these benefits and yield some additional ones. Some of the arguments in favour of large retailers (both Indian and foreign) are listed below.

- *Connecting the farmer to the urban market:* Large retailers, whether Indian or foreign, invest in the supply chain. This is true particularly in the food and grocery sector. Adequate investment in supply chain infrastructure such as cold storages etc. will connect the farmer to the market.
- *Better value for money for the consumer:* Large retailers introduce more competition in the market by offering greater variety and better price. They offer better packaging and have higher product standards. This gives quality assurance to the consumers and, therefore, leads to higher consumer satisfaction. Apart from this, the consumer benefits from economies of scale.
- *More revenue for government:* The operations of large retailers lead to higher tax collections. This is because large retailers are constituted under the companies act and the revenues and expenses are clearly accounted for and audited. There is, therefore, greater transparency and better tax collection.
- *Better employment conditions for workers:* The quality of employment is better in the case of large retailers. This is because large retailers have clearly defined service rules for employees and they follow labour regulation. Employees of large retail organisations have fixed working

[1] The author is a researcher with ICRIER

hours, are eligible for increments and social security benefits and have access to training and skill development opportunities.

Additionally, the entry of large-scale modern foreign retailers may yield the following benefits:

- *Supplementing extension activities by government agencies:* Government agencies have been unable to discharge their responsibilities on agriculture extension activities. Agricultural extension is known as the application of scientific research and new knowledge to agricultural practices, including pre and post-harvesting practices, through farmer education. Foreign retailers can supplement the activities of government agencies and support efforts to introduce farmers to newer methods of crop cultivation.
- *Strengthening technology intervention in manufacturing:* Foreign retailers bring in newer technology and knowhow. This helps Indian manufacturers to upgrade existing technical knowledge and reaching global standards. Once the standards of Indian manufactures meet global export requirements, exports from the country may increase.
- *Helping Indian products get access to distribution channels abroad:* Foreign retailers can increase sourcing from India not only for the domestic (Indian) market but also for their home and third-country markets.
- *Introducing global best practices in logistics in India:* Foreign retailers will facilitate exposure of Indian retailers to global best practices in logistics and retail.

Despite these benefits of modern retail, the government is hesitant to go ahead with the liberalisation of foreign direct investment mainly because fears of the likely adverse impact this would have on the over 12 million small retailers in the country. In theory, it is difficult to contest the contention that small retailers would be affected, in greater or smaller measure, especially those located close to modern retail outlets. Studies by ICRIER researchers found that unorganised retailers located close to organised retailers saw a decline in the volume of business and profit soon after the entry of large organised retailers. But it was also found that the adverse impact on sales and profit weakened over time. How adversely unorganised retail gets affected depends on the rate of expansion of consumer spending. If the economy expands at the rate of nine per cent as expected, expansion in consumer spending may mitigate the adverse impact of the entry of modern retail on the small retailer.

Not all the problems of the small retailers are related to the entry of big modern retailers. These need to be addressed quite independently of the decision to allow foreign direct investment in multi-brand retail. Their problems are the following: (a) access to finance (b) poor infrastructure and (c) a fragmented supply chain. Ensuring better credit facilities to small retailers from banks and micro-credit institutions should be a top priority. In addition, emphasis should be placed on proper urban planning with a dedicated space for small retailers with adequate access to facilities like power and parking and modernisation of the wet markets. In this respect, the government can consider working in public-private partnership (PPP) model. In addition, small retailers can be linked to supply chains by encouraging big retailers to sell large packages to small retailers in a manner similar to wholesale cash-and-carry operations.

Indian Council for Research on International Economic Relations

Core - 6A, 4th Floor, India Habitat Centre
Lodi Road, New Delhi - 110003, INDIA
Tel: 43112400 Fax: 24620180
Website: www.icrier.org

In case of any suggestions/queries please contact Swapna Nair at snair@icrier.res.in